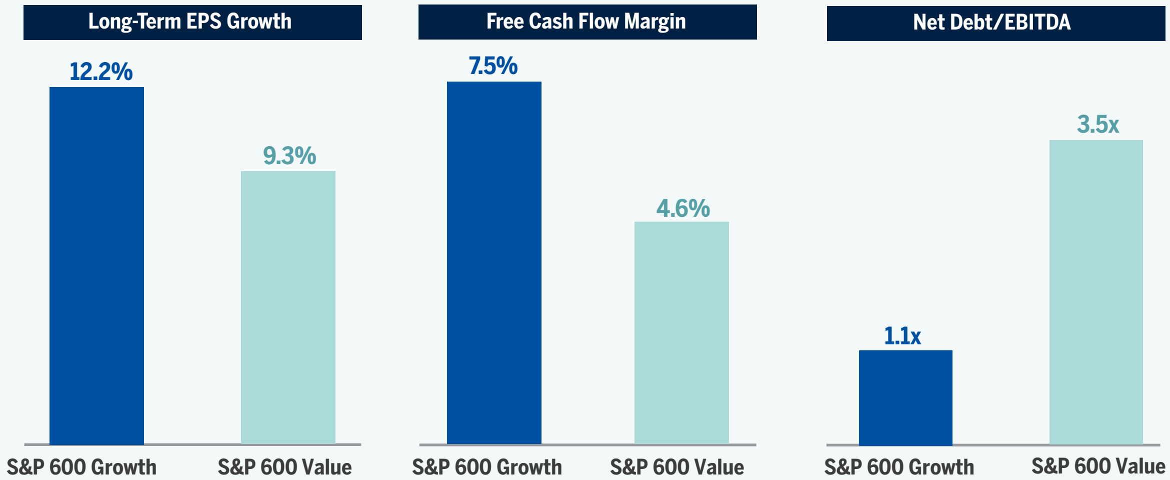
ALGER

Alger On the Money

Small Cap Foundation

While valuations for small cap growth stocks have fallen considerably over the past year, we believe the market may be underappreciating their potential earnings growth and financial strength compared to other segments of the market, such as small cap value stocks. How might investors assess financial durability when identifying potential opportunities over the long-term?

Potential Drivers of Durability



Source: FactSet as of 3/31/23. Long-term EPS Growth represents a consensus long-term aggregate of analyst estimates over the next 3-5 years and actual future EPS growth rates might be materially different than the forecasts shown. Free Cash Flow Margin and Net Debt/EBITDA represent the aggregate of companies within the S&P 600 Growth and S&P 600 Value Indexes over the last twelve months.

- Historically, small-cap growth stocks have exhibited higher EPS growth projections, which indicates a company's potential for long-term growth, compared to small-cap value stocks.[1] We believe this growth potential stems from their ability to gain market share with innovative products or services.
- Moreover, small cap growth stocks have historically exhibited higher free cash flow margins than their value counterparts, demonstrating greater efficiency in converting revenues into cash that can be used for reinvestment, debt repayment, acquisitions, or shareholder distributions.[2]
- Finally, companies with relatively lower financial leverage may be in a healthier financial position compared to those with higher financial leverage. Historically, small cap growth stocks have exhibited a lower net debt/EBITDA ratio than small cap value stocks.[3] Moreover, having lower financial leverage could potentially make small cap growth fundamentals more resilient during economic downturns, as they may be able to better manage debt obligations with potentially greater flexibility to gain market share and pursue growth opportunities, in our view.
- During times of market uncertainty, investors may seek to own companies that can weather challenging economic conditions and discount those that may be more susceptible to a weak macroeconomic environment. As such, we believe investors may want to consider these characteristics when exploring potential opportunities in small cap growth equities.

[1] Long-Term Earnings Per Share (EPS) Growth: represents the sustained increase in a company's after-tax profit per share over a projected three-to-five year period, indicating its potential for delivering returns to shareholders.

[2] Free Cash Flow Margin: is a ratio that measures a company's ability to generate free cash flow (i.e., cash available after paying its operating expenses, interest expense, taxes, and capital expenditures) relative to its revenue.

[3] Net Debt/EBITDA (earnings before interest, taxes, depreciation, and amortization): is a financial leverage ratio that assesses a company's indebtedness relative to its operating performance.

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