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TRIVARIATE RESEARCH

HOW DO YOU IDENTIFY COMPOUNDERS?

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RESEARCH SUMMARY

We are used to hearing from investors that they want to find “compounders” for multi-year investment. However, of late, this phrase has surfaced more frequently in our conversations, perhaps because investors want to find “compounding” businesses when they sell-off. Growth, value, and hedge fund managers have all used the “C” word with us in the last few days, prompting us to study this idea more carefully.

To study this, we need to establish a definition of compounding, and we did this by analyzing the stocks that have seen sustained performance on four metrics (sustained defined as consecutive quarters) in the 90th percentile or above of names that have seen *any* consecutive growth (we excluded all micro cap. and small cap. names). The four metrics we studied are:

1. Gross margin growth (page 5)
2. Revenue growth (page 6)
3. Net margin growth (page 7)
4. Prior stock performance - quarterly outperformance of the SPX (page 8)

WHAT IS THE BEST WAY TO COMPOUND?

If you want to find compounders, focus on companies that consistently have YoY gross margin growth. Companies that have had the most consecutive quarters of gross margin expansion (in the top 10% of names with any consecutive growth) produce the highest subsequent compounding returns. Persistent gross margin expansion is a better predictor of future returns than sustained revenue growth or net margin expansion, though all are better than just picking the stocks that went up the most consecutive quarters relative to the market

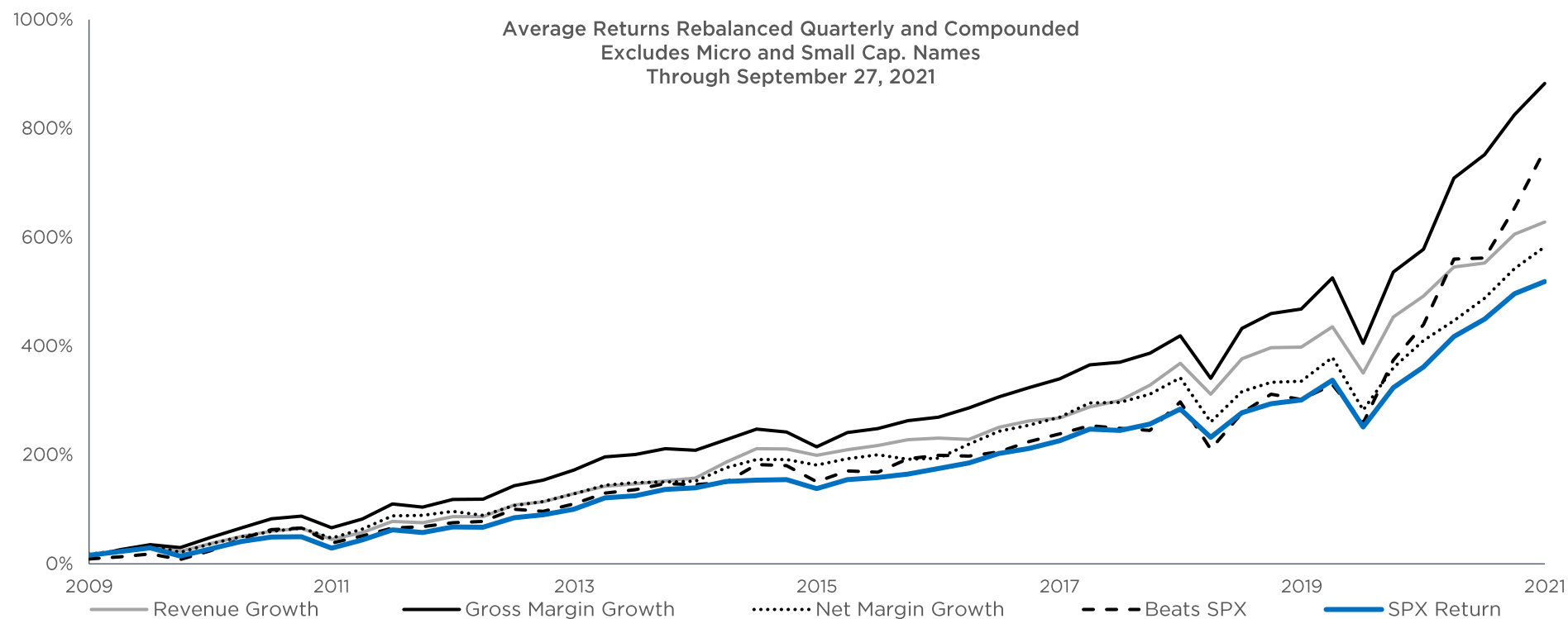
The top 10% of companies on revenue growth, net margin growth, and even relative prior stock performance all beat the SP500, though gross margin growth has the highest total performance. Stocks that have the most consecutive quarters of previous gross margin expansion and are forecasted to have continued gross margin expansion next quarter, are shown on the right side of page 5, and include NFLX, AVGO, MO, and ADSK, among others.

While gross margin growth is clearly the best way to identify future compounders, the other approaches (revenue growth, net margin growth, prior stock compounding) still produce stocks that subsequently beat the SP500

For questions about methodology or small / micro cap. ideas, please reach out to us

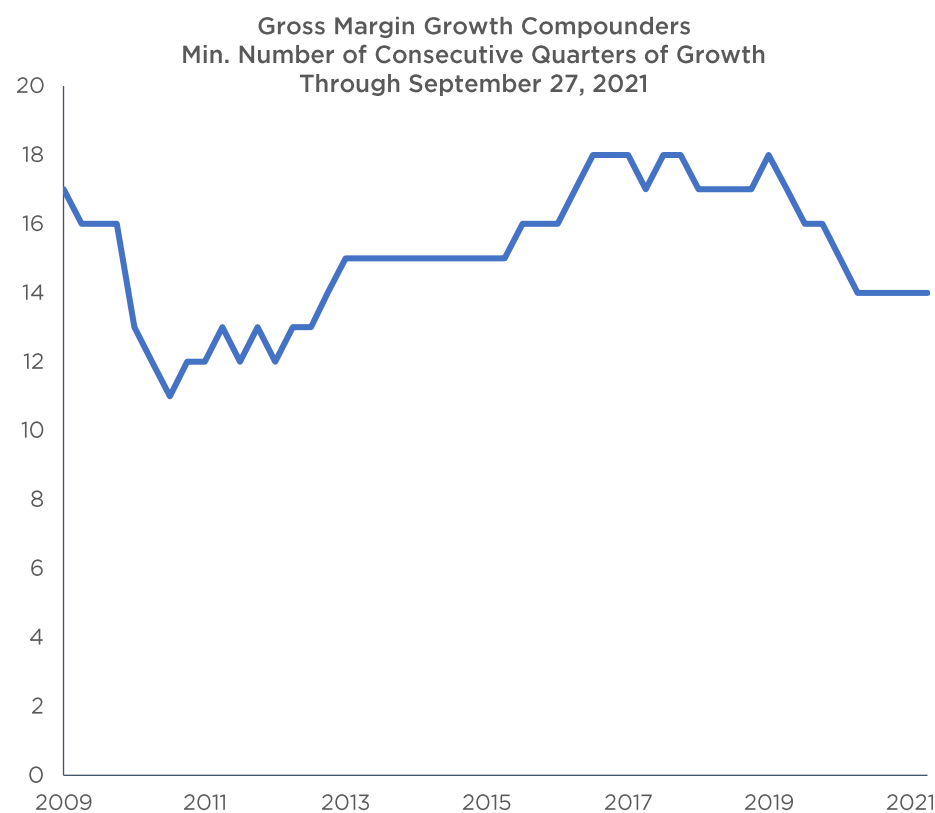
BUY CONSISTENT GROSS MARGIN EXPANDERS

Of the four signals we studied (prior relative stock performance, revenue growth, gross margin expansion, and net margin expansion) buying stocks in the top 10% of consistent previous gross margin expansion resulted in the best subsequent stock performance. While all four approaches beat the SP500, the consistency and total performance of the gross margin approach far bested the others. Net margin growth was clearly the weakest. Prior stock performance was strong, but much of this was generated since COVID



GROSS MARGIN GROWTH COMPOUNDERS ARE BEST

Of the ~400 companies with at least 2 consecutive quarters of gross margin growth this last quarter (on a year-over-year basis), 35 companies (top decile) had quarterly year-over-year gross margin expansion for at least 14 straight quarters (left chart). This universe of stocks has typically resulted in strong, above market performance. The stocks among this list with forecasted further gross margin expansion include NFLX, AVGO, AMD, MO, and ADSK (right chart) among others

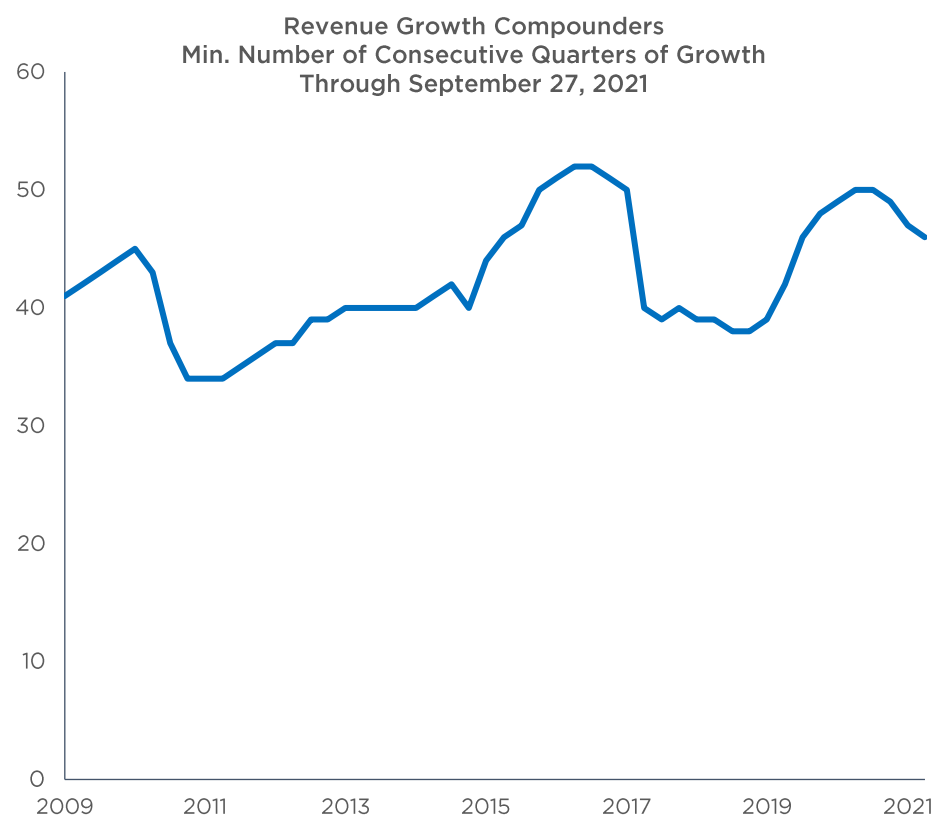


Gross Margin Growth Compounders
And Forecasted Gross Margin Growth
September 27, 2021

Ticker	Company	Industry Group	Market Cap. (US\$ Bil.)
NFLX	Netflix, Inc.	Entertainment	262.30
AVGO	Broadcom Inc.	Semiconductors & Semiconductor Equipment	207.80
AMD	Advanced Micro Devices, Inc.	Semiconductors & Semiconductor Equipment	131.19
MO	Altria Group, Inc.	Tobacco	89.88
ADSK	Autodesk, Inc.	Software	64.65
ATVI	Activision Blizzard, Inc.	Entertainment	58.39
IDXX	IDEXX Laboratories, Inc.	Health Care Equipment & Supplies	55.30
MSCI	MSCI Inc.	Capital Markets	52.65
FTNT	Fortinet, Inc.	Software	49.09
ROP	Roper Technologies, Inc.	Industrial Conglomerates	48.68
CVNA	Carvana Co.	Specialty Retail	26.97
STE	STERIS plc	Health Care Equipment & Supplies	21.45
QRVO	Qorvo, Inc.	Semiconductors & Semiconductor Equipment	19.53
GPC	Genuine Parts Company	Distributors	17.85
RH	RH	Specialty Retail	14.82
NTRA	Natera, Inc.	Biotechnology	10.80
HRC	Hill-Rom Holdings, Inc.	Health Care Equipment & Supplies	9.83
SITE	SiteOne Landscape Supply, Inc.	Trading Companies & Distributors	9.21
RL	Ralph Lauren Corporation	Textiles, Apparel & Luxury Goods	8.67
NTNX	Nutanix, Inc.	Software	8.58

CONSISTENT REVENUE GROWERS ALSO OUTPERFORMED

Of the 580 companies that have positive revenue growth in the last year, the top decile (or 58 companies) have grown their revenue (on a year-over-year basis) for at least 46 straight quarters (left chart), or for every quarter for more than 11 years. Stocks include (right chart) AMZN, UNH, NFLX, AMT, DG, MNST, ORLY, RMD, and CNC, among others



**Revenue Growth Compounders
And Forecasted Revenue Growth
September 27, 2021**

Ticker	Company	Industry Group	Market Cap. (US\$ Bil.)
AMZN	Amazon.com, Inc.	Internet & Direct Marketing Retail	1724.84
UNH	UnitedHealth Group Incorporated	Health Care Providers & Services	382.14
NFLX	Netflix, Inc.	Entertainment	262.30
AMT	American Tower Corporation (REIT)	REITs	124.75
DG	Dollar General Corporation	Multiline Retail	50.57
MNST	Monster Beverage Corporation	Beverages	48.55
ORLY	O'Reilly Automotive, Inc.	Specialty Retail	43.00
RMD	ResMed Inc.	Health Care Equipment & Supplies	39.41
CNC	Centene Corporation	Health Care Providers & Services	37.22
AZO	AutoZone, Inc.	Specialty Retail	35.75
ANSS	ANSYS, Inc.	Software	31.05
O	Realty Income Corporation	REITs	25.58
ABC	AmerisourceBergen Corporation	Health Care Providers & Services	25.48
SIRI	Sirius XM Holdings Inc.	Media	24.75
TSCO	Tractor Supply Company	Specialty Retail	24.05
MKC	McCormick & Company, Incorporated	Food Products	22.55
DLTR	Dollar Tree, Inc.	Multiline Retail	19.54
ROL	Rollins, Inc.	Commercial Services & Supplies	18.00
JKHY	Jack Henry & Associates, Inc.	IT Services	12.63
FFIV	F5 Networks, Inc.	Communications Equipment	12.36

NET MARGIN GROWTH IS WEAKER THAN GROSS MARGIN OR REVENUE

Of the 200 names with positive net margin growth in the last year, the top decile, or 20 names all had 8 consecutive quarters or more of net margin growth (left chart). The total number came down meaningfully during COVID. The top net margin compounders are on the right exhibit

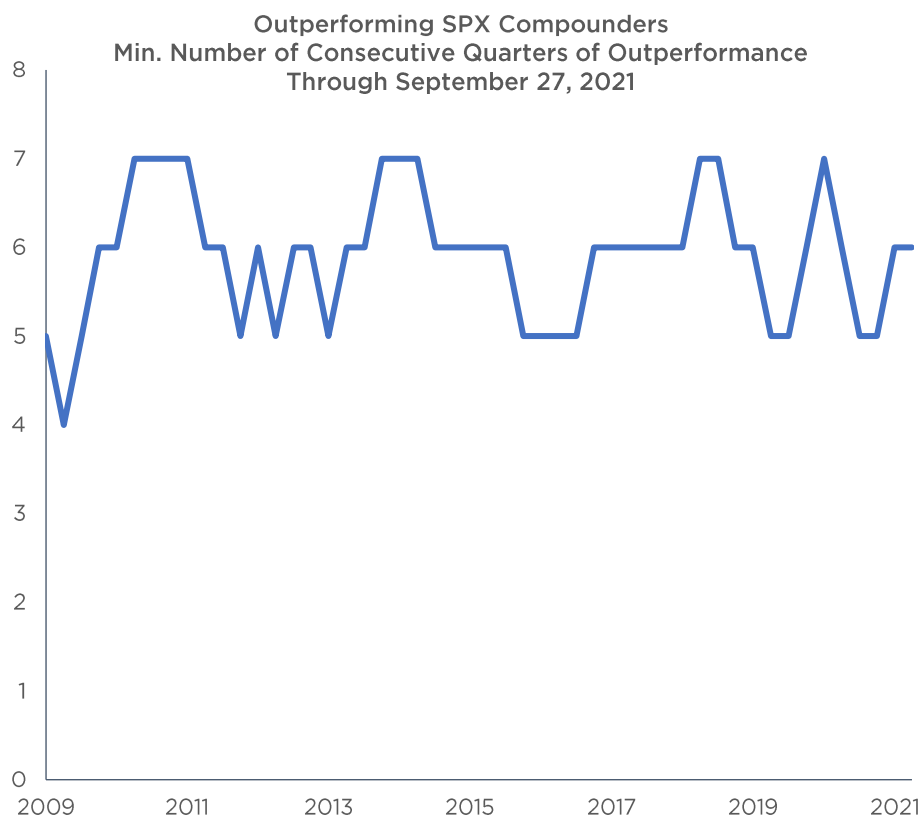


**Net Margin Growth Compounders
And Forecasted Net Margin Growth
September 27, 2021**

Ticker	Company	Industry Group	Market Cap. (US\$ Bil.)
ACN	Accenture plc	IT Services	211.74
AON	Aon plc	Insurance	66.37
MTD	Mettler-Toledo International Inc.	Life Sciences Tools & Services	34.17
SSNC	SS&C Technologies Holdings, Inc.	Software	18.00
NVR	NVR, Inc.	Household Durables	17.85
CMS	CMS Energy Corporation	Multi-Utilities	17.22
DOX	Amdocs Limited	IT Services	9.77
TPX	Tempur Sealy International, Inc.	Household Durables	9.71

OUTPERFORMING SPX COMPOUNDERS

The top decile of stock performers have beaten the market for at least six consecutive quarters (left chart). MRNA, COF, JCI, A, and SIVB, among others, all qualify (right chart). This list is not as effective as using the fundamental metrics to pick future performance, though it has historically still outperformed the SP500. As an example, a stock like MGM have worked 6 straight quarters after being crushed in Q1 of 2020, so the trailing stock performance appeals to us less than the fundamental assessment in terms of identifying future compounders



Outperforming SPX Compounders
September 27, 2021

Ticker	Company	Industry Group	Market Cap. (US\$ Bil.)
MRNA	Moderna, Inc.	Biotechnology	165.03
COF	Capital One Financial Corporation	Consumer Finance	75.73
JCI	Johnson Controls International plc	Building Products	51.22
A	Agilent Technologies, Inc.	Life Sciences Tools & Services	50.37
SIVB	SVB Financial Group	Banks	39.56
KKR	KKR & Co. Inc.	Capital Markets	35.87
HUBS	HubSpot, Inc.	Software	33.32
SYF	Synchrony Financial	Consumer Finance	29.46
GNRC	Generac Holdings Inc.	Electrical Equipment	28.01
CZR	Caesars Entertainment, Inc.	Hotels, Restaurants & Leisure	24.83
MGM	MGM Resorts International	Hotels, Restaurants & Leisure	21.73
ALLY	Ally Financial Inc.	Consumer Finance	19.33
BBWI	Bath & Body Works, Inc.	Specialty Retail	18.14
ENTG	Entegris, Inc.	Semiconductors & Semiconductor Equipment	17.69
TXT	Textron Inc.	Aerospace & Defense	16.30
RH	RH	Specialty Retail	14.82
ATH	Athene Holding Ltd.	Insurance	13.56
PNR	Pentair plc	Machinery	12.73
TREX	Trex Company, Inc.	Building Products	12.56
CROX	Crocs, Inc.	Textiles, Apparel & Luxury Goods	9.58

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