

# A Recipe for Investing in Wingstop



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**ALEX BERNSTEIN:** Hello, I'm Alex Bernstein and you're listening to The Alger Podcast, Investing in Growth and Change. 2024 marks Alger's 60th anniversary as an investment manager and a pioneer of the growth-style of investing. It also marks Alger Small Cap Focus Portfolio Manager Amy Zhang's 21st year of industry experience managing that asset class. Now, with interest rates stabilizing and even potentially dropping, small caps may be making a comeback. Here to give an update on her small cap portfolio is Amy Zhang. Amy, thanks so much for joining me this afternoon.

**AMY ZHANG:** Thank you, Alex.

**ALEX:** Amy, as many investors know, 2023 was a challenging year for small caps. Why do you think it was such a difficult year?

**AMY:** We think we've been in a bear market for small cap for like three years. The key reason for that was the rate hikes. Over 500 basis points of rate hikes, and clearly small cap growth by nature are long-duration assets. So, I think our strategy is over 90% correlated<sup>1</sup> to the ten-year in a very significant way. So, clearly we think that's a key factor in why we underperformed.

But now with rates peaking, we really think that the headwinds that we experienced in the last three years including last year, that it should be turning into a tailwind.

We have, I think, a historically high discount compared to large cap. Because of that, I think small caps should be well positioned to catch up. But I think near term there's going to be some volatility because people are waiting for the Fed to cut rates.

**ALEX:** Amy, as I mentioned, this year you're celebrating 21 years of investing in small caps. What's that experience taught you about managing through market cycles with this asset class?

**AMY:** Well, I think it's really important to have a consistent playbook and stick to our knitting. Any long-only strategy, especially a focused strategy, you're going to be out of favor sometimes. It's really about the process and our research capabilities. At Alger, we are stock pickers. So, clearly, it's really about improving the craft. So, we strive to continue to improve that day in and day out. I feel like nothing can substitute experience because a lot of it is pattern recognition. So, to have been through different, multiple market cycles has really served me very well.

**ALEX:** Looking through your portfolio, you've got a number of different themes you're focused on. But one holding in particular stands out for me, and not just because I like to eat there. But because it seems to really represent a core focus of this portfolio which is "patience and conviction". I'm talking here, of course, about Wingstop. Can you talk a little bit about that company?

**AMY:** Our playbook is to identify and invest in exceptional small companies that have the wherewithal to become exceptional large companies. I think Wingstop really exemplifies that. I really feel like it's a technology company that sells chicken wings. I think they are a pioneer in digital transformation. So, their goal is to digitize every transaction. And I think the benefit of being digitized to have those transactions is not only for cost efficiency but also really turning data into actionable insights that you can personalize. You know your customers' spending habits. And they also are adopters of AI in terms of

using online transactions and chatbots and so forth. So, we think they are really in the forefront of digital transformation.

**ALEX:** You've been investing in Wingstop for a while now. What made you get into Wingstop in the first place?

**AMY:** We actually initially invested in Wingstop in April 2016. So it's been a long time, and then we initially invested when it was the lockup of IPO. Why? Because it's a franchise model, and we think it's very portable, what we look for in consumer names.

Now they have about 2,000 locations, and I think they can get to 4,000. Internationally they only have 300 units. We think they can get to 3,000. So, we think it's a long runway for growth. We always want to invest in consumer and the franchise model is extremely asset-light. I think they're more insulated to labor costs and so forth, so I think that's a fantastic model in terms of financially.

Then you always want to have a strong value proposition. For Wingstop, we believe that it would become from a snack bar, to really we call it a destination, but also lunch and dinner items which I think is very significant. So, when we invested, we thought it had the potential to do that. I think Wingstop will be more resilient with an economic slowdown or even a recession.

**ALEX:** And you expect continued growth from Wingstop?

**AMY:** I think it should continue. For exceptional growth companies, I think scalability is really important so they can continue to exhibit strong same-store growth and linear growth, and I think the digitization will continue to provide them significant saving costs and turning data into actionable insights. Those are very important characteristics that we look for in companies in being a forefront of innovation.

So, for us, it's really about investing in long-term compounders and to identify them early in their corporate lifecycle when they're still under the radar, under-discovered. So that was Wingstop back in April 2016. We want to have the patience and fortitude to let our winners run because I think most small cap companies are of low quality. So when we find those exceptional small companies – and we call them gems – we really want to hold onto them because

there's a lot of opportunity cost if you sell a Wingstop too early.

**ALEX:** Amy, Wingstop as a holding, seems very representative of the overall philosophy of the portfolio. Tell me about that.

**AMY:** Yes, in terms of what we look for, we want a company that has a very strong moat, something we think is truly differentiated. They are not only a category leader, but the combination of strong same-store growth plus the very durable unit growth and asset-light franchise model. All of that is very unique, and we're always looking for the durability of the business model. So, that's why it really exemplifies what we look for in Small Cap Focus.

**ALEX:** And you like their wings?

**AMY:** Yes, of course. We've ordered Wingstop multiple times, and we think it's fantastic. It's really in a category of one in terms of how tasty it is. We definitely invest in what we like, so to speak.

**ALEX:** Amy, aside from Wingstop, I know artificial intelligence is also a primary focus in the portfolio. What's your position regarding AI?

**AMY:** We think AI is really transformative, and we have a lot of exposure in this portfolio in terms of both enablers of AI and also adopters of AI. In the technology sector, of course, we invest in companies that are making coding much easier and secure. So that's clearly moving the AI play but also companies as a leader in data streaming to help their customers to adopt AI in a more efficient way.

But also, in other areas like in industrial, one of the companies we invest in is really an under-the-radar AI play that is specialized in thermal management of data centers. As you know, that's a very important area in AI. Then we have an AI-enabled platform to drive the machine learning algorithm to really match buyers and sellers, for example. That's also an industrial play. Then also in the healthcare area, we have exposure to companies that are using AI to do drug discovery. So, the list can go on. So, I think it's important to have exposure in those areas.

**ALEX:** I think many investors, right now, may be focused on the big-name headlines in AI. But you're seeing a lot of opportunities in small caps that you think may one day be tomorrow's leaders?

**AMY:** Yes, exactly because we always want to plant

the seeds and be early in the company's corporate lifecycle. A key reason why I love investing in small cap growth companies, I think they're really very inefficient companies, and most companies are really under the radar. So, I think we're still very early in adopting the AI theme, whether it's enablers or users for a company because I think that's going to be pervasive. Automation has always been a common theme for us, but AI, I think, is automation on steroids. And we believe that we are in the forefront of it in terms of exposure.

**ALEX:** Amy, twenty-one years in, are you as excited about small caps as you ever were?

**AMY:** Yes. I'm always excited about small cap. I think in terms of asset allocation, I believe everybody should have small cap growth allocation throughout their life because it's really a secular growth asset class. Eventually, an exceptional small company, when they have the characteristics that we talked about – a strong moat or the moat is becoming wider, durable revenue probability growth, proven management, profitability, an attractive model that can fuel EPS growth and a strong balance sheet, truly differentiated science-based companies in many ways, and a forefront innovation – I think those companies have the drivers for long-term value creation. So, we think they will eventually become big.

So that's why I think at any given time, I am excited about unearthing the next big winners in the small cap growth space.

**ALEX:** Amy, what's the one message you want to send to investors who might be taking another look at small caps?

**AMY:** Well, I think market leadership is incredible and narrow, and it's also trading at a significant discount to large cap. It's sort of waiting for Godot, although in this case, I do think Godot will show up. Whether the Fed cuts rates in May or June, I don't think it's really that impactful when you think about a company. So, I think we should be forward thinking. I think investors should be proactive. And you should actually look at small cap because I think in the next one to three years, small cap growth is going to be one of the best areas to invest.

**ALEX:** Amy, thank you so much for joining me today.

**AMY:** Well, thank you so much for having me, Alex.

**ALEX:** And thank you for listening. For more information on the Alger Small Cap Focus strategy, and for more information on how Alger can help you unlock your growth potential, please visit [www.alger.com](http://www.alger.com).

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<sup>1</sup>Correlation is a statistical measure that shows how two variables are related to each other. If two variables are correlated, it means that they tend to move together in some way. The strength of the correlation is measured by a number called the correlation coefficient, which ranges from -1 to 1. A value of 0 indicates no correlation, a value of 1 indicates a perfect positive correlation (i.e., as one variable increases, the other increases as well), and a value of -1 indicates a perfect negative correlation (i.e., as one variable increases, the other decreases).

The following positions represent assets under management for the Alger Small Cap Focus Portfolio as of January 31, 2024: Wingstop, Inc., 3.52%;