

# Polen U.S. SMID Company Growth

Portfolio Manager Commentary – September 2024

## Summary

- U.S. SMID cap stocks ended the third quarter on a solid note, buoyed by interest rate cuts and diminishing recession fears. However, the journey through the period was somewhat akin to a roller coaster ride, representing one of the most volatile quarters in recent history.<sup>1</sup>
- Admittedly, we are dissatisfied with our performance this year. Fueled by interest rate uncertainty, the market's short-term focus has prevented investors from seeing beyond upcoming rate decisions. Nonetheless, we remain confident in our Portfolio companies and their robust return expectations.
- Amid the heightened volatility, the U.S. SMID Company Composite Portfolio (the "Portfolio") outperformed drawdowns in the Russell 2500 Growth Index (the "Index"). Still, it lagged amid strong, risk-on market rallies.
- The top three contributors to the Portfolio's relative and absolute performance in the quarter were Goosehead Insurance, Revolve Group, and Hamilton Lane.
- The Portfolio's top relative and absolute detractors were Progyny, Five Below, and elf Beauty.
- We initiated new positions in TopBuild, Applied Industrial Technologies, Booz Allen Hamilton, and elf Beauty.
- We exited out of positions in Monolithic Power Systems, SiTime, RH, Doximity, Five Below, and Alight.
- Reflecting our opportunity cost mindset, we added to positions with better risk-reward profiles and stronger Flywheels, and trimmed positions largely for valuation reasons in order to fund new positions and add to existing holdings.

<sup>1</sup> Source: Bloomberg

## Seeks Growth & Capital Preservation (Performance (%) as of 9-30-2024)



	Qtr	YTD	1 Yr	3 Yr	5 Yr	10 Yr	Inception
Polen US SMID Company Growth (Gross)	9.12	-0.35	14.57	-9.14	-	-	13.88
Polen US SMID Company Growth (Net)	8.82	-1.25	13.17	-10.14	-	-	12.64
Russell 2500 Growth	6.99	11.20	25.20	-0.75	-	-	14.98

The performance data quoted represents **past performance and does not guarantee future results**. Current performance may be lower or higher. Periods over one-year are annualized. Performance figures are presented gross and net of fees and have been calculated after the deduction of all transaction costs and commissions, and include the reinvestment of all income. Please reference the GIPS Report which accompanies this commentary.

The commentary is not intended as a guarantee of profitable outcomes. Any forward-looking statements are based on certain expectations and assumptions that are susceptible to changes in circumstances. Opinions and views expressed constitute the judgment of Polen Capital as of the date herein, may involve a number of assumptions and estimates which are not guaranteed, and are subject to change. Contribution to relative return is a measure of a securities contribution to the relative return of a portfolio versus its benchmark index. The calculation can be approximated by the below formula, taking into account purchases and sales of the security over the measurement period. Please note this calculation does not take into account transactional costs and dividends of the benchmark, as it does for the portfolio. Contribution to relative return of Stock A = (Stock A portfolio weight (%) - Stock A benchmark weight (%)) x (Stock A return (%) - Aggregate benchmark return (%)).

All company-specific information has been sourced from company financials as of the relevant period discussed.

## Commentary

U.S. SMID cap stocks ended the quarter on a solid note, buoyed by interest rate cuts and diminishing recession fears. However, the journey through the quarter was akin to a roller coaster ride, representing one of the most volatile quarters in recent history.<sup>1</sup> Amid this heightened volatility, the Portfolio outperformed amid drawdowns in the Russell 2500 Growth Index. Still, it lagged during strong, risk-on market rallies.

This aligns with the broader market trend we've observed through the year, where low-quality stocks with high price momentum have driven positive SMID cap performance—an environment we believe is not conducive to success for long-term-oriented, high-quality growth companies.

Admittedly, we are dissatisfied with our performance this year. Fueled by interest rate uncertainty, the market's short-term focus has prevented investors from seeing beyond upcoming rate decisions. Nonetheless, we remain confident in our Portfolio companies and our robust return expectations for them.

### Even minor setbacks in earnings growth or outlooks prompted outsized stock reactions that we believed did not accurately reflect company strength. Such disparity can make for challenging stock selection.

A case in point is Goosehead Insurance, a digitally enabled insurance brokerage with long-term opportunity to gain share from captive and independent brokers with a significantly better "mousetrap." In our view, the business has remained attractive despite challenges for the broader insurance market. These challenges led to a weaker-than-expected outlook earlier in the year, sending the stock down over 40% from its mid-February high through the end of April. Despite the market reaction, we were less concerned as we believed positive changes the company implemented last year would eventually lead to accelerating revenue growth. When the company reported 2Q24 results, not much had changed fundamentally, but the stock was up nearly 60% over the course of a few weeks in July. In our view, this illustrates how rapidly expectations can change, even without a substantial shift in a company's fundamentals.

Stepping back, it's clear that the recent market volatility has worked both for and against us. In a few instances, it became clear that our thesis for a particular stock was no longer intact, and we dispassionately moved on to other opportunities. In most cases, however, we retain our deep conviction in specific holdings and use these periods of weakness to add to our positions. We think this approach represents a significant opportunity.

<sup>1</sup>Source: Bloomberg

Despite year-to-date performance challenges, we maintain our firm conviction that uncovering high-quality compounders at a discount to their intrinsic value will generate solid returns for our clients over the long term. We believe our seasoned team, disciplined process, and guiding Flywheel investment framework combine to ensure we remain true to our principles regardless of the prevailing market environment.

### Portfolio Performance & Attribution

The top three contributors to the Portfolio's relative and absolute performance in the quarter were **Goosehead Insurance**, **Revolve Group**, and **Hamilton Lane**.

**Goosehead Insurance**, a digitally enabled insurance brokerage business, was up nearly 60% in the third quarter following a significant drawdown in the stock in the first half of the year, as described above. Subject to broader market conditions, we expect core revenues to reaccelerate in 2024's second half, driven by increasing headcount and improving productivity.

**Revolve Group**, an online apparel retailer targeting primarily the Millennial and Gen Z demographics, was another top performer after demonstrating improving fundamentals following a challenging period. While the consumer environment remains under pressure, we are encouraged by the company's efforts to drive cost efficiencies, reduce return rates, expand product lines, and continue its international push. We believe Revolve is well-positioned to grow earnings at an accelerating rate over the near term while the long-term outlook remains intact.

**Hamilton Lane**, a private markets fund manager and service provider, was the third largest contributor to the Portfolio's relative performance. Over many quarters, Hamilton Lane has delivered consistently solid fundamental results, and the stock continues to be a robust performer with no significant change in our underlying expectations.

The portfolio's top relative and absolute detractors were **Progyny**, **Five Below**, and **elf Beauty**.

It's been a tough year for **Progyny**, a managed care provider specializing in fertility. Earlier this year, the stock came under pressure due to fluctuations in benefits utilization trends, which are within a normal range for the company. In retrospect, we believe company management could have been more thoughtful about guidance for the year, given natural fluctuations in the business. Additionally, the utilization briefly came under pressure, then normalized after the February 2024 Alabama Supreme Court ruling on IVF—which declared that embryos created through IVF should be considered children—and the subsequent media attention. This fueled uncertainty but does not appear to be the driver of weaker fundamentals. The company lowered guidance again and later reported the loss of a very large customer, Amazon. While much is unchanged about the massive long-term opportunity we see in fertility benefits, we have placed Progyny under review, as our process dictates.

Similar to Progyny, **Five Below** has been under pressure for some time. A combination of consumer weakness, elevated shrink (shoplifting), poorly timed investments in self-check-out, and turnover in the management ranks has weighed on the stock. As detailed in the Portfolio Activity section below, we eliminated the position and will follow it closely from the sidelines as we view the risks as too elevated currently.

**elf Beauty**, a discount beauty company focused on cosmetics and skincare, is a new addition to the Portfolio this quarter. Please see Portfolio Activity below for further detail. We are intrigued by the impressive track record for growth, margins, and returns on capital. elf has reported significant results all year, but shares came under pressure, in our view, as short-term investors primarily appeared to anticipate a slowdown in revenue growth, possibly due to concerns of market saturation, economic conditions, and valuation concerns, among other factors. While we are confident in how we underwrote our initial investment for returns above the portfolio average, the stock has come under even more pressure than we anticipated. We used this weakness to add to our position. We're intrigued by the strength elf has experienced across its retailer and ecommerce channels, particularly in taking market share in a challenging consumer environment, given their relatively inexpensive prices vs. competitors.

## Portfolio Activity

During the quarter, we instituted four new additions and six complete sales. We also added to and trimmed several existing positions.

The new positions included **TopBuild**, **Applied Industrial Technologies**, **Booz Allen Hamilton**, and **elf Beauty**.

**TopBuild** provides insulation distribution and installation services in the residential construction, commercial, and mechanical insulation markets. We believe the business offers exposure to the secular tailwinds from years of new home underbuilding, as well as a superior, high-return business model that should prove more resilient than traditional homebuilders. Historically, the company has gained share from independent mom-and-pop players, given their scale and greater value proposition.

**Applied Industrial Technologies** is a leading industrial distributor of parts and services across diversified end markets including, but not limited to, manufacturing, food & beverage, oil & gas, life sciences, and chemicals. The company operates 500 service centers, providing aftermarket parts and a significant services component. We find the company compelling not only as it appears to be a superior operator but also due to its impressive capital allocation track record and returns on capital. Overall, we expect Applied Industrial Technologies to become a low-double-digit earnings growth business with a narrower range of outcomes and added value creation from capital allocation.

**Booz Allen Hamilton** provides management and consulting services to U.S. government clients across civil, defense, and intelligence departments. Over the past ~100 years, Booz Allen has developed a reputation as a trusted partner in delivering high-quality services and strategic advice on the government's most pressing missions, including classified work. Booz Allen has been in our library for over a year, and we used recent price weakness to initiate a position. Based on our Flywheel framework, we believe this is a high-quality company that we expect to deliver low-teens earnings growth but with a narrow range of outcomes, driving a mid-teens return with capital allocation.

**elf Beauty**, the discount beauty company described above is uniquely positioned, in our view, due to its reputation for quality, innovation, and prices well below those of other mass cosmetics brands. While this combination of innovation, quality, and value has led to extraordinary growth, we still believe it's early days for the company. elf's brand awareness is considerably less than more prominent players; it is still adding shelf space, expanding its product portfolio, and entering the skincare market. elf is also still a US-focused business, with some early signs of international success. The company's financial profile is strong and we expect earnings per share to grow 25% over the long term.

We exited six positions during the quarter including **Monolithic Power Systems**, **SiTime**, **RH**, **Doximity**, **Five Below**, and **Alight**.

**Monolithic Power Systems** and **SiTime** are both semiconductor companies that rode the momentum-AI trade to new highs. We were fortunate to exit these positions before the broader sell-off in semis because we had difficulty justifying the valuation. Both are still great businesses that we would own for the long term at better prices. We also view Monolithic Power Systems as successfully "graduating" from the Portfolio due to market cap.

**RH** and **Doximity** Flywheels are still intact though they are experiencing headwinds from lower housing turnover and lower pharma ad spending, respectively. While we believe these issues are temporary, given the risk-reward relative to our opportunity set, we decided to upgrade with our new positions.

We exited our position in **Five Below**, the dollar store concept for tweens and teens. The business has struggled fundamentally with weaker consumer spending and lower margins due in part to a problem with shrink (shoplifting). While many companies are struggling with elevated shrink, Five Below's problems were compounded by a large investment in self-checkout that made matters worse. This was in the process of being fixed, but Five Below was further hampered by growing pressure on consumers. We continue to believe these issues may prove temporary, but we were surprised when the CEO was terminated. For now, we prefer to wait on the sidelines to ensure we fully understand the extent of the issues and how the CEO transition plays out.

Our position in **Alight**, a benefits outsourcing and business process-as-a-service company, was an unsuccessful investment. We decided to move on due to activist pressure that led to a breakup of the business. We were dissatisfied with both the plan and the new standalone business. This culminated with the CEO leaving and uncertainty over the company's long-term strategic direction. As a result, we felt it was time to move on with other investment ideas in our pipeline.

During the quarter, we added to and trimmed existing holdings, largely reflecting our normal practices driven by an opportunity cost mindset. We added to positions with better risk-reward profiles and stronger Flywheels and trimmed positions largely due to valuation, in order to fund new positions and add to existing holdings. We added to **Repligen**, **Pool Corp.**, **Tetra Tech**, **MarketAxess**, and **Progyny**.

We trimmed our positions in **Goosehead Insurance**, **Tyler Technologies**, **Hamilton Lane**, and **Clearwater Analytics**.

## Outlook

In our view, high-quality SMID cap companies have great latent potential for growth and are trading at significantly below-average valuations, particularly relative to most of the market. We believe the highest quality SMID cap companies will be more likely to take advantage of strong balance sheets and reinvestment to enhance their competitive position, tackle adjacencies, and make compelling acquisitions. Given so few companies meet this high hurdle, we hold a concentrated portfolio of companies that, in our view, offer growth and high returns, durability, robust financial models, and the ability to self-fund growth. We believe great investing requires a clear and proven philosophy and the ability to adhere to that philosophy and process with discipline in periods of uncertainty. It also requires humility and a willingness to recognize when you are wrong and update your views—something we are always prepared to do.

Although this continues to be a challenging environment in many ways, we are excited about potential opportunities as the rate environment becomes more accommodative and growth across many businesses accelerates in the years ahead. We remain confident in the resilience and growth prospects of our Portfolio holdings and look forward to keeping you updated in future commentaries.

Thank you for your interest in Polen Capital and the U.S. SMID Company Growth Portfolio. Please contact us with any questions.

Sincerely,  
Rayna Lesser Hannaway, CFA and Whitney Young Crawford

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## Experience in High Quality Growth Investing



**Rayna Lesser Hannaway, CFA**  
Head of Team, Portfolio Manager & Analyst  
28 years of industry experience



**Whitney Young Crawford**  
Portfolio Manager & Analyst  
17 years of industry experience

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## Important Disclosures & Definitions:

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**Source:** All data is sourced from Bloomberg unless otherwise noted. All company-specific information has been sourced from company financials as of the relevant period discussed.

### Definitions:

**Flywheel:** Polen Capital's Flywheel framework is how we assess a company's quality aimed at supporting sustainable growth. It is comprised of five self-reinforcing elements: 1) unique positioning, 2) repeatable sales process, 3) robust business model, 4) effective management, and 5) value-creating reinvestment.

**Secular tailwinds:** long-term, favorable trends or factors that positively influence economic growth, industries, or companies over an extended period, often due to structural changes like demographic shifts or technological advancements.

**Earnings per share:** a company's net income subtracted by preferred dividends and then divided by the average number of common shares outstanding.

**Contribution to relative return:** a measure of a security's contribution to the relative return of a portfolio versus its benchmark index. The calculation can be approximated by the below formula, taking into account purchases and sales of the security over the measurement period. Please note this calculation does not take into account transactional costs and dividends of the benchmark, as it does for the portfolio. Contribution to relative return of Stock A = (Stock A portfolio weight (%) - Stock A benchmark weight (%)) x (Stock A return (%) - Aggregate benchmark return (%)). All company-specific information has been sourced from company financials as of the relevant period discussed.

# GIPS Report

Polen Capital Management  
U.S. SMID Company Growth Composite—GIPS Composite Report

Year End	UMA		Firm	Composite Assets		Annual Performance Results				3 Year Standard Deviation <sup>2</sup>	
	Total (\$Millions)	Assets (\$Millions)	Assets (\$Millions)	U.S. Dollars (\$Millions)	Number of Accounts	Composite Gross (%)	Composite Net (%)	Russell 2500 Growth (%)	Composite Dispersion (%)	Polen Gross (%)	Russell 2500 Growth (%)
2023	58,910	22,269	36,641	26.63	11	29.39	28.05	18.93	0.1	26.29	20.95
2022	48,143	18,053	30,090	22.57	10	-44.40	-44.95	-26.21	0.1	N/A	N/A
2021	82,789	28,884	53,905	4.95	7	22.03	20.64	5.05	0.0	N/A	N/A
2020 <sup>1</sup>	59,161	20,662	38,499	0.51	1	105.23	103.70	82.91	N/A	N/A	N/A

## Performance % as of 12-31-2023:

(Annualized returns are presented for periods greater than one year)

	1 Yr	5 Yr	10 Yr	Inception
Polen US SMID Company Growth (Gross)	29.39	-	-	16.99
Polen US SMID Company Growth (Net)	28.05	-	-	15.77
Russell 2500 Growth	18.93	-	-	14.96

<sup>1</sup>Performance represents partial period (April 1, 2020 through December 31, 2020), assets and accounts are as of December 31, 2020.

<sup>2</sup>A 3 Year Standard Deviation is not available for 2020, 2021 and 2022 due to 36 monthly returns are not available.

Some versions of this GIPS Report previously included assets of the Firm's wholly-owned subsidiary in the 2022 Firm Assets figure, in error. The figure above has been corrected to no longer count assets at the subsidiary level.

N/A - There are five or fewer accounts in the composite the entire year. Total assets and UMA assets are supplemental information to the GIPS Composite Report. While pitch books are updated quarterly to include composite performance through the most recent quarter, we use the GIPS Report that includes annual returns only. To minimize the risk of error we update the GIPS Report annually. This is typically updated by the end of the first quarter.

# GIPS Report

The U.S. SMID Company Growth Composite created and inception on April 1, 2020 contains fully discretionary small and mid-cap company equity accounts that are not managed within a wrap fee structure and for comparison purposes is measured against the Russell 2500 Growth Index. Effective January 2022, fully discretionary SMID company equity accounts managed as part of our U.S. SMID Company Growth strategy that adhere to the rules and regulations applicable to registered investment companies subject to the U.S. Investment Company Act of 1940 were included into the U.S. SMID Company Growth Composite. The accounts comprising the portfolios are highly concentrated and are not constrained by EU diversification regulations.

Polen Capital Management claims compliance with the Global Investment Performance Standards (GIPS®) and has prepared and presented this report in compliance with the GIPS standards. Polen Capital Management has been independently verified for the periods April 1, 1992 through December 31, 2022. The verification reports are available upon request. A firm that claims compliance with the GIPS standards must establish policies and procedures for complying with all the applicable requirements of the GIPS standards. Verification provides assurance on whether the firm's policies and procedures related to composite and pooled fund maintenance, as well as the calculation, presentation, and distribution of performance, have been designed in compliance with the GIPS standards and have been implemented on a firm-wide basis. Verification does not provide assurance on the accuracy of any specific performance report.

Polen Capital Management is an independent registered investment adviser. Polen Capital Management maintains related entities which together invest exclusively in equity portfolios consisting of high-quality companies. A list of all composite and pooled fund investment strategies offered by the firm, with a description of each strategy, is available upon request. In July 2007, the firm was reorganized from an S-corporation into an LLC and changed names from Polen Capital Management, Inc. to Polen Capital Management, LLC.

Results are based on fully discretionary accounts under management, including those accounts no longer with the firm.

Effective January 1, 2022, composite policy requires the temporary removal of any portfolio incurring a client initiated significant net cash inflow or outflow of 10% or greater of portfolio assets, provided, however, if invoking this policy would result in all accounts being removed for a month, this policy shall not apply for that month. The U.S. Dollar is the currency used to express performance. Returns are presented gross and net of fees and include the reinvestment of all income. Net of fee performance was calculated using either actual management fees or highest fees for fund structures. The annual composite dispersion presented is an asset-weighted standard deviation using returns presented gross of management fees calculated for the accounts in the composite the entire year. Policies for valuing investments, calculating performance, and preparing GIPS Reports are available upon request.

The separate account management fee schedule is as follows:  
Institutional: Per annum fees for managing accounts are 100 basis points (1.00%) on the first \$50 Million and 85 basis points (0.85%) on all assets above \$50 Million of assets under management. HNW: Per annum fees for managing accounts are 175 basis points (1.75%) of the first \$500,000 of assets under management and 125 basis points (1.25%) of amounts above \$500,000 of assets under management. Actual investment advisory fees incurred by clients may vary.

The per annum fee schedule for managing the Polen U.S. SMID Company Growth Fund, which is included in the U.S. SMID Company Growth Composite, is 100 basis points (1.00%). The total annual fund operating expenses are up to 130 basis points (1.30%). As of 9/1/2023, the mutual fund expense ratio goes up to 1.30%. This figure may vary from year to year.

**Past performance does not guarantee future results and future accuracy and profitable results cannot be guaranteed.** Performance figures are presented gross and net of fees and have been calculated after the deduction of all transaction costs and commissions. Polen Capital is an SEC registered investment advisor and its investment advisory fees are described in its Form ADV Part 2A. The advisory fees will reduce clients' returns. The chart below depicts the effect of a 1% management fee on the growth of one dollar over a 10 year period at 10% (9% after fees) and 20% (19% after fees) assumed rates of return.

The Russell 2500® Growth Index is a market capitalization weighted index that measures the performance of the small to mid-cap growth segment of the U.S. equity universe. It includes Russell 2500® companies with higher price-to-book ratios and higher forecasted growth values. The index is maintained by the FTSE Russell, a subsidiary of the London Stock Exchange Group.

The volatility and other material characteristics of the indices referenced may be materially different from the performance achieved. In addition, the composite's holdings may be materially different from those within the index. Indices are unmanaged and one cannot invest directly in an index.

The information provided in this document should not be construed as a recommendation to purchase or sell any particular security. There is no assurance that any securities discussed herein will remain in the composite or that the securities sold will not be repurchased. The securities discussed do not represent the composite's entire portfolio. Actual holdings will vary depending on the size of the account, cash flows, and restrictions. It should not be assumed that any of the securities transactions or holdings discussed will prove to be profitable, or that the investment recommendations or decisions we make in the future will be profitable or will equal the investment performance of the securities discussed herein. A complete list of our past specific recommendations for the last year is available upon request.

Return	1 Year	2 Years	3 Years	4 Years	5 Years	6 Years	7 Years	8 Years	9 Years	10 Years
10%	1.10	1.21	1.33	1.46	1.61	1.77	1.95	2.14	2.36	2.59
9%	1.09	1.19	1.30	1.41	1.54	1.68	1.83	1.99	2.17	2.37
20%	1.20	1.44	1.73	2.07	2.49	2.99	3.58	4.30	5.16	6.19
19%	1.19	1.42	1.69	2.01	2.39	2.84	3.38	4.02	4.79	5.69

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