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PODCAST TRANSCRIPT

Now Money Moves Even Faster

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"We're being inundated with new ideas. But our job, as fundamental analysts, is to sort through the noise and find the companies that are extending that competitive advantage over time." Weatherbie Specialized Growth Portfolio Manager Josh Bennett explains how rapid innovations are transforming the digital payments industry.

ALEX BERNSTEIN: Hello, I'm Alex Bernstein and you're listening to The Alger Podcast: Investing in Growth and Change. It's always a pleasure to speak with the portfolio managers at Weatherbie Capital, who have dedicated themselves to the pursuit of hidden gems in mundane industries. Last week, I spoke with Ed Minn about companies leveraging artificial intelligence. Today, I'm joined by Weatherbie Specialized Growth Senior Portfolio Manager Josh Bennett, who has quite a few things to say about technology and rapid digital transformation. Josh, thanks so much for joining me today.

JOSH BENNETT: Well, thanks again for having me, and it is a pleasure to be here.

ALEX: Josh, the last time we spoke the markets were experiencing tremendous volatility as the Covid era was just starting. You described that period as a "sustained blizzard." What do the markets look like to you today?

JOSH: In general, our outlook on the markets is quite positive. We believe fundamentals for our companies are really shining through. Coming out of Covid we've been quite positive on economic prospects since the election and we're finding a lot more fundamentally attractive companies that we would typically characterize as foundation growth stocks. We're seeing some really interesting foundation growth stocks. These are coming through various methods.
One was when the market corrected. We had some interesting companies drop down into our cap range that we could then buy for the long haul. So, we own some of those till this day.
But the other thing is the IPO market. While we don't do a lot in terms of initial IPO allocations, we do see the IPO market as a really fruitful way to find new ideas. These are excellent companies that had to delay their coming public process, and the IPO market has been very hot, if you will, a lot of names coming either versus the traditional or SPAC method. They brought some really interesting ideas into our cap range. We're doing deep research on those names to see if they have the characteristics that we look for in a Weatherbie growth stock.

ALEX: You mention SPACs, or special purpose acquisition corporations, which have been in the news quite a bit lately. How are you using SPACs in your process?

JOSH: So, what's happened recently is, we are finding that some companies are choosing to go public via SPAC instead of going public via the IPO process. And the reason they might do that is it's a lot less of a management distraction to go public via SPAC. Then it would be what you can do in a matter of say months, maybe three months or so versus an IPO process would take six months to a year by the time you write up the book and make the filings and then do a roadshow. There's also a bit more control in terms of kind of the valuation at the end.
So, what I'll say, Alex, is we look at it as one more potential way for a company to go to market, but we also are very cognizant of the fact that most likely some of these companies coming public via SPAC should not be coming public at all. They're using SPAC as a shortcut. So, our work on the fundamental side is to distinguish between the companies that are coming public via SPAC that would have come public anyways via IPO.

ALEX: Josh, I know you and the team are always focusing on innovation and rapid digital transformation. And I understand that you're very interested in some companies in the digital transactions space – specifically in accounts payable and receivable. Can you talk about that?

JOSH: So, for decades and longer, business-to-business transactions have happened via paper or in person, and today we still see that 50% of all payments in this B2B space are done by paper check. Well, that's transitioning. So, it began on the customer side with a bunch of these small-medium businesses who are receiving invoices either via fax or paper invoice or e-mail invoice with even a pdf form. They were getting swamped with these invoices, multiple times per month. So, up popped these companies where the invoices from the large suppliers now go to these AP (accounts payable) automation software companies, and that has solved that part of the business.

The fact that the accounts payable side is taking off puts the pressure on the accounts receivable side now because now these accounts payable companies are helping these small-medium businesses send a bunch of payments in different forms at different times. It could still be a paper check. It could be ACH, automated clearinghouse, through the banks. It could be virtual cards, virtual credit cards.

So, on the AR (accounts receivable) side, we're seeing companies that are popping up in accounts receivable automation, creating software that now helps the large suppliers send the invoices in a digital format.

And what's happening is the AR automators, the accounts receivable automators, are meeting with the accounts payable automators, trading payments, matching payments up where they should be and creating a network effect where these companies can move away from paper and toward digital over time, leading to incredible boosts in efficiency.

ALEX: And I'm guessing, because of the complexities, you have companies that are uniquely focused on either accounts payable or receivable. As opposed to fulfilling both functions?

JOSH: That's right. Most companies have decided to focus on one side or the other. Some are trying to do a bit of both, but in reality, it's a different customer set for each. If you think about the AR, accounts receivable side – you're dealing with medium to large enterprise companies. So, 50 million to 600 would be a medium enterprise company. Six hundred million and up in revenues would be a large enterprise. That's very different than the small-medium business that the accounts payable side is dealing with, helping to pay their bills.

So, it is a complex industry. Most companies are choosing to do either one side or the other, and the company that we're invested in is actually creating a network by which these AR companies like them can connect with the AP side and have a unique network that they're helping develop.

This is as close as we get where we see a movement in digital payments where paper checks need to go away over time. Digital payments will gain traction and we found a really interesting company on the accounts payable side and now another interesting company on the accounts receivable automation side. So, we're playing both sides of this move toward digital.

ALEX: Did the one lead you to the other?

JOSH: The one was an excellent foundation to do work on the other. So, it wasn't necessarily that we found one and they told us about the other, which does happen sometimes in small cap growth. It's more that learning about the company on the accounts payable side helped us understand the industry and the importance of kind of a network effect and then understanding how that was taking off and adding value to small-medium businesses helped us then put that in place to understand why that matters and drives the accounts receivable side.

ALEX: Josh, digital transformation has always been a big focus across Alger strategies and never more so perhaps than in the past year. With so many companies going through this kind of rapid transformation, has it been difficult to determine which ones are most likely to have long-term legs?

JOSH: So anytime you're investing in technology, Alex, you need to be very aware of the fact that it's a constantly changing, competitive landscape. I love when our team is inundated with these kinds of new opportunities because that's exactly what we do. This is what we do at Alger. We sort through the mountain of potential companies and we're always looking for the gems. So, it's an exciting thing where we can find a lot of new companies that are coming to business in a relatively new technology landscape and then our job is to identify which of these companies have the lead. Why do they have that lead and is that lead sustainable?

JOSH (continued): So quite often I talk about, in growth stock investing, everybody claims to have barriers to entry. Everybody claims to have a moat around their business. That's a great starting point. Our job as fundamental analysts as we dig into these companies is to determine whether that moat is expanding getting deeper, or is the moat drying up and shrinking? Because a technology company with a moat that's shrinking and drying up—inevitably another company will come along, jump that moat and make progress in the industry.

So, I do find that we're being inundated with new ideas, especially in an area like payments for example or anything to do with artificial intelligence, machine learning. But that's our job as fundamental analysts and that's the value that we think we can bring to our clients – sorting through the noise and finding the companies that actually are doing what they say and extending that competitive advantage over time.

ALEX: Josh, as you know, Alger, across strategies has continued to take an active role in looking at companies through an ESG – or environmental, social and governance – lens. Have you been increasing that focus in your process?

JOSH: Absolutely. Thank you for the question. ESG is absolutely getting a lot more attention broadly in the market than it has before. What we say is we've always looked at measures of quality, and it has always been important to us.

Now that said, over the last few years we've been taking a much harder look into a more structured way and we're now beginning the process of integrating ESG into the deep fundamental research process that we undertake as we gauge a company's sustainable competitive advantage. So, I mentioned we're always looking for companies that are extending their moat, extending their advantage over time. One way companies are doing this is by handling ESG better than their peers and thus positioning the company for a longer-term, more sustainable future.

So how are we doing that? Our entire team now has a research platform on their desktop to not only know what the ESG score is of a given company but also to know what are the key drivers of that score? So, is that score a function of the industry that they are in? If the score is good, is that a sustainable score over time? If the score is weak, are they aware? Is the management team aware of why that score is weak and are they taking steps to improve it?

The way we think about ESG is it's not just about the score or that negative screening. It's about understanding the fundamentals of the business and the likely trajectory of that ESG score over time. So, in our opinion, this has been a long time coming. We're proud to see that ESG is becoming a core part of everything we do at Alger in terms of our research process.

ALEX: Josh, one last question. I know you and the team have been working remotely for much of the past year. How's the team process going now that this sustained blizzard seems to be finally moving past us?

JOSH: Thank you. So, it's nice to be through the blizzard. From a research standpoint, I feel that our team has been more productive than we've ever been before in this work-from-home period, but that said, we do miss a couple things. We miss getting together in a conference room and debating an idea face to face. It's not quite the same in Zoom, but if you sat in on one of our research meetings, you would see that we are pretty heated in our debates, and it's a good and healthy process that we developed even on Zoom but there's something about being in person that my sense is our team would like that over time.

The other piece that I would say is a key part of our investment process has always been to visit our companies at their premises, at their headquarters and ideally to visit even some of the regional headquarters of our companies. Why do we do that? It's not just about checking the box, Alex. It's really about getting on site to get a feel for the company and to have the opportunity, if management will allow us, to meet that next layer of management. So it's one thing to meet the CEO or the CFO at a conference, to hear them pitch from the podium, to meet in a conference room, but when you get to see the next layer of management who are actually doing the hard work, the boots on the ground, if you will, for these companies, now you get a real insight into the company's ability to actually execute the strategy that the top management is setting.

All that said, spring is coming. We're excited to see that happening. We're coming through. The team is doing well, so thank you for the question.

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

JOSH: Thanks, Alex. Great talking to you.

ALEX: And thank you for listening. For more information on Alger Weatherbie strategies and for more of our latest insights, please visit www.alger.com.

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