Friess Small Cap Growth Q3 2019 Webinar Transcript
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Speaker Details:

S1 – Tracy Rogers, *Moderator*
S2 – Joe Fields, *Director of Marketing/Client Service and Managing Partner for Friess Associates*
S3 – Scott Gates, *CIO and Managing Partner for Friess Associates*

Transcription:

S1 00:04 Good day, and welcome to the Friess Associates Q3 2019 webinar. After today's slide presentation, we'll take some time to review topical questions that have come up in recent conversations with our prospects and clients. I would now like to turn the call over to Joe Fields, Managing Partner and CIO and Portfolio Manager, Scott Gates, with Friess Associates. Gentleman, please go ahead.

S2 00:28 Thank you, Tracy. This is Joe Fields. I'm the Director of Marketing and Client Service at Friess Associates. With me today is Chief Investment Officer Scott Gates. We're here to review our firm and our process with particular emphasis on discussing results for the three months through September. Please turn to page 4 in the presentation book to see where we finished the third quarter in terms of assets under management. Assets totaled $1.35 billion, up about $150 million from the end of 2018. The smaller company portfolios that we manage accounted for $222 million with our small-cap mutual fund at about $145 million of assets. We currently hold 49 companies in the small-cap portfolios we manage. Our investable universe for small-cap is in the $200 million to $4 billion market-cap range. Our process thins the candidates' pool from there. I'll turn it over to Scott to come out on the specific drivers during the third quarter.

S3 01:46 Thanks, Joe. Earnings performance is the primary driver of our investment strategy. Earnings are the ultimate measure of a company's operational execution and as a result, we believe earnings performance is the most important influence in determining a company's appeal as an investment. As the third quarter showed, other things also influence stock prices. The combination of trade tension and growing economic uncertainty dictated the direction of stocks during the three months through September. Our strategy concedes that macro factors will move stocks for fleeting periods, but in the end though investors always return to evaluating each company on its own merits over the long haul. On page eight, you'll notice the various ways we screen companies. After we isolate companies with rapid earnings growth potential, we direct our focus to the stocks that sell at reasonable multiples of that earnings estimate.

S3 02:51 The idea here is to maximize upside potential while minimizing downside risk. Page nine shows how our research process kicks into high gear once we've narrowed down our pool of candidates. It's an all-cap approach, meaning we interview customers, competitors, and suppliers up and down the market-cap spectrum, the entire food chain if you will, large-cap customers, mid-cap competitors, small-cap suppliers, and so on. We speak to public companies, private companies, consultants, industry experts, and our database includes more than 20,000 contacts that we've developed over decades. Our analysts spend their days focusing on conducting interviews mostly by phone, but also including face-to-face meetings and company visits. What we're really trying to do here is develop a mosaic of data around our target companies to help us make best decisions ahead of upcoming catalysts. All of this is done in real-time as these conversation meetings are dictated into our digital transcription system and I pushed everybody in research. Every analyst is a generalist with deep knowledge in years of experience in several sectors. So information is shared and cross-pollinated on an ongoing basis.

S2 04:16 Thanks Scott for that recap. Let's turn our attention to page 18. There we'll see the Friess Small-cap Composite declined 9.7% in three months ending September. The Russell 2000 and 2000 Growth declined 2.4 and 4.17 percent. Longer-term, the Friess Composite outperformed both indexes in the trailing 3, 5, 10-year and inception periods. Third-quarter results show that economic anxiety tends to be bad for small-cap stocks. The immediate impact can be greater among companies with promising outlooks as investors bet that a turn for the worse will begin at the economy's leading edge. While each company is unique and its ultimate fate is determined over time, the reaction in the September quarter was sweeping and in our opinion, short on company-specific motivation in too many cases. Healthcare Holdings represented the second-largest position in the quarter. They were the biggest detractors from absolute performance and return relative to the benchmarks by significant margins. Healthcare equipment makers and service providers were the primary detractors. Technology Holdings comprise the largest portfolio position during the quarter. They were the second biggest detractor from absolute relative results.

S2 05:56 Positive contributions from the semiconductor and hardware makers were overshadowed by performance trends among software and service providers. Positive contributions came from different areas. EverQuote, which operates an online insurance marketplace, was a standout contributor. Under new leadership, Papa John's was also a notable contributor as they rolled out a new advertising campaign featuring Shaquille O'Neal. And youth apparel retailer, Zumiez, was a material positive influence, following their big earnings upside.

S3 06:41 For some additional color, let me go over some of the quarter's top contributors and detractors. On the contributor side, Enphase Energy, ENPH, they're a maker of micro-inverters used in solar photovoltaic applications. They earned 18 cents per share in the June quarter. That was up from 2 cents in the year-ago period and 5 cents ahead of a consensus earnings estimate. Revenue increased 77% due to market share gains and the improving conditions in the domestic market. The company also revised guidance higher for the quarter ahead. EverQuote, EVER, an online insurance marketplace operator, exceeded both top and bottom-line expectations for the June quarter. Revenue increased 36% in the period as a company's auto segment grew 40%. Total quote request increased 50% from year-ago levels. EverQuote also raised full-year revenue guidance. Infinera INFN, they're an optical networking equipment supplier to the telecom industry. They grew their June quarter revenue 47%, and results showed Infinera's cost reduction program running ahead of plan helping the company exceed bottom-line expectations. The company reported encouraging growth in its customer pipeline, including-- excuse me, including opportunities driven by political and security concerns around Chinese competitor, Huawei. On the detractor's side, McDermott, symbol MDR, the company which provides engineering construction and project management services to the oil and gas industry, provided strong visibility into 2020 revenue by reporting a record 7.4 billion backlog at the end of June. Shares declined as June quarter results showed delays in ongoing projects and lower expectations for proceeds from previously announced asset divestitures. Vapotherm, symbol VAPO, they are a maker of medical devices designed to treat respiratory distress, reported a 14% revenue increase for the June quarter in line with expectations. International sales were slightly better than expected. Shares declined as domestic sales came in below expectations due to the Salesforce turnover following a realignment of sales strategy that the company initiated last year. And lastly, Fluidigm FLDM, the company makes fluidic circuits, assays, reagents, and other tools used in life science research. They demonstrated progress and its shift toward greater contribution from its fastest-growing mass cytometry business, which grew 27% to account for 62% of the June quarter revenue. However, shares declined because total revenue was below expectations, prompting the company to revise guidance lower.

S2 09:56 Thank you, Scott. Let's go into some questions that we've received regarding the third quarter. First question, as part of the reason, Friess Associates focuses on companies with reasonable valuations, is to minimize downside risk. Yet the composite declined more than the benchmarks in the third quarter. Can we explain? Obviously, no strategy is going to work 100% in every time period, the idea is to generate a performance advantage over time. Third-quarter downturn largely stemmed from rising economic concerns. So it's common for companies with above-average outlooks, the kind of companies we isolate, to take the brunt of the markets initial attitude adjustment. Performance trends will firm up and demonstrate a widening picture as more solid details unfold. Page 21 in our deck shows how effective our reasonable price-to-earnings ratio discipline can be when viewed in a longer-term context. You'll see that the Friess Small-cap Composite participated in just 83% of the Russell 2000 Growth index's downside over the five years through September, limiting the impact of the market downturns that occurred over that stretch.

S3 11:30 Another question we've been getting is amid all the growing economic concerns, analysts continue to ratchet up their earnings-- continue to ratchet their earnings downward. So how do you maintain your commitment to robust earnings in a period when earnings expectations appear to be deteriorating? Back on page eight, it showed that we generally see companies experiencing 20% year-over-year earnings growth. We're very successful at doing that in what I would call normal market conditions with portfolio averages regularly exceeding 20% by significant margins. With that said, growth rates certainly can fluctuate with the environment. While we hold many companies right now that are expected to grow earnings more than 20% this year, the current average reflects the broader climate. Still, our goal in building the portfolio is to maintain a sizable earnings edge relative to benchmarks. Page 23 shows that the average 2019 earnings growth rate for the Russell 2000 and Russell 2000 Growth are 3.1% and 9.8%, respectively. We're still finding companies that are expected to grow earnings 16.8% on average. Just as important as we continue to isolate above-average growth at a discount to the benchmarks. The typical Composite holding sells at just 14.2 times 2019 earnings estimates. That compares with a 16.7 times for the Russell 2000, and 18.4 times for the Russell 2000 Growth.

S2 13:16 Thanks, Scott. This concludes our remarks. We think it is an opportune time to review your small-cap allocation and learn more about our Friess Associates strategy. We have an experienced team committed to prudently growing the assets entrusted to us. We would appreciate any contact that you'd like to make with any questions. Please do not hesitate to give us a call or email. Thank you for your time.

S1 13:50 Thank you very much to Joe and Scott for all of your comments this afternoon. The webinar's now concluded and thank you for listening.

DISCLOSURES

Performance data quoted represents past performance; past performance does not guarantee future results.

Any sectors, industries, or securities discussed should not be perceived as investment recommendations. There is no assurance that any securities discussed herein will remain in a portfolio at the time you receive this information or that securities sold have not been repurchased. The securities discussed do not represent the entire portfolio and in aggregate may represent only a small percentage of a portfolio's holdings. It should not be assumed that any of the securities transactions discussed were or will prove to be profitable, or that the investment recommendations we make in the future will be profitable or will equal the investment performance of any security discussed herein. Friess Associates will provide a list of security purchases and sales for the past 12 months upon request.

Earnings growth rates quoted refer solely to the estimated earnings growth rates of the average investment holding of Friess Associates based on consensus estimates. This is not a forecast of future performance. Earnings growth for a portfolio holding does not guarantee a corresponding increase in the market value of the holding or the portfolio. Diversification does not guarantee a profit or protect against a loss in declining markets.

The Small Cap Composite includes all discretionary accounts that invest primarily in securities with market capitalizations of less than $4 billion. The Small Cap Composite was created in accordance with GIPS® standards as of January 1, 1993, the earliest possible adoption date. The inception date of Friess Associates' management of the Small Cap Composite is December 31, 1981. There are no non-fee paying accounts in the Composite. To receive a presentation that complies with the GIPS® standards, contact David Marky at Friess Associates, P.O. Box 4166, Greenville, DE 19807 or dmarky@friess.com.

The Russell 2000 Index measures the performance of the 2,000 smallest companies in the Russell 3000 Index, which represents approximately 8% of the total market capitalization of the Russell 3000 Index. The Russell 2000 Growth Index measures the performance of those Russell 2000 companies with higher price-to-book ratios and higher forecasted growth values. The Russell Investment Group is the source and owner of the Russell Index data contained or reflected in this material and all trademarks and copyrights related thereto.

As of September 30, 2019, the Friess Small Cap Composite's average annual total returns (including Friess Associates' management fee up to a maximum of 1% of assets annually and the reinvestment of dividends and all brokerage fees) for 1-, 5- and 10-years were -13.63, 14.25 and 12.13 percent, respectively. Over the same time periods the Russell 2000 Growth Index's average annual total returns for 1-, 5- and 10-years were -9.63, 9.08 and 12.25 percent, respectively and the Russell 2000 Index's average annual returns were -8.89, 8.19 and 11.19 percent, respectively. You cannot invest directly in the Composite or the Index.

The market index performance capture rates discussed were calculated using quarterly returns for the Friess Small Cap Composite for the five years ended September 30, 2019. Up market and down market data represent performance relative to the returns in the Russell 2000 Growth Index.