Can a Centralized Research Firm Deliver Both Value and Growth?

Kennedy Capital Management has been honing its craft for 40 years. In that time, we've often heard that it takes one distinct mindset to invest in growth stocks, and another to invest in value.

We've discovered something different in our tenure, however — and it has allowed us to build a track record of investing our clients' capital in micro- to mid-cap companies across value, growth, and core styles.

Specialization vs Generalization

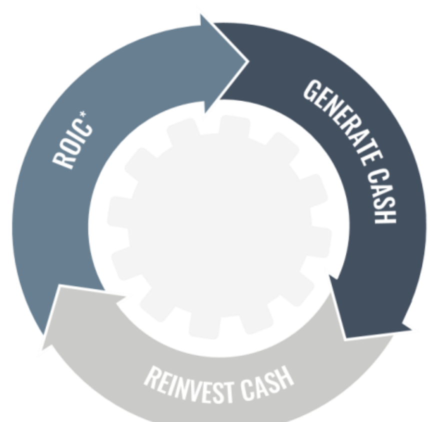
Academic literature is starting to preach what we've been practicing for some time: a broader approach can lead to better outcomes.

Author David Epstein develops this thesis in his best-selling *Range: Why Generalists Triumph in a Specialized World.* He highlights the relative simplicity of golf against the comparable complexity of tennis. (Golf aficionados are no doubt silently shaking their heads, while tennis practitioners are nodding along.) Tiger was a specialist. Roger was a basketballer, soccer player, swimmer, skier, and he even threw in some wrestling before venturing into tennis.

Epstein eloquently describes his view of golf being a "kind" environment, while tennis is a "wicked" one. The key differentiator is the number of variables and patterns. In the world of investing, there are endless patterns. It is, in Epstein-speak, a wicked environment.

Our philosophy is centralized and generalist

Kennedy's overarching investment philosophy may seem simple: a company's value is derived from the present value of future cash flows.



What's imperative, though, is that we work to understand the *future* investments a company will make after reinvesting their cash flows — thus engendering additional future cash flows. This powerful compounding effect is important to take into account.

This can be surprising for those who may use a simple price-to-earnings framework to evaluate companies.

**ROIC – return on invested capital*

How we conceptualize growth and value

At the **value end** of the spectrum, we attribute most of a business' value to the cash flows it generates via its existing investments.

As a company begins to turn its cash flows into successful investments, creating future cash flows, it begins to move into the **growth realm,** where the value of a company tends to rely more on the investments it has not yet made.

When assessing growth and value prospects, our investment professionals focus on understanding competitive dynamics within an industry. They search out opportunities for enduring moats or meaningful change, and don't limit their appraisal to only the current level of growth.

Economic moat - A concept developed by Warren Buffett, a "moat" refers to a business' ability to protect its "castle" of long-term profits from competitors. A few moat examples include: superior brand recognition (e.g., Coca-Cola) and extraordinary product quality.

The 5 different types of companies

We characterize the companies in which we invest as belonging to one of five groups, which are represented in Kennedy's main strategies.

- **Growth portfolios** generally own a combination of Early Growth, Steady Compounders, and Material Positive Change companies.
- **Value portfolios** all focus on Steady Compounders, Material Positive Change, and Out of Favor in identifying new investment opportunities.
- **Core portfolios** typically contain the middle three, but can range across all groups.

EARLY GROWTH	STEADY COMPOUNDER	MATERIAL POSITIVE CHANGE	OUT OF FAVOR	DEEP VALUE
• Rapid asset growth • Improving CFROIs* • Low penetration	• Sustained asset growth • High or expanding CFROI • Barriers to entry	• Enduring change that improves asset growth and / or CFROI	• Intrinsic business returns undervalued • CFROI > WACC over a cycle • Near-term negative sentiment	• Significant Value Gap • Current growth & CFROI may be weak

CFROI – cash flow return on investment, Credit Suisse HOLT Lens™

Alignment and benefits for our clients

Relative to our peers, we maintain a large research team, wherein we seek to cultivate "broad" thinkers who can distill massive amounts of input into clear investment theses.

Covering companies (and strategies) that range across growth and value gives our analysts a distinct advantage: they can identify when companies move from one category to another.

By not narrowing our focus to small subsets based on style or market cap parameters, our centralized research approach also allows our analysts a more complete view of a sector — a valuable insight that siloed analysts may lack.

"By not narrowing our focus to small subsets based on style or market cap parameters, our centralized research approach also allows our analysts a more complete view of a sector — a valuable insight that siloed analysts may lack."

Oftentimes, when growth rates of "value" companies begin to accelerate for company-specific or cyclical reasons, these stocks transform into "growth" companies. By employing sector experts, rather than style specialists, our body of accumulated research can be easily applied and transferred from product to product, as appropriate. This helps ensure that all opportunities, regardless of style, are given our full and informed attention.

A well-rounded approach

The Kennedy Capital Management approach to investing is a holistic one. We eschew the notion that a successful firm must either concentrate on value or specialize in growth — a storyline likely circulated by those who tend to focus on just one.

Our investment philosophy, our views on growth and value, and even the way we structure our investment team all speak to our belief in a generalized approach. And they all inform our response to the question:

"Can our team capably recommend a growth stock one day and a successful value stock the next?"

Well, **"Can eight-time Wimbledon title holder Roger Federer crisply strike a backhand on one shot and a solid forehand on the next?"**

Absolutely.

About Kennedy Capital

Kennedy Capital Management, Inc. is a St. Louis-based, boutique investment firm that has focused on a goal of generating superior returns in the small and mid-cap domestic equity markets for our clients since 1980.

We are an independent and 100% employee-owned investment adviser. Our team's top priority is working for institutions and high-net-worth individuals, fostering an entrepreneurial culture that results in mutually beneficial long-term relationships.

For more information about Kennedy Capital Management's strategies and investment management services, call 314-262-7788 or send us an email at business@kennedycapital.com.

For client inquires, call 314-262-7777 or send us an email at clientservice@kennedycapital.com.

Although the statements of fact and data in this report have been obtained from, and are based upon, sources that Kennedy Capital Management, Inc. ("KCM") believes to be reliable, we do not guarantee their accuracy, and any such information may be incomplete or condensed. All opinions included in this report constitute KCM's judgment as of the date of this report and are subject to change without notice. This report is for informational purposes only and is not intended as an offer or solicitation with respect to the purchase or sale of any security. The information provided herein should not be considered a recommendation to purchase or sell any particular security. Past performance of any investment is not indicative of future results.