

Conestoga Small Cap Investors CCASX

A fine fund, but keep an eye on flows.

Morningstar's Take CCASX

Morningstar Rating ★★★★★

Morningstar Analyst Rating Silver

Morningstar Pillars

Process	+	Positive
Performance	+	Positive
People	+	Positive
Parent	+	Positive
Price	+	Positive

Role In Portfolio

Supporting

Fund Performance CCASX

Year	Total Return (%)	+/- Category
YTD	24.00	5.06
2017	28.44	6.94
2016	14.06	2.87
2015	8.03	10.44
2014	-8.05	-10.49

Data through 9-30-18

10-03-18 | by Tony Thomas

Conestoga Small Cap's small but sufficient team continues to execute well despite strong inflows. The fund retains its Morningstar Analyst Rating of Silver.

Manager Bob Mitchell is the linchpin of the team and its process. Mitchell cofounded Conestoga Capital Advisors in 2001 and has managed the fund since its 2002 inception. He navigated retirements from the firm's small investment team, bringing aboard veteran Joe Monahan as comanager in 2014 and hiring two dedicated analysts. Mitchell also comanages Conestoga SMid-Cap CCSGX, which extends this fund's process to slightly larger companies.

That process is sensible and clearly defined. Mitchell and Monahan like firms with solid growth prospects and healthy balance sheets. They prefer businesses with the ability to grow earnings at least 15% per year and generate 15% or more return on equity over

the next three to five years. Low debt and decent insider ownership help. The team has proven faithful to these principles: The July 2018 portfolio easily topped both its typical small-growth Morningstar Category peer and its more-relevant Russell 2000 Growth benchmark on average return on equity, return on invested capital, and net margins--all while sporting a lower debt/capital ratio.

The high-quality portfolio has produced stellar results over time. Its trailing total returns through August 2018 were top-third or better in its category over one, three, five, 10, and 15 years, while its 13.4% annualized total return since inception bested the 12% peer average and the 12.2% index tally. Less-volatile returns also give the fund a risk-adjusted advantage.

Flows pose the greatest challenge. The strategy's total assets ballooned from \$1.8 billion to \$4.3 billion over 20 months ended August 2018 despite gradually closing to new investors (in March and July 2018). So far, the team has responded well, keeping the portfolio's number of holdings, average weighted market cap, and annual turnover within historical ranges. Absent warning signs there, the fund still earns high marks--but capacity concerns loom.

Process Pillar + Positive | Tony Thomas
10/03/2018

This team's process is straightforward and well-executed, earning the fund a Positive Process rating.

The managers take a relatively conservative approach to the small-cap universe. They like firms with strong growth characteristics, including the ability to grow earnings and returns on equity at a 15% clip over the next three to five years. They also prefer firms with debt/capital ratios under 40%. Significant insider ownership (usually 10% or more) also gets their attention. Overall, the team's goal is

to pick stocks that have the potential to appreciate by at least 100% over the next three to five years.

The managers invest with conviction. They typically keep the number of holdings within a narrow range (45-55), and they tend to hang on to their picks for three to four years, on average. By mandate, the team must keep 80% of its assets in firms with rolling three-year average market cap of the Russell 2000 Growth Index at the time of purchase, though they're willing to hold a company as it grows into mid-cap territory if they like its fundamentals. While the portfolio is generally well-diversified across individual holdings and sectors, the managers can deviate from their Russell 2000 Growth benchmark's sector weightings by up to 25% of assets or twice the index's sector weighting (whichever is least). They also like to stay fully invested, often keeping cash levels below 5%.

The portfolio scores well on key quality metrics. Given the managers' preference for high returns on equity, the July 2018 portfolio's average ROE was 14.8%, surpassing the 9.5% small-growth Morningstar Category average and more-relevant Russell 2000 Growth Index's 7.5%. Their aversion to debt-ridden companies also stands out, with the portfolio's 27% debt/capital ratio well below the 39% mark for the typical peer and the index.

Sector weightings can veer widely from the index. The fund's 38% technology stake in July 2018 was well ahead of the relevant index's 25%. On the other hand, the fund is often significantly underweight financials, which often don't meet the team's growth criteria. Only one financials firm was in the July 2018 portfolio: Westwood Holdings Group WHG, an asset manager and advisor.

The team is willing to hold its best picks as they grow into mid-caps. Pest-control firm Rollins ROL had the largest market cap in the July 2018 portfolio (at over

\$13 billion). The company embodies the team's favorite traits, including high returns on equity and margins. It also shows their buy-and-hold style: They first bought Rollins in early 2005. Typically, however, the managers will exit positions as they reach a threshold of about \$6 billion to keep the fund in the small-cap space. Over two thirds of the fund's assets were in small-cap stocks in July 2018.

Performance Pillar + Positive | Tony Thomas
10/03/2018

This fund looks good from various angles, earning a Positive Performance rating.

For starters, the fund has a solid record since its 2002 inception. From October 2002 through September 2018, the fund's 13.4% annualized total return beat the 11% small-growth Morningstar Category average and 12.2% tally for the most relevant index, the Russell 2000 Growth. The portfolio's high-quality tilt yielded lower-than-average volatility (as measured by standard deviation) and did not fall as far in down markets. This gave the fund a healthy risk-reward advantage: Its 1.2 Sortino ratio (a measure of risk-adjusted returns) topped the 0.9 peer average and the index's 1.0.

The fund's dominance shows over other time periods as well. Its trailing three-, five-, 10-, and 15-year total returns through September 2018 were top-quintile in the category. (Its one-year mark was top-third.) Its rolling three-year returns since inception beat the relevant index in 61% of periods and its typical peer 76% of the time.

Even calendar-year 2014's relatively ugly performance proved short-lived. The fund lost 8%--versus modest gains for the typical peer and the index--on poor stock selection in technology, healthcare, and energy. The managers pared weak energy holdings, such as Geospace Technologies GEOS, and stuck to their best tech and healthcare picks. The fund then swung to an 8% gain in 2015, beating 98% of its peers.

People Pillar + Positive | Tony Thomas
10/03/2018

This fund's experienced investment team has carefully added new pieces to address turnover and flesh out its resources, earning the fund a Positive People rating.

Comanager Robert Mitchell brings experience and continuity to the team. A 23-year industry veteran, Mitchell cofounded Conestoga with William Martindale in 2001. Together they comanaged this fund from its 2002 inception until Martindale retired in mid-2014. Joseph Monahan eased into Martindale's place alongside Mitchell during a yearlong transition. Monahan brings 36 years of industry experience to the team.

There have been other changes. David Lawson, who had comanaged Conestoga SMid Cap CCSGX with Mitchell and was part of the firm's general research process, retired in early 2016. Again, the firm laid out plans for Lawson's retirement in advance and gradually transferred his duties to Derek Johnston, a 2015 hire with 22 years of experience. The firm has also added new research resources as its assets have grown. Conestoga hired its first dedicated analyst, David Neiderer, in 2013, followed by Larry Carlin in 2015.

Manager ownership of the fund is a weak spot, but they invest in other ways. As of September 2017, Mitchell and Monahan each invested \$100,001-\$500,000 in the fund. That's especially modest for the long-tenured Mitchell, but he and Monahan have directed some of their assets toward buying out the retirees' stakes in the firm.

Parent Pillar + Positive | Tony Thomas
09/21/2018

Conestoga Capital Advisors is a small but efficient firm that takes a thoughtful approach to investing and to its own operations. It earns a Positive Parent rating.

The Wayne, Pennsylvania-based firm excels at small-cap investing. It runs two mutual funds, Silver-rated Conestoga Small Cap CCASX and unrated Conestoga SMid Cap CCSGX, using a conservative, straightforward approach. Its managers favor firms with solid earnings growth, low debt, and significant insider ownership. They're patient with such firms, and the results have put both funds' performance in

the upper echelon of their respective Morningstar Categories.

The firm also makes effective use of its personnel and has handled change well. It has only 12 employees, split evenly between its investment team and operations staff. Co-founder Bob Mitchell serves as a comanager on both mutual funds. The firm is 100% employee-owned, and it has executed clear, step-by-step plans for buying out the stakes of retiring employees.

Success comes with challenges, and the firm's handling of flows bears watching. It responded to the Small Cap strategy's exponential asset growth with two rounds of gradual closures, allowing total assets to balloon from \$2.4 billion to \$4.3 billion over the 20 months ended August 2018. All that cash hasn't overwhelmed the managers yet, but tighter closures might be needed to keep their successful investing style intact.

Price Pillar + Positive | Tony Thomas
10/03/2018

Below-average fees earn this fund a Positive Price rating.

Sizable fee waivers help keep investors' costs affordable. The firm caps operating expenses at 0.90% for the Institutional and 1.10% for the Investors share classes. That puts both expense ratios below the median for similarly distributed shares (0.99% for institutional shares and 1.16% for no-load shares). The waivers are set to expire in January 2019, though the firm has indicated that it expects to renew them.

The fund closed to new retail investors using financial intermediaries in March 2018, and all new intermediary business in July 2018.

Total Returns % (As of 9/30/2018)	Average Annualized Total Returns							
	QTD	YTD	1-Yr	3-Yr	5-Yr	7-Yr	10-Yr	Since Inception 10/1/2002
CONESTOGA SMALL CAP FUND								
CCASX– Investors Class	10.40	24.00	28.47	25.49	14.91	19.03	14.66	13.30
Russell 2000® Growth Index	5.52	15.76	21.06	17.98	12.14	17.52	12.65	12.24
Russell 2000® Index	3.58	11.51	15.24	17.12	11.07	16.43	11.11	11.50

Gross expense ratio: 1.54%, Net expense ratio: 1.10%; Conestoga Capital Advisors, LLC (the Adviser) has contractually agreed to limit the Fund's net annual operating expenses to 1.10% of the Fund's average daily net assets until at least January 31, 2019, subject to termination at any time at the option of the Fund. There is no guarantee that the agreement to limit the Fund's annual operating expense will be renewed or extended.

Performance is based upon closing NAV calculation on listed dates and represents past performance. Past performance does not guarantee future results and current performance may be lower or higher than the performance quoted. Performance data includes reinvestment of dividends. Investment returns and principal value of an investment in Conestoga Small Cap Fund will fluctuate so that an investor's shares, when redeemed, may be worth more or less than their original cost. For the Fund's daily NAV, list of additional holdings, total return as of the most recent month-end and a copy of the Fund's prospectus, please visit www.conestogacapital.com or call 1-800-320-7790.

Mutual Fund Investing involves risk, principal loss is possible. Investment in the Fund is subject to investment risks, including, without limitation, equity risk, market risk, management risk, small company risk, foreign investment risk, currency risk, large redemption risk. Funds that invest in small and mid-cap stocks are often more volatile than large cap stocks. Smaller companies generally face higher risks due to their limited product lines, markets and financial resources. For more information about the Fund, including the Fund's objectives, charges, expenses and risks (including more information about the risks listed above), please read the prospectus.

An investor should consider investment objectives, risks, charges, and expenses carefully before investing. Download a prospectus, which contains this information or call toll free 1-800-494-2755. Read the prospectus carefully before investing or sending money.

The Russell 2000 Growth Index measures the performance of those Russell 2000 companies with higher price-to-book ratios and higher forecasted growth values. An individual cannot invest directly in an index.

A rate of return (ROE) is the gain or loss on an investment over a specified time period, expressed as a percentage of the investment's cost. Gains on investments are defined as income received plus any capital gains realized on the sale of the investment.

Standard deviation is a measure of the dispersion of a set of data from its mean. If the data points are further from the mean, there is higher deviation within the data set. Standard deviation is calculated as the square root of variance by determining the variation between each data point relative to the mean.

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