SWS Growth Equity

As of January 26, 2023

Inception
March 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.

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.

Additional Resources

Scan the above QR Code to read more Growth Equity strategy-related insights and research.

Audio version →
available on Spotify

For the fourth quarter of 2022, SWS Growth Equity returned -2.91% net and -2.70% gross of fees, lagging the 2.20% total return of the Russell 1000 Growth Index, our strategy's stated benchmark. The quarter capped a second half of 2022 that edged out slight overall relative ground (-0.12%/0.32% net/gross for our strategy vs -1.48% for our index over 2H2022). Although it may feel like a garden hose's progress in refilling an Olympic-sized pool—after the market's 1H2022 cannonball displaced us from our high-water—signals from bottom-up fundamental sources provide critical insights on our path to recovery. Our analysis of the latest data dives into conclusions informed by recent onsite due diligence trips, deconstructs read-throughs via the top performance contributors/detractors of our portfolio, and assesses how we plan to navigate the macro. We may not be out of the woods on clearance of economic overhangs, but the good news here: those conditions are not a prerequisite for active return generation.

Since our days of managing capital during the GFC inside a $100 billion pension, a lot has changed regarding the composition of incremental buyers to US public equity. It's an easy dynamic to discard as significant, but it's a critical one to consider at our current market juncture. The complete anonymity that market participants enjoy today, and the killer feature of having zero humans to insert fat-fingered friction, make equity trading's reach for liquidity manifest in very different pricing reactions, particularly the red-colored ones that glare at us from our screens. It's also far harder to pinpoint the source of capital flows without a headline to hint at a sizable participant being forced out or shuttered entirely. Public equity prices, by definition, are set by the marginal buyer 252 days/year. These same pricing outcomes, from an entirely different composition of market participant activity, also act as the hand that forces investor capitulation. That is unless you harness the power of this context to avoid the head fake.

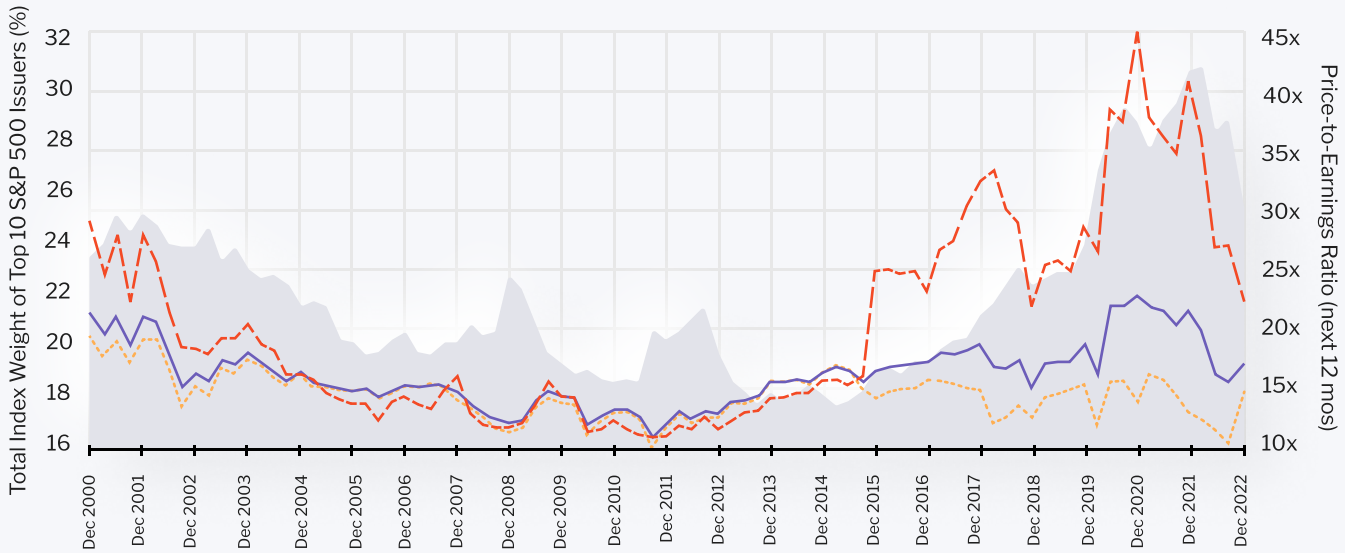
Tools exist to assist in sizing today's pool of marginal buyers: we know that 2022 capped another year where passive US equity flows dwarfed that of active: $278 billion flowed *into* passive whereas $232 billion *departed* active last year. Over the past decade, $1.8 trillion in total has left active. The total AUM snapshot at year-end 2022 favored passively managed US equity at record disparity to active, with passive funds having amassed $6.3 trillion compared to active's $4.6 trillion. We also know a record number of options contracts traded last year, making triple-witch days more eventful than any prior period. In essence, the 1H2022 market capitulation occurred in hands of a record number of algorithmic participants, leaving its 2H2022 aftermath to a record dearth of fundamental investors to bargain hunt.

Growth Equity currently holds 36 individual positions. As such, we spend the lion's share of our time underwriting the prospects of individual issuers. However, marrying macro with micro is a critical exercise we perform to diagnose the market's capacity to bear risk. Coming off a year where 1,200+ issuers in the Russell 3000 experienced 50%+ drawdowns off their 52-week highs, 753 of whom went on to close the year at a >50% discount off that high, these conditions make it highly unlikely for 2023 pricing outcomes to pattern match any prior precedent. Yes, inverted yield curves are powerful prognosticators for recessions. However, we'd argue that this magnitude of indiscriminate selling—largely at the hands of an entirely different composition of players on the field—could make a solid portion of the likely economic recession reflected in the pricing levels of some (but certainly not all) issuers. We have high confidence that our 36 names are disproportionately exposed to issuers with a greater disparity between current price and intrinsic value in comparison to what's reflected in the broader markets.

A whole new generation of investors has again been schooled on how 30-100x forward sales entry points rarely, if ever, pencil out to being attractive returns over any reasonable holding period. However, now many of these 30-100x names trade 3-16x, and some issuers in the cohort have gotten religion on the need to prove cash flow generation potential. Vista Equity Partners' $2.6B bid this month for Duck Creek Technologies [DCT] at 6.5x EV/sales (ntm), and Thoma Bravo's $8.0B bid for Coupa Software [COUP] at 7.6x last month act as tangible reminders of how valuation floors can occur, especially in software. No better precedent exists on how customer stickiness, pricing power, and capital-lite benefits can translate into attractive out-year margin + cash flow potential in software business models than Oracle with its 40% operating margin profile. That said, not all of the 185 sub-$10B market cap software issuers in the Russell 3000 will survive to show Oracle-like profitability, nor will many cash-strapped unicorns. That said, we have strong hunches on some that might.

Rolling forward our deep-dive analysis on overall market valuation from last quarter, we see preliminary evidence that the great valuation impairment may be behind us. While the

Chart 1: Under the Hood of 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.

US treasury yield curve was inverting, overall equity multiples slightly expanded in 4Q2022, largely via S&P earnings cuts. Under the hood, we saw the largest constituents (i.e. the top-10 issuers in dashed orange in Chart 1 on the prior page) converging towards the smallest (ie. the remaining 493, the orange-dotted line) in terms of forward-P/E. Outside of the concentrated largest, the 10.5x forward earnings of the non-top-10 that we saw in 3Q2022 may prove to be one of the most attractive valuation entry points we'll see for some time.

Tying in observations from our recent due diligence meetings, we have increased confidence that the wholesale indiscriminate selling we experienced in 2022 has entirely dismissed many opportunities that will yield meaningful value creation. Coming away from our Consumer Electronics Show meetings, we see a clearer runway for uptake on the undeniable trend of higher semiconductor and software content into the automotive sector over the next decade+. We go into greater detail in the discussion of one of our top contributors later on, but we are on the cusp of specific opportunities penciling out to meaningful revenue and profits starting next year.

We also left CES with a better sense of how the autonomous debate has firmly crossed from a peak of inflated expectations into the trough of disillusionment, in Gartner hype cycle parlance. The cloud of doubt that's been growing over the industry was on full display at a forum we attended that consisted of the president of the Insurance Institute for Highway Safety, an MIT research scientist, and an industry journalist. From the panel's perspective, we are decades away from the everyday consumer vehicle being fully autonomous, while describing the industry as currently facing an "emperor's clothes" moment on the promise of the technology. These conclusions are entirely merited and correctly assess what's available today. However, after spending time talking with the engineers designing the L2-L5 systems, with the tier-one suppliers making bets on their uptake, and with the global OEMs ordering them for their 2026 models, we see a clearer bridge to eventual uptake. It will start with demand for a tech stack enabling safety functionality in the near term, while laying the groundwork to a full suite of functionality down the road.

Regardless of how many autonomous miles we'll be driving over the next decade, significant milestones will arrive sooner. Next year the European Union ups its requirement for new vehicles to have advanced emergency braking capabilities. This 2024 deadline enhances the requirement to detect pedestrians and cyclists, after its 2022 mandate required new vehicles to ship with vehicle-to-vehicle emergency braking for collision prevention. The US has taken an industry opt-in approach versus regulatory compulsion, with nearly all 2022 US models having shipped with the technology following formalized plans in 2016. The driving force behind all of this is a common interest to save lives, namely by making a dent in the 43k lives lost in US motor vehicle crashes last year (a figure that's heading in the wrong direction from the 33k lost in 2014). Pedestrian injury is also up 80% since 2009, all summing to perfect use cases for non-distracted, always-on computer vision systems. For solution providers laser-focused on this end market, real value unlock can occur when the same autonomous braking system can monitor driver focus/drowsiness, can fuse inputs from radar (and in some cases LiDAR), and can ingest data from over a dozen+ cameras (another plug for our AMBA write-up). All of this capability will become available as the bar for safety scoring moves higher.

The semiconductor use case in automotive is just one example, but countless other opportunities exist where price levels suggest issuers have been left for dead despite improving opportunity sets. Netflix's [NLFX] quarterly print last week is one such case, and it represents a reminder of how falling victim to indiscriminate selling doesn't require a company to dispel every existing bear case thesis. We are still very early on NFLX's model transition to an ad-supported pricing tier, and we don't have perfect clarity of how its password sharing clampdown will ultimately impact churn and ARPU. However, these answers are not prerequisites to effecting a 100% move off the stock's May 2022 bottom, especially as a multi-year transition towards scale that begets meaningful cash flow generation begins to take hold.

The institutional long-only industry has built a convention of assessing managers for five-year periods for an important reason. This is typically a sufficient timeframe for mettle to be tested by a large enough sample of curveballs. As we approach our strategy's five-year milestone in May since spinning out from our pension fund predecessor, this

particular five-year period seems to have crammed in multiple decades' worth of macro challenges. That said, the light illuminating our path forward is a core tenet of our investment process: careful underwriting of future cash flows. Having navigated through a period drowned out by a sea of speculators who now have largely been flushed out, and trillions of passive dollars sitting on their hands, the door is wide open for fundamental investors to put cash flow valuation rigor to work. We see the current environment as target-rich for a discerning yet adaptable process that can uncover situations where value deviates meaningfully from price.

Raison D'être: Alpha Delivery

The final quarter of 2022 provided significant dispersion of returns between sub-indices, finalizing a volatile and bifurcated 2022, headlined by the S&P 500 returning +7.6% for the fourth quarter. Growth again lagged value in the large-cap space exhibited by the Russell 1000 Growth Index returning +2.2%, versus the Russell 1000 Value Index at +12.4%.

Sector-wise, performance dispersion was just as extreme in the Russell 1000. Energy, materials, industrials, staples, healthcare, and financials led the way, all returning >12% in the quarter, and technology and consumer discretionary lagged, returning +0.6% and -5.7%, respectively.

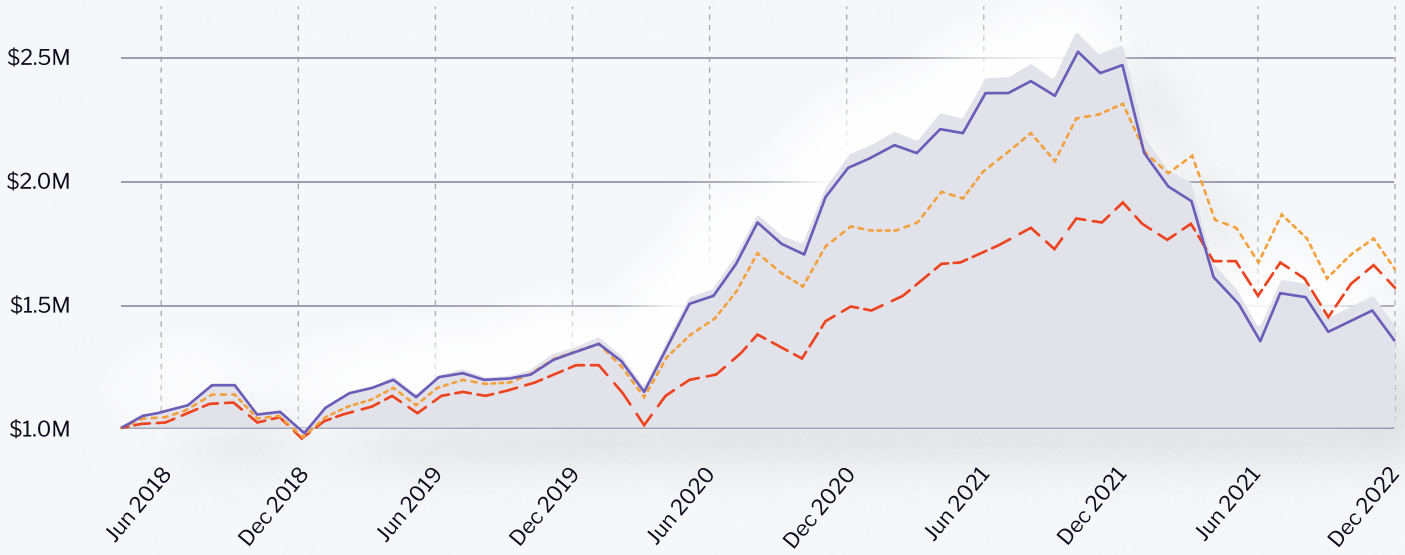
SWS Growth Equity underperformed in the quarter, returning -2.9%/-2.7% net/gross of fees, respectively, relative to the Russell 1000 Growth Index's +2.2%, giving back some of the relative gains from the third quarter. The intentional decision throughout 2022 to concentrate our portfolio and increase weighting to our higher conviction ideas has shifted the portfolio to a smaller market cap weighting, higher growth prospects, and slightly higher daily volatility. While this decision hurt performance at the December 31st fourth-quarter snapshot, we remain convicted in our portfolio posturing and are beginning to see evidence that stock-specific factors will return as performance drivers soon.

Chart 2: SWS Growth Equity Performance as of 12/31/2022

	4Q2022	YTD	1-Year	3-Year *Annualized*	Since Inception *Annualized*	Since Inception *Cumulative*
SWS Growth Equity (net wtd. avg. fee)	-2.91%	-45.36%	-45.36%	1.07%	6.70%	35.36%
SWS Growth Equity (gross)	-2.70%	-44.89%	-44.89%	1.93%	7.59%	40.67%
Russell 1000 Growth	2.20%	-30.66%	-30.66%	7.79%	11.22%	64.28%
Russell 1000 Value	12.42%	-17.75%	-17.75%	5.96%	7.77%	41.84%
S&P 500	7.56%	-18.11%	-18.11%	7.66%	10.16%	57.08%
Russell Midcap	9.18%	-17.32%	-17.32%	5.88%	7.73%	41.59%
Russell 2000	6.23%	-20.44%	-20.44%	3.10%	4.13%	20.80%
NASDAQ Composite Index	-0.79%	-32.54%	-32.54%	6.10%	9.56%	53.13%

Source: FactSet. Data represent total return (dividends reinvested into a respective index) for the period 9/30/2022-12/31/2022. Please see important disclosures on page 11.
SWS Growth Equity inception 5/1/2018.

Chart 3: Growth of $1 Million in SWS Growth Equity Since Inception



$1.41M	$1.35M	$1.64M	$1.57M
SWS Growth Equity (gross)	SWS Growth Equity (net wtd. avg. fee)	Russel 1000 Growth Index	S&P 500 Index

Above chart displays the value of a hypothetical $1 million investment in SWS Growth Equity since its May 1, 2018 inception, both on net of asset-weighted average 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

AMBA Ambarella, Inc. **+46.4%**

AMBA, a staple on our quarterly list of contributors/detractors, finds itself as a positive contributor, returning +46.4% outpacing its semiconductor peers at +14.2% for the quarter. We most recently wrote about AMBA in our 1Q2022 and 3Q2021 letters as a detractor and contributor, respectively.

We have an extensive history with AMBA, owning it in the portfolio since SWS Growth Equity's May 2018 inception and participating in the initial public offering at $6/share in 2012 at our prior shop. Owning a position for almost five years requires a deep level of due diligence upfront and then a constant reassessment of valuation, market backdrop, and stock-specific near-term and long-term setups. The above diligence is a common criticism of "growth" investors. They may understand

technology at its core and can spot trends early, but struggle to size, value, and position a stock correctly. We think AMBA is a good example of generating active trading alpha, i.e., our stock sells at $178 and $225 in 2021 and subsequent repurchases in 2022 from $61-$78, all while building towards our largest position at a 6.5% portfolio weighting, as the thesis strengthens relative to today's valuation.

We recently sat down with AMBA's CEO/CFO, key customers, and others within the company at CES (Consumer Electronic Show) in Las Vegas. While AMBA always has a heavy presence at CES, we think 2023 was the coming out year for the company. Before CES, critical updates from tier 1 automotive suppliers Continental and Bosch announced they would partner with AMBA on its newest chip, CV3. These partnerships are much more involved than a typical "press release" announcement, which typically delivers little in the way of true collaboration or partnership, and served as validation that Ambarella's CV3 is the chip to disrupt the automotive semiconductor market for L2+ deployments.

We have long suspected that a vision-based system, combined with high-definition radar, was the best approach to tackling autonomous driving relative to LIDAR and other modalities. In turn, a semiconductor should focus on these specific tasks first to best process information. A vision-based semiconductor company focused on computer vision algorithms via its 2015 acquisition of VisLab, should be better positioned than a GPU-centric company (NVDA), a wifi/cellular company without an updated 5nm automotive chip (QCOM), and a black-box originally LIDAR-centered company (Mobileye).

The current setup for AMBA is skewed asymmetrically bullish. There is limited downside to estimates as AMBA continues to execute in home and enterprise security via the access control market and enters the automotive market through its vision-based driver recorder monitoring and e-mirror solutions. Current estimates contemplate only ~$3.5B in revenue over the next six years, relative to AMBA's $2.3B in the automotive-only pipeline and estimates of $2B for camera-based revenue. We estimate this $2.3B pipeline number will ultimately be conservative, even without AMBA winning a major domain controller socket with its CV3 chip.

The opportunity for the $2.3B pipeline to be much larger, i.e., much closer to NVDA and QCOM's cited $18B and $30B, respectively, is greater now than ever. Issues with the various competitor approaches are running into physical limitations. As we heard directly from Continental engineers at CES, automotive OEMs are being forced to contemplate new designs to incorporate water cooling for some models that utilize MBLY or NVDA systems, while QCOM still hasn't delivered a new chip for the 2025/2026 models. Ambarella unveiled its CV3 chip, offering 500 eTOPS operating at just 50 watts last January, and had samples in customer's hands this past summer. CV3 translates to a 5.5x performance, 4x power efficiency, and 10x DRAM efficiency advantage; we believe this is the right solution at the right time for the ADAS market. We would not be surprised to see a tier-one automotive OEM decide to utilize AMBA's solution in the next year. Our early best guesses would be VW via CARIAD (its autonomous software partner), Ford, or Kia.

Top Contributor

INTUITIVE®

ISRG Intuitive Surgical, Inc. **+41.6%**

ISRG returned +41.6% for the fourth quarter, significantly outpacing its medical equipment peers at +16.6% in the fourth quarter. ISRG's outperformance in the fourth quarter had clawed back underperformance earlier in the year, where at one point the stock traded down -50% YTD. ISRG received support from investors who found the de facto industry leader in robotic surgery trading at its lowest earnings multiple since 2017 (ex-March 2020). The difference in 4Q2022's forward-P/E of ~35x versus the same level in 2017: it's much clearer who the industry leader is now than it was back then.

For full-year 2022, ISRG stock returned -26.2%, narrowly outpacing its medical equipment peers at -29.1% and losing out to healthcare generally at -12.1%. Like many companies exiting the pandemic, ISRG suffered from the bullwhip effect of 2020 being down in procedure volume, 2021 bouncing back to above-trend growth, which left 2022 to return towards trend as supply/demand normalized. We see a normalized order pattern for da Vinci machines resuming for surgical centers and hospitals in 2023.

With procedure volume growing 28% and 18% in 2021/2022 and unit growth growing slower at 7% and 12%, we expect the installed base to reaccelerate as robotic utilization reaches its limit. Additionally, the street's expectations for 11% and 10% procedure growth in 2023/2024 are underestimating growth in the near term. Pandemic headwinds in US/Europe and now China are finally waning, and robotic surgery can resume taking share at a normal pace from laparoscopic surgeries, while additional indications increase robotic addressability globally.

Top Contributor

tapestry®

TPR Tapestry, Inc. **+35.0%**

Tapestry had a standout quarter, returning +35.0%, besting the -13.2% performance of its consumer discretionary peers. We last wrote about TPR in 1Q 2021 as a previous top contributor. Similar to our practice in AMBA, TPR is another example of disciplined position sizing. While not as active with trading in TPR, we purchased shares in June 2020 @ $14, sold in March and May 2021 at $43 and $46, and recently repurchased at $32 in September 2022.

Despite the +54% move off the October bottom through January 20th, TPR trades at just 11x NTM earnings. We continue to like the setup for TPR relative to the rest of consumer discretionary. Tapestry compares favorably with earnings growth expected to be 10% and trades at 11x NTM versus the rest of retail at -5.6% EPS growth and trading at 29x NTM earnings. We expect 2023 to be a tough year for retail as margins come under pressure with increasingly stretched consumers and bloated inventories. We would not be surprised to see EPS numbers ratcheted down further. TPR will have some of these same headwinds but has offsetting tailwinds to dampen this effect via share buybacks, China reopening (15% of sales), and heightened logistic costs retreating as supply chain pressures ease. Additionally, the handbag market didn't oversell end consumer demand, growing in line with history at ~6% revenue CAGR since 2019. Revenue growth was exclusively due to price, as unit sales have been effectively flat since 2019.

We were able to sit down with TPR's management at their headquarters at the end of 2022 and came away more convinced of their ability to execute on plans for $8B in revenue and $5 in EPS in 2025. Our conversation centered around TPR's internal digital and data strategy that allowed its Coach brand to pivot successfully toward Millennials and Gen Z generations without

alienating its core Baby Boomer customer. This same data strategy is being deployed at Kate Spade to prove it can be a successful sidekick to Coach. New CFO, Scott Roe, brings critical experience in working with a house of brands from his time at VF Corp, and he will focus the team as they target high-teens TSR (total shareholder return) growth over the next three years.

Top Detractor

GH Guardant Health, Inc. **-49.5%**

GH falls into our list of detractors for the first time since our initiation in 1Q 2022, significantly underperforming in the fourth quarter, returning -49.2%, versus its pharmaceutical and biotechnology peers, returning +15.2%. The pharmaceutical and biotechnology peers are dominated at the index level by a few large-cap pharma companies, beneficiaries of the market's "flight to safety" experienced in the fourth quarter.

So, what occurred to cause a 49% loss in a single quarter to GH, a liquid-bio cancer diagnostic company? Surely, its much-anticipated readout from the Eclipse trial proving the efficacy of diagnosing colon cancer from a simple blood draw must have been proven ineffective and now stands no chance of FDA approval? As investors, this would have been the easy way out, forcing our hand to capitulate on technological failure, destroying our DCF and NPV of $5B in recurring revenue derived from 10 million annual tests for colon cancer at $500 a piece.

This hypothetical scenario isn't what occurred for GH. The Eclipse trial read out at 83% sensitivity and 90% specificity on a random trial of ~20k patients was well above the stated FDA guidelines of 74% sensitivity and current FIT/FOBT tests, which currently account for 6.7M tests per year. While the 83% sensitivity and 13% advanced Adenoma detection came below street expectations of ~87% and ~20%, respectively. We think investors put on their proverbial "biotech" hats and saw a headline trial readout that was "below" expectations and instinctively sold. Typically, an investor's first sell in biotech is their best sell. This phenomenon is due to most biotechs having a single drug or product portfolio, and if it fails to hit headline readout number expectations, the company usually fails.

After speaking with management and listening to the CEOs at the JPM healthcare conference, it's clear Guardant has heard positive feedback from the Eclipse trial and still feels very confident about FDA approval. While there is no way to minimize the risk of the FDA not approving the blood draw, we think we've sufficiently investigated this potential issue and are comfortable with the risk.

Following significant prodding on the FDA front, we turned our attention to our internal valuation metrics. 83% sensitivity relative to 87% sensitivity is not statistically significant. Nor do we suspect this difference is important to primary care physicians who will ultimately recommend and administer the test and will be ecstatic about another modality for cancer screening that increases the number of patients screened. There are currently 16 million annual unscreened patients in the US. A portion of Guardant's demand will come from this unscreened population and a portion from those who prefer a blood draw to a stool-based test. Our cash flow projection contemplates no share gain from colonoscopies.

Liquid bio as a cancer detection modality is highly preferred to stool-based tests and has a significantly higher adherence rate

of 90% versus 65%. Colon cancer detection is the stepping stone for liquid biopsy usage as a cancer diagnostic. Next is lung cancer detection, opening up the annual testing requirement versus three years for colorectal screening because of the accelerated cancer spread, and because 50% of all lung cancer deaths are from non-smokers.

Once annual testing is unlocked and approved by the FDA, this same Guardant Shield test can be used on other cancer types under one flat LDT price without FDA approval for every cancer type. We think in the next ten years, it will be common practice for 45+ year-olds to have an annual blood draw in conjunction with their physical to screen for cancer. GH's Eclipse readout solidified itself as the leading player in the cancer diagnostic space. We purchased incremental shares at $30 a share or ~$3B market cap.

Top Detractor

TEAM Atlassian, Corp. **-38.9%**

TEAM, an original May 2018 SWS Growth Equity inception position, makes its way to our list of detractors for the first time after last appearing as a contributor in 3Q 2021. TEAM underperformed in the fourth quarter, returning -38.9% relative to its software peers at -0.1%.

TEAM's underperformance was caused by the company's third-quarter earnings release, which showed that the initial softening experienced in 2Q had worsened. Free-to-paid conversions via procurement of new customers slowed further from 2Q, and in the third quarter upsell growth from existing customers started to slow.

We think this disappointment is a temporary setback, purely related to macro headwinds affecting many tech companies, i.e., high-profile job cuts. As the de facto choice for ITSM, DevOps, and work management, the sudden shift from rapid hiring to firing across the tech sector hurt TEAM disproportionately. Generally, we view this trend of firings as a short-term blip versus a long-term trend. We still subscribe to the belief that software is eating the world and the world is still short of developers.

While GDP may be under-indexed to software versus what it will be in 2030, we acknowledge that the transition from a hyper-growth industry boosted by pandemic tailwinds to an industry that produces sustainable cash flow has not been smooth from an equity price perspective. From a fundamental perspective, the transition hasn't been as harsh. Atlassian, for example, saw a 10%/9% reduction in 2025 sales/gross profit estimates post 3Q's earnings disappointment, fully reversing the positive estimate revisions since April. Netting these effects out was neutral to estimates, but the stock fell 50% in the same period. Now trading at just 10x NTM gross profits at year-end 2022 and underwriting ~25% CAGR revenue growth through 2025 seems extremely attractive to us as investors. With a TAM (target addressable market) of 27M software developers, 100M technical workers, and 1.1B knowledge workers, TEAM demonstrated its pricing power this quarter, highlighting its model's stickiness and long-term optionality.

Top Detractor

TWLO Twilio, Inc. **-29.2%**

TWLO earns the unfortunate distinction of repeat detractor in back-to-back quarters, returning -29.2% versus its software peers' return of -0.6% in the fourth quarter. We won't rehash the entire thesis and encourage investors to read the 3Q 2022 write-up for more detail.

Our early attempts to pinpoint a bottom on TWLO's stock price before its November analyst day proved wrong. The highly anticipated event left investors underwhelmed. The combined pulling of medium-term growth targets and a half-hearted approach to reigning in operating expenses sent the stock tumbling ~35% after hours. While extremely painful to watch in real-time, this type of reaction appeared to be hate-selling by investors.

Facts disclosed at the event help formulate our view of TWLO's path forward: concerns over the messaging business losing profitability were disproven; gross profit per message is going up; TWLO is gaining profitable message share; and the messaging TAM is expanding. On the software side of the house, TWLO disclosed known issues with Segment's sales turnover and revealed its stand-alone software business comprised $416M of LTM revenue, or ~$500M NTM revenue at >75% margins. Segment, a software offering for TWLO that's the #1 rated CDP player, is a big beneficiary from the shift to first-party day from third-party data as the online advertising market grapples with navigating the Apple disruption via ATT. Flex, the software contact center solution offered by TWLO, is showing strong adoption, but sales cycles are long. For expense management and margins, the company announced an 11% headcount reduction, and sales compensation for messaging offerings were shifting focus to gross profit dollar generation versus top-line growth.

All of these factors resulted in a reset to 2023 expectations. However, the long-term success of Segment/Flex, combined with a still attractive and more profitable messaging business, remains intact. Turning to the valuation picture, TWLO trades at ~4x gross profits, has 42% of its market cap in cash, and trades at a ~36x multiple of the company's net interest income, all while being cash-flow neutral now.

Listening to the company post its November analyst day, it was clear company management understood investors' messaging and the proposed cost-cutting initiatives were insufficient, and GAAP profitability is now the target. Management has major incentives to execute quickly as CEO Jeff Lawson's 21% super-voting shares convert to 2% voting power in June. We would not be surprised for this to attract activist interest or for TWLO to be involved M&A discussion. While it has been disappointing owning TWLO over the last year, the embedded skepticism has presented opportunistic investors with a high margin of safety. Upside from the core business inflecting, reduced expenses showing true profit potential, or M&A/activist involvement provide multiple pathways to investor success. We utilized this mosaic investment approach to increase our position in TWLO at $53.

Portfolio Changes

New Positions:	None
Position Additions:	AMBA PYPL NET MP META TWLO PCT NTRA GH
Position Reductions:	NEWR AMH ACN NFLX VC ANET ISRG VRTX
Position Exits:	None

Michael Parker, CFA Partner, Chief Investment Officer

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.

Kurt Grove, CFA Partner, 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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