SWS Growth Equity

Strategy Update as of October 24, 2022

SWS PARTNERS

Firm Overview

SWS Partners focuses on using technology to deliver contemporary asset management solutions to endowments, foundations, pensions, family offices, and high net worth individuals. We believe that by emphasizing the application of modern technologies, we can create broad efficiencies and deliver better outcomes to clients.

Key Information

Inception	May 1, 2018
Benchmark	Russell 1000 Growth Index
Portfolio Managers	Michael Parker, CFA Kurt Grove, CFA

Strategy Objective

SWS Growth Equity seeks to create long-term capital appreciation by investing in companies across multiple industries that have the ability to maintain or take profitable market share.

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For the third quarter of 2022, SWS Growth Equity returned +3.10% gross of fees and +2.87% net of fees, outperforming the -3.60% total return of the Russell 1000 Growth Index, our strategy's stated benchmark. See page 4 for further performance granularities. In this installment of our quarterly accountability check-in, we offer up our latest effort to extract signal from noise while providing a glimpse of our continual bottom-up fundamental underwriting in our Contributors/Detractors analysis.

Any attempt to make sense of equity market dislocations invariably entails a careful study of historical precedent. Through its lens we attempt to diagnose our plot point and whether that falls on the slope of recovery or decline. The next natural step is an attempt to isolate factors that make our predicament "different this time," a task even the Fed admits is difficult to pinpoint (hence its "meeting by meeting" approach to rate hikes and the data ingest process that informs their decisions).

For public equity investors, determining the market's capacity to bear risk is an interplay of art and science; some may also say overlaid with a sixth sense. Here our goal is to diagnose the scenarios embedded into current public equity market price levels. Once you can reasonably conclude that humanity isn't facing mass extinction, the question quickly becomes, "How forward-looking is the stock market?" Dislocations ultimately transform into opportunities, particularly in the public markets where the fungibility of capital seeks out the highest-returning opportunities. This also happens well before the gears of economic value creation become dislodged; often just the state of conditions getting "less bad" can be a capitulation point.

As we roll up our sleeves to study the latest data that inform our answer to the "how forward-looking" question today, there's a familiarity with the data-parsing exercise. It's very reminiscent of the adjustments we had to make while managing long-only capital at the pension during the global financial crisis ("GFC").

Back then, to make a reasonable stab at determining how cheap "blue chip" stocks could get, any semi-accurate bottom-up analysis had to exclude the crater-sized hole delivered by the entirety of the financial

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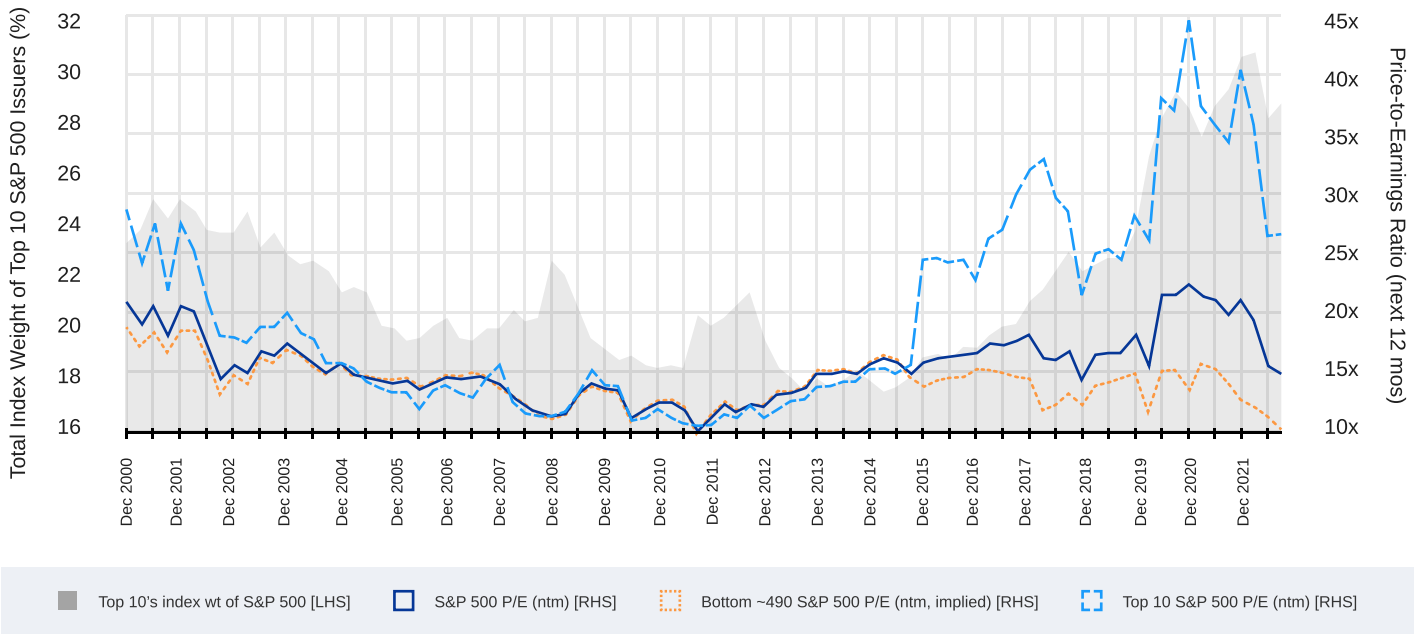
services sector. This near-fatal wound severely hampered the equity markets for a good 24 months via earnings impairments. The pain infliction transferred from public equity shareholders to the US taxpayer, once Fannie and Freddie were placed into Federal conservatorship. No need to rehash that play-by-play, but the March 2009 market bottom formation arrived in the exact week of AIG executive retention bonus payouts, which delivered a second jab behind the earlier investor gut punch that was the company's record $62 billion net loss in 4Q2008 (side note: this, along with some "green shoots" commentary by Bernanke, were the "all clear" signal in US public equity).

A sector that began 2008 carrying an 18% index weight would deliver $184 billion in net losses to the S&P across the year ($300 billion if you include names that were booted from the index due to bankruptcy, acquisition, or index removal). Long before we knew the entire US automotive manufacturing sector would require a bail-out, and well before banks could make a meaningful dent in the glut of their foreclosure backlogs, the S&P 500 marked its price bottom on Mar 9, 2009. The index also settled at a 10.0x forward earnings ratio that same day, where deploying capital felt like catching a falling knife.

Fast forward to today, and we don't have to nix the earnings contributions of a systemically critical sector in order to determine whether fertile ground exists amidst the scorched earth surrounding us. However, just-as-critical adjustments are required to see past the current sources of distortion. These adjustments also account for a larger weighted average influence than the financial services sector during the GFC. Failing to take into consideration the modern-day distortion is the Achilles heel of prognosticators' assessment that the market's current ~15x forward-P/E faces another 20-30% impairment on valuation alone.

The ten largest constituents of the S&P 500 comprise 29% of index weight. Slicing out their earnings contribution paints a very different picture of what's priced into current market levels, specifically what valuation the remaining 98% of index constituents implies. At the end of 3Q2022, the 15.2x forward-P/E of the overall S&P 500 translates to 10.5x for the 495 issuers that fall outside its 10 largest, the latter of which average 27.0x.

Chart 1: Concentration's Influence on S&P 500 Valuation



Source: FactSet, overlaid with historical SPY issuer analysis for S&P 500's top 10 issuers by constituent size, recalculated quarterly. Top 10 forward-P/E utilizes FactSet consensus bottom-up, inferring remaining constituents' weighted average valuation from the top-down S&P 500's consensus multiple.

Discerning why March 2009 merited its 10.0x bottom, whereas October 2002 hit a 14.1x floor, entails another art-meets-science exercise. The answer would probably lie somewhere in measuring the magnitude of financial "cure" required for each dislocation's cause plus consideration for the required level of global coordination. As challenging as our current slate of macroeconomic uncertainties are, it's interesting to consider that today's S&P 500, when excluding its top 10 constituents, is close to valuation parity with the financial crisis and below that of post-dot-com fallout.

The magnitude of this top-heaviness isn't an influence with which modern investors ever had to contend. Its presence was far more diminished during the early-2000s period of irrational exuberance; for a good portion of the prior two+ decades, the largest S&P constituents' valuation has largely been close to parity with the rest of the pack…that is, until that relationship changed course in late-2015. Since market cap weighted indexes are proxies to how individual company efforts roll up to GDP—e.g. Amazon's systemic impact should carry greater influence than Kohl's—paying close attention to these influences are critical, especially at this market juncture.

To be clear, we're not viewing this as a signal to stuff a growth portfolio with swaths of sub-10x P/E issuers in hopes of mean reversion. Nor are we calling a bottom. The analysis is merely a helpful tool for assessing the remaining downside realization re: valuation multiples. It also provides a helpful reminder of what can occur once multiples cease to contract indiscriminately. By the time the market had re-tested its valuation bottom in Aug 2010 and Sep 2011—at 11.2x and 10.3x fwd-P/E, respectively—the S&P 500's price already had recovered +57% and +70%. In other words, market multiples can go sideways while market prices rebound.

The white knight to achieving this market outcome is fundamentals: cash flow (and earnings as its proxy) ultimately carry the market on its back out of the ashes of a recovery. We think that the solution to our predicament today entails a similar theme. Earnings are a decent proxy to study (due to the continuity of their use in forward consensus estimates over prior decades), but they're a placeholder for the ultimate truth that we underwrite behind every security's value: cash flow available to common equity holders.

We've taken steps to lower our portfolio's exposure to the sources of this valuation disparity, namely via exits of Microsoft [MSFT] and Apple [AAPL] in 2020 and 2021, respectively. Each had its own stock-specific justification, but they shared our desire to be on the other side of this concentration distortion at the macro level. Today our portfolio's weighted average market cap is $168 billion versus our benchmark's average of $700 billion (the Russell 1000 Growth's top-10 represent 47% of its constituency). The expected revenue growth for our portfolio in 2023 (excluding PCT's outlying >3,000% growth) is +16% year-over-year on a wtd avg basis, with free cash flow growth of +17% (outliers excluded here too). Foreign exchange headwinds indeed will erode USD-translated results, and inflation will persist. However, we offer up a sampling of the fundamental merits to our holdings later in this report and why that leads to the confidence of being on better footing than the overall market.

The latest October read-throughs also reinforce aspects of our thesis, with both Netflix [NFLX] and Intuitive Surgical [ISRG] acting as reminders of how miscalculated prospects have become at these unique market crossroads.

With our portfolio at near parity with our benchmark on valuation—(adjusted P/E: 38.0x vs 37.6x; P/S: 6.6x vs 5.2x; rev growth of +16.0% vs +9.7% for us vs the bench, resp.)—we see the delivery of fundamental results in the coming quarters as an important mechanism for upside capture. With the overall market showing signs that the public equity valuation reset is largely complete, we are very optimistic for future results of our holdings to be reflected in their pricing. Daily volatility is likely to persist, and we will continue to make adjustments consistent with our investment process (3Q highlights in Portfolio Changes), but these are the exact conditions that reward the patient yet opportunistic investor.

Raison D'être: Alpha Delivery

The third quarter delivered significant upside and downside volatility across equity markets, headlined by the S&P 500 delivering a total return of -4.88% for the quarter after being up +13.94% midway through the quarter. Comparing index returns across the US markets saw growth outperform value and small-cap outperformed large-cap. The Russell 1000 Growth bested the Russell 1000 Value, -3.60% vs. -5.62%, and the Russell 2000 outperformed the Russell 1000 -2.19% vs. -4.61%.

Sector-wise it was a very bifurcated market for the S&P 500, with only consumer discretionary and energy providing positive returns for the quarter. Traditional safe havens became less safe this quarter, as utilities and real estate underperformed in tandem with the upward rate move. The only index to provide a positive return for the quarter was the Russell 2000 Growth, returning +0.24%

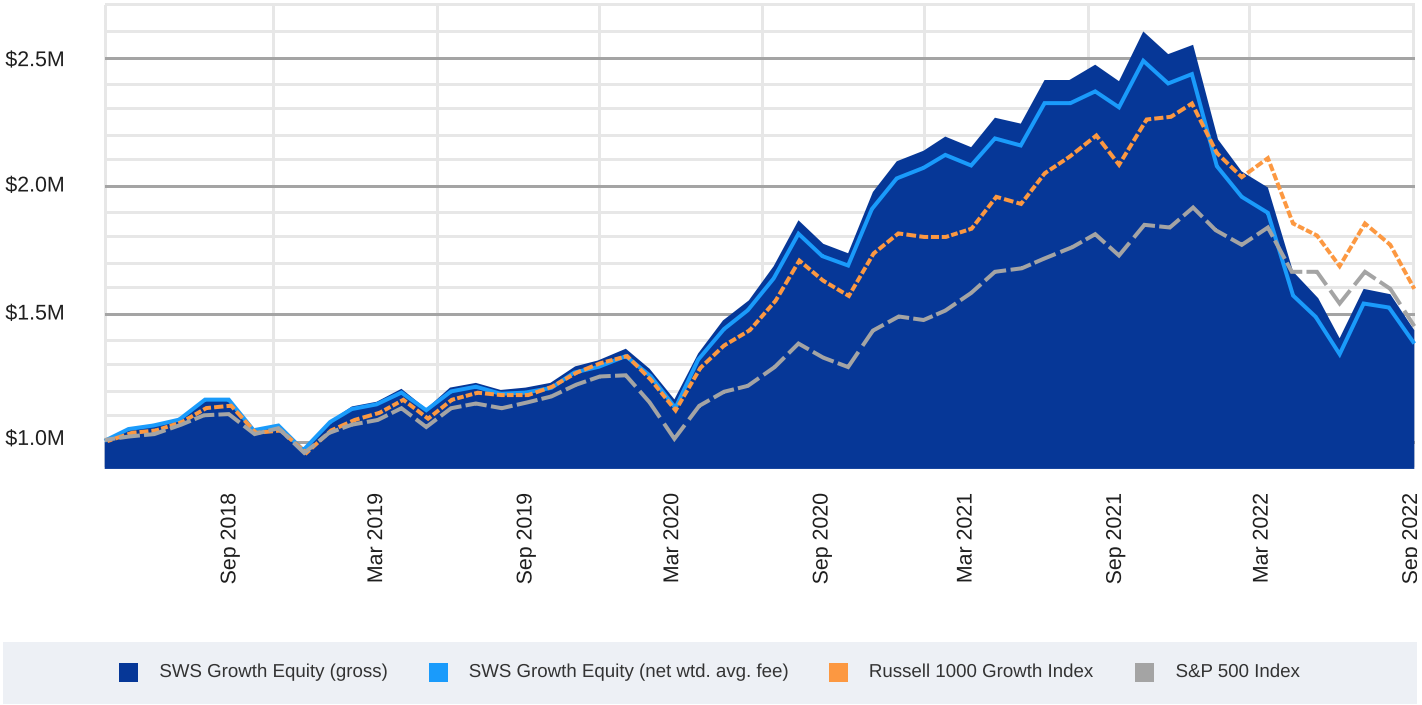
SWS Growth Equity delivered a +3.10% return relative to the Russell 1000 Growth at -3.60%. The intentional decision throughout 2022 to concentrate our portfolio and increase weighting to our higher conviction ideas has shifted the portfolio to a smaller market cap weighting, higher growth, and slightly higher daily volatility.

Chart 2: SWS Growth Equity Performance as of 9/30/2022

	3Q2022	YTD	1-Year	3-Year (Annualized)	Since Inception (Annualized)	Since Inception (Cumulative)
SWS Growth Equity (net wtd. avg. fee)	2.87%	-43.73%	-40.59%	5.05%	7.81%	39.42%
SWS Growth Equity (gross)	3.10%	-43.36%	-40.08%	5.94%	8.70%	44.56%
Russell 1000 Growth	-3.60%	-30.66%	-22.59%	10.67%	11.35%	60.75%
Russell 1000 Value	-5.62%	-17.75%	-11.36%	4.36%	5.40%	26.17%
S&P 500	-4.88%	-23.87%	-15.47%	8.16%	8.95%	46.04%
Russell Midcap	-3.44%	-24.27%	-19.39%	5.19%	6.06%	29.69%
Russell 2000	-2.19%	-25.10%	-23.50%	4.29%	2.95%	13.71%
NASDAQ Composite Index	-3.91%	-32.00%	-26.25%	10.63%	10.33%	54.34%

Please see performance disclosures on *page 12*. SWS Growth Equity *inception 5/1/2018.*

Chart 3: Growth of $1 Million in SWS Growth Equity Since Inception $1.45M $1.39M $1.61M $1.46M



Above chart displays the value of a hypothetical $1 million investment in SWS Growth Equity since its May 1, 2018 inception, both on net wtd. avg. advisory fee and gross of advisory fee bases. These results are compared with broad-based indices, which do not include expenses, and are shown on a total return basis with dividends reinvested.

Contributors & Detractors

The following analyses highlight the fundamental work underlying our investment process. Here we deconstruct the merits of the top contributors and detractors to portfolio performance on the quarter (with total return contributions listed):

Top Contributor

Etsy, Inc. [ETSY]: +36.8%

Etsy had a positive rebound quarter returning +37% versus its consumer products peers falling -6% for the quarter. It has been a volatile two and a half years for Etsy's business and an even more volatile period for the stock price. Going from a pre-pandemic growth rate of GMS (gross merchandise sales) of mid- to high-teens in the US to 170% in the height of the pandemic, the company now faces a slight retraction in 2022 revenue levels with an estimated 2% YoY

decline. Etsy's stock price has followed in tandem with this growth rate, going from a pre-pandemic-high of $60 in March 2020, briefly trading above $300 in December 2021, and trading below $70 coming into the third quarter of 2022.

Etsy perfectly represents what the market has decided to discard indiscriminately in 2022 as an ecommerce-centered issuer and a pull-forward pandemic beneficiary. We heavily push back on the latter point and think discerning investors will notice the relative gains Etsy has made. Etsy has seen its overall GMS go from ~$5B in December 2019 to ~$13.2B for 2022, down from a high of $13.4B, and its active buyers go from 46M to 94M, down from a high of 96M. Overall, U.S. ecommerce sales have gone from CY 2019 of $571B to, the last twelve months sales of $992.1B, growing at an annualized rate of 24.7%. After digesting and comp'ing the truly "one-time" sales from face masks, ETSY has expanded its US GMS from $3.0B to $7.5B, a 43.4% annual growth rate and easily outpacing U.S. ecommerce sales.

We anticipated and are pleased by Etsy's ability to keep most of its buyers throughout the pandemic, which lead to our June 2021 initiation. Etsy should return to mid-teens growth over the next twelve months as the reopening comps are fully reflected in numbers. Now valued at just ~$115 per user, we think it is an attractive time to own Etsy. Etsy has demonstrated its market power with a dominant two-sided marketplace in ecommerce; is building a strong lead in markets like Germany, India, the UK, and elsewhere in Europe; and already has achieved 30+% EBITDA/FCF margins.

Top Contributor

NETFLIX®

Netflix, Inc. [NFLX]: +34.6%

Netflix, another fallen-from-grace pandemic beneficiary, delivered a bounce-back quarter returning +34.6% versus its software peers at -9.1%. Investors have been whip-sawed with Netflix, reaching a pre-pandemic stock price high of $423 in June 2018, a pandemic high of $700 in November of 2021, and a post-pandemic low of $162 in May 2022.

After losing 200k subscribers in 1Q2022 and 970k in 2Q2022, alarm bells were sounded for Netflix, and bearish hypothetical questions were thrown at the company. Has Netflix hit its peak penetration in developed markets? Was this latest increase in pricing the theoretical limit to pricing power? Has competition caught up to Netflix? Did the rush into an ad-supported model and cost-cutting signal more sinister problems at the company?

As investors, we needed to examine these hypotheticals in context relative to valuation and come up with an answer. Our July 8th purchase at <$190 a share of Netflix, our first since May 2018, sheds light on our conclusion. We ultimately lumped Netflix into the "too bearish" category and purchased incremental shares. We viewed the aforementioned hypothetical questions as extremely valid but answerable.

While disappointing, it was not shocking to see a decline in subscriber numbers for Netflix as post-pandemic consumer behavior favored in-person spending versus stay-at-home spending. We don't believe this to be the end of pricing power for Netflix and expect the new, ad-supported model to be a subscriber and ARPU (average revenue per user) accretive, in addition to lessening the rampant password sharing on the app. On competition, we thought it was helpful

to think about it relatively with context paid to the macro environment. We expect this time period to be the "peak" relative OTT competition for Netflix. The valuation multiple of $1,360 per subscriber per Netflix subscriber in May 2018 is no longer the case, now valued at just $460 per subscriber. The era of "free" money is over, and if Netflix is going to be valued at 17x forward EBITDA, others will need to quickly demonstrate profitability or face consolidation. Decisions made to launch OTT services and green-light shows were made many years ago, prior to rate changes and subsequent valuation reset. It was comforting to see Netflix's management agree with this view on its latest earnings call.

Top Contributor

Uber®

Uber Technologies. [UBER]: +29.5%

We last wrote about Uber as a top detractor in 2Q2021 during the Delta variant surge. This quarter Uber outperformed its industrial/transport peers returning +29.5% versus -4.6%.

We're encouraged by what we see in the underlying business at Uber and see that our predictions proved out mostly correct from our 2021 piece: 1) Mobility and food delivery would see profitability in 2022; EBITDA projections are now >$5B for 2024, 2) Ads would be greater than $100M in 2021 (vs $141M actual), targeting $1B by 2024 3) Delivery would not be a one-time phenomenon brought on by the pandemic as it is still growing 12% on a $55B revenue run-rate. We still stand by our initial thesis of Uber and see a pathway to a multi-hundred billion combined TAM of ridesharing, delivery, and freight with ancillary services of advertising, grocery, alcohol, and general logistic services. Ridesharing is still in its infancy for adoption, and we think the scale and network effect advantage Uber enjoys on its two-sided network for mobility transfers well to the three-sided network of delivery relative to peers. One and two percent iterative improvements compound over time, and they should disproportionately accrue to the largest, most efficient player in the space, namely Uber.

We have slowly accrued a larger position in Uber, most recently purchasing in August <$30/sh. The market is clearly discounting Uber's ability to achieve its stated 2024 EBITDA target of $5B, indicating the stock is trading ~10x 2024 EBITDA, growing at >50% y/y. We think this is a hangover effect from Uber being the poster child of poor capital allocation and bloated venture valuations. Uber has raised a cumulative $25B in investor capital relative to its current market cap of ~$50B, achieving a high-water valuation mark of $82B at the 2019 IPO. The end result has been a valuation that's gone sideways for over seven years, compared to its July 2015 valuation of $50B.

As we highlighted in our November 2019 piece, we thought unscrupulous venture investors were enabling poor capital allocation decisions and highlighted WeWork, Uber, and Lyft as evidence of valuation bloat. Seven-plus years of a sideways valuation, with a lot of volatility in between, tends to shake out the investor base, but we think investors are doing this at precisely the wrong time.

The debate over the ridesharing ecosystem was never that it wouldn't be profitable for the companies left standing. It was always a debate on how long until the inevitable monopoly, duopoly, or oligopoly developed globally, and how

profitable market share eventually would be distributed. If we rewind 12-18 months, this future timeline was many years away. Didi, Grab, Lyft, and Doordash were all still nipping at Uber's heels and, in some cases beating back Uber in specific markets and categories, exemplified by the United States where another round of "temporary" driver incentives were to be issued. The November 2021 press conference by Jay Powell—the one that finally acknowledged inflation's persistence and the need for interest rate hikes—changed this competitive dynamic dramatically. This effectively was the end for easy money in the ride-hailing and food-delivery categories. Companies would need to justify their existence by generating profitability. Since then, Uber has fallen 42% compared to its public peers (Lyft, Dash, Grab, Just Eat, Didi), all down between 73-79%.

A scenario that recently seemed unlikely to occur until the late 2020s is now more probable to emerge in the next couple of years. Uber-specific profitability results will appear over the next twelve months, demonstrating the strong incremental free cash flow and providing validity to the multi-hundred billion dollar TAM investors expected when they underwrote Uber's current $50B valuation back in 2015. As long-only investors, we are not happy with the negative absolute return over this time period, but we think this hypothetical "distant" homeostasis profitability environment for Uber is now very near.

Top Detractor

Match Group®

Match Group, Inc. [MTCH]: -31.5%

Match had a rough 3Q, falling -31.5% relative to its software peers, down -9.1%. MTCH ran into a few issues in 2022 and the third quarter that specifically contributed to this outsized weakness.

First, the strength of the US dollar was a headwind for MTCH, more so than other companies in our portfolio. With 55% of 2021 revenue derived outside the US and expenses generally denominated in US dollars, combined effects have contributed to downward estimate revisions, with f/x being a -7% headwind last quarter. Second, the pace of global reopening has occurred slower and more disjointed than expected. Specifically, Japan has been much slower to reopen its economy, and even as it has reopened, the propensity to rejoin online dating has been slower to react than other developed countries. Third, new CEO Bernard Kim has taken over the reins and has instituted recent changes at Tinder, replacing Tinder CEO Renate Nyborg.

The replacement of another Tinder CEO highlights the recent execution issues the Tinder brand has encountered, which are expected to slow revenue growth over the next couple of quarters. Bernard and COO Gary Swindler indicate these issues are not brand-endangering but minor optimization execution issues that will be short-term hiccups for revenue optimization. Our internal checks do not show any material impacts on the brand, and we do not believe the "swipe" innovation is outdated and threatened by new forms of online dating.

The longer-term secular trends of online dating are still positive tailwinds to Match. Only 43% of North Americans and Europeans have tried an online dating product, and lower on the adoption curve sits the Middle East and Asia at 26%

and 18%, respectively. Match has another brand "hit" on its hands with Hinge, expected to hit $300M in revenue this year, growing >50% YoY and entering its first international market this year. Lastly, we don't think the days of a high-teens growth rate investors have come to expect from the $1.8B Tinder business are done.

CEO Bernard Kim in his prior role as head of Zynga is well suited to gamify the online dating space further and build a better revenue optimization model. We expect to see progress on paid women's features and features for power users. The recent acquisition of the League, where users can spend upwards of $1k a week, indicates that Tinder has been placing an artificial ceiling on its power users. We expect ARPU to increase from its current state of ~$20 per month. There is no reason that Tinder revenues shouldn't follow the Pareto principle, i.e., the top 20% of users contribute 80% of revenues. Today, spending over $100 a month on Tinder is almost impossible and is almost certainly artificially low.

Top Detractor

ServiceNow, Inc. [NOW]: -20.6%

We own ServiceNow as a software holding within our technology sector allocation, where the role NOW plays is largely to provide relative value to Microsoft [MSFT]. We have owned NOW across various stages of its public existence, at its IPO issuance in 2012 during our tenure at the pension, and it's been a position in Growth Equity since our May 2018 launch. The investment thesis has evolved, and the composition of its management has changed, but the opportunity to capture profitable market share has not. For ServiceNow, this revolves around creating a platform addressing workflow automation across the global enterprise. Its total addressable market ("TAM") has long been misunderstood and hard to pinpoint. It's clearer now than it was a decade ago, but evidence of its magnitude (and how meaningful it will become) can be gleaned by its out-year milestones: NOW is on course to generate over $16 billion in recurring revenue by 2026, with a current operating margin profile of 25%, as it penetrates a $175 billion TAM.

Despite two significant changing of the guards, NOW has a deep bench of talent and is run by a CEO who knows a thing about selling multi-million-dollar global software deals from his prior tenure running SAP. A key metric to measure the company's efforts here is its ability to address the largest global enterprises. Today the company has 1,463 customers that pay the company >$1 million in annualized contract value ("ACV"), a figure that grew 22% YoY in the June 2022 quarter; within this, over 100 customers pay NOW >$10M/year, which grew 50% YoY. Once landed, customers are also very sticky: the company enjoys a 99% average renewal rate due to a high net promoter score. A tremendous amount of execution and product enhancements have gone into expanding the >$1M cohort from when it first crossed the 100 count mark in 1Q2014 (back when a "mega deal" was considered above $4M, at which time the company generated $478M in TTM revenue).

There was no material change to NOW's competitive advantage or business model during the quarter. Across the course of 3Q, street expectations for 2023 sales declined 2.7% largely due to foreign exchange adjustments on the heels of US dollar strengthening (a 400 bps uptick for NOW since 12/31/2021). This leaves the delta of the stock's 3Q performance mainly due to valuation compression, with the stock beginning the quarter trading 11.4x forward sales and

exiting it at 8.8x. Consistent with our introductory commentary, we believe that majority of NOW's valuation reset is behind the stock, which capped out at 19.6x back in Nov 2021. Today it's less than a turn of P/S multiple more expensive than MSFT, with a superior runway of cash flow growth and profitabiltiy leverage prospects. As such, we remain optimistic on NOW's relative value creation opportunity within our portfolio.

Top Detractor

Twilio. Inc. [TWLO]: -17.5%

Twilio has avoided our list of top contributors/detractors up until now, returning -17% relative to its software peers at -6%. This is somewhat of a surprising fact, considering the stock price roundtripped its pandemic low, going $70 in March 2020 to $457 in February 2021 before trading at $70 today.

Twilio was a pandemic beneficiary, its DBNE (dollar-based net expansion), a proxy used to measure existing customer spending, growing from 125% in 4Q 2019 to 139% in 4Q 2020, back to 123% in 2Q 2022. Much of this pandemic-induced benefit came via its messaging business. As enterprises rushed to be able to communicate with their customers, employees, and suppliers, they quickly scrambled to utilize various messaging applications.

TWLO's messaging business is a large portion of existing revenue and profit driver, but it carries significantly lower margins than traditional software. Twilio uses messaging as an on-ramp to build out its CDP (customer data platform). The CDP, acquired via TWLO's purchase of Segment, carries with it traditional SaaS margins but has been dwarfed by the outsized messaging growth over the last two years. As investor appetite towards software has flipped from euphoria to dismay, particular hate has been spewed at TWLO and its mid-50s% gross margin versus traditional SaaS margins in the 80s%. Particular concern has been paid to TWLO's excess hiring and opex growth, which subsequently damaged incremental margins. We understand investors' concerns on the operating expense side and are glad to see frugality starting to take place. On the gross margin side, we are less concerned with using messaging as a form of customer acquisition to drive customers towards TWLO's CDP, which will be very ROI positive.

The price decline from $457 to $70 was entirely multiple-driven, as gross profit (GP) estimates for 2023 have gone from $2.3B to $2.6B. Excluding small acquisitions, estimates are ~flat over this time, despite the -84% stock price decline. We use a GP multiple to properly account for TWLO's lower gross margins versus other SaaS securities. This forward GP multiple has declined from ~49x to 5.3x today. This is well below its previous historical low valuation of 10.9x in February of 2018 when Uber, a 12% customer, announced it would be insourcing its messaging product.

The equity market is littered with stocks that will never eclipse their 2021 stock prices, whether due to high valuations with interest rates at zero or a one-time pull forward of growth and margins that will not reoccur. For Twilio, it remains to be seen whether it can eclipse its previous high, but we don't believe the company is impaired on either the growth or margin front. With a high degree of confidence in TWLO's future growth prospects of >25%, we view TWLO as too cheap to ignore and purchased TWLO twice in 3Q 2022, most recently in August at $74. Currently valued at $12.4B,

with $3.4B of net cash and $7.2B worth of federal, state, and foreign NOLs (net operating losses), and an upcoming share class conversion reducing voting rights by insiders, makes TWLO a ripe activist/take-out target.

Portfolio Changes

New Positions: PINS
Position Increases: NFLX, AMBA, NET, GH, MP, RH, PCT, UBER, TWLO, TPR
Position Reductions: AMH, GOOGL, META, ACN, LII, VC
Position Exits: EA

New Positions

Pinterest (PINS): Is the only new position to be added to the portfolio in the last quarter, despite several intra-portfolio weighting adjustments. At first glance, PINS has similar qualitative characteristics to our top three contributors this quarter, a fallen from grace covid beneficiary down 80% from its pandemic-high stock price and generally left for dead by investors.

Pinterest is generally described as a social media photo feed where users can “pin” their ideas, events, recipes, etc., in photo or video form backed by a solid user base of 433M MAUs (monthly average users). PINS represents a different type of “social media.” Overall time spent on the app is not the end goal. Pinterest has a unique offering to individuals relative to other social media sites and other forms of advertising: it is where discovery meets intent. This unique combination should monetize at significantly higher rates on a time spent metric and should convert to generally higher ARPU than what Pinterest currently experiences.

Pinterest rode the stay-at-home wave, growing MAUs from 265M to a high of 478M in 1Q 2021 and growing revenue from $756M in 2018 to $2.57B in 2021. All while showing FCF margins of ~13%, the model's true power was unveiled with >70% incremental FCF margins. Revenue growth was created by improving ARPU in the US and Canada, which saw ARPU go from $8.72 in 2018 to $23.44 in 2021. This compares to META (formerly known as Facebook), TWTR, and SNAP at $204, $75, and $18, respectively. We expect this to continue to grow and realistically could be similar to TWTR, but the real opportunity is internationally. PINS significantly under-monetizes internationally, despite a solid user base of 346M users. This compares favorably to TWTR at ~180M, SNAP 379M, and META at ~2.7B, but PINS significantly under-monetizes at just $1.62 per user versus its peers at $12.50, $3.02, and $23.21, respectively.

After an 80% share price decline since February 2021, we think the bear case around TikTok and past execution issues are well understood and now more than discounted. Timing-wise, we believe the opportunity is ripe for a Pinterest investment, influenced heavily by new CEO Bill Ready, formerly of Google and PayPal, replacing CEO and co-founder Ben Silberman. Bill’s background and focus on monetization internationally should allow for quick acceleration in international revenue growth without the need for massive investment and engineering rewrite.

Additionally, we don’t think the leash is long for Pinterest from the board as a standalone public company. Rumors were widespread that PayPal was interested in buying PINS in the mid $50s, >100% from today’s prices, and the recent announcement of an activist investor acquiring a significant stake makes a quick, shareholder-friendly turnaround likely.

Portfolio Manager

Michael Parker, CFA, is the CIO of SWS and lead portfolio manager for the SWS Growth Equity strategy. Before joining SWS in 2017, Mike was a portfolio manager of $4 billion of long-only equity portfolios at the Ohio Public Employees Retirement System (OPERS). He leverages over twenty years of experience on both the buy-side and sell-side to bring an institutional research and portfolio management framework to SWS Partners. Prior to OPERS, Mike was responsible for investment bank equity research at FBR Capital Markets. He received his Bachelor of Science in economics, finance concentration, from the Wharton School at the University of Pennsylvania and is a CFA® charterholder.

Portfolio Manager

Kurt Grove, CFA, is a portfolio manager for the SWS Growth Equity strategy. Before joining SWS in 2020, Kurt was an analyst on the internal active long-only US equity portfolios at Ohio Public Employees Retirement System (OPERS). He leverages over eight years of experience on the buy-side and in risk management to bring an institutional research and portfolio management framework to SWS Partners. Prior to OPERS, Kurt was responsible for Quantitative Risk Management at Key Bank. He received his Bachelor of Science in business administration, finance concentration, from the Fisher College of Business at The Ohio State University and is a CFA® charterholder.

Important Disclosures

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Performance results and comparisons are made on a total-return basis, which include all income from dividends and interest, and realized and unrealized gains or losses. SWS Growth Equity returns are shown both gross and net of fees and are calculated by asset weighting total returns of the strategy's composite accounts. These results are geometrically linked monthly for all periods shown. Gross returns exclude advisory fees paid to the firm. Net returns include the deduction of composite accounts' weighted average wrap fee (which includes both SWS's management fee and trading costs) and assume all cash flows occur at month-end.

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The Russell 1000 Growth Index is a market cap-weighted index of common stocks incorporated within the US and its territories and may not necessarily be substantially similar to your portfolio. It is not possible to invest directly in an index.

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