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THE WALL STREET TRANSCRIPT

Connecting Market Leaders with Investors

Three SMID-Cap Companies with Superior Management Teams

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SECTOR — GENERAL INVESTING

TWST: Could you provide an overview of Baird?

Mr. Good: Sure. Baird is a privately held, employee-owned, diversified financial services firm. The firm has several businesses, including asset management, private wealth management, venture capital, and then sales, trading, investment banking. My initial job was to be the health care analyst for our Mid Cap Growth Fund.

Within Baird Asset Management, we have a fixed-income group called Baird Advisors and that's run by Mary Ellen Stanek. And then we have Equity Asset Management, which is run by Reik Read. Within Equity Asset Management, we have a growth team that I'm on that's based in Milwaukee. We have a global and international group called Chautauqua. They're based out in Boulder, Colorado. And within the Baird funds, we also have a small-cap opportunities fund that's sub-advised by a firm called Greenhouse.

But my role, again, has been based in Milwaukee and managing the SMID Growth Fund, and then working as a health care analyst for our Mid Cap Growth Fund, as well.

TWST: Could you talk about the two areas that you work on?

Mr. Good: Sure. Equity Asset Management includes our longest-running strategy and fund, Baird Mid Cap Growth Fund, which was founded almost 30 years ago. We've always taken a bottom-up fundamental approach to investing.

Several years ago, it would have been referred to as the high-quality type of strategy. It's a long-only domestic mutual fund and we've just really focused on owning high-quality growth stocks with a longer investment time horizon. We have an investment team that's currently eight members. That's two portfolio managers on Mid Cap, myself on SMID. The other analysts have sector responsibilities. So we have an industrials and energy analyst, we have health care, we have consumer and staples, and then technology.

So again, that strategy has a favorable track record over a very long time horizon. We have a philosophy and process that has done very well in a variety of investment environments, too. That is the background for why we launched a SMID strategy almost seven years ago. That was something for which I raised my hand, saying it was something I was interested in and wanted to do.

And the reason that our SMID strategy came about was, essentially, mid-cap growth stocks were getting bigger and bigger as the market has increased, post the financial crisis. A lot of the names that typically would fit in our mid-cap strategy were suddenly too small. My approach as an analyst was: Well, wait a second. If I'm already familiar with this company and I'm doing the work and I think it's a great investment opportunity, why should I wait for this stock to double or triple and then we'll buy it? Maybe we can find a way to take advantage of it sooner.

And so, one of the philosophies of Baird is we're very focused on client service and so we're not a firm that has a gazillion different strategies. We wanted to focus on things that we felt we were good at, where we had some expertise, and where we could drive alpha for clients. And so, we settled on SMID as a way to continue to do that.

It was really a natural fit for the investment team because in a lot of ways, we were already doing the work. We were already tracking a lot of these names, whether they were going to be emerging mid-cap names or potential competitors to holdings.

The SMID-cap asset class, which I would say, is in the $1 billion to $20 billion market cap range — that's probably what mid-cap used to be a decade ago. And so, we felt, again, that we had a philosophy and process that had survived and done incredibly well over a lot of different investment environments over a variety of market cycles.

We felt, let's take that same philosophy and process, the same team, and apply that to SMID. That was the genesis of us launching a separate account in the fall of 2015. We launched a mutual fund in October of 2018. As it sits today, we have a seven-plus-year track record on the separate account and recently did four years on the mutual fund and are heading towards the five-year mutual fund number in the fall of 2023.

TWST: Sometimes there is concern with large-cap stocks being overvalued. SMID stocks oftentimes have shown they have potential for growth. Is that your feeling now, especially with concerns about a recession or a correction going forward?

Mr. Good: Yes. We're big believers in small-mid-cap growth, or SMID, as an asset class in general, in addition to our ability to try to do even better than benchmark returns. I think so much of media coverage of stocks in general has just been so focused on large-cap stocks. You only need to turn on CNBC and it's **Tesla**, **Netflix**, **Amazon**, **Google** — kind of the same stocks over and over again.

And particularly for institutional investors who want exposure to growth stocks that aren't these mega-cap household names that you can get really cheaply in an index fund, I think SMID growth has been a really fertile ground for a lot of great growth stocks.

In recent times, throughout COVID, SMID growth has been rebranded into some sort of speculative, disruptive, aggressive growth type stock — and that's certainly not been our philosophy. I mean, we're not a GARP — growth at a reasonable price — fund. We do want true growth, but we also have a focus on balance sheets, a focus on profitability, and want to be invested with management teams that see a longer runway for growth as opposed to something that might just be a really short product opportunity.

TWST: Did you want to give an example of a stock you think the readers would find interesting?

Mr. Good: I'll stick with a health care name. One really interesting company that we've held for quite a while and continue to really like is **Insulet** (NASDAQ:PODD).

It's often referred to as **PODD**, which is their core diabetes pump, which is called the Omnipod. I think diabetes is a very closely followed space with a tremendous amount of innovation in recent years.

For the longest time, there has been this belief in medical devices to create the artificial pancreas. This is an idea that probably came about 20, 30, maybe even 40 years ago. And over the last couple of years, technology has come to the forefront where this has been possible.

And because diabetes, unfortunately, is a tremendously growing market. If you have poor exercise or poor diet or are overweight, you're likely to have a potential increased risk for diabetes. This big growing market has just been an opportunity for a pump company then to come on the scene.

1-Year Daily Chart of Insulet Corporation

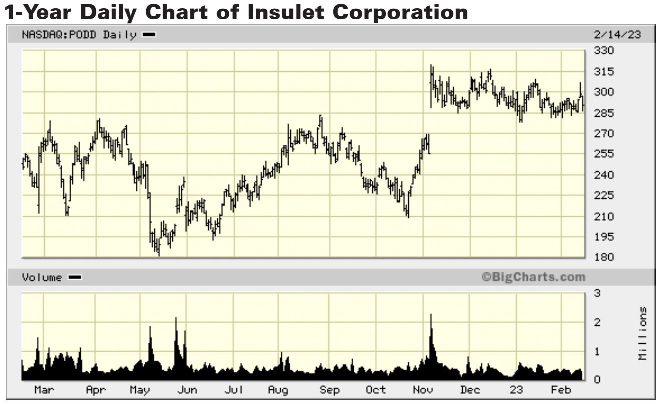

Chart provided by www.BigCharts.com

And so **Insulet**, again, has just had a big advantage with not only their business model, but also just phenomenal technology and really big growth prospects going forward.

Insulet is not the cheapest stock. This is something that we recognize, that as the stock has done really well, the multiple has expanded. I would certainly say that as we look at this business in 2023, expectations are high. But again, I think they just have an advantage, not only with a phenomenal technology, but a really strong business model and there's just a really long runway for growth even if the stock may look expensive as it sits today.

"So Insulet has a patch-based pump that you can wear on your arm and then it's tied with a continuous glucose monitor, which monitors your glucose readings throughout the day. There's an algorithm in their software that helps both those two devices communicate with each other."

So **Insulet** has a patch-based pump that you can wear on your arm and then it's tied with a continuous glucose monitor, which monitors your glucose readings throughout the day. There's an algorithm in their software that helps both those two devices communicate with each other. You're able — for a Type 1 diabetic — to have an automated insulin pump.

And so, this has been something that got approved about a year ago and then there's been a lot of interest and enthusiasm for an automated insulin delivery system in a patch format.

What makes **Insulet** really interesting, even more so than their technology, has been their business model, which they've coined as pay-as-you-go. And because this has been a disposable patch pump, from an insurance standpoint, you're able to go to the pharmacy and get a pump for a low monthly payment — as opposed to an insurer who in the past would have spent several thousand dollars on a more permanent pump that you'd wear for four years.

TWST: Is there a lesson for investors there: Sometimes certain stocks might appear expensive, but you have to look at them carefully to see that there's potential?

Mr. Good: Yes. I think that's always a challenge for any long-term investor. You can always get worried over the short-term that this stock has had a big run or everything's priced in, and maybe the stock pulls back a little bit. Then you think, things are over; I need to sell this.

But what we really try to do is that as long as the investment thesis is valid and we continue to see a strong fundamental outlook — certainly if you own a stock for five years, maybe you get all your returns in two of those five years, and a couple of those years, maybe the returns aren't as strong. But again, from a longer-term investment time horizon, you still have a phenomenal return over that time period.

That's so much of what growth investors are wrestling with right now. Obviously, there were worries throughout the previous calendar year on multiples. Expensive stocks certainly were in the penalty box through demand from COVID — and then I think there are worries over recession.

But I think if we look at calendar 2023 and beyond, I'm not necessarily trying to make any macro forecasts, that's not what we do, but if the macroeconomic environment ends up being less bad than people were thinking, then I think companies that have had strong fundamental growth prospects, you're going to see really good revenue growth, really good earnings growth, and that will continue to be rewarded regardless of whether people are making a call over a soft landing or a shallow recession or whatever the latest macro forecast may be.

TWST: Did you want to mention a second company?

Mr. Good: Yes. Another business in financials that we've liked for a long time is an insurance company called **Kinsale** (NYSE:KNSL). What has been interesting to me about this business over time is, I'm certainly not an insurance expert, but here was a company with an entrepreneurial CEO who saw an opportunity in a niche market in insurance. It's called excess and surplus. This might be a nightclub or a restaurant, or some type of business that doesn't really typically fall into a traditional property and casualty insurance bucket.

And so, when you think about both of these companies, whether it's a company like **Insulet** or a company like **Kinsale**, the M in PRIME for management is something that we spend a lot of time on. It's very important to us because we're taking our clients' capital and investing that with companies that are going to make the same decisions on how to best run their business.

And so, in both of these instances, at **Insulet**, where their CEO actually recently stepped down, but we like the next guy in charge, and at **Kinsale** — another example of just a CEO that's done a really good job.

TWST: And for investors who are interested in the SMID space in general, do you have any advice for them in the coming year of what they should look out for? Maybe some precautions they can take and maybe some opportunities they should be looking for?

Mr. Good: Sure. Like I mentioned earlier, SMID growth has sometimes been labeled as these disruptive, speculative growth stocks. I think post-COVID, we're seeing a lot of this idea of growth at any cost with a complete lack of profitability or minimal visibility on profitably going forward, but the fact is that you're going to need to raise money. I think that's something to pay close attention to.

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What **Kinsale** has been able to do is to grow quickly by both gaining market share and doing a better job of pricing their business. They feel that their competitive edge is just a better IT system and a management team that is only focused on this market. And so, they've been able to show really strong growth for the last several years.

And again, it's a CEO that's done a phenomenal job in managing this business. Even with their recent success, I think their total market share is still 2% or less of the total market.

Some companies have struggled in this market segment where a company will come in, they'll win a bunch of business in this area, then some event will happen, they'll do poorly, they'll lose money and they exit.

And, just like we do a really good job focusing on mid and SMID growth stocks, this is a management team that's been really focused in this excess and surplus segment of the insurance business. It has just done really well over a long period of time.

TWST: You gave the example of nightclubs. It was a challenging time for some, because during COVID many of them were forced to close. They're reopening and trying to bring customers back in. Is there some growth potential for the stock there, too?

Mr. Good: Yes. Also, they obviously had some hurricane exposure. But I think a lot of times when insurance companies are faced with natural disasters, the business gets repriced and that tends to bode pretty well for growth going forward. A lot of times, the companies that they insure, they're mandated by state laws to be insured, so if they can have some leverage from a pricing standpoint, that's something that insurance companies are really good at.

One thing I should add about our philosophy and process that I think is unique to what we do, is the acronym we call PRIME. The P is for profits, R is for revenue growth, I is for industry dynamics, M is for management, and E is for expectations.

And so many of these stocks that were the fad stocks post-COVID, whether that's stuff like **Zoom** (NASDAQ:ZM) or **Peloton** (NASDAQ:PTON), or in the health care side of things, various COVID vaccines and diagnostics, I think a lot of that stuff is never really coming back and is something to avoid.

1-Year Daily Chart of Kinsale Capital Group Inc.

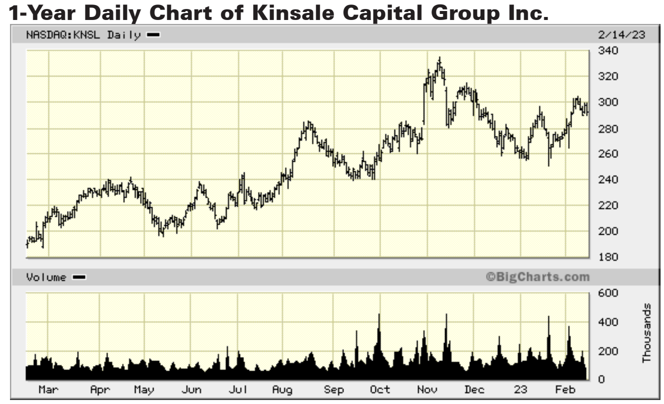

Chart provided by www.BigCharts.com

But I think as long as you think about SMID growth as smaller companies that still have really great fundamental opportunities in front of them, then I think those are the kind of companies that we're always trying to find. Those are the companies that we want to build a portfolio with.

We certainly don't have a fund that takes big sector bets. We always stay in the range of 75% to 125% of the index weight. Again, that's something we've found that over a longer investment time horizon keeps us in the game without making big sector bets.

Because a lot of times with a benchmark like the 2500 Growth index, those stocks might be weighted 2, 3, 5, 10 basis points, and we're going to own a 1% and 2% position. We're making significant active bets just by position size because we're a fund that is going to own 60 to 70 names, not necessarily 150 or 200, like an index fund that has a bunch of tiny little positions.

So we feel we can make concentrated bets, have good active share, but not take big sector bets, which potentially gives us a smoother ride throughout more volatile times.

TWST: Also for the SMID space, it sounds like it would be particularly interesting for younger investors who have a long time horizon because it would give a lot of these companies time to grow and succeed. Is that something you've seen too?

Mr. Good: Sure. I think there's so many phenomenal companies in this area that aren't necessarily household names. Now, maybe other SMID investors might know a company like **Insulet** or **Five Below** (NASDAQ:FIVE) or **Pool Corporation** (NASDAQ: POOL) or **Heico Corporation** (NYSE:HEI). Those might be more familiar to SMID investors. But they're certainly not household names, like I said, because they're not being blared about in the media or by CNBC on a daily basis.

I think you can own established companies with good growth prospects that potentially are household names in the future.

TWST: What about Five Below? What about it that might interest investors?

Mr. Good: One thing that **Five Below** has in front of it is that the story isn't necessarily about the individual comps like a lot of retailers because they have so much possibility for store growth. They might be able to triple their store base over the next decade.

I think the retail market can be so challenging given the emergence of e-commerce and there's always going to be consumers who have a focus on a lower price point. When you enter their stores, they put snacks and candy right in front and that can be tempting as a consumer. It's almost like a stocking stuffer type of store.

There might be various fads over the years whether it was things like fidget spinners or whatever the latest fad is, that also drives a lot of traffic to those sorts of stores. They've also branched out into a slightly higher price point. I think it's kind of unofficially $10 and below.

But when you go through tougher economic times, do consumers trade down and become more focused on value? I think consumers are always going to gravitate to stores where they feel they have a really good value.

So again, it's another company with a phenomenal management team that has a really strong strategy on how they want to grow. Sometimes, with retail stocks, you live and die over the comp trends over short time horizons. I think one of the unique aspects of **Five Below** is just the fact they can grow their sales and grow their earnings by growing their store base over time because they still have a relatively small footprint nationwide.

TWST: And more generally, are you seeing some of the SMID stocks paying dividends and has that been useful for people that are in retirement or nearing retirement?

Mr. Good: There certainly are a handful of SMID names that pay dividends. Certainly, those with a good balance sheet and strong cash flow. That's not really been a direct focus for us. It's something that we obviously take note of, the names of our portfolio that pay dividends. But it's not something that we pay really close attention to or prevents us from owning a stock if they don't pay a dividend. From an investor standpoint, you want exposure to a SMID growth fund purely more for capital appreciation than you would for a dividend payment.

TWST: But the fund still would be something somebody in their retirement years might want to consider to be part of their diverse portfolio?

Mr. Good: Yes, without a doubt. I think SMID growth makes a lot of sense as part of a diversified portfolio.

TWST: And for that age group too?

Mr. Good: Sure. If you retire at 65, but you live to 95, that's a pretty good investment time horizon.

TWST: Any more advice for investors, especially if there's something similar to a recession coming up? Is there anything they can do now that might help prepare them for later this year?

Mr. Good: Well, 2022 was a difficult year, particularly more expensive growth stocks were in the penalty box. I think that bodes well for returns — anytime you're taking advantage of a good asset class that maybe just was out of favor for a year.

And so I think in a lot of cases, macro forecasts are really difficult. It's not something that we spend a lot of time thinking about. But whether there's a recession this year or next year or whether it's shallow, or whatever that may be, there are a lot of companies now whose stock prices are down 30%, 40%, 50% from where they were 12 months ago. I think that's just a good entry point and bodes well for future returns looking out two-plus years.

TWST: Thank you. (ES)

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Disclosures: For important information about the Baird Small/Mid Cap Growth Fund, including its performance, risks, holdings and access to the fund's prospectus, please visit the fund's page on bairdfunds.com.