

THE WALL STREET TRANSCRIPT

Connecting Market Leaders with Investors

Investing in Innovators with a Buy-and-Hold Philosophy



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SPENCER STEWART is a Portfolio Manager and Founding Partner of Seven Canyons Advisors. Before Seven Canyons, he was a senior research analyst and a portfolio manager at Grandeur Peak Funds where he managed the Grandeur Peak Emerging Opportunities Fund from 2013 to 2017 in the diversified emerging markets category, the Grandeur Peak International Opportunities Fund from 2015 to 2016 and the Grandeur Peak Global Reach Fund from 2013 to 2015. Mr. Stewart was previously a research analyst at Wasatch and an analyst at Sidoti & Company in New York, a small-cap stock institutional brokerage firm.

SECTOR — GENERAL INVESTING

TWST: Could you tell me a little bit about the firm?

Mr. Sam Stewart: Seven Canyons is really built on the same framework that both Wasatch Advisors and Grandeur Peak Global Advisors — where we previously worked — were built upon. It's a buy-and-hold philosophy, where earnings drive stock prices in the long run. We like that strategy, and it has been successful at both Wasatch and Grandeur Peak. The process relies on earnings, and we believe it can result in more consistent and predictable results over time. Another aspect of both of those models — and our model — is: We perform deep due diligence on the companies we select, where we kick the tires, talk with the company and thoroughly understand their financials.

TWST: Maybe you could explain a little bit about what you bring from the other firms, especially since you were at Wasatch a long time. What do you bring to this new firm from that experience?

Mr. Sam Stewart: First, I probably should have mentioned that we think a small, talented team can produce excellent results, and that's why we're focused on only a limited number of experienced partners. Let me give you the rundown briefly. I founded Wasatch, literally, as a bootstrap operation. We had no accounts to begin with. Our first account was \$25,000, and Wasatch is now a \$17 billion manager.

My son, Josh, was the lead manager on Wasatch's World Innovators Fund, which we brought over to Seven Canyons, along with Josh. The fund recently received the 2018 Lipper Award for being the best global multicap growth fund over the 10-year period. Spence's primary portfolio responsibility at Grandeur was leading their emerging markets fund, which was the number-one emerging markets fund from inception to January 2017, while he served as the Portfolio Manager. And then finally, Co-Founder Wes Golby was a portfolio manager at S-Squared, which is one of the premier tech hedge funds. So that's our team.

And the other thing I think it's worth adding is people always worry about family; they may think, "OK, isn't this nepotism? What's going on here?" And here's what I think we've got going on: I think a family is less political and more candid and opinionated. We see this in our discussions, with Wes bringing his perspective and sometimes performing a referee function. That dialogue among a small group of people, we think, is critical.

Mr. Spencer Stewart: The Wasatch and Grandeur model is essentially the model we are running. It's driven by screens and driven by company touches and driven by due diligence. What we figured out is that a team doesn't require 50 people but four people that are collaborating on every idea, seeing every idea and actually debating that idea. And through

our experience at Grandeur and Wasatch, we see there can be challenges with scale. As opposed to seeing thousands of companies a year and having people spread throughout the planet that return and discuss ideas in large groups with everyone fighting for attention, we consolidate the opportunity set and see hundreds of companies, debate them thoroughly and come up with a sharper, quicker conclusion.

Mr. Sam Stewart: The other thing is that in the early days of Wasatch, we were a four-person team that produced excellent results. In the early days of Grandeur, they were a five-person team and produced excellent results. So even though both Wasatch and Grandeur have chosen to build larger teams, we're satisfied that a smaller team can produce great results. We believe that we can produce superior results with a small team.

TWST: Given the age of the new firm, what are some of the priorities that you're going to have as you're moving forward?

Mr. Sam Stewart: Well, I should mention that when Josh and I told Wasatch we were leaving, they very graciously said, "OK, we will give the shareholders an opportunity to vote on whether they are willing to make the move to Seven Canyons along with Sam and Josh." The shareholders did in fact approve that vote. So our lead product at this point is the World Innovators Fund, which is now a Seven Canyons Fund, with the same portfolio managers who recently received the Lipper Award.

So it's blocking and tackling for the Innovators Fund. Nothing is really going to change very much. As I said, we're not using a different process over here. It's the same: run the screens, see what looks good on the screen, go out, visit the companies and dig deep into the financials. Strategic Income Fund, same thing: same portfolio manager, same

We think of innovators as companies that are doing one thing better every day. So it's not that they're making a major discovery, it's that they're doing one little thing better. Maybe they simply decided to file their travel reports in a different way. But the result of that is that these companies end up being superior companies that take market share.

So for us, the hallmark of an innovator is a company that can gain market share. And we found that market share gainers, over time, produce great results, with the one caveat that we also like to see margin improvement along with the market share because it's always possible to gain share by simply cutting prices. That business model doesn't go anywhere.

Mr. Spencer Stewart: I want to give another add-on to the innovator idea. It's also somewhat disruptive and thematic. I'm going back into history now, but I remember when Josh was buying **De'Longhi** (BIT:DLG), which is a souped-up espresso machine. Here in the U.S., you were seeing a coffee-shop revolution. He was very far ahead of the curve, and so for the themes, it's as simple as saying, "OK, the writing is on the wall, so now we're going to go and find the superior companies that target these particular industries."

I won't go into our long list of video game and peripheral players, but Josh had keyed into this back in 2009 when he first went to Korea and, I believe, Japan. At the time, people were thinking this is a

hit-driven business, but as the models switched to premium or they evolved, you could see that this was becoming a very sustainable model. It was simply registering this process as disruptive and recognizing that all gaming is moving in this direction. I don't personally play video games, but I could see it. Would you like an intro to where I see the market right now?

Highlights

Sam Stewart and Spencer Stewart discuss Seven Canyons Advisors. Mr. Sam Stewart and Mr. Spencer Stewart use a buy-and-hold philosophy. Since this process relies on earnings driving stock prices, they believe it can provide consistent and predictable results over time. Part of their process also includes performing deep due diligence on the companies they select. In the firm's World Innovators Fund, Mr. Sam Stewart and Mr. Spencer Stewart invest in companies that are doing one thing better every day. They note that innovators are companies who are gaining market share and improving margins. These investments also tend to be disruptive and thematic. Companies discussed: De'Longhi SpA (BIT:DLG); Catur Sentosa Adiprana Tbk PT (IDX:CSAP); Home Depot (NYSE:HD); Home Product Center Public Co. Ltd. (BKK:HMPRO); BBI Life Sciences Corp. (HKG:1035); Myriad Genetics (NASDAQ:MYGN); Swedencare AB (STO:SECARE); PetIQ (NASDAQ:PETQ) and Walmart (NYSE:WMT).

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process, nothing is really going to change. The new element is that we are also managing a private partnership fund that will focus on emerging-market small caps, as we still think there is tremendous opportunity in emerging markets. And we've got some of those companies sprinkled around Innovators and some of them sprinkled around Strategic Income.

TWST: What do you think makes the Innovators Fund successful? Is it unique among its peers?

Mr. Sam Stewart: Well, many people hear "innovators" and they go right to inventions and think, "OK, this is a new drug on the market or a new technology that didn't exist before." And so they've got a very limited set of companies in mind.

TWST: Yes, that would be great. And maybe we can highlight some stocks.

Mr. Spencer Stewart: Well, what we're seeing today is huge valuation discrepancies around the globe. And what people are willing to pay for quality growth has likely overshot in our view. At the same time, risk aversion has likely overshot. So every day, there's a new concern or catastrophe to contend with, and there are some legitimate high-level issues that we have to contend with. The interest rate cycle is starting to turn. So for sure, there will be volatility as we go through this major shift, but we see this volatility as impending opportunity versus impending doom. So that's kind of our in-house view.

As for stocks, I'll jump into them now. There's a lot of opportunity still out there. So the first stock I'm going to mention is **Catur Sentosa** (IDX:CSAP). It's a little microcap, \$180 million-market-cap Indonesian company. One of the primary go-to strategies is to invest in proven business models, and **Catur** fits directly into that pattern. It's essentially a little building materials retailer.



Chart provided by www.BigCharts.com

Mr. Sam Stewart: I might add a la **Home Depot** (NYSE:HD).

Mr. Spencer Stewart: Yes, a la **Home Depot** in the U.S., a la **HomePro** (BKK:HMPRO) in Thailand. They are the largest pure-play building materials retailer with 26 outlets serving a population of 260 million. The rest of the market is totally unorganized. The core underlying theme is that many emerging markets have been subsistence income countries, and they are just switching into some level of discretionary spending. And you probably heard from many people about this tipping point, but the point is, they've got 26 stores. They are the largest in Indonesia — versus 2,000 **Home Depots** or 100 **HomePros** in Thailand.

The most important part is, this stock is overlooked because their legacy is in building materials distribution and FMCG — fast-moving consumer goods distribution — which, despite giving them advantage in pricing and supply, overshadows the embedded retail business. The retail portion is their biggest focus and has an immense amount of runway. That's one example.

TWST: Do you think, too, that some investors when they think of Home Depot in America, it sort of clicks with them that people are going in there and getting stuff for their home improvements or contractors are going in there, but they might not realize that similar trends are going on in other countries and maybe in the developing world?

Mr. Sam Stewart: I think that's definitely true. I'm just going to underscore one of the things that Spencer said, and I remember this. I'm a little older than Spence, but about 10 years ago, everybody said the theme was, "Gosh, we already invested in China. There are a billion people in China, but even though they are a huge manufacturer of goods, there is no market there because everybody is so poor." I think literally everybody was shocked by the speed at which China transitioned from essentially no market to now the largest market in the world for many things. It's a larger market for cars, for example, than the U.S. is, and you could go down the list and see many more examples.

It was a transition from being a very poor economy, which was focused on, "Where's my next meal coming from?" to an economy now of, "I have a little spending money." In these emerging markets, most of

the housing is substandard, and so when they get a few dollars in their pocket, one of the first things they want to do is improve their house, which is not vastly different from what we're experiencing here. I mean, that's a common trait around the world.

TWST: Do you want to mention a second company?

Mr. Spencer Stewart: Well, I'm just going to stick with my knitting, which is emerging markets and hidden-gem small caps, though I want to be clear that is not what comprises the entire fund. The next one I'll mention is a company we've been following for years. Grandeur deserves some credit here because it's a legacy idea from way back when. It is **BBI Life Sciences** (HKG:1035).

At the highest level, Chinese health care spending as a percentage of GDP has been headed up and to the right for the past decade, and this trend is going to continue. China is facing a Baby Boomer issue, and Western health care is becoming very mainstream. **BBI** essentially offers the picks and shovels of the health care pharmaceutical drug industry. **BBI** serves the laboratories. They offer DNA synthesis, sequencing and gene editing along with all the peripheral consumables that go into that business, such as proteins and antibodies.

But so not only from a China level are they a leading player in a very rapidly growing market, they're playing into the global trend of personalized medicine. **BBI** is still a microcap company, and it's playing this trend without any specific drug risk. There is a long runway for **BBI** and this theme as well.

TWST: Personalized medicine I guess is becoming more popular throughout the world?

Mr. Sam Stewart: Yes, definitely. We have a kind of an interesting perspective on that since we are located in Salt Lake City near the headquarters of the Mormon Church, which has long had an interest in researching family records. So being Salt Lake people, we got on the idea of, "Hey, we need to get genetic understanding as much as we can throughout families and throughout generations." Then, we started to realize, with these family health histories, we can better identify if a drug is going to work or if it is not going to work.

One of the interesting things is, you find, for example, an antidepressant that has been approved — and of course, there are tons of those in the U.S. — and it has a 55% success rate. So the whole idea of looking back at genetics is to say, "OK, what is it about the 55% that are responsive that is different from the 45% that are nonresponsive?" So we think the runway is very wide and very long for personalized medicine. We are not unique in that view, but I think we have maybe unique insight because of the interest in the genealogical history as it links into the medical developments.

One of the leading companies along these lines — which World Innovators used to own, but it's gotten a little ahead — is **Myriad Genetics** (NASDAQ:MYGN). And they have been a real leader. One of their primary focuses was on breast cancer and testing, identifying who was a breast cancer candidate and who wasn't, and they had a high degree of success, saying 30% of the population has a very low risk for breast cancer and so no need to do anything special. On the other hand, 70% of the population is at high risk for breast cancer, and so we want to make them aware of it and get them tested. If they develop any symptoms, it ought to be treated aggressively. So that company is an example of what I'm talking about.

TWST: OK, great. Do you want to mention another company?

Mr. Sam Stewart: I would just like to come back and expand on the gaming theme that Spence touched on because we own a number of those in World Innovators. I think the thing that Josh picked up on by visiting Korea was that the social aspect of games will be hugely

important. I remember in the early days at Wasatch, we had a lot of people interested in the gaming. Spence is not a gamer, I'm not a gamer, so it was hard to appreciate this, but they had lots of fun.

The Internet — and this is one of the things Josh picked up on — said, “OK, now we can have this same competition, but we don't need to be in the same place.” Also, the Korean companies and other Asian companies were having things you could buy inside the games. I think it really was a hit-driven business when it was just a console. But then, it transitioned to more of a franchise/ongoing payment system.

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So you have something like a Grand Theft Auto, with the idea that, “We can come back every few years with a new updated version of Grand Theft Auto, and in the meantime, players can buy certain things like a turbo or a booster for the engine.” And from the gamer's perspective, “Now I'm all of a sudden driving a more powerful car with just micro-payments in order to do that.” It's turned what was a very volatile business into a much more predictable business, and apparently, the supply of people that enjoy games is growing because it's the fastest-growing sector of the whole entertainment industry, including movies and sports broadcasts. Gaming is growing much faster than any of those other segments of entertainment, and there's no stopping that trend.

TWST: OK. Are there any other companies that you wanted to mention?

Mr. Spencer Stewart: Yes. **Swedencare (STO:SECARE)**, another microcap, which comes not out of an emerging market, but interestingly, in a couple of years, it's growth will be predominantly driven by China's growth. The company is **Swedencare**. As the name suggests, it's a Swedish company. The high-level theme is increasing spending on pets; we love this theme throughout the world. **Swedencare** has I.P. around an organic seaweed-based oral care product. The product treats plaque, promotes healthy teeth and improves breath. It started out as a powder, now it's a chew, and ultimately, we believe it can be part of the global pet food supply chain. It frees people from taking their animals to a veterinarian, first of all, and then secondly, from brushing their animals' teeth.

This product has been highly disruptive and has grown all through the globe — Korea, North and South America, and now China is their fastest-growing market — as people spend more and more on their animals. It's a \$100 million-market-cap company right now, and it has doubled year to date, but the market they're addressing is massive, and they have differentiated product. So **Swedencare** is a very small company with phenomenal returns that is growing nicely. When we first met the CEO, it was a \$35 million-market-cap company, and he was eager and willing to talk to us and tell us the story.

Mr. Sam Stewart: I want to jump in on this theme of personalization of pets and throw one more company into the mix. Again, I'm an old-school guy, and dogs were always outside. I've owned dogs since I was a little kid, but the idea of bringing a dog into the house is like, “OK, I can't wrap my mind around that.” But it's obvious that more and more people are treating pets like family members, and it's a

trend around the globe. And if you think of a pet as a person, of course, you want every care for your pet that you would for your child.

So one interesting U.S. company that we own in Innovators is **PetIQ (NASDAQ:PETQ)**. **PetIQ** started out in medicine that you could buy only at the vet. Their attempt has been to take this medicine and get it into a more common retail environment where you can just walk into the store and buy it rather than having to go visit the vet. They just started a deal with **Walmart (NYSE:WMT)** where they're having a vet come into **Walmart** one day a week — the distribution

1-Year Daily Chart of PetIQ



Chart provided by www.BigCharts.com

potential of **Walmart** is huge. **Walmart** likes it because they are thinking, “If pet owners are coming here, and we've got **PetIQ** or **Swedencare's** products on our shelf, we all of a sudden have brought the pet shopper into our store.” So again, this is a company that capitalizes on the idea, “My pet is my child,” an idea that probably started in the U.S. but has spread rapidly around the globe.

TWST: As things like tariffs have gotten the attention of a lot of investors through the media, do you see that being an issue for your clients?

Mr. Sam Stewart: The job of the newspapers or media is to get something into the headlines that grabs people's attention. I think the reality is, regardless of the headlines, the world probably will over time go to increasingly free trade because it benefits everybody. It might be two steps forward, one step back, but I don't think the underlying trend is going to be reversed. And because we're long-term buy-and-hold investors, we tend to just say, “You know what, that's a wiggle that might provide us with a buying opportunity if it knocks the price down.” But we don't think that tariffs are fundamentally going to change anything.

TWST: Do you hear any other concerns from investors as you talk to them about the rest of this year and into next year?

Mr. Sam Stewart: Well, I think the main concern that, again, gets talked a lot about is, “Hey, we've been on an expansion now for 10 years, and therefore, it's got to come to an end soon.” One of the things

that I've learned over my career is that expansions come to end not because of a clock but because of excesses. It's either the excesses themselves or the Fed's response to try to cool them off that brings the economy to its knees. So you look around and you say, "You know, we've got a full-employment economy, and that's nice because everybody can work that wants to work."

You have to look hard to see excesses. I mean, if you look at home prices, where the last problem was, you see that now they are under reasonable control. This is partly because the credit is now much, much tighter than it was before the meltdown. You can look to other

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places in the economy, and again, it's hard to see excesses. What you mostly see is that this economy is doing pretty well. People don't seem to be taking on excess credit thanks to the banks being much more conservative. So I think that the common investor fear is that because the clock has been running for so long, we're going to have a downturn. But I would just come back and say, no, it's not the clock, it's excesses. You should keep your eye focused on excesses.

Mr. Spencer Stewart: I just want to just jump in here, and I'm not going to go into much detail, but what we've seen in the emerging markets has been overly dramatic. For our emerging markets LP, we have spent a lot of time digging into Indonesia, for example, watching the currency fall further every day, and you find yourself wondering, "Is the contagion risk real, and is the Asian crisis coming back?" On the margin, Indo is in a very good place versus 10 years ago, 15 years ago, 20 years ago. The way we look at it is, we are getting a lot of opportunity. I mean, we haven't seen the capitulation and the fear; we've seen hints of it, but we haven't seen broad panic yet. It feels like more opportunities may be ahead in the U.S. as well.

As I said before, there are a lot of stocks that we view as mispriced. The global economy has changed a lot, but the valuation seems off in places, which plays right into what we are looking for. For example, are video games a better business than everyone thought? And we think they are because the world has changed.

Of course, there will be volatility. Everybody is looking for something new, and this bull market is long in the tooth. But right now, we're saying we can buy great companies on sale, whether it's currency, crude, emerging markets; we don't feel like we are running at 70 miles per hour into a brick wall yet. So right now, things feel OK.

Mr. Sam Stewart: The one thing I would just add to emphasize Spencer's remarks is that during the Asian crisis, the governments had borrowed heavily in U.S. dollars, and so that created big problems for them. The governments of the Asian economies learned that lesson very well. They are not borrowing in dollars to anything like the degree they were doing, and they have accumulated substantial reserves. So there might be a company-by-company issue in some of those emerging economies because the companies may not have been as conservative as the governments, but it's the governments that tend to take the whole economy down. Whereas if we have a company here and a company there, yes, they can get into trouble, they

might even go bankrupt, but it's a very different situation than the whole economy going south.

TWST: Is there anything we didn't mention that you care to bring up, either about the firm and its priorities or relationships with its customers or about some trends out there?

Mr. Spencer Stewart: The last thing? I left Grandeur Peak 18 months ago, and Wes left S-Squared four years ago, and there's no question about Sam and Josh's passion as they join us now. But the idea of getting together is all about the fact that we have passion for this business and this will be fun. At its core, we love this business

because every day is dynamic and there are competitive bones in all our bodies. We want to win, and we want to do this for performance. It's not about raising billions and billions of dollars; it's about beating the market and being proud of it.

TWST: With that, do you also get to be able to spend more time with the clients, get to know their needs a little better, than if you were in the kind of Pepto-Bismol, tense kind of place?

Mr. Sam Stewart: You do. Obviously, we can't cover clients in the same way that you can in a larger firm because the resources aren't going to be the same. The disadvantage for the clients in any large firm is that there are client people and there are portfolio managers. Our clients will actually have a chance to speak to the PMs directly, and so I think it's a situation that clients will enjoy more.

I should mention that the two funds don't require lots of client interaction beyond the quarterly reports that you send out, so our primary interaction will be via a very high-quality report. Instead of throwing it into the garbage can, as we typically do with mutual fund literature, clients will say, "Oh, I've been waiting to get this report. I want to see what Sam and Josh and Spence and Wes have to say. It's interesting. It's informative." However, because we intend to take on a small number of clients, they're probably expecting to have some face-to-face interaction, and we're expecting that too.

TWST: Thank you. (ES)

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