

Why Investing in Digital Transformation Goes Beyond Technology

Digital transformation, in its simplest terms, is the process of taking activities that are offline to online. This evolution has been in motion for decades, but COVID-19 appears to have quickened the pace of change. The question is not what should go online, but rather what isn't? Consequently, we believe this accelerated shift has eroded some more traditional barriers to entry and presents compelling small- and mid-cap investment opportunities that go far beyond the technology sector. Here's why:

Internet Ubiquity Has Changed the Dynamic Between Consumers and Companies

Worldwide internet ubiquity is spurring change that extends far beyond a location, a website, or the cloud—it has given consumers more power and changed their expectations. At their fingertips, consumers can access more information, a breadth of choices, and platforms to amplify their voice. The internet has also changed the relationship between buyers and businesses by forming a more direct link between customer and company through social media or gathering customer intelligence and feedback through digital means. This evolution has created a push-pull dynamic that did not exist pre-internet.

Customers are "pulling" information to research products and services that meet not only their needs but also their values, and many companies are being "pushed" to change their behavior to serve these ever-evolving demands. Businesses can no longer ignore the shift to digital, and we think that embracing digital transformation is essential to survival.

The pandemic's impact has only served to accelerate digital transformation, in our opinion, and it has become even more clear to us that habits, preferences, and norms have been permanently altered. According to McKinsey, consumers' use of online channels

has increased 15-30% across retail categories post-COVID-19. In addition, 75% of consumers have tried new shopping behaviors post-COVID-19, and surveys show that the vast majority of consumers expect this new behavior to continue.¹ Therefore, it seems unlikely that digital adoption and penetration rates will return to pre-pandemic levels.

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Digital Democracy Changes the Game for Many Smaller Companies

Digital has also been democratized. Burgeoning dot.com-era businesses and successful, adaptive incumbents have laid the digital infrastructure and drafted the blueprint to success. Smaller companies now have more "access to the plumbing" than was previously available. Large stalwart businesses, historically, could hide behind legacy barriers due to their scale and resources. But, in our view, the game has changed for smaller companies because of their ability to leverage digital transformation.

For example, the transition to the cloud has helped create businesses that were not accessible or possible with on-premise software. Many small and medium-sized customers could not afford to purchase more expensive solutions or offerings in years past. At the same time, many smaller players could not afford to build these more costly offerings. The cloud has helped to remove this barrier, and today many smaller companies are finding opportunities to serve more targeted groups of customers according to their needs and price points.

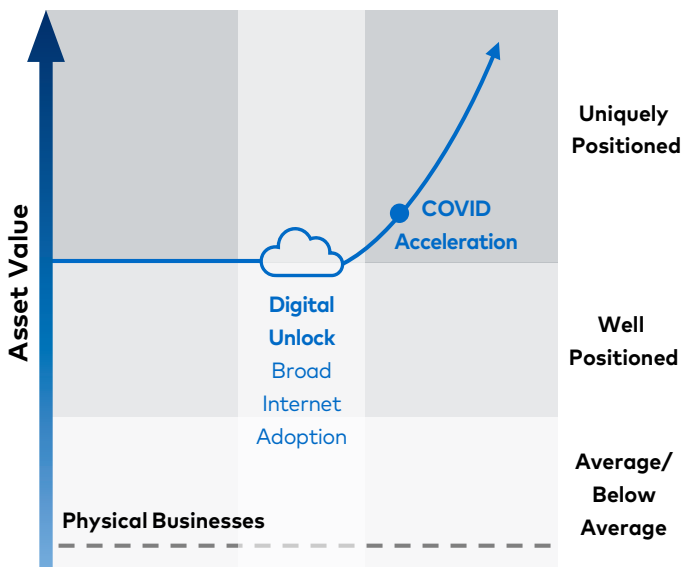
¹ <https://www.mckinsey.com/business-functions/marketing-and-sales/our-insights/the-great-consumer-shift-ten-charts-that-show-how-us-shopping-behavior-is-changing#>

Customer Connections and Feedback Loops Help Create Robust Business Models

We believe that to thrive in today's digital-first economy, companies must solve problems through the lens of the customer. Digital technology has enabled feedback loops that never existed and opened the door for a new breed of companies to shine—those that can be flexible and adapt to consumers more seamlessly.

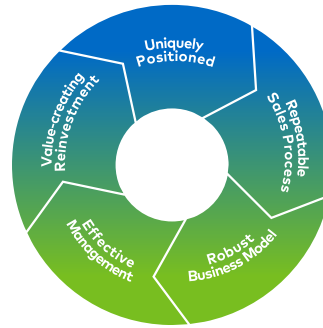
Companies can uncover what consumers genuinely want using data, both qualitative and quantitative. More information can lead to better decision-making. As a result, return on investments in new products, services, and enhancements can lead to better profitability for both provider and customer. Consider a software solutions provider whose value add is to improve their customers' business productivity. If the provider helps its customer improve business results, it not only supports the bottom line for its customers but also its own business. Essentially, aligning interests and solutions with the customer creates a win-win relationship that supports a robust business model with potentially strong customer lifetime value and possibly even stronger revenues. And, ultimately, in our opinion, giving customers what they want is what leads to small brands becoming great brands.

Not all companies can and will leverage digital successfully. Across the small- and mid-cap universe, we see companies in the digital-first world fitting into three categories: uniquely positioned, well positioned, and positioned average to below average. Over time, we expect to see a wide divergence in compounding earnings and returns from the uniquely positioned versus the rest.



The companies that we think will be successful over time share a common set of characteristics, as defined by our flywheel framework.

The Polen Small Company Growth Team Flywheel



Investing Beyond Technology to Access Digital Transformation

While the pace of digital transformation varies across industries and geographies, we think this trend is all-encompassing. Many companies may not appear to be digital on the surface. Yet, we continue to find compelling opportunities to invest in digital transformation that extends far beyond traditional Silicon Valley tech.

Wingstop is a franchisor and operator of quick-service restaurants focused on chicken wings, and, for us, exemplifies both a Polen 'flywheel' company and a play on digital. We believe the company is thriving because of its digital-first mindset. Its business model is centered around small footprint storefronts designed for takeout. Even before the pandemic, the company has been committed to enabling online ordering and delivery. It not only uses digital to improve the customer ordering experience, but it also uses technology to improve the rate of restaurant production, workflow, and cost management. All together, we think this allows Wingstop to do business in the way many customers want.

Internationally, CTS Eventim is another example of investing in digital transformation outside traditional tech. CTS is a global leader in ticketing and live events with a dominant position in many European countries. Before the pandemic, the company was uniquely positioned amid the shift from offline to online ticketing versus competitors. With weaker demand for live events, less financially sound players have not survived the pandemic's aftermath. Thus, we think the company has further entrenched its dominant position by signing partnerships, acquiring agencies, and expanding geographically with a recent joint venture in Israel. With CTS Eventim at the forefront of digital tickets, it is our belief that the incremental data from this shift away from paper tickets will allow CTS Eventim to benefit from a valuable customer feedback loop. We expect promising innovation in the years to come.

As digital transformation continues to take root, we believe it will be a great equalizer for smaller companies and drive an even faster spinning flywheel. Companies uniquely positioned to leverage digital and build a direct connection with customers, we think, will distance themselves from the pack.

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