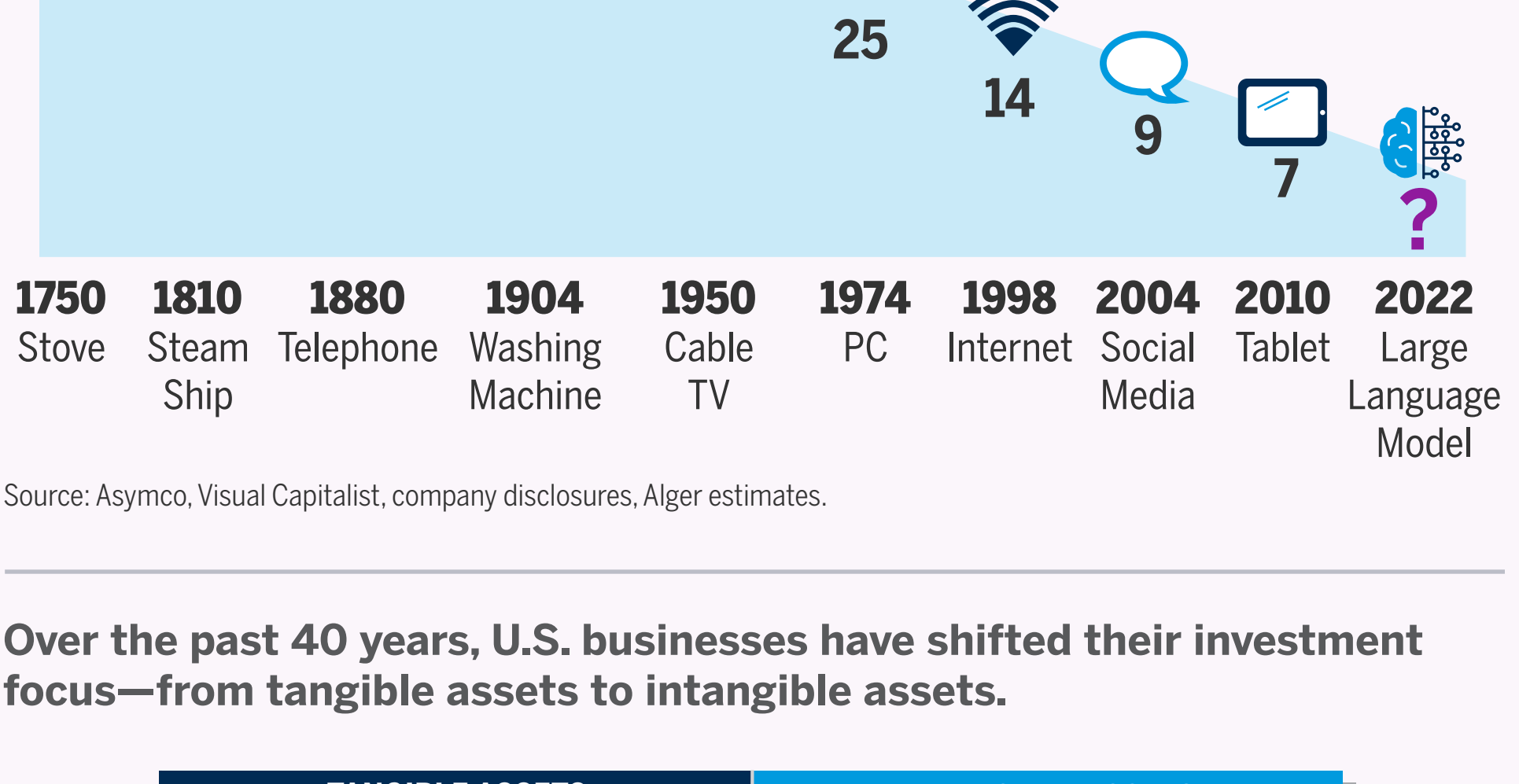


RETHINKING HOW WE ACCOUNT FOR INNOVATION

As companies’ market values are increasingly driven by intangible assets, we believe it’s crucial to look beyond traditional shorthand valuation metrics and instead focus on how innovation drives company value and long-term potential. This approach, in our view, is essential for identifying long-term opportunities in today’s innovation-driven businesses.

ACCELERATING INNOVATION & THE RISE OF INTANGIBLES

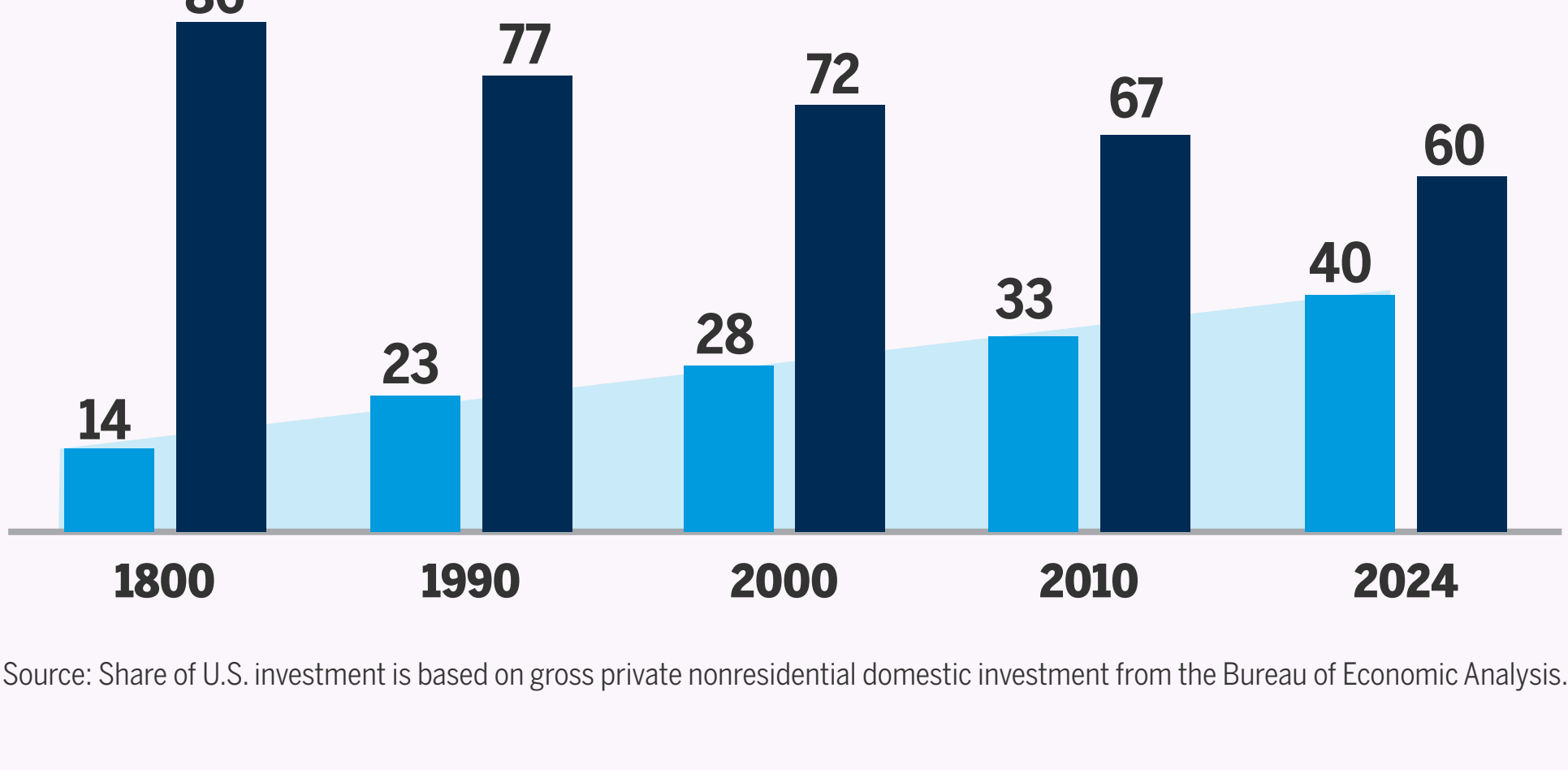
Innovation is accelerating across many areas of the economy, causing new products and services to diffuse through society faster and disrupt businesses at a greater pace.



Over the past 40 years, U.S. businesses have shifted their investment focus—from tangible assets to intangible assets.

TANGIBLE ASSETS	INTANGIBLE ASSETS
Physical assets or property owned by the company.	Non physical assets like intellectual property, brand or innovation efforts.
<div><div>Buildings</div><div>Machinery</div><div>Trucks</div><div>Land</div><div>Equipment</div><div>Factories</div></div>	<div><div>Copyrights</div><div>Brand-Building</div><div>Trademarks</div><div>Patents</div><div>Internal Software</div><div>Drug Development</div></div>

INTANGIBLES HAVE NEARLY TRIPLED AS A SHARE OF COMPANY INVESTMENT



THE UNDERLYING ACCOUNTING PROBLEM

Accounting rules treat tangible and intangible assets differently, leading to what we believe are financial distortions:

CASE IN POINT: Two banks trying to attract more customers.

	INTANGIBLE EXAMPLE	TANGIBLE EXAMPLE
	BANK A Uses \$100 million to expand its virtual bank via building digital software and services.	BANK B Uses \$100 million to purchase land and build branch locations.
	Generally expensed Costs deducted in the year incurred (if internally developed)	Capitalized Can be spread out over several years via depreciation
	No (unless the software is acquired)	Yes

This may cause innovation-driven companies which typically invest in intangible assets to appear less profitable on their income statements and to have lower asset values on their balance sheets.

SO WHAT'S THE INVESTMENT CONSEQUENCE?

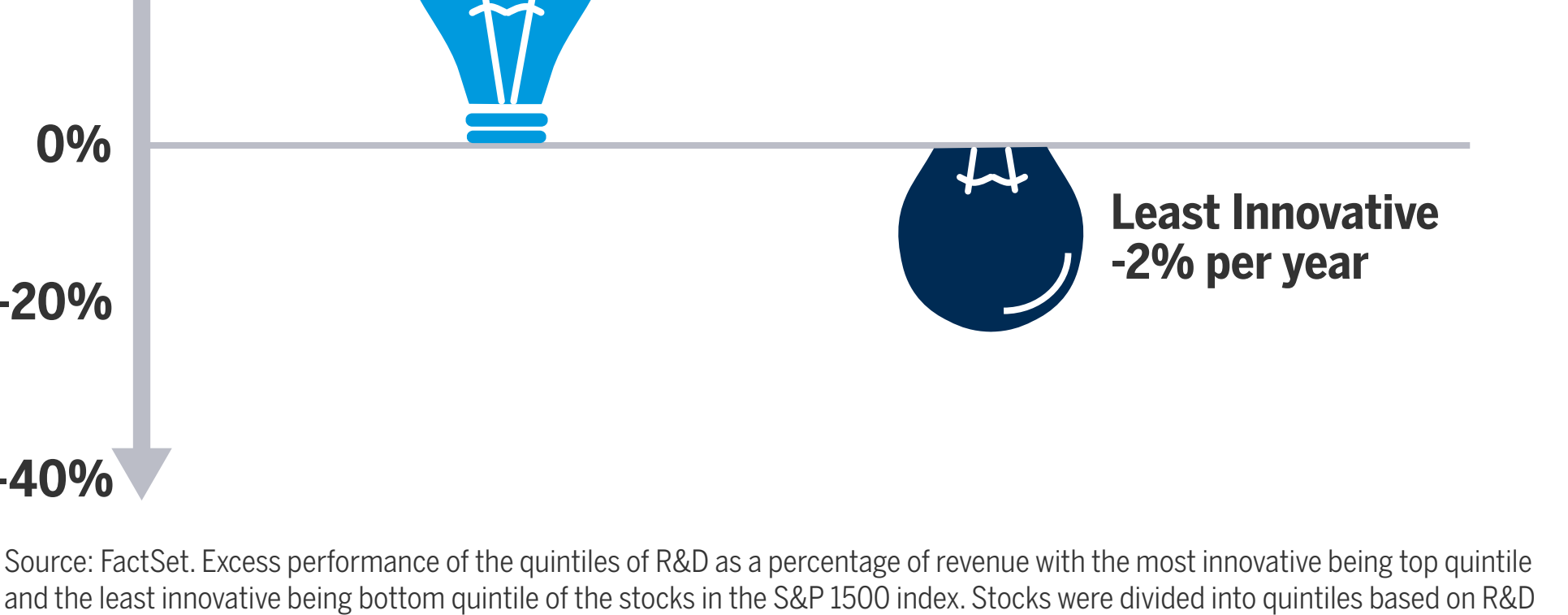
Due to outdated accounting standards, we believe key valuation metrics often misrepresent innovative companies, including:

METRIC	INVESTMENT CONSEQUENCE	WHY?
PRICE-TO-EARNINGS (P/E)	P/E ratios seem inflated and growth companies look more expensive.	Intangible investments are <i>generally</i> expensed immediately, lowering reported earnings artificially.
PRICE-TO-BOOK (P/B)	P/B ratios appear high, making companies seem asset-light—even when they own valuable intellectual property or proprietary technology.	Because intangibles are <i>not typically</i> recorded on the balance sheet as assets, a company’s book value may be understated. Book value represents the net worth of a company based on its financial statements (assets minus liabilities).

Innovative companies, which are often growth stocks, may appear overvalued, potentially leading investors to miss investment opportunities.

INVESTING IN INNOVATION REQUIRES A DIFFERENT APPROACH

Over the past decade, the most innovative companies have consistently outperformed the least innovative, highlighting the potential missed opportunities when innovation isn't properly assessed.



Source: FactSet. Excess performance of the quintiles of R&D as a percentage of revenue with the most innovative being top quintile and the least innovative being bottom quintile of the stocks in the S&P 1500 index. Stocks were divided into quintiles based on R&D spending-to-revenue and data was calculated monthly for the 10-year period ended November 2024. **The performance data quoted represents past performance, which is not an indication or a guarantee of future results. Innovative companies may be defined as those companies with a high ratio of annual R&D investment to revenue. Investing in innovation is not without risk and there is no guarantee that investments in research and development will result in a company gaining market share or achieving enhanced revenue.**

Given today’s accelerating pace of innovation and the increasing shift of companies toward intangible investments, we believe a different approach is needed to investing in innovation-driven companies.

At Alger, we go beyond traditional valuation metrics to develop a deeper understanding of how innovation can impact a company’s long-term potential. This approach allows our investment team to form a more comprehensive view of businesses and seek out opportunities from today’s most forward-thinking companies.

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Price-to-earnings (P/E) ratio is a company's share price compared to earnings per share.

Price-to-book (P/B) ratio is a company's market capitalization compared to its book value.

The S&P Composite 1500 combines three indices, the S&P 500, the S&P MidCap 400, and the S&P SmallCap 600, to cover approximately 90% of U.S. market capitalization. The S&P 500 Index is an unmanaged index considered representative of the U.S. stock market with regard to company size. S&P MidCap 400 Index is an unmanaged index considered representative of mid-sized US companies. S&P SmallCap 600 Index is an unmanaged index considered representative of small-cap stocks.

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