

FIRST QUARTER 2017 – U.S. GROWTH EQUITY - MID & SMALL CAP

Achieving Growth Via Efficiency

In an uncertain environment, we believe it's important to identify efficient companies that can withstand volatility and create their own pathways to growth.

The presidency of Donald Trump presents investors with many unknowns in 2017. Proposals to cut taxes, increase government spending, and deregulate certain industries could stimulate economic growth. However, the impact of the stimulus could be muted by rising rates, a stronger dollar, inflationary pressure, and worries about trade.

In an evolving environment such as this, some stocks are better equipped than others to withstand volatility. A key characteristic we seek is efficiency, a “self-help” factor that a company can largely control even amid uncertain political agendas it cannot control. Zero-based budgeting and smart acquisitions are two ways companies can make themselves more efficient.

Zero-Based Budgeting Integrates Planning with Prudent Budgeting

Zero-based budgeting takes an outcome-based approach to resource planning. It allows primary strategic goals to be integrated into the budgeting process by tying them to specific functional areas of the company. Management examines all expenses for each new period, not just incremental expenditures in the customary areas. When implemented properly, it allows them to fundamentally overhaul their cost structures and boost competitiveness.

Food and beverage company Mondelez International, whose global portfolio of brands includes Oreo, Nabisco, and Cadbury, established a zero-based budgeting system and saved \$350 million in operating expenses in its first year. More recently, the company increased its adjusted operating margins from 13.0% in the first nine months of 2015 to 15.6% for the same period in 2016. This a significant feat in the relatively slow growing economy we've experienced the last few years.

Smart Acquisitions Can Fuel Growth

Another successful way to gain efficiencies is through smart acquisitions. Two companies transform into one that is leaner and more capable. The new company's management can eliminate redundancies in general and administrative expenses, reduce operating costs, and find ways to gain economies of scale in plant and manufacturing facilities. Management can also apply best practices from the pre-merger entities and reduce debts by refinancing, changing loan terms, and obtaining new lines of credit.

For example, Ball Corporation became the largest manufacturer of beverage cans in the world by acquiring Rexam in 2016. Notably, Ball undertook a review of the newly acquired business's expenses, capital allocation, supply logistics, and balance sheet management in order to gain estimated synergies in excess of \$300 million by the end of the third year of combined operations.

Not Your Typical Growth Stories

Mondelez and Ball are not prototypical growth stocks in that they do not exhibit particularly strong revenue growth rates. They sell into the consumer staples sector, a sector not typically known for companies with high growth rates in revenues. However, they both have other important growth stock characteristics: improving margins through efficiency initiatives and smart capital allocation, which can include stock buybacks and reinvesting in a company's capabilities.

Closing Thoughts

Our process allows us to find many investment opportunities that look attractive according to our metrics as growth investors. We use our bottom-up process in order to build diverse portfolios that we believe will outperform our benchmarks and peers.



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“We look for companies that are improving their operations using zero-based budgeting and those that realize efficiencies through smart acquisitions.”

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