

FUNDS & PERSONAL FINANCE

MUTUAL FUNDS PROFILE

How This Fund Seeks Stocks With A Competitive Advantage

BY PAUL KATZEFF
INVESTOR'S BUSINESS DAILY

One of the key traits that managers of \$444 million Nicholas Limited Edition Fund look for in stocks is a competitive advantage, something that a company does so well that it gives it a leg up on existing rivals and discourages new challengers from entering the game.

The fund finds companies with a competitive advantage — many investors call them protective moats — everywhere from hazardous waste managers to drugmakers to computer software makers. Along with unique business models and savvy management, they are among the most important factors in making David Nicholas and co-manager Neal Dihora bring a stock into their portfolio.

That's helped the I-class shares (NCLEX) rack up a 10.60% gain this year going into Thursday vs. 10.59% for their small-cap growth mutual fund rivals tracked by Morningstar Inc. and 6.67% for the S&P 500.

Over the past three years, the fund's average annual gain is 14.36% vs. 13.87% for its peers and 13.69% for the big-cap bogey.

The fund also puts a premium on managing risk. Nicholas and Dihora do that by sidestepping many aggressive growth names, instead seeking less volatile names, mainly small caps. "We try to dampen our risk level," Dihora said.

Competitive Advantage: How It Pays Off

It's a formula that stands out in volatile markets — which investors have witnessed recently.

"We tend to outperform more in classic down markets," Dihora said. "We've tended to kick butt in the last couple of weeks," amid general weakness in most sessions. In hot markets, the fund tends to lag leaders, he added.

To reduce risk, Limited Edition's managers aim for

companies with recurring revenue models — companies that produce more steady and predictable sales no matter what's happening in the broader economy.

The managers' goal is to preserve gains by minimizing setbacks. They seek gains by looking for companies with traits like competitive advantages and skilled management.

In fact, the fund has used recent market volatility as an opportunity to add to names it likes, Dihora says.

Competitive Advantage: Euronet Has 4

When it comes to competitive advantage, **Euronet Worldwide** (EFT) has four that Dihora likes. One is its network of ATMs in European locations favored by affluent tourists who want to exchange one currency for another. European regulators are considering caps on fees, but any action is likely years in the future, Dihora says.

A second competitive advantage is its group of acquisitions, which Dihora says continue to thrive. In the past decade, Euronet has taken over money transfer company Ria; HiFX, whose activities include foreign exchange services for businesses and high net worth individuals; and XE.com, a provider of online tools for foreign exchange and money transfers.

A third line that Dihora likes is Euronet's money transfer service for **Walmart** (WMT). Dihora also likes Euronet's role as the back-end facilitator of gift cards for service from **Netflix** (NFLX).

CyberArk Software's (CYBR) competitive advantage is its focus on programs that keep watch over customer's privileged accounts — accounts of corner-office executives. "If hackers gain access to those accounts, it gives them access to accounts throughout a company," Dihora said.

Likewise, CyberArk aims to protect application-develop-

Nicholas Limited Edition I



David Nicholas



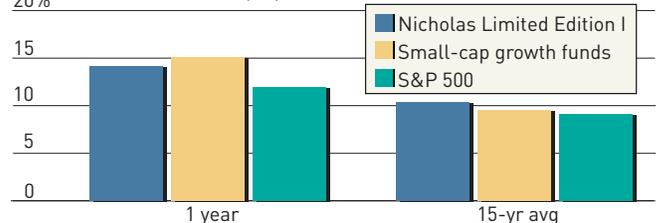
Neal Dihora

■ Load: None
■ Expenses: 0.86%
■ Symbol: NCLEX
Total returns as of 10/17/18
2017: 19.92% 3-yr. avg.: 14.36%
YTD: 10.60% 5-yr. avg.: 10.05%
10-yr. avg.: 14.39%

Sector weightings as of 9/30/18

	% of stock assets	% of S&P 500
Cyclical	31.05%	
Basic materials	7.72	2.27%
Consumer cyclical	11.54	12.18
Financial services	9.32	15.79
Real estate	2.47	2.18
Economically sensitive	47.42	
Communication services	0.00	3.24
Energy	0.00	6.00
Industrials	24.40	10.35
Technology	23.02	23.08
Defensive	21.53	
Consumer defensive	4.44	7.13
Health care	17.09	14.96
Utilities	0.00	2.83

20% Total returns as of 10/17/18



Source: Morningstar Inc.

ers' accounts.

Recent earnings have benefited from comparisons to some quarters last year, when the company had problems with its European sales unit, Dihora says. "The other thing we like is this company's acquisitions," Dihora said, citing the 2017 takeover of Conjur, whose software protects very sensitive corporate information.

Competitive Advantage: Ollie's Bargain Outlet

Ollie's Bargain Outlet (OLLI) has created a competitive advantage by offering merchandise at discount prices in a store environment that makes shopping fun. "They cater to customers looking for deals, looking for a treasure hunt experience," Dihora said.

The discount chain also has a management team that Dihora likes. One reason he likes them: The company originally stocked only closeout merchandise, Dihora says. Those were goods available just once or rarely. But now roughly 20% of

the stores' inventory are goods that its customers want on a regular basis.

Heico's competitive advantage is that it sells aircraft parts approved by the Federal Aviation Administration at a discount, Dihora says.

Heico (HEI) has learned from experience that it can win about 25% to 33% of a given part's market share without triggering a withering counterattack by the original-part manufacturer. "The airlines save money, OEMs (original equipment manufacturers) don't get killed and Heico can make a business of it," Dihora said.

When **Deutsche Lufthansa** (DLAKY) invested in Heico years ago, it was like a seal of approval from a major airline that Heico parts were of reliable quality, Dihora says.

The stock's recent pullback was due mainly to the broader market's decline, Dihora says.

N-class shares (NNLEX) of the fund can be purchased for \$500 or more.



Nicholas Limited Edition Class I

NCLEX

Lead Portfolio Manager: David O. Nicholas, CFA Co-Portfolio Manager: Neal Dihora, CFA

As of 9/30/2018

Investment Philosophy

The advisor employs a bottom-up process investing primarily in small-sized companies we believe have high quality characteristics and sustainable business models for the long-term. An emphasis is placed on balancing capital appreciation potential while managing downside risk through security selection. We believe our patient, long-term approach along with lower turnover and fees, enhances the total return potential for shareholders.

Investment Approach

Security selection is based on identifying key characteristics we feel are critical to the long-term success of investments. These criteria include:

- A history of consistent, sustainable revenue and earnings growth.
- Own an enduring product or service with a strategic position within their industry.
- An identifiable moat to protect and enhance market share.
- Manageable balance sheets and debt service.
- Ability to generate free cash flow to reinvest in the business or return capital to investors.
- Proven management teams with interests aligned with shareholders.
- Stocks offering potential capital appreciation relative to historical valuations and earnings growth potential.

Portfolio Information

Investment Style	Small-Cap Growth
Date of Inception	5/18/1987
Net Assets	\$408.6 million
Number of Holdings	73
Weighted Avg. Forward P/E Capped	27.12x
Weighted Avg. Trailing P/E Capped	30.24x
Weighted Avg. Market Cap	\$3,779.2 million
Geometric Avg. Market Cap	\$2,875.8 million
Turnover Rate (Annualized)	24.18% (6/30/18)
Standard Deviation (10-yr Annual Avg.)	16.24%
Sharpe Ratio (10-yr Annual Avg.)	0.79

Top Equity Holdings - % of Net Assets*

Portfolio Date: 9/28/2018

Ticker	Portfolio Weighting
Ollie's Bargain Outlet Holdings Inc	1.82%
Paylocity Holding Corp	1.77%
Bottomline Technologies Inc	1.75%
Icon PLC	1.73%
Vocera Communications Inc	1.73%
CyberArk Software Ltd	1.72%
LivaNova PLC	1.72%
K2M Group Holdings Inc	1.67%
NuVasive Inc	1.64%
Heico Corp	1.64%
	17.19%

Morningstar Category Ratings

	Overall Rating	3 Yr Rating	5 Yr Rating	10 Yr Rating
Nicholas Limited Edition Class I	★★★★	★★★	★★★	★★★★
# of Funds	606	606	532	404

Category: US Fund Small Growth Source: Morningstar

The Overall Morningstar Rating™ for a fund is derived from a weighted average of the risk-adjusted performance figures associated with its three-, five- and ten-year Morningstar Rating™ metrics. (1)

Trailing Returns (periods longer than 1-year are annualized)

As of Date: 9/30/2018

	Quarter	YTD	1 Year	3 Year	5 Year	10 Year
Nicholas Limited Edition Class I	8.57%	16.53%	20.12%	18.04%	11.66%	12.49%
Russell 2000 Growth	5.52%	15.76%	21.06%	17.98%	12.14%	12.65%
Russell 2000	3.58%	11.51%	15.24%	17.12%	11.07%	11.11%

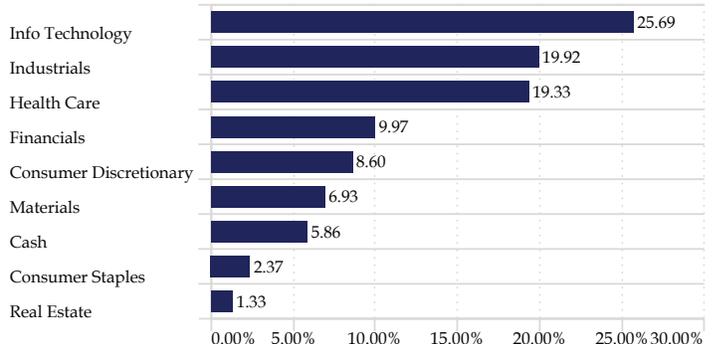
Calendar Year Returns

	2017	2016	2015	2014	2013
Nicholas Limited Edition Class I	19.92%	12.37%	-1.83%	4.34%	36.13%
Russell 2000 Growth	22.17%	11.32%	-1.38%	5.60%	43.30%
Russell 2000	14.65%	21.31%	-4.41%	4.89%	38.82%

Prospectus Gross Expense Ratio 0.86%

Performance data quoted represents past performance; past performance does not guarantee future results. The investment return and principal value of an investment will fluctuate so that an investor's shares, when redeemed, may be worth more or less than their original cost. Current performance of the Fund may be lower or higher than the performance quoted. Performance data current to the most recent month-end may be obtained by visiting www.nicholasfunds.com/returns.html or calling 1-800-544-6547.

Sector Allocation - % of Portfolio*



The Fund's investment objectives, risks, charges and expenses must be considered carefully before investing. The statutory and summary prospectus contain this and other important information about the investment company, and it may be obtained by visiting www.nicholasfunds.com. Read it carefully before investing.

Diversification does not assure a profit or protect against loss in a declining market.

Mutual fund investing involves risk. Principal loss is possible. Investing in small and medium sized companies involves greater risks than those associated with investing in large company stocks, such as business risk, stock price fluctuations and liquidity.

Please refer to Page 2 for additional disclosures.

Quasar Distributors, LLC - Distributor

Additional Trailing Returns (periods longer than 1-year are annualized)

As of Date: 9/30/2018

	<u>Quarter</u>	<u>YTD</u>	<u>1 Year</u>	<u>3 Year</u>	<u>5 Year</u>	<u>10 Year</u>
S&P 500 TR USD	7.71%	10.56%	17.91%	17.31%	13.95%	11.97%
Morningstar Small Growth Category	7.00%	18.94%	24.44%	18.39%	11.75%	12.57%

Russell 2000® Index measures the performance of the 2,000 smallest companies in the Russell 3000 Index, which represents approximately 10% of the total market capitalization of the Russell 3000 Index. As of September 30, 2018, the weighted average market capitalization was approximately \$2.443 billion; the median market capitalization was approximately \$0.943 billion. The largest company in the index had an approximate market capitalization of \$8.507 billion.

Russell 2000® Growth Index measures the performance of those Russell 2000 companies with higher price-to-book ratios and higher forecasted growth values.

S&P 500 TR USD Index is a broad based unmanaged index of 500 stocks, which is widely recognized as representative of the equity market in general.

Morningstar Small Growth Category is comprised of mutual fund portfolios focused on faster-growing companies whose shares are at the lower end of the market-capitalization range. These portfolios tend to favor companies in up-and-coming industries or young firms in their early growth stages. Because these businesses are fast-growing and often richly valued, their stocks tend to be volatile. Stocks in the bottom 10% of the capitalization of the U.S. equity market are defined as small-cap. Growth is defined based on fast growth (high growth rates for earnings, sales, book value, and cash flow) and high valuations (high price ratios and low dividend yields).

One cannot invest directly in an index or category peer group.

*Due to rounding, numbers presented may not total.

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Earnings growth is not representative of the Fund's future performance.

Fund holdings and/or sector weightings are subject to change at any time and are not recommendations to buy or sell any security.

While the fund is no-load, management and other expenses still apply. Please refer to the Prospectus for more information.

Glossary of Terms:

Earnings Per Share: Company total earnings divided by outstanding shares.

Free Cash Flow: Free cash flow is cash flow available for distribution among all the securities holders of an organization.

Geometric Avg. Market Cap: A measure of the mean market capitalization of the portfolio. It is calculated by raising the market capitalization of each company to a power equal to that holdings weight in the portfolio. The resulting numbers are then multiplied by each other.

Price/Earning Capped: PE is a valuation ratio of a company's current share price compared to its per share earnings or in the case of REITs (real estate investment trusts), their funds from operations. These weighted average values are limited in a range between 0 and 60.

Sharpe Ratio: A measure of a fund's historical returns adjusted for risk, or volatility.

Standard Deviation: Standard Deviation is a statistical measure of the historical volatility of a mutual fund or portfolio, usually computed using 36 monthly returns.