

Market Observations & Portfolio Commentary

Quarterly Market Update

US stocks traded higher during the quarter driven by improving economic data, monetary and fiscal stimulus, and optimism around the eventual availability of vaccines and treatments to fight COVID-19. Stocks traded higher during July and August, but declined a bit in September. For the quarter, stocks posted gains across the market cap spectrum led by Large Caps. The Growth indexes continued their outperformance over the Value. Though Cyclical sectors outperformed Defensive in the Small Cap space, there was little difference among Large Caps. At the individual stock level, exposure to Growth, Volatility, Size, and Momentum factors had a positive impact on relative performance, while Value, Yield, and Quality had a negative impact.

Key Performance Takeaways for the Quarter

- The London Company Mid Cap portfolio returned 8.1% gross (8.0% net) during the quarter vs. a 7.5% increase in the Russell Midcap Index. Relative outperformance was driven by positive sector exposure, partially offset by stock selection and our allocation to cash.
- We are bottom-up stock pickers, but sector exposures influenced relative performance as follows:
 - *What Helped:* Underweight Energy & Real Estate (the two worst performing sectors)
 - *What Hurt:* Underweight Comm. Services (a better performing sector) and overweight Info. Technology (a weaker performing sector)
- For the quarter, absolute and relative performance were quite strong. Given the market's tilt towards growth and the strength of highly leveraged, loss making companies with bottom quintile Returns on Invested Capital, we were quite pleased with the Mid Cap strategy's outperformance, despite these headwinds to our higher quality portfolio.
- We do not view the opportunity set through the lens of Growth or Value, instead believing that financial strength and profitability are critical to constructing concentrated portfolios capable of delivering downside protection over full market cycles. By that measure, we believe the Mid Cap portfolio remains built for long-term durability.

Top 3 Contributors to Relative Performance

- **Entegris (ENTG)** – Despite some industry headwinds earlier in the year, ENTG continues to gain share in its specialty chemical consumable business. These results have translated to higher returns throughout the year. Long-term growth drivers around advanced nodes, higher materials per wafer and higher purity requirements should add to further share gain.
- **Copart (CPRT)** – CPRT rallied after reporting a solid quarter led by strong average selling prices, international buyers, and better mix. This quarter highlighted how resilient this business model is and how it continues to strengthen. CPRT is benefiting from structural shifts in the industry such as increase in vehicle complexity, higher repair costs & stronger auction involvement.
- **Cintas (CTAS)** – Once again, CTAS exceeded expectations as lockdown and quarantine orders were lifted. Revenue benefited by large surges in orders of first aid and safety services. Margins meaningfully improved due to reduced expenses.

Top 3 Detractors from Relative Performance

- **Perrigo (PRGO)** – PRGO traded down following its 2Q20 earnings release; investors were likely disappointed that management only reaffirmed guidance rather than raising it. In addition, ProAir was recalled despite having finally obtained FDA approval earlier in the year.
- **Armstrong World Industries (AWI)** – AWI struggled after reporting a rough 2Q20, as mandatory shutdowns in their top 7 markets disproportionately hurt sales and margins. As a result, management issued second half guidance below consensus.
- **NewMarket (NEU)** – Despite a rebound in the economy, NEU declined during Q3 due to its nearly 100% exposure to the automotive industry and miles driven by motor vehicles. NEU's 2Q20 earnings weaker than expected, as management highlighted that the global transportation market came to a near halt during early 2020 which greatly affected the consumption of NEU's products.

Trades During the Quarter

- **Reduced: Brown-Forman (BF.B), Old Dominion Freight Line (ODFL) & Cintas (CTAS)** – Trims reflect the recent strength of the stocks, market caps exceeding \$30B, and the resulting elevated valuations. We remain attracted to the fundamentals of these companies, but felt smaller positions were warranted.
- **Initiated: Steris (STE)** – STE is a provider of equipment, consumables, and services to hospitals, medical device and pharmaceutical manufacturers. STE is the US market leader (~50% share) in sterilization equipment for hospitals and contract sterilization for medical device OEMs. We believe STE's geographic scale and scope of product offerings is a key competitive advantage in an industry where products are mission critical to customers. We believe there is a quality compounding story here with secular tailwinds from an aging population and the growth of procedures combined with margin expansion potential. STE maintains a strong balance sheet with room for optimization.
- **Increased: HD Supply (HDS)** – Addition reflects growing conviction in the strength of the facilities management business and pending sale of the construction and industrials business.

Looking Ahead

We are encouraged by the improvement in the economic data, but risks remain. In the near term, the US economy faces the dual risks of a possible spike in the virus potentially leading to delayed openings or business closings, and reduced unemployment benefits possibly limiting consumer income and consumer spending. In that environment, combined with relatively high valuations for stocks (20x P/E and 16x EV/EBITDA), we expect significant share price volatility. Longer term, we remain optimistic about the prospects for the economy. While we believe the risks and rewards are somewhat balanced as they relate to stocks overall, we always remain cautious and focus on limiting downside in each holding. Fortunately, we are still finding high conviction investment ideas with quality attributes to populate the portfolios.

Performance

As of September 30, 2020

	QTD	YTD	Annualized			
			One Year	Three Years	Five Years	Inception to Date
Composite						
Gross	8.1	-1.5	3.7	12.3	13.8	13.3
Net	8.0	-1.8	3.4	11.8	13.4	12.9
Russell Midcap	7.5	-2.4	4.6	7.1	10.1	10.9

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Disclosure notes

The London Company's performances are size weighted and annualized based on calculations for the period ending September 30, 2020. The characteristics discussed herein relate to a representative account, and not every client's account will have these exact characteristics. As London manages its client portfolios according to each client's specific investment needs and circumstances, London cannot affirm that the characteristics of the account shown are similar to all accounts participating in the strategy. This is due in part to the timing of trades by the Adviser, market conditions, cash availability, and the timing of client deposits and withdrawals. Therefore, prospective clients should not assume that similar performance results to those shown would have been achieved for their accounts had they been invested in the strategy during the period. None of the information contained herein should be construed as an offer to buy or sell securities, or as investment recommendations. An investment in a London Company strategy is subject to risks, including the loss of principal.

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Composite Creation/**Inception Date:** March 31, 2012

Composite Definition: The Mid Cap equity strategy invests mainly in conservative, low-beta mid cap equities with a focus on above-average downside protection. Primarily, we seek profitable,

financially stable mid cap companies that consistently generate free cash flow, high returns on unleveraged operating capital, trade at significant discounts to their intrinsic values, and are run by shareholder-oriented management. Positions are usually within the market capitalization range of the major, domestic mid cap indices. Accounts in this product composite are fully discretionary taxable and tax-exempt portfolios with a minimum of \$100,000 in assets. This product is measured against the Russell Mid Cap Index and has a creation and inception date of March 31, 2012. There is no use of leverage, derivatives or short positions. All actual fee-paying discretionary portfolios are included in one or more composites that have been managed for a full calendar quarter with limited restrictions and similar objectives. Composite may include accounts under dual contract.

Benchmark Description: Primary: Russell Midcap Index measures the performance of the mid-cap segment of the U.S. equity universe. The Russell Midcap is a subset of the Russell 1000 Index. It includes approximately 800 of the smallest securities based on a combination of their market cap and current index membership. Secondary: Russell Midcap Value Index measures the performance of the mid-cap segment of the U.S. equity universe. It includes those Russell Midcap Index companies with lower price-to-book ratios and lower forecasted growth values. Benchmark returns are not covered by the report of independent verifiers.

Performance and Fees: Gross of fee returns are calculated gross of management and custodian fees and net of transaction costs. Net of fee returns are calculated net of actual management fees and transaction costs and gross of custodian and other fees. Returns may be net of miscellaneous fund expenses. The gross figures do not reflect the deduction of investment advisory fees. For example, an account that earned 15% per year for 10 years would have an accumulated return of 305% before fees and 270% after fees, assuming a 1% fee. Returns are calculated and stated in US dollars. Returns are calculated gross

of withholding taxes on foreign dividends and interest. Dividends are reinvested. Policies for valuing portfolios, calculating performance, and preparing compliant presentations are available upon request.

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