

# Looking Forward

Friess Associates market observations and insights

March 31, 2020

## Finding Companies Ready to Rise to the Challenge

Where to begin? What seems the appropriate question to start our discussion of the investment landscape at the end of March is the same question that we posed to ourselves in February as an ostensibly healthy bull market began to succumb to an encroaching virus.

The question sprang from the cause. It wasn't inflation, rising rates, recession, geopolitical instability, lofty valuations or some other textbook culprit highlighted in the chapter on how bull markets end.

It was a different threat, prompting aggressive responses from medical experts, central bankers, politicians and others positioned to confront the outbreak and its far-reaching consequences. Unprecedented and unique are rightly among the adjectives most used to describe the steps being taken to battle this menace to public health and economic well-being.

For us, though, this time is not different. Our work might seem more challenging than it did only a few short months ago, but our job is the same. We know where to begin. The cause is beyond our control. Understanding how the effects reverberate through the ongoing operations of individual companies in the coming days, weeks and months will be critically important in charting a path to recovery.

One of the main advantages of being in business for the better part of five decades is experience. Granted, there's nothing fun about time spent experiencing the downside of a crisis, but there's no discounting the value of the lessons learned while weathering it. Investing for growth is a long-term pursuit, one that requires perspective seasoned over time.

The global pandemic is an example of what economists call an exogenous shock, an unpredictable, economy-jolting event that develops outside of the economy or financial system. The terrorist attacks of September 11, 2001 represented the last exogenous shock to push stocks into bear market territory.

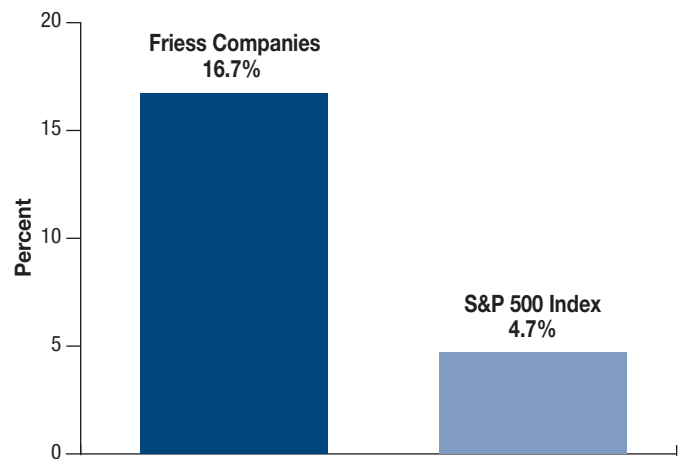
Friess Associates was founded at the start of 1974 in the midst of a 23-month bear market sparked by oil prices. During every major market downturn since then, we told

clients that one day, as today's pain fades, we will look back at this period as a great time to invest. It turned out to be well-founded encouragement for long-term investors. So, even though we know that the market's collective resolve will be tested for some as-yet-unknown duration, we're boosted by our confidence in the long-term opportunity that the downturn represents.

We firmly believe that investors who maintain longer-term horizons will one day, in retrospect, come to view the pandemic-triggered bear market of 2020 as an opportune time to put money to work in stocks.

That's the future as we see it. Back to the present, we expect volatility to persist as long as the novel coronavirus lurks. We've all been told to prepare for the possibility that restrictive measures could be in place for an extended period.

### Estimated Earnings Growth



Forecasted Increase in Earnings Per Share 2020 vs 2019

Source: Consensus estimates from FactSet Research Systems Inc., as of March 31, 2020.

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.

Earnings, battered as they are, remain the key consideration in identifying promise while avoiding peril. Evaluating earnings potential may be more complicated and fluid around the edges than usual, but the central concern is still each company's ability to make money.

Based on consensus earnings estimates compiled by FactSet Research Systems, the companies in the portfolios we manage are expected to grow earnings 16.7 percent this year on average. The comparable growth rate for the companies in the S&P 500 Index is 4.7 percent.

Those numbers are a snapshot in time. They represent expectations at the end of March, making them very likely to change as the situation evolves and visibility improves. Management teams with whom we speak report being in various stages of re-assessing their outlooks. To say there's a bias toward lower expectations is an understatement.

Recent conditions foreshadow related earnings pressure. A collapse in oil prices to a 20-plus-year low lays energy sector earnings to waste. In banking, rock-bottom rates squeeze profit potential. As for consumer spending, the major driver of the U.S. economy, significant retrenchment is a given amid shuttered businesses, stay-at-home orders and mass unemployment.

Friess Associates is an active manager, so the portfolios we manage reflect the times. As we do every quarter, we highlight examples of the companies that we hold on pages 4 and 5. This quarter's report comes with a special warning: Every stock chart depicted inside is ugly. The charts also reflect the times.

In many cases, companies that we held through this past quarter's volatility or added during it benefit from an existing secular trend and/or company-specific attribute that became more apparent due to the way life changed as the pandemic expanded. Zoom Video Communications (page 5) is a prime example.

About half of the workforce works from home, or telecommutes, at least once a month, according to Global Workplace Analytics, with growth in remote work roughly doubling over the past 10 years. Zoom, which facilitates collaboration among remotely located meeting participants, was doing a fine job capitalizing on the growth in telecommuting before droves of nonessential employees were forced to work from home.

With stay-at-home orders abundant, Zoom went from 10 million daily paid and free users to 200 million in three months. The new-user bonanza represents an unprecedented opportunity for the company to expose people to its technology and user-friendly interface. The unusual circumstances led to a new user boost in China, where Zoom was struggling to gain a foothold.

An expected surge in orders for delivery came at a similarly fortunate time for Papa John's International

(page 4). Led by a new management team, the company is embracing a range of improvements, including new dough spinner equipment, call center utilization, delivery model enhancements and menu innovations.

Papa John's is pursuing profit margin expansion just as potential customers need more help than usual in procuring pizza. The operator of the world's third largest pizza chain announced in March that it was seeking to add 20,000 new employees.

Scotts Miracle-Gro Co. (page 5) in January shored up its supply chain in an effort to avoid major disruption from the global pandemic. At this juncture, the company's preparations appear shrewd. In late March, Scotts raised guidance for March-quarter sales and reaffirmed its full year forecast.

While there is obvious risk on the consumer side, retail channels for Scotts seed, fertilizer and other lawncare and gardening products such as home centers remain open in all major markets at the time this was written. Plus, consumers will be spending more time at home and in their yards, which should feed demand. The company's Hawthorne segment is primarily a business-to-business operation.

The rollout of the 5G wireless network continues, albeit at a slower pace. And, while disruptions are a distinct near-term possibility, the critical role in technology development played by Keysight Technologies (page 4) seems unlikely to change anytime soon. Keysight provides electronic measurement solutions, putting it at the forefront of advancement in the wireless, aerospace and semiconductor markets. Keysight enables technology developers to test, measure and optimize their innovations.

Friess Associates was front-and-center for every calamity to befall the market over the past 46 years, and we adjusted to the realities of the moment in each instance. Going forward, we plan to capitalize on reduced valuations and emphasize companies with the financial strength and strategic positioning to capture market share as the backdrop shifts. We're grateful for your confidence in us. Stay safe.



**Scott Gates**  
Chief Investment Officer



## Companies Mobilizing to Help

It's a time marked by shockingly high, shutdown-driven unemployment. The first tangible data point to reflect the economic fallout of the coronavirus outbreak was the weekly jobless report released March 26 showing a record 3.3 million unemployment claims. The following week's report set a new record, twice as high.

It's a time marked by retirement plans in limbo due to steep investment declines, with uncertainty compounded by corporate efforts to rein in costs. In "Companies Hit Hard by Coronavirus Look to Cut 401(k) Contributions," *The Wall Street Journal* on April 1 reported that Amtrak, La-Z-Boy, Mattress Firm and Sabre Corp. "are among the first in an expected wave of businesses suspending or reducing matching contributions" to 401(k) plans.

There's a lot of bad news out there, and we're by no means criticizing any company in highlighting some of it. These are tough decisions that management teams are making to ensure the long-term survival of their companies, and we haven't encountered an executive during this trying period who takes his or her responsibility lightly. In fact, *The Wall Street Journal* article points out that in many cases cutbacks in contributions are being made to preserve health care benefits.

Still, amid all the economic anguish, this is also a time marked by shared sacrifice, generosity and thoughtful leadership among companies big and small. We asked our teammates to suggest their favorite positive business-related stories from the earliest weeks of the coronavirus crisis so we could share a few here.

The day after the first jaw-dropping jobs report was released, Comcast Corp. Chief Executive Brian Roberts and his wife Aileen donated \$5 million to the Philadelphia School District to buy 50,000 Chromebooks for students. A week later, Roberts sent an email to Comcast employees saying that he, the company's Chief Financial Officer and the leaders of Comcast's various business units would donate their salaries to COVID-19 relief efforts "for the duration of this situation" as part of a broader announcement.

Comcast pledged \$500 million to continue providing pay and benefits to employees from operations suspended, including shuttered theme parks, delayed movie releases and stalled content production, due to the outbreak. "We hope in some small way we can make this time easier on our employees, our local communities and our customers," Roberts said.

Many companies are leveraging their resources to support medical personnel and emergency responders on the

frontlines in the fight against COVID-19. For example, Ford Motor Co. is shifting gears to lend manufacturing and engineering expertise to help build respirators and ventilators quickly. The car company will also assemble face shields and use its 3D-printing capabilities to produce parts used in other personal protective equipment.

Apple in late March donated about 10 million masks to U.S. medical personnel, including nearly 2 million sent to New York with plans for more to come. Crocs is donating 10,000 pairs of shoes each day to health care workers. Starbucks is handing out free coffees to nurses, doctors, police officers, firefighters and paramedics as they report to work.

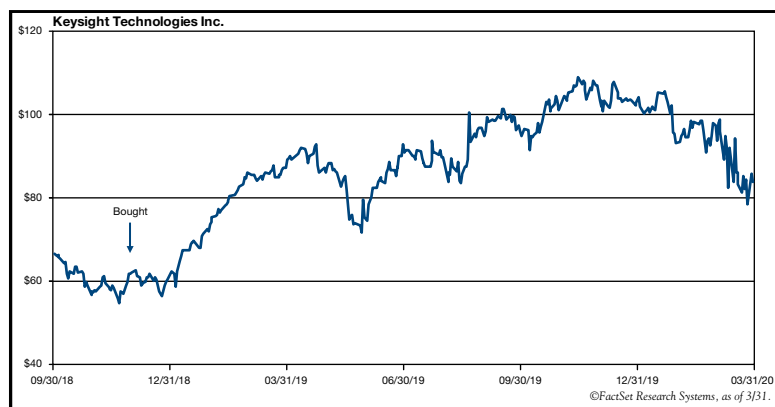
With schools and non-essential businesses shut down across the nation, some companies are focused on helping students, employees and families adjust their lifestyles. Internet providers are boosting speeds on their basic packages, offering free internet to low-income customers and providing limited-time Internet to families with school-age children. CVS Health Corp. and Walgreens Boots Alliance are waiving fees for prescription home delivery, helping people maintain social distance and still get the medicines they need.

Google parent company Alphabet established a fund that enables all temporary staff and vendors, globally, to take paid sick leave if they have potential COVID-19 symptoms or can't come into work due to quarantine. While Walt Disney Co. closed its parks and cruises in response to coronavirus, the company also promised to continue paying employees during the closure and will provide refunds to all customers who had planned on visiting.

As anyone who's visited a grocery store knows, paper products are in short supply amid pandemic-driven purchasing. The Scott and Cottonelle brands are owned by Kimberly-Clark Corp. The company announced it will commit \$1 million and one million rolls of Cottonelle to the United Way Worldwide COVID-19 Community Response and Recovery Fund. The company also encourages the public to #ShareASquare with neighbors and members of their community who may run low on toilet paper.

The portfolios we manage don't hold all the companies mentioned in this article. The ones held in the AMG Managers Brandywine Funds are listed in the disclosure material on page 8 of this report. Companies on this page, whether portfolio holdings or not, are highlighted because they deserve recognition for their positive efforts.

## Keysight Technologies Inc., KEYS

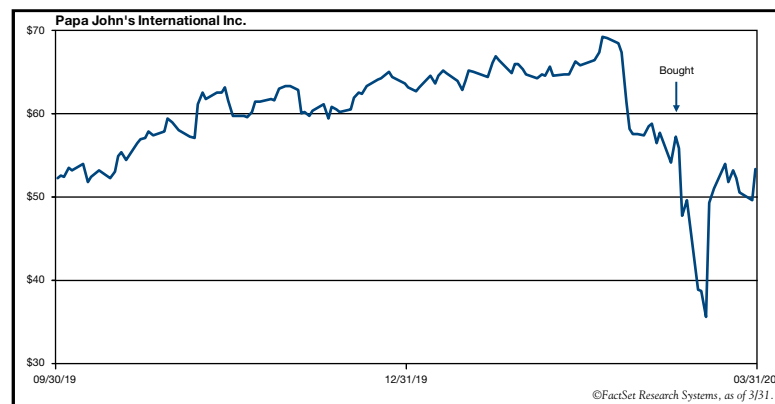


electronic products, components and networks. Keysight products facilitate development, reduce time to market, ensure product performance in production, and add significant value to customer R&D and production processes. Sales grew 8 percent to \$4.3 billion in the 12 months through January.

Keysight concentrated its focus on 5G-related R&D in the early stages of the technology's emergence, positioning the company to gain market share. January-quarter earnings grew 35 percent, topping the consensus estimate. Revenue growth also exceeded expectations thanks to ongoing strength in 5G-related investments as well as increased spending in aerospace defense and semiconductor measurement.

Chief Financial Officer Neil Dougherty talked about Keysight's longer-term goals at a recent investor conference. The company outlined how accelerating growth in software revenue, which was 19 percent of total revenue in fiscal 2019, and recurring revenue, at 18 percent of last fiscal year's total, could increase the profit potential of the company's revenue stream. Keysight set new, higher targets for gross profit margins and operating profit margins over the next three years. While Keysight's near-term outlook is subject to change, we believe the company's leadership and competitive differentiation in test and measurement give it an indispensable role in developing future networks and applications.

## Papa John's International Inc., PZZA



ed for about 40 percent of Papa John's more than \$1.6 billion in revenue in the 12 months through January.

The company more than doubled December-quarter earnings, exceeding the consensus estimate by 16 percent. Global restaurant sales grew 4.7 percent (excluding foreign currency impact) as Papa John's turnaround following a high-profile falling out with the company's founder continued to gain momentum.

Less than a month after reporting those results, the company issued a press release titled "Papa John's to Hire 20,000 New Team Members Immediately." An industry trailblazer in digital customer interactions, we believe Papa John's is primed to benefit from a surge in demand for no-contact deliveries. This demand comes as a new management team, including a new Chief Executive joined by new leadership in operations, marketing and development, aims to build on Papa John's record of product and service quality. Keeping with the company's "better ingredients, better pizza" motto, Papa John's recently introduced three new menu items, including two in February, with more to come. Based on the consensus estimate, Papa John's is expected to grow earnings 23 percent in 2020.

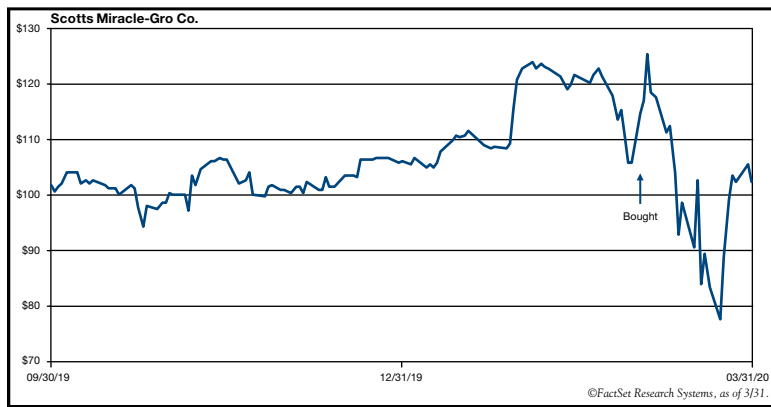
Companies contributing to the push toward 5G wireless technology were not immune to coronavirus outbreak, as supply chains throughout the world faced challenges. While momentum may slow in the short term, consensus thinking about the continued progression of the 5G rollout is still upbeat and intact. Likewise, Keysight remains uniquely positioned as a supplier of test systems used throughout the communications ecosystem.

NYSE-listed Keysight Technologies Inc. makes testing tools that enable customers to design, simulate, prototype and manufacture next generation

It's a phrase you might not expect during an economy-halting pandemic marked by widespread job losses. Still, due to the need for members of the public to alter their habits to minimize up-close interaction, certain businesses are uniquely positioned: Papa John's is now hiring.

Nasdaq-listed Papa John's International Inc. is the world's third largest pizza chain. With total locations topping 5,400, the chain spans all 50 states and reaches into an additional 45 countries. Operating through a combination of company-owned stores and franchised locations, company-owned units account-

## Scotts Miracle-Gro Co., SMG



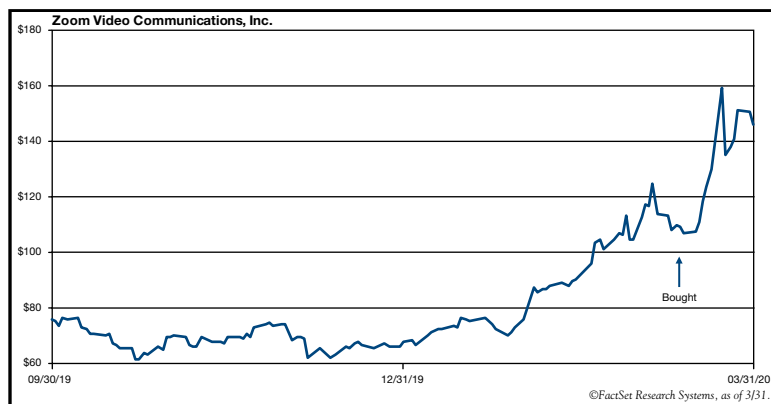
In mid-January, the Scotts team activated a contingency plan to secure its supply chain and protect sales amid the global pandemic. Benefits from that foresight were in bloom in late March, when management raised March-quarter sales guidance for the second time this year.

NYSE-listed Scotts Miracle-Gro Co. is among the largest makers of branded lawn care products in North America, including grass seed, fertilizers, soil, mulch, herbicides, pesticides, and rodent control products. In addition, through its Hawthorne segment, the company is a supplier of a broad array of products used in hydroponic gardening and cannabis growing. Brands include Scotts, Turf Builder, Miracle-Gro, Ortho, Tomcat and General Hydroponics. Sales grew 18 percent to \$3.2 billion in 2019.

December-quarter earnings and sales topped consensus estimates in a seasonally slow period. Sales for the Hawthorne segment increased 41 percent, driven by demand in nearly all categories of indoor growing equipment and supplies. U.S. Consumer segment sales increased 8 percent due to improved listing support with certain retail partners, including Home Depot, Lowes and Costco. For the March quarter, Scotts now expects sales in its Hawthorne and U.S. Consumer segments to increase 55 percent and 12 percent, respectively.

Your team met with Chief Financial Officer Thomas Coleman at an industry conference and discussed the company's preparedness for uncertain economic times. Healthy cash flow generation, recent debt reduction and consistent dividends provide financial flexibility. The company's core segment continues to leverage relationships with retailers considered essential in all markets, while Hawthorne continues to see demand from its business customers.

## Zoom Video Communications Inc., ZM



A lot of people who otherwise might not have known Zoom now are getting quite familiar with the videoconferencing platform out of necessity. If their experience is typical, chances are they will end up wondering how they ever got by without it.

Nasdaq-listed Zoom Video Communications Inc. connects people through frictionless video, voice, chat and content sharing, enabling face-to-face experiences in a single meeting place across disparate devices and locations. Customers range from small businesses to big corporations and institutions, including Delta Air Lines, Uber, Columbia Business

School and Texas A&M University. Revenue jumped 88 percent to \$623 million in the 12 months through January.

Zoom earned \$0.15 per share in the three months through January, more than doubling the consensus earnings estimate and representing its fourth consecutive positive earnings surprise since going public in spring 2019. Revenue rose 78 percent, aided by a 61 percent increase in customers with 10 or more employees. The company finished the period with \$855 million in cash and marketable securities on its balance sheet,

Working from home was a growing trend long before COVID-19. Now, with the outbreak prompting scores to shelter in place, the trend is accelerating. Zoom, with a free basic subscription and an intuitive interface, is a prime beneficiary. As stay-at-home orders went into effect in California, New York and other populous states, iPhone users downloaded the Zoom app more than any other.

Remotely conducted commerce is a long-term trend, but current conditions offer Zoom an unprecedented near-term opportunity to showcase its product leadership in the category. Based on the consensus estimate, Zoom is expected to grow earnings 29 percent in the year ending January 2021.

# Searching for Green Shoots on the Forest Floor

Our investment strategy's guiding motto is: "Never invest in the stock market, invest in individual businesses." In terms of our philosophical mission, the message is spot on.

We pay no mind when newscasters dutifully report how many points the Dow Jones Industrial Average gained or lost on a given day. We make no attempt to predict the level at which the S&P 500 Index might finish the year. We're guided by a deeply held belief that the benefits of focusing on the promise of individual companies outweigh the effects of more difficult to predict broad factors such as interest rates, foreign currency values, commodity prices and general market trends.

Still, emphasizing individual-company earnings trends, as we do, doesn't mean ignoring all of those other factors that, at various times, influence stocks to one degree or another. After all, the stock market is the conduit through which we employ our company-by-company approach. Market-moving events like the COVID-19 crisis spur us to broaden our scope to ensure we're not exclusively focused on a few good-looking trees as fire threatens the proverbial forest.

Exponentially increasing risk prompted investors to reconsider the premium prices they were willing to pay for stocks as recently as mid-February. We always aim to buy companies at reasonable prices, but in the current environment our definition of "reasonable" turned markedly more conservative.

Other steps we're taking are similarly practical. We actively check in with contacts at our companies to fully appreciate their perspectives on potential impacts and opportunities. Recognizing that we can't predict how long the virus-impacted backdrop will persist, we scrutinize balance sheets to make sure we hold companies with the financial wherewithal to weather extended strain. We also evaluate liquidity in an effort to hold stocks that we can trade effectively amid heightened volatility.

Even as we pay increased attention to sentiment, risk tolerance and the other macro matters that define the idiomatic forest, looking for the most promising individual "trees" remains our top priority. In the near term, that means finding companies unlikely to materially suffer amid the current day's challenges as well as companies that are positioned to capitalize on them. Beyond that, we want to thoughtfully identify the companies that we believe will emerge as green shoots heralding the forest's eventual resumption of growth.

Our investment strategy is straightforward at its core. We believe that earnings drive stock prices. As a result, we strive to capitalize on the relationship between earnings performance and stock prices by isolating companies experiencing rapid earnings growth that appear poised to deliver expectation-beating results. To boost upside potential and limit downside risk, we focus on rapidly growing companies that also sell at reasonable multiples of earnings estimates.

Exhaustive research is the key to our earnings-driven approach. We develop individualized earnings expectations for every existing holding and target company by keeping in constant contact with executives and others who manage, interact with and/or work in the same industry as these companies.

Friess Associates is an active, bottom-up manager. Each day we ask ourselves whether we're putting the assets we manage to their most productive use, based on the individual-company forecasts we develop through bottom-up research.

Existing holdings must continuously earn their keep by showing more upside potential than a new buy we're considering based on their respective fundamental outlooks. The idea is to replace good ideas with great ones. This process of "forced displacement" triggers a sale when assets from an existing holding are needed to fund the purchase of a new, more promising investment opportunity.

We use our company-level research findings to build portfolios one company at a time without regard to the composition of any particular index. Maintaining an individual-company focus typically results in portfolios with low correlations to benchmarks. The portfolios we manage won't always track the market from one week to the next, but that's because we aim to hold the kind of companies that position our portfolios to outperform over the long haul.

## Friess Investment Strategy Highlights

- Rapidly growing companies
- Reasonable price-to-earnings ratios
- Focus on companies likely to exceed consensus earnings estimates
- Emphasis on under-researched, lesser-known companies rather than industry leaders
- Intensive and repeated contacts with company management teams, customers, competitors and suppliers

## On the Cutting Edge

Examples of innovative ideas that cross your team's radar screen appear here each quarter. Chances to capitalize on investment opportunities related to them may lie in the future or may never materialize.

### Copper the Virus Stopper

Sometimes cutting-edge capabilities are underappreciated. Despite attracting praise thousands of years ago for sterilizing wounds and drinking water, contemporary use of copper belies the material's effectiveness in stifling the spread of disease-inducing bugs. Bacteria and viruses die on copper surfaces.

Various studies confirm copper's ability to thwart a long list of microbial health threats such as E. Coli, MRSA, noroviruses and coronaviruses, including the novel strain behind the COVID-19 outbreak. A microbe that lands on copper triggers the release of electrically charged copper ions that destroy the entire uninvited cell, eliminating its ability to develop copper resistance by wiping out its DNA and RNA.

To gather information about the latest viral outbreak, researchers from the National Institutes of Health virology lab in Montana sprayed the COVID-19 coronavirus on seven surfaces common in homes and hospitals to see how long the virus would remain infectious on them. Steel and plastic were the worst performing surfaces, with infectious germs still present after three days. The best performing surface was copper, where the virus disappeared in just four hours.

Clinical trial results published in 2015 showed that the use of copper alloys, such as brass and bronze, in patient rooms in three hospitals – one in New York and two in South Carolina – showed that the presence of copper could significantly reduce hospital acquired infections (HAIs). Introducing copper to bed rails, nurse call buttons and other high-touch areas resulted in an 83 percent reduction in microbes and a 58 percent reduction in HIAs.

The bottom line is copper more than pays for itself in health care settings. The current outbreak highlights the potential societal benefits that could emerge were copper to be increasingly incorporated into doorknobs, handrails and other frequent touch points in public spaces. Perhaps the global pandemic prompts decisionmakers to recalculate copper's cost-benefit analysis. A little upfront cost can deliver a perpetual benefit to human health.

### Machines that Fight Hospital Acquired Infections

Hospitals can be hotbeds for pathogens. One out of 25 patients in acute care hospitals, or 4 percent of the population, is afflicted with a hospital acquired infection (HIA) on any given day, according to the Centers for Disease Control and Prevention. The problem is made more vexing as pathogens mutate to resist common antibiotics and disinfectants, increasing the need for solutions that can blast bugs for good. Enter light and liquid.

Ultraviolet-emitting robots are taking up residence in hospitals across the nation. TRU-D, a robot made by Memphis, Tenn.-based Lumaleer Corp., bathes patient rooms with UV-C rays after patient discharge and traditional cleaning. The process can only be performed in empty rooms, as the UV light is more than 1,000 times more intense than sunlight. TRU-D conquers MRSA in 25 minutes and Clostridium difficile in 45 minutes. Xenex, a device made by Xenex Disinfection Services in San Antonio, Texas, uses pulses xenon to decontaminate rooms. TRU-D and Xenex cost about \$125,000 and \$81,000 per unit, respectively, according to the ECRI Institute.

Hydrogen peroxide vaporization is another line of defense in the fight against HIAs. In that category, Horsham, Penn.-based Bioquell offers Q-10, a robot team that resembles a pair of portable air conditioning units. One unit distributes a solution of 35 percent hydrogen peroxide into the air while the other aerates the room. The system is remotely activated to prevent human exposure and it runs for approximately 90 minutes. Q-10 costs \$47,000 on average.

A little more human involvement can achieve a strong level of decontamination at a relative-bargain price. The Clorox total 360 System costs roughly \$6,000 not including the cleaning solution. The system – a suitcase-sized sprayer, cleaning solution and a person to spray it – is simple. It's results, thanks to the Clorox-derived solution and an electrostatic sprayer that helps deliver superior coverage, are laudable, with claimed effectiveness against nearly four dozen different organisms.

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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.

As of March 31, 2020, Apple Inc., Keysight Technologies Inc., Papa John's International Inc., Scotts Miracle-Gro Co. and Zoom Video Communications Inc. represented 3.14, 1.85, 1.51, 2.24 and 1.12 percent of AMG Managers Brandywine Fund's assets. AMG Managers Brandywine Blue Fund held Apple, Keysight, Scotts and Zoom at 3.08, 2.21, 2.26 and 1.53 percent of assets. AMG Managers Brandywine Advisors Mid Cap Growth Fund held Crocs Inc., Keysight, Papa John's, Scotts and Zoom at 0.32, 2.45, 3.17, 2.28 and 1.46 percent of assets. Other securities discussed were not held by the Funds. Earnings per share, or EPS, is the portion of a company's profit allocated to each outstanding share of common stock. The Price-to-Earnings (P/E) Ratio is calculated by dividing current price of the stock by the company's estimated earnings per share for the current calendar year. "Bought" date highlighted in stock charts represents the initial purchase date by Friess Associates. The S&P 500<sup>®</sup> Index is a capitalization-weighted index. The index is designed to measure performance of the broad domestic economy through changes in the aggregate market value of 500 stocks representing all major industries. The index is unmanaged, unavailable for investment and does not incur expenses. Friess Associates LLC serves as the subadvisor to certain mutual funds advised by AMG Funds.

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