

# The Polen Heat Map: Degrees of Expected Return

## 5 Year Annualized Return Scenarios<sup>1</sup>

	% Change in P/E Multiple - Contraction (-), Expansion (+)							
	-67%	-50%	-33%	-25%	-10%	0%	10%	
0.0%	-20%	-13%	-8%	-6%	-2%	0%	2%	
1.3%	-19%	-12%	-7%	-4%	-1%	1%	3%	
2.5%	-18%	-11%	-5%	-3%	0%	2%	4%	
3.8%	-17%	-10%	-4%	-2%	2%	4%	6%	
5.0%	-16%	-9%	-3%	-1%	3%	5%	7%	
6.3%	-15%	-8%	-2%	0%	4%	6%	8%	
7.5%	-14%	-6%	-1%	1%	5%	8%	10%	
8.8%	-13%	-5%	0%	3%	6%	9%	11%	
10.0%	-12%	-4%	2%	4%	8%	10%	12%	
11.3%	-11%	-3%	3%	5%	9%	11%	13%	
12.5%	-10%	-2%	4%	6%	10%	13%	15%	
13.8%	-9%	-1%	5%	7%	11%	14%	16%	
15.0%	-8%	0%	6%	9%	13%	15%	17%	
16.3%	-7%	1%	7%	10%	14%	16%	18%	
17.5%	-6%	2%	8%	11%	15%	18%	20%	
18.8%	-5%	3%	10%	12%	16%	19%	21%	
20.0%	-4%	4%	11%	13%	17%	20%	22%	
21.3%	-3%	6%	12%	14%	19%	21%	24%	
22.5%	-2%	7%	13%	16%	20%	23%	25%	
23.8%	-1%	8%	14%	17%	21%	24%	26%	
25.0%	0%	9%	15%	18%	22%	25%	27%	

### Interpreting the Heat Map:

- The y-axis:** Compounded earnings growth rate of a company over a five-year period. Over the long term, we believe that earnings growth is a key determinant of expected returns (x, y) and has a solid correlation with long-term market returns.
- The x-axis:** % change in P/E multiple over a five-year period. The P/E multiple is the price investors are willing to pay per dollar of earnings. In the short term, the market might be swayed by various external factors like news and sentiment. These factors can positively or negatively influence the P/E multiple. Long term, we observe that the market factors in company fundamentals, and returns primarily reflect a company's earnings trajectory (the y-axis).
- Result (x,y):** Expected return.

### Example: Consider company ABC growing at a 15% rate.

If ABC's EPS CAGR is **15%** with no change to its P/E Multiple (**0%**), then the expected return would match the company's earnings stream, with an expected return of **15%**.

If the multiple contracts by **-25%**, then ABC's expected return would be **9%**.

Valuations would need to compress by **more than 50%** before an investor experiences a **negative return**.

At Polen Capital, the value of truly understanding a business cannot be overstated. We believe that a company's earnings growth is a critical factor that dictates long-term stock returns. Thus, we focus our efforts on deeply understanding a company's business fundamentals, its growth prospects, and the sustainability of that growth. We then assess valuation and a company's ability to withstand market fluctuations.

We target a mid-teens earnings growth rate or higher for our portfolios, and our analysis must indicate this same growth threshold for any company we invest in. This double-digit growth threshold can provide a cushion amid periods of market contraction and helps us to understand the level of multiple compression a company can withstand.

We believe this investment discipline supports our ability to own compelling growth businesses at a discount to their intrinsic value while also reaping the benefits of wide competitive moats, sound financials, and durable earnings growth.

<sup>1</sup> Excludes dividends.

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**Past performance does not guarantee future results and profitable results cannot be guaranteed.**

Methodology and Assumptions:

The calculation methodology assumes that the 5-year EPS CAGR will match 5-year annualized return excluding dividends if there is no change in the P/E multiple. The calculation is as follows:  $[(1 + \% \text{ Change in PE Multiple}) * (1 + \text{EPS CAGR})^5]^{1/5}$ .

There are numerous other factors which have not been fully accounted for in the preparation of these results which could adversely affect actual results. There is no guarantee that performance will follow earnings growth.

This example is for illustrative purposes only and has been prepared based on assumptions believed to be reasonable; however, there is no guarantee that any forecasts made will come to pass. There may be several unexpected developments and market factors which may affect these scenarios, potentially adversely. There are certain inherent limitations. No representation is being made that any investment will or is likely to achieve future results similar to those shown.

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