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BI PRIME

The lead manager at a highly ranked small-cap fund crushes peers in the riskiest part of the market. He reveals the 4 attributes he looks for in a stock pick.

Marley Jay

- Ken Korngiebel's Wasatch Micro Cap Fund beat 98% of its peers in 2019. Kiplinger also ranks it as one of the 10 best small-cap mutual funds over the past three, five, 10, and 20 years.
- He told Business Insider he makes sure he's getting his calls correct by zeroing in on these four areas.

It's survival of the fittest in Ken Korngiebel's portfolio. When he took over as manager of the Wasatch Micro Cap Fund in 2017, he decided he wanted to shrink it. He's reduced the number of stocks in his portfolio to 75. And now that it's more concentrated, he won't add a new stock to the fund unless it's clearly better than one he already holds.

"There's always competition for capital," he told Business Insider in an exclusive interview. "A new idea needs to be compared with an existing idea to see what might be better going forward."

That's helped him raise the level of a fund that was already highly successful. The micro cap fund beat 98% of competing funds in 2019. Kiplinger ranks it as one of the 10 best small-cap mutual funds over the past three, five, 10, and 20 years. It's also picked up an Overall Five-Star Rating from Morningstar along the way.

The small-cap landscape is a broad one and Korngiebel can't hang on to many companies that outgrow it, so the competition is intense.

He explained that he's always looking for these four qualities before he adds a company to his fund.

(1) Revenue growth

"Revenue growth is where I start," Korngiebel said. "Without topline growth, ultimately you run out of bottom line growth."

His portfolio is filled with two kinds of companies: Steady, mature businesses that are posting revenue growth in the mid-single digits, and companies that might be at an earlier stage, but are posting sales growth of 20% to 40% a year. For the latter group, he says it's vital that they're growing under their own power and not just snapping up their competition.



Wasatch Global Investors

"When you're dealing with micro caps and small caps, the types of stocks that we're looking for that can go on to be big companies, it begins with revenue growth and particularly organically," he said.

(2) Economic power

Korngiebel spends a lot of time examining companies that are in early stages of development, and when he does buy a stock, the competition, and how they might evolve over that time.

"Understanding the core economics of the business in terms of what's the margin profile today (and) what would that margin profile look like at more revenue scale" is critical, he said. "We want to understand the competitive intensity of the industry, because that directly influences how much market share a company is going to take and therefore what the future profitability of the firm looks like."

(3) Outstanding management

"This is a part of the market which is, I think, really dependent on your assessment of management because these aren't big companies," Korngiebel says. "The benches aren't as deep."

When he's enthusiastic about a company, an exceptional

management team is always a major reason. And he says he goes into a lot of depth in examining those companies.

“I have on a retainer a former investigative journalist who conducts background due diligence and interviews of former employees to help us understand certain questions we might have about any particular executive,” he said.

(4) Disruption

“You’re looking for companies that have innovative products, technologies that map on to large markets that have great business models,”

Korngiebel said of his highest-upside investments.

At the end of 2019 a whopping 57% of his holdings were in either healthcare or technology companies. He says he targets those two. Combined with the other data he’s gathered, that gives him a good idea about the trajectory of the companies he’s evaluating.

“We can make some pretty educated forecasts about competitive environment with the likelihood is of capturing market share, significant revenue growth and ultimately cashflow and profitability,” he said.

Average Annual Total Returns
For Periods Ended December 31, 2019

| | 1 Year | 3 Years | 5 Years | 10 Years |
|--------------------------------|--------|---------|---------|----------|
| Wasatch Micro Cap Fund (WMICX) | 42.23% | 25.68% | 16.17% | 15.34% |

Data show past performance, which is not indicative of future performance. Current performance may be lower or higher than the data quoted. To obtain the most recent month-end performance data available, please visit wasatchglobal.com. The Advisor may absorb certain Fund expenses, without which total return would have been lower. Investment returns and principal value will fluctuate and shares, when redeemed, may be worth more or less than their original cost.

Wasatch Funds will deduct a 2.00% redemption proceeds fee on Fund shares held 60 days or less. Performance data does not reflect the deduction of fees or taxes, which if reflected, would reduce the performance quoted. For more complete information including charges, risks and expenses, read the prospectus carefully. The Total Annual Fund Operating Expenses for the Investor Class shares of the Micro Cap Fund are 1.66%.

The Morningstar Rating for funds, or 'star rating,' is calculated for managed products (including mutual funds, variable annuity and variable life subaccounts, exchange-traded funds, closed end funds, and separate accounts) with at least a 3-year history. Exchange-traded funds and open ended mutual funds are considered a single population for comparative purposes. It is calculated based on a Morningstar Risk-Adjusted Return measure that accounts for variation in a managed product's monthly excess performance, placing more emphasis on downward variations and rewarding consistent performance. The top 10% of products in each product category receive 5 stars, the next 22.5% receive 4 stars, the next 35% receive 3 stars, the next 22.5% receive 2 stars, and the bottom 10% receive 1 star. The Overall Morningstar Rating for a managed product is derived from a weighted average of the performance figures associated with its 3-, 5-, and 10-year (if applicable) Morningstar Rating metrics. The weights are 100% 3-year rating for 36-59 months of total returns, 60% 5-year rating / 40% 3-year rating for 60-119 months of total returns, and 50% 10-year rating / 30% 5-year rating / 20% 3-year rating for 120 or more months of total returns. While the 10-year overall rating formula seems to give the most weight to the 10-year period, the most recent 3-year period actually has the greatest impact because it is included in all 3 rating periods. As of December 31, 2019, the Fund's Investor Class was rated 5, 5 and 5 stars against 571, 505 and 379 funds in the Small Cap Growth Category for the for the 3-, 5- and 10-year periods, respectively. The Fund ranked 12th out of 640 funds (top 98%) based on total return for the calendar year 2019. The Fund's other share class may have different performance characteristics. Past performance is no guarantee of future results.

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Investing in small cap funds will be more volatile and loss of principal could be greater than investing in large cap or more diversified funds. Investments in value stocks can perform differently from the market as a whole and from other types of stocks and can continue to be undervalued by the market for long periods of time. Investing in foreign securities, especially in emerging markets, entails special risks, such as currency fluctuations and political uncertainties, which are described in more detail in the prospectus. The *Fund's* investment objective is long-term growth of capital. An investment in the Fund involves risk, including loss of principle.

An investor should consider investment objectives, risks, charges and expenses carefully before investing. To obtain a prospectus, containing this and other information, visit wasatchglobal.com or call 800.551.1700. Please read the prospectus carefully before investing.

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