

Why We Think Our Flywheel Framework Creates a Natural Margin of Safety

The Small Company Growth Team analyzes opportunities through a unique Flywheel Framework, which seeks to uncover compelling long-term compounders across the small company universe. This research framework helps us determine if the right conditions are in place to identify companies that we think are well-positioned to deliver significant value over a five-year period.

The fulfillment of each Flywheel component is crucial to the long-term compounding potential of a business. It is our belief that once the Flywheel starts moving, it gathers momentum and begins to spin faster without incremental effort, growing stronger and longer than competitors. Conversely, if any part breaks down or stops, the Flywheel itself slows.



Our Focus

With a five-year time horizon, we do not emphasize short-term results. We think and act like owners because compounding can take time. Flywheel companies we look for are:

- Patient, seek to grow revenues thoughtfully, and aim to produce attractive and sustainable returns
- Constantly innovating and thinking about how operations can improve
- In pursuit of continuous improvement, undergoing change, and adapting to new landscapes with agility

Flywheel attributes, in our opinion, not only create a natural margin of safety but also enable companies to become true compounders. These are the companies we seek to own.

Our Flywheel Framework is ingrained in everything we do:

- It is the premise for our screens
- It guides our research process
- It is how we hold ourselves accountable and look at every angle
- It keeps us consistent and disciplined

The Five Elements of our Flywheel Framework are:

1. Uniquely Positioned
2. Repeatable Sales Process
3. Robust Business Model
4. Effective Management
5. Value-Creating Reinvestment

Uniquely Positioned

Unique positioning is the ability to provide a product or service that solves a legitimate customer problem and does so in a truly differentiated way. If the advantage is durable, competitors and new market entrants should have difficulty copying products or services. The key tenets we look for when assessing such advantage include:

- Leading market position
- Being on the right side of change
- Operating in industries that possess attractive market characteristics
- Showing resilience against well-capitalized competitors

Repeatable Sales Process

We believe high-quality businesses, those capable of generating sales that are both durable and grow year-over-year, do so through a unique ability to methodically retain and service existing customers while also efficiently acquiring new ones. We have found that such businesses commonly have:

- A playbook for expansion that is constantly refined and adapted
- Clear internal communication channels and tight customer feedback loops
- Large addressable markets and attractive opportunity set
- Good unit economics and evidence of skill and consistency in executing growth initiatives

There is no guarantee that companies included in the portfolio will exhibit all of these qualities.

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Robust Business Model

The financial flexibility of a company's business model can be a source of competitive advantage. Our ideal business model creates and captures current value for all company stakeholders while generating cash flows that feed a company's investments in the future. Key drivers we look for include:

- Pricing Power
- Compensation Structure
- Expense management
- Sales and marketing initiatives
- Competitive behaviors
- Balance sheet management

Effective Management

We believe having an effective, disciplined, and entrepreneurial management team is essential for building a durable company. At a high level, we want to invest in businesses whose managers exhibit:

- Cognitive flexibility
- A long-term strategic orientation
- Cultural values that reinforce competitive advantages
- Evidence of experimentation and learning from failure
- Business expansion readiness and the ability to navigate change

Value-Creating Reinvestment

Sustaining a company with durable growth and persistently high returns on capital can be difficult. An attractive growth and return profile inevitably attracts competition, so we think it is essential for management to continuously (and successfully) invest in the future. This value-creating reinvestment could be in the form of:

- Innovation
- Product or service extensions to upsell customers
- Pursuit of new geographies
- Expansion into adjacent categories

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