THE WALL STREET TRANSCRIPT
Connecting Market Leaders with Investors

Identifying Future Growth Prospects Wherever They Exist

NANCY PRIAL, CFA, is Co-Chief Executive Officer and Senior Portfolio Manager at Essex Investment Management Company, LLC. She is the Portfolio Manager for the micro, small and smid growth strategies, leading an all-women investment team. Earlier, she worked at Burridge Growth Partners as the Chief Investment Officer and Senior Vice President responsible for the smid and small-cap growth strategies. The Essex Small Cap Growth Strategy was launched and developed by Ms. Prial in 2001 while at Burridge. Previously, she worked for four years as a senior vice president and senior portfolio manager at American Century Investors where her responsibilities included leading the team that managed the Heritage Fund. She began her career at Frontier Capital Management where she was both a fundamental analyst and portfolio manager in the small and midcap area. She received a degree in electrical engineering and mathematics from Bucknell University and an MBA from Harvard Business School. Ms. Prial is a trustee at Bucknell and is the Chair of the finance committee. She is also on the executive board of the Evanston Art Center.

SECTOR — GENERAL INVESTING

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

Ms. Prial: Essex Investment Management is a boutique investment management firm, specializing in the identification of growth. We look for companies that are growing in any industry. We want to find growth wherever growth exists. And we want to identify these growth stocks at a point in time when we believe their future growth prospects are not yet fully discounted in the price of the stocks.

TWST: And does the firm have any target audience, or is it a diverse group of investors?

Ms. Prial: We have a diverse group of high net worth and institutional investors, including corporations, endowment foundations as well as public plans. Overall, the firm manages a little over $750 million in assets.

TWST: And did you want to highlight a stock that you find interesting now?

Ms. Prial: Sure. So as I said, in terms of the firm, we are looking to identify growth trends early. We want to identify these growth companies, as I said, at a point in time when we believe that their stock prices do not fully reflect their future growth prospects. And we tend to look for these companies on a fundamental, bottom-up basis. But we also want to focus in areas that we believe provide exciting opportunities for growth in the future.

One of the areas that we are particularly excited about as a firm and in our portfolios is in the area of life sciences, particularly in the area of diagnostics of cancers. A company that I'd like to talk to is a company called **Veracyte Inc.** (NASDAQ:VCYT). **Veracyte** has a roughly $485 million market cap. They develop molecular tests for oncology that help answer the right clinical question as to whether or not the patients have the disease, so they help save health care costs that happen from over-treatment of diseases.

Right now, they have three different tests. One for thyroid cancer, lung cancer, and then, they have one for idiopathic pulmonary fibrosis. Then, of course, they have other tests that are under development. We think it's a very interesting growth story. Their top line is growing at a little over 20% a year. They should reach over $100 million in revenues in 2019, and it's still not very well-covered. Only four analysts cover the name.

TWST: And I would think too that in the past that a lot of these tests were limited to affluent areas like the United States or parts of Europe. And now, with more affluence throughout the world, more opportunities exist for these tests to be done throughout the world. Has that sort of been the experience of this company?

Ms. Prial: Right now, most of this company's business is actually still coming from the United States. But certainly over time, international markets are a big opportunity for them, as they are for many health care markets, for many health care companies. They are gaining share with their test, getting improved coverage for people who are on Medicare as well as by private insurance.

TWST: And the idea of that would be the insurance companies would love to get these tests done before the disease starts to spread because then it can be a lot less costly and have less impact on the patient and easier to heal?

Ms. Prial: Right. Obviously, you want to identify the cancers as early as possible. It makes it much easier, much more likely to have a successful outcome with treatment. In addition, you want to make sure that you accurately identify what the diseases are. And that really is **Veracyte's** value proposition.

What happens is, right now, there are a lot of inconclusive diagnoses of cancers, which lead to either unnecessary, delayed or wrong surgeries, which leads to money wasted as well as outcomes that aren't as good as either the patient or the physician would hope for. In general, in health care, we like to find companies that we believe are not only helping to provide better outcomes for patients but are also instrumental in bending the cost curve so that we can control the amount of spending as a nation that we need to do for health care.

Ms. Prial: Certainly, if it happens, that would be a great benefit to **Sterling**. One of the things that we like about **Sterling** though is that they are growing their backlog and growing their business without those federal dollars being authorized currently. So we think that, that would simply be additional growth that the company could achieve.

The other area where they are growing is, they've been expanding their exposure to residential construction. What they do there relates to the concrete foundations for single-family homes. We particularly like their exposure there because they are focused on high growth areas, particularly in Houston, Phoenix and Austin, Texas, where you are seeing a lot of housing growth.

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TWST: Did you want to mention a second company?

Ms. Prial: Another area that we are very excited about is in the infrastructure rebuilding area, as it will not be a surprise to anybody that our roads, bridges and infrastructure are in dire need of rebuilding. And interestingly, although there hasn't been much done at the federal level yet, we are seeing a lot of work being done at the state level as they use their improved tax revenues to help fix some of the infrastructure that's been crumbling.

A name that we are particularly excited about in this space is a company called **Sterling Construction** (NASDAQ:STRL). We believe that this is still a very undiscovered player in the area of highways, bridge, water, sewer, transportation as well as homebuilding exposure. Only three analysts cover it with a $415 million market cap. They should hit over $1 billion in revenue this year on an annualized basis and earn almost $1 a share. Just to put that in context, the stock is selling at about $15 a share right now.

And so the value proposition here is simply that it is a great play on rebuilding the infrastructure that is so instrumental in having our economy run, and they have a strong balance sheet. They've been focusing on improving their margins, and they are shifting their business to higher-margin business away from just highways into more civil construction as well as residential construction. One of the areas that we are particularly excited about is that they have exposure into some of the big transportation hubs, whether it's airports, rail, ports or industrials. As we look at manufacturing coming back into the United States, as we look at exports increasing and, particularly, exports of energy, we need good transportation infrastructure to allow the country to do that, and **Sterling** has been winning a lot of projects in this area.

TWST: And I seem to remember the Trump Administration at one point wanted to have a federal infrastructure program, but I guess it didn't get enacted. But after the 2018 election, that's always a possibility, that may be something that both Democrats and Republicans could agree on, and that would benefit companies like Sterling if there was a federal implementation of more infrastructure spending?

Highlights

Nancy Prial discusses Essex Investment Management Company, LLC. Ms. Prial specializes in the identification of growth. She looks for growth wherever it exists, in any industry. Ms. Prial wants to identify a stock when its price does not fully reflect its future growth prospects. Some of the areas she is currently finding growth include life sciences, infrastructure rebuilding and technology. Ms. Prial uses a fundamental, bottom-up approach.

Companies discussed: Veracyte (NASDAQ:VCYT); Sterling Construction Company (NASDAQ:STRL); Luna Innovations Incorporated (NASDAQ:LUNA); Amazon.com (NASDAQ:AMZN); Alphabet (NASDAQ:GOOG); Microsoft Corporation (NASDAQ:MSFT); Alibaba Group Holding Ltd. (NYSE:BABA); AT&T (NYSE:T); Perceptron (NASDAQ:PRCP) and Cavco Industries (NASDAQ:CVCO).

TWST: And anything else on the horizon for them that could be interesting to investors?

Ms. Prial: Well, we see that margins still have room to improve. Their backlog was over $1 billion at the end of the year. And again, we believe that the margins and the backlog are considerably higher than the margins of the projects they've been working on. So we think that they can continue to beat and raise on revenue and earnings as time goes forward.

TWST: And did you want to mention another company?

Ms. Prial: Technology is an area that's a big focus for us in our portfolios. When you think of the economy overall, both in the U.S. and really all around the world, technology has clearly become one of the building blocks on which all industries rest. And as a result, we have a fairly healthy exposure to technology across all of our portfolios.

When we look at these technology trends — and we are talking about things like the internet of things. We are talking about things like factory automation and robotics. We are talking about cloud computing and the need to build out the data centers to accommodate that cloud computing. We are talking about e-commerce. What we like to do is to find some less well-known and less well-understood ways to play these very exciting growth areas. And so I have a couple of microcap names that I was going to talk about in this area.

One of which is a company called **Luna Innovations** (NASDAQ:LUNA), about $100 million in market cap. They are a semiconductor device company. They provide optical technology products. It's mostly test products for telecommunications, and the way they are used is in the data centers, which is a big driver of their growth.

So if you look at what they are calling hyperscale expansion and cloud growth, places like **Amazon** (NASDAQ:AMZN), **Google** (NASDAQ:GOOG), **Microsoft** (NASDAQ:MSFT), **Alibaba** (NYSE:BABA), **AT&T** (NYSE:T) are building these massive data centers in order to accommodate all of this computing, all of the data that's being driven over these big pipes. Optical technology is a way to get even more data into the same type of pipe, but you need the test equipment, and you need the testing in order to make sure that it continues to work. So we think **Luna** is a really undiscovered way to benefit from the growth in the space.

1-Year Daily Chart of Veracyte

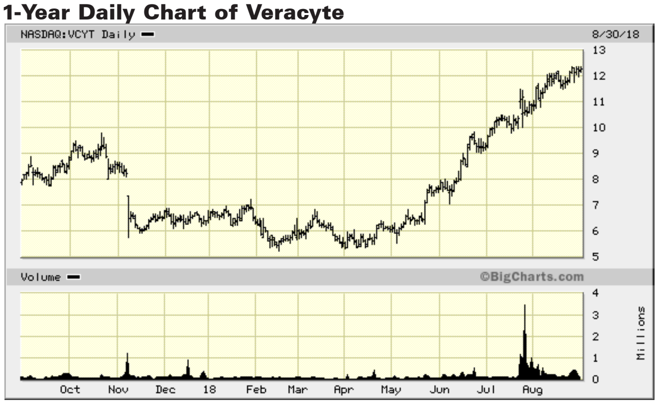

Chart provided by www.BigCharts.com

are used in what they call 3D automated metrology and measuring machines. The drivers really are factory automation and robotics. They're gaining share in aerospace and industrial markets as well as in the automotive market.

It's a company that has just recently undergone a restructuring in 2017 with a brand-new management team. And we're really starting to see that come through in their results. In the March quarter, they beat on revenue, they beat on earnings, they had record quarterly bookings. They're heading toward double-digit EBITDA margins. And we think there's a lot of room for this company to continue to thrive and prosper.

TWST: And you mentioned with Luna, it was an example of where there was merger and acquisition activity. Do you think in fields like the internet of things and automation and e-commerce that a lot of these smaller companies are going to encourage more M&A activity in the next couple of years?

Ms. Prial: Well, we've certainly seen a fair bit of M&A activity even over the last couple of years. And yes, we do expect that larger companies will continue to look for tuck-in acquisitions that add technologies and customer exposure that they want as they too go after these fast-growing markets of the internet of things and factory automation and robotics. In addition, some of these smaller companies with very strong balance sheets can look to acquire either equal-sized companies or even smaller peers for the same reason. And so we do think that there will continue to be a very healthy amount of activity as these markets continue to grow.

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1-Year Daily Chart of Luna Innovations Incorporated

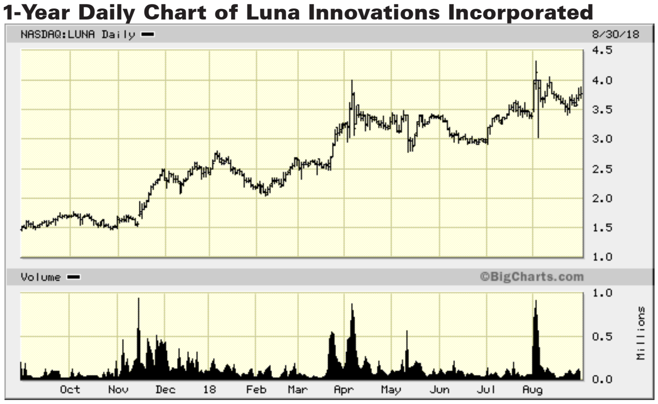

Chart provided by www.BigCharts.com

One of the things that's very interesting about **Luna** is, they just sold a division that wasn't a core division. So of their $100 million in market cap, $50 million of it is currently sitting in cash, while they are still growing their revenue and they are making money as a company as well. So you have a company that's making money with good organic growth, an opportunity to potentially do some attractive M&A or at the very least have a very solid cash position that's covered by only one analyst. So we think it can be discovered as it continues to prosper and grow.

The other name in technology that we like is a name that's a backdoor play on factory automation and robotics. It's a company called **Perceptron, Inc.** (NASDAQ:PRCP). Again, it's about a $95 million market cap. It has one analyst who covers them. This is a company that's actually been around for a fairly long time. They make components that

TWST: And did you want to mention another company?

Ms. Prial: I will mention one other that just reported today, a company called **Cavco Industries Inc.** (NASDAQ:CVCO), which is in the manufactured-housing space. As I mentioned residential construction as a driver for **Sterling Construction**, manufactured housing is a good way of participating in this trend. We think one of the very interesting things that's happened in this housing cycle is that manufactured housing has really come of age. And what we've seen is, manufactured housing has become a very predictable and quality way to get housing construction done relatively quickly without as many of the issues of labor shortages that the stick-built players — which is the traditional way of building houses — have.

Cavco reported last night, and they had very strong results, where they beat on both earnings and revenue. They saw very high bookings, and we believe that they're really starting to gain share in the industry. In general, as we look at these less traditional growth areas, like industrials, the construction and homebuilding areas, what we want to see are not only companies that are executing well and where the management teams are able to deliver solid returns to the shareholders but where the companies are able to gain share within their industry as well.

TWST: And do you see manufactured housing continue to be popular — especially among Millennials as they might look for their first home or maybe a second home?

Ms. Prial: Yes. So we see two drivers behind manufactured housing. I mentioned that one of the big advantages is quality control because they are built at the factory, and they're built on very tight specs. The quality control is there, and it's built in. And because their workers are employed on a full-time basis by the factory, it's easier for them to find workers in a tight employment situation than what we're seeing from some of the more traditional homebuilders, who've been having trouble. There's a shortage of workers out there.

The customers for these houses are twofold; one is clearly that first-time homebuyer, which would be more likely to be the Millennials, younger homebuyers, but we're also seeing a big trend of second homebuyers or Baby Boomers, who are downsizing, who are recognizing that the quality of the home that you get and the design specifications that you get with these manufactured houses are just as good as what they would get on the traditional stick-built house, but yet they can get it faster with better quality control and more certainty of getting the product they want. So we're seeing drivers from both ends of the demographic spectrum.

1-Year Daily Chart of Cavco Industries

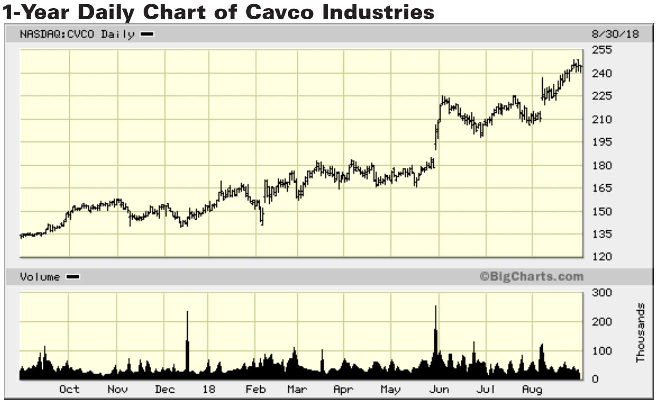

Chart provided by www.BigCharts.com

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TWST: So some of these people might be people who have been watching carefully when a property goes up for sale, and they buy the land and then get the manufactured house to go on that piece of property — maybe a lot with a great view or in a vacation area or whatever they want?

Ms. Prial: Exactly.

TWST: Changing gears a bit, did you want to talk a little bit about what some of the concerns are that you're hearing about from some of the investors?

Ms. Prial: One of the big questions that we get a lot is just how long this market can keep going. Obviously, we've been in a strong market now for a number of years, and investors are always looking over their shoulder for the specter of the next bear market. And today is no different. In fact, I think with this current bull cycle, given that the last bad bear market was 2008, 2009, investors are particularly nervous. They ask, "Are we going to see a repeat of that environment?"

What I would tell you is that we do not see any signs of excess in the market at this point nor concerns that we're about to enter a severe bear market. We may have corrections, and we think it's likely that we will have corrections going forward, but what we see is a strong economy with strong margins, strong earnings results and valuations that are really quite reasonable. As we look, in particular, at our small and microcap names, what we see is an environment where, for the first time in a number of years, investors are being rewarded for individual stock picks.

In the period right after the financial crisis of 2008 and 2009, we had a multiyear period where correlations were very high and where much of the trading was rotation from group to group with very little differentiation within the group of companies that were performing well or performing poorly; all of the stocks either went up together or went down together. That started to change last year, where we started to see a lot more dispersion within a group based on the fundamentals of the companies in what they were reporting and what their growth rates were, what their balance sheets were like, what the management quality was.

This is an environment that we think is good for the markets overall and particularly good for active management because it gives us an opportunity to benefit from the intellectual property that we create as we understand the company fundamentals and invest in companies where those future growth prospects are not yet fully reflected in the price of the stock. So we're pretty comfortable that the next couple of quarters certainly, and hopefully the next year or so, will continue to be a favorable environment for our kind of investing.

TWST: And we mentioned in passing about Baby Boomers and people in retirement years, do you think they still really need to have equities as part of their portfolios in order to make sure that they have enough money to live out their retirement years comfortably?

Ms. Prial: I certainly do. Particularly with interest rates where they are today, unless you have an extraordinary amount of money, it's very hard to earn the return that you need with current rates. In addition, as Baby Boomers live longer and as Baby Boomers' retirements are very different than what previous generations expected their retirements to be like, they're more active, they're healthier, they travel more, they want to experience more, that requires having an asset base that can grow and can keep up with inflation. And Baby Boomers need to continue to stay invested with their savings in order to keep up with inflation.

In addition, Millennials are starting to and certainly need to start investing so that they can save, so that they too can have the kind of retirements that we think they will expect to have, particularly if they watch their parents use their retirements to travel and experience things that they didn't have the time perhaps to do when they were fully employed. I saw a statistic maybe about a year ago that showed when you look at different asset classes, the only asset class that has consistently outperformed inflation are small-cap stocks. Now, I'm a small-cap investor, so of course I like that statistic, but we do think that, that means that investors not only want to stay exposed to equities, but they really should have exposure not only to the large-cap equities but also to the small-cap space where they do have that opportunity to outperform inflation.

TWST: And do you think that the Millennials are sort of getting over what might be a discomfort with equities after the corrections of 2008, 2009, and that they are going to be like other generations and invest in small cap and then even large cap?

Ms. Prial: I do think that. I think your wording is very accurate that they are getting over the fear that they had following the financial crisis of 2008, 2009. When we first started investing in housing-related equities, which was in 2013, 2014-ish, we would get this same question about Millennials and household formations and buying houses. And my joke to my clients was always that, eventually, Millennials would in fact move out of their parents' basement and would start to do the things that normal human beings always do: get married, have families, form households. And in fact, we are starting to see that. It was delayed because of the financial crisis, it was delayed because of the employment issues that happened to those students, Millennials who came of age during the financial crisis, but in fact, it's happening.

And we believe that the same thing is starting to happen with investing. Now, Millennials may invest differently than their parents did. They may rely more on technology to give them guidance and less on individuals, but they still, we believe, are starting to recognize the power of compounding and the power that comes from investing in growth assets, where you can benefit not only from multiple expansion but also from the growth of those underlying assets. And so they will be full participants in the equity markets just like the other generations have been before them.

TWST: And one of the things that's been in the news recently has been the whole issue of trade wars and tariffs and those kinds of things. How is that impacting a lot of the small-cap-type holdings?

Ms. Prial: Well, one of the blessings of small-cap investing is that we are a little bit sheltered from some of the global issues, in that many of our companies are very small and haven't yet needed to expand as much overseas as you see with the megacaps and even many of the large-cap companies. Having said that, it certainly has an impact. We're paying very close attention to both our industrial companies and what they're seeing in terms of raw material price increases and whether or not they think these cost increases are going to get passed on to their customers in terms of price increases, which will lead to more inflation than we might otherwise have expected in the system. Similarly, we're looking at food and at retail goods, and trying to see when we're going to see the early warning signs that maybe we're going to see more inflation in these channels as well.

So we are hopeful that this is a trade skirmish — and I think at this point, it is still more of a skirmish than a war — that this trade skirmish will get resolved fairly quickly, because if it doesn't, it will definitely slow down economic growth in the United States and will depress profit margins. At this point, we have not seen a big impact on most of our companies.

TWST: Is there anything I didn't bring up that you care to mention either about your firm or about some of the trends out there?

Ms. Prial: I think we've done a good job covering the trends. I would just close by saying that as we continue our search for growth, wherever we might find that growth, in traditional or nontraditional areas, we're particularly excited because we feel that we're at an inflection point where there are a number of very exciting growth opportunities out there.

TWST: Thank you. (ES)

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