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GROWTH INVESTING | Q&A

Why This Growth-Stock Pro Favors EV-Parts Makers

By Lauren Foster


Janus Henderson's Brian Demain

Photograph by Carmen Chan

Brian Demain has a healthy respect for efficient markets and downside risk.

In college, Demain wrote his senior thesis with guidance from Princeton University economics professor Burton G. Malkiel, godfather of the efficient market theory and author of the investing classic A Random Walk Down Wall Street, which turns 50 on New Year's Day. He joined Janus Capital, now part of Janus Henderson Group, in 1999, right after graduating and just before the dot-com crash of 2000-01.

"There was a lot of capital destruction and a lot of clients who lost a lot, so it gave me an appreciation for the downside of paying too much for growth stocks," says Demain, who now manages the five-star-rated Janus Henderson Enterprise fund (JMGRX) with Cody Wheaton.

In 2022, the $18 billion fund was down 16.8% but outperformed its category peers and benchmark index, down 27.7% and 25.9%, respectively. The fund's performance places it in the top quartile over one, five, and 10 years, according to Morningstar. "We focus on both upside and downside when we look at stocks," Demain says. "We care about valuation. We consider ourselves growth investors, but downside matters, and that's part of our investment process."

Barron's spoke with Demain recently about his outlook for 2023, investment themes and stocks he's most excited about, and why Formula One Group (FWONK) is one of his top picks. An edited version of the conversation follows.

Barron's: **We made it through 2022. Now what?**

Brian Demain: Next year we could see inflation slowing, and the economy slowing meaningfully on the back of the Federal Reserve rate increases. Our average hold period for a stock is close to 10 years, so we're thinking longer term. What is most important for equity investors to focus on is the return of the normal laws of economics.

The cost of capital matters. That's a big difference from what we saw since the late 2010s. Different industries and companies will fight for capital. Not every idea will get funded.

What does that mean for retail investors?

A lot of the excesses were wrung out in 2022. But there still are excesses in the market. A fair number of businesses have been afforded high multiples by investors, especially in higher-growth areas of software, consumer discretionary, and medical devices. These companies can have strong fundamentals, but their valuations are dangerously high. The idea is to look at companies based on their fundamentals and the discounted value of their future cash flows.

What do you look for in your fund's investments?

Companies must meet four criteria: sustainable growth, strong competitive position, good management and corporate board, and reasonable valuation. What we mean by sustainable growth is companies that are growth companies today and will still be growth companies in three, five, seven, and 10 years. With a strong competitive position, we want companies that are adding value to their employees and their customers.

We also look for management teams we can partner with, and boards that will hold the CEO accountable. The last piece is valuation. We're growth investors and think that revenue growth is the strongest driver of value creation for companies over time. It is the metric that gets us most excited, but valuation does matter.

What do you consider your edge?

I go back to what I learned with Professor Malkiel. If you think about efficient markets, you can't just do the same thing as everybody else and try to do it better. You have to approach it differently. Our time horizon is our biggest competitive advantage. The average mid-cap growth manager has had turnover of 76%, on average, over the past decade, and hedge funds playing in mid-cap growth stocks have even higher turnover than that. Our average turnover has been 14% in the past decade. We're playing a different game.

What stocks are you excited about?

One of the investment themes that we're most excited about over the next decade is the growth in electric vehicles, or EVs. In 2022, out of 80 million cars produced globally, 10 million were electric. By 2030, that's going to be up to 40 million, so that's a quadrupling of the EV market.I At that point, about half of new cars produced will be electric.

When you pull out an internal combustion engine and put in a battery and all of the associated content, the amount of semiconductor content more than doubles. Semiconductor content per car will be going from about $600 in 2022 to over $1,000 by 2030.

One company we like in this space is ON Semiconductor [ON], which has 34% of revenue exposed to the auto market. And that exposure is in the right areas: electrification and advanced driver-assistance systems.

The really exciting piece of the story is ON's power semiconductor business. Power semiconductors are used to control and convert electrical power in electronic circuits. There's a component in EVs called the traction inverter, which converts direct-current power from an onboard high-voltage battery into alternating-current power to drive the main motor or motors. This is the most mission critical part of the EV, outside of the motor and battery.

Most chips are built from silicon, but there's a new substrate called silicon carbide that allows EVs to charge about 10% faster and extends driving range by about 10%. That's a huge deal. The silicon carbide substrate allows energy to transfer more efficiently between DC and AC power. There are only a few companies that produce silicon carbide power semiconductors, and ON is one of them. This is an exciting growth story and the stock is only trading for 16 times 2023 earnings, so we're not paying a heady growth multiple.

What is another stock you like?

TE Connectivity [TEL] provides connectors used in auto and industrial applications. Its business mix is about 60% transportation, 30% industrial, and 10% communications. It is benefiting from the EV transition, as the connector content in an EV is about twice the connector content of an internal-combustion-engine vehicle. The connectors link the cables in cars to all things electrical, from sensors to energy-storage systems. The stock trades at 17 times 2023 expected earnings. This isn't a company growing its revenue 20% a year, but one that we think can grow its revenue in the 5% to 7% range for five, 10, 15 years. And that's a powerful way to compound capital over time.

What other themes inform your investments?

One is the "greening" of the economy and the need for wind and solar energy. Flex [FLEX] is a contract manufacturer, which means it historically helped assemble products designed by other companies. That's a very low-margin, commodity-like business, but over the past several years, Flex has focused on what it calls "high reliability solutions." One of those areas is mobility, and it is doing a lot of work on EVs. It is also doing healthcare work, such as building continuous glucose monitors, or CGM devices. These products have long life cycles and higher margins than the traditional tech commodity business.

One business Flex owns is Nextracker, which builds technologies that will allow solar cells to follow the sun through the day. So, it also has exposure to the broader demand for greener energy. The stock is trading at about 10 times 2023 expected earnings.

Is there also a turnaround story here?

Yes. In 2019, the company hired Revathi Advaithi as CEO, and she has done a terrific job. She came from Eaton [ETN] and has the industrial business-process approach. She has helped Flex become a much more consistent earnings grower and much better on cash management. Flex has gone from a company that had its ups and downs and poor capital allocation to a well-run company, and Advaithi is a powerful part of the story. She has changed the quality and predictability of the business model.

Any other stock picks?

There is one more stock we're very excited about: Formula One Group. In 2017, Liberty Media bought Formula One and has reinvented the sport. They restructured the competitive dynamic. In the past, only a couple of teams were winning every year, and they've leveled the playing field. We now have a much more interesting sport. They also broadened the fan base. Formula One is adding a Grand Prix in Las Vegas in 2023, there is increased interest and viewership in China, and you've got the hit documentary Drive to Survive on Netflix [NFLX], which has created a whole new group of fans. That will accelerate the growth of the company.

One of the ways Formula One makes money is through race promotion: It gets paid by promoters for the right to put on races. As the company renegotiates those contracts, it has pricing power. There are also media rights. What we've seen with sports content everywhere is that it's not just the traditional networks that are bidding for the content, but also the streaming platforms. So there is strong growth potential in media rights and opportunities in sponsorship. The third driver of the investment thesis is sponsorship.

How does that work?

The teams have sponsors, but Formula One had few sponsors and is now getting more. We think the company can grow its revenue at a high-single-digit clip for the next five to 10 years. That will come with nice incremental margin expansion.

The biggest cost for Formula One is contractual payouts to the teams, which are independent companies. The company renegotiated that deal in 2021, and as it starts to boost revenue, more of the revenue will end up staying with Formula One. Stefano Domenicali is the CEO. He was the team principal of the Scuderia Ferrari Formula One team, so he knows the sport well. The stock trades at about 21 times expected 2023 Ebitda [earnings before interest, taxes, depreciation, and amortization] and at about 26 times on free cash flow.

As is typical of Liberty-backed companies, it doesn't have a lot of earnings because it's doing a lot of depreciation of noncash acquisition expenses and the like. But when we think of high-single-digit revenue growth, and double-digit Ebitda growth for a long time, we get excited about how the capital can compound there. It's not the fastest grower today, but it will grow for a long time and it is well positioned competitively.

Thanks, Brian.

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Enterprise Fund as of 3/31/2023	**1 Year**	**5 Year**	**10 Year**	**Exp Ratio (Gross/Net)**
Class I shares	-2.10	10.46	12.99	0.76% / 0.76%
Russell Midcap Growth Index	-8.52	9.07	11.17	

Morningstar Mid-Cap Growth	**1 Year**	**5 Year**	**10 Year**
Percentile Ranking	4	15	6
Rank/Count	21/579	73/529	27/489

Returns include reinvestment of dividends and capital gains. Returns greater than one year are annualized. Net expense ratios reflect the expense waiver, if any, contractually agreed to for at least a one-year period commencing on January 27, 2023. This contractual waiver may be terminated or modified only at the discretion of the Board of Trustees.

Returns quoted are past performance and do not guarantee future results; current performance may be lower or higher. Investment returns and principal value will vary; there may be a gain or loss when shares are sold. For the most recent month-end performance call 800.668.0434 or visit janushenderson.com/performance.

Maximum Offering Price (MOP) returns include the maximum sales charge of 5.75%. Net Asset Value (NAV) returns exclude this charge, which would have reduced returns.

When an expense waiver is in effect, it may have a material effect on the total return or yield, and therefore the ranking and/or rating for the period.

Index performance does not reflect the expenses of managing a portfolio as an index is unmanaged and not available for direct investment.

The Morningstar percentile ranking is based on a fund's total return (including income and capital gains, if any, and excluding sales charges) relative to all funds in the same category for the period, and may not indicate positive performance. The highest (or most favorable) percentile rank is 1%, and the lowest (or least favorable) percentile rank is 100%. The top-performing funds in a category will always receive a rank of 1.

As of 03/31/23, Enterprise Fund Class I Shares Morningstar Ratings™ in the Mid-Cap Growth category: 5 stars out of 529 funds, 5 stars out of 498 funds, 5 stars out of 387 funds and 5 stars out of 529 funds, for the 3-, 5-, 10-year and Overall periods, respectively.

The Morningstar Rating™ for funds, or "star rating", is calculated for funds with at least a three-year history. Exchange-traded funds and open-ended mutual funds are considered a single population for comparative purposes. It is calculated based on a Morningstar Risk-Adjusted Return measure that accounts for variation in a fund's monthly excess performance, placing more emphasis on downward variations and rewarding consistent performance. The Morningstar Rating does not include any adjustment for sales loads. The top 10% of funds in each category receive 5 stars, the next 22.5% receive 4 stars, the next 35% receive 3 stars, the next 22.5% receive 2 stars, and the bottom 10% receive 1 star. The Overall Morningstar Rating for a fund is derived from a weighted average of the performance figures associated with its three-, five-, and 10-year (if applicable) Morningstar Rating metrics, and may not indicate positive performance. Ratings may vary by share class.

As of 3/31/2023 the top 10 portfolio holdings of the Enterprise fund are: ON Semiconductor Corp (4.59%), Constellation Software Inc/Canada (3.34%), Boston Scientific Corp (2.95%), Amdocs Ltd (2.88%), Intact Financial Corp (2.72%), SS&C Technologies Holdings Inc (2.70%), GoDaddy Inc (2.47%), WEX Inc (2.38%), Teleflex Inc (2.35%), Flex Ltd (2.29%). There are no assurances that any portfolio currently holds these securities or other securities mentioned.

Investing involves risk, including the possible loss of principal and fluctuation of value.

Growth stocks are subject to increased risk of loss and price volatility and may not realize their perceived growth potential. **Smaller capitalization securities** may be less stable and more susceptible to adverse developments, and may be more volatile and less liquid than larger capitalization securities.

Discounted Cash Flow (DCF) analysis is a valuation method used to estimate the attractiveness of an investment opportunity. DCF analysis uses future free cash flow projections and discounts them (most often using the weighted average cost of capital) to arrive at a present value, which is used to evaluate the potential for investment. If the value arrived at through DCF analysis is higher than the current cost of the investment, the opportunity may be a good one. **Price-to-Earnings (P/E) Ratio** measures share price compared to earnings per share for a stock or stocks in a portfolio. **Turnover** is a measure of portfolio trading activity. Higher turnover may indicate higher transaction costs and vice versa.

Russell Midcap® Growth Index reflects the performance of U.S. mid-cap equities with higher price-to-book ratios and higher forecasted growth values.

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