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How Polen Capital Picks Winning Small Cap Stocks, Manages Risk

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Small cap stocks get a bad rap. Critics say they have too much volatility and pose too much risk. But with the proper approach, small cap stocks seek to offer growth and add diversity to a portfolio.

The challenge is finding the right stocks and managing the risk.

SHOOKtalks turned to Tucker Walsh, who heads Polen Capital's small cap investment team, to get insights into how advisors can tackle the small-cap market. The session was moderated by Raj Pathak, a wealth advisor with Morgan Stanley Wealth Management in Boston.

Polen's U.S. Small Company Growth Investor Fund (PBSRX) posted a 49.53% return in 2020 after posing a 20.97% return the previous year. (The fund started operations in February 2019.) Polen also offers an institutional class of shares (PBSIX) that invests in the same stocks.

So how does Walsh do it?

"We look for companies that have presented a combination of strong revenue growth and margins and have generated strong cash," Walsh said.

Walsh leads a team of analysts who cull 2,000 small cap companies for potential investments. The list is whittled down to 20-30 potential candidates. "We take a concentrated approach to the sector," he said.

"We are looking for companies that



Tucker Walsh KAYLA MENDEZ PHOTOGRAPHY

are benefiting from digital disruption but also offer a disciplined approach toward the market," Walsh said.

Companies with a strong digital platform have the added advantage of having a direct line to the customer, Walsh said.

"Forty years ago, everything was sort of a multi-step distribution system. So, there were markups along the way," Walsh said.

The growth and widespread acceptance of the Internet has made it easier for companies to set up their own low-cost digital distribution system. "We look for companies that create a direct channel to the consumer," Walsh said.

Once the channel is established, Walsh said the best managed firms take the sales data they have collected and use it to deepen their relationship with customers.

One such company is the online retailer Revolve Group (2020 sales: \$580.6 million). The Los Angeles-based company is an e-commerce fashion apparel merchant that sells men's and women's designer clothing, shoes and accessories catering to millennial customers. The company drives customers to its website by connecting with Instagram influencers, Walsh said.

"The amazing thing about Revolve's business model is it is all data-driven so they never get in a position of where they have excess inventory," Walsh said.

By keeping inventory low, Revolve (NYSE: RVLV) eliminates costly mark downs, which hurt profit margins. "They see what is popular based on past sales and they order more. This is one example of how digital has transformed business models," Walsh said.

Another example of digital disruption is the restaurant company Wingstop WING +0.3% (Nasdaq NDAQ). The Dallas-based company is one of the nation's largest sellers of chicken wings with 1,538 stores and systemwide sales of \$2 billion at year-end 2020, up 28.8% from 2019.

On the surface, Wingstop looks like

most fast-food restaurant chains. But that ignores a key component behind the company's growth story: how it leverages technology.

Wingstop invested in an online ordering system that allows customers to place orders from their mobile phones for carryout, curbside pickup or delivery. The average order is approximately \$20 and online orders account for 80% of sales, Walsh said.

Walsh said Wingstop's system collects data on past orders, customer satisfaction and it also assesses restaurant performance. This information is used by headquarters to decide where to locate new stores and place advertising.

"Data is key to Wingstop acquiring

new customers," he added. "Going digital with ordering has made Wingstop's business much stronger. They are also better positioned for future growth potential."

Walsh likes cloud-base businesses that eliminate paperwork and streamline processing. Polen's small cap funds own shares in Duck Creek Technologies (Nasdaq: DCT) a cloud-based insurance servicer (2020 revenue: \$211.6 million.) and BlackLine (Nasdaq: BL) a cloud software firm that automates complex, manual accounting processes (2020 revenue: \$351.7 million).

Another Walsh pick: Exponent (Nasdaq: EXPO), a Palo Alto, Calif., science and engineering consulting firm. The

company is a play on research and development outsourcing, bringing together 90 different scientific and engineering disciplines to solve problems. Exponent posted 2020 revenue of \$399.9 million.

"Some of these companies may seem expensive by today's valuations but we think given their digital scale, these companies may grow faster for much longer and that justifies the valuation," Walsh said.

"Even though small caps are considered to be risky, our goal is to own 30 of the best and to identify companies with strong growth, good margin structure and good profitability. We feel these companies will weather the tough times."

Important Information Concerning the Forbes April 19, 2021 Article Reprint

Our U.S. Small Company Growth Fund objective seeks to achieve long-term growth of capital. The advisor identifies a concentrated portfolio of competitively advantaged business with the sustainable, above-average earnings growth.

Investor Share Details		Top Ten Holdings (% of Portfolio as of 06-30-2021)	
Ticker	PBSRX	Revolve Group Inc	7.32
CUSIP	360875173	Fox Factory Holding Corp	5.63
Inception Date	02-07-2019	Goosehead Insurance Inc	5.42
Min Investment	\$3,000	Wingstop Inc	5.15
Expense Ratio Net	1.35%	Trupanion Inc	4.98
Expense Ratio Gross	2.41%	Endava PLC	4.89
AUM (as of 06-30-2021)	\$140.2M	YETI Holdings Inc	4.42
		Blackline Inc	4.27
		Medpace Holdings Inc	4.24
		Globant SA	4.16
		Total	50.48

Fund Performance 06-30-2021– Polen U.S. Small Company Growth (PBSRX) Shares (%)

	Qtr	YTD	1 Yr	Inception
Polen U.S. Small Company Growth Fund - Investor	22.45	22.85	50.98	28.13
Russell 2000 Growth	9.27	14.59	59.17	23.70

Source: Polen Capital.

The performance data quoted represents past performance and does not guarantee future results. Current performance may be lower or higher. Performance data current to the most recent month end may be obtained by calling 1-888-678-6024. The investment return and principal value of an investment will fluctuate so that shares, when redeemed, may be worth more or less than their original cost. Performance would have been lower without fee waivers in effect. Data shown (%) as of recent calendar quarter end. Periods over one-year are annualized. Since inception results are from 02-07-2019. Gross expense ratios as of the most recent prospectus are 2.16% for Institutional and 2.41% for Investor Shares. Polen Capital Management has contractually agreed to reduce its fees or reimburse the Fund's operating expenses in order to limit the total annual operating expenses. Total returns would be lower had such fees and expenses not been waived and/or reimbursed. This agreement will terminate on 08-31-2021, unless the Board of Trustees approves an earlier termination.

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Important Information: There can be no guarantee that any strategy (risk management or otherwise) will be successful. Mutual fund investing involves risk, including possible loss of principal. The Fund is non-diversified, which means that a large portion of the Fund's assets may be invested in one or few companies or sectors. The Fund could fluctuate in value more than a diversified fund.

Mutual fund investing involves risk, including possible loss of principal. The Fund is non-diversified, which means that a large portion of the Fund's assets may be invested in one or few companies or sectors. The Fund could fluctuate in value more than a diversified fund.

The primary benchmark for the Fund is the Russell 2000® Growth Index which measures the performance of those Russell 2000 companies with higher price/book ratios and higher forecasted growth values.

The performance of an index does not reflect any transaction costs, management fees, or taxes. Returns are presented net of management fees and include the reinvestment of all income.

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