Q1 | 2021

Mid Cap

THE LONDON COMPANY

Market Observations & Portfolio Commentary

Quarterly Market Update

US equities rallied during Q1 across major indexes and the market cap spectrum. Gains were driven by improving economic data, an accommodative Federal Reserve, recent fiscal stimulus, and continued progress with the rollout of vaccines to fight COVID. Small cap shares led the way with a 12.7% increase in the Russell 2000 Index. The Value indexes significantly outperformed the Growth indexes across the market cap spectrum. Cyclical sectors outperformed the more defensive sectors in the large and mid-cap space, while defensive sectors outperformed in small cap. With regard to factors driving performance during Q1, Value, Yield, and Volatility had a positive influence on relative returns. Growth, Momentum, and Quality factors had a mixed impact.

Key Performance Takeaways for the Quarter

- The London Company Mid Cap portfolio returned 6.2% gross (6.1% net) during the quarter vs. a 13.1% increase in the Russell Midcap Value Index. Both sector exposure and stock selection were headwinds to relative performance.
- We are bottom-up stock pickers, but sector exposures influenced relative performance as follows:
  - *What Helped*: Underweight Utilities & Real Estate (two weaker performing sectors)
  - *What Hurt*: Underweight Energy (best performing sector) & overweight Info. Technology (a weaker performing sector)
- Expectations for strong real GDP growth in 2021 led to a rally in higher beta and traditional value (older businesses most leveraged to the overall economy) companies. The Mid Cap portfolio did not keep pace with the double digit returns for the Value index. Similar to Q4'20, our Quality focus with defensive, lower beta positioning was out of favor in this risk-on, pro-cyclical environment. We would not expect to outperform in a strong market, driven by high beta and low quality.

Top 3 Contributors to Relative Performance

- **CarMax (KMX)** – KMX shares rallied during Q1, as it's omni-channel business, digital enhancements and strategic initiatives have been paying dividends. KMX is generating higher incremental sales with a lower cost structure and its lending business is generating strong returns.
- **Old Dominion Freight Line (ODFL)** – ODFL reported very strong results with a record operating ratio that shows no sign of stopping improvement. Revenue per shipment accelerated and yields improved even more as ODFL remained true to its pricing and customer service strategies. ODFL and other stocks of LTL providers have done very well on rising spot rates (that turn into higher contract rates) and the improving economic backdrop.
- **Skyworks (SWKS)** – SWKS outperformed in Q1 following its better than expected 4Q20 earnings report. Total revenue was up 69% vs. last year driven by broad 5G momentum and sales into Apple's product launches. SWKS indicated this was just the beginning of the 5G cycle and even suggested that Apple would be a significant source of growth for them for years.

Top 3 Detractors from Relative Performance

- **Copart (CPRT)** – CPRT underperformed during Q1 due to concerns around the sustainability of average selling prices and lack of volume growth. That said, the quarterly results were impressive with margin expansion and market share gains.
- **Black Knight (BKI)** – BKI underperformed during Q1 following weaker than expected guidance from management during its earnings conference call. Guidance was weighed down by a number of factors including: the foreclosure moratorium, a very difficult origination volume comparison vs 2020, and COVID cost reductions to revert back to normalized levels.
- **Brown-Forman (BF.B)** – BF.B shares fell 13% during Q1. BF.B was negatively impacted by some cost pressures in the business which led to lower gross margins in recent results.

Trades During the Quarter

- **Exited: Fox Corp. (FOXA)** – Sale reflects concerns around cord cutting and greater competition for Fox News.
- **Exited: Axalta (AXTA)** – Sale reflects our lower conviction in this smaller position in the portfolio as well as the desire to reduce exposure to the Materials sector.
- **Reduced: Amphenol (APH)** – Trimmed our position as APH's market cap now exceeds $37B. We typically start moving stocks out of the Mid Cap portfolio once the market cap exceeds $30B.
- **Initiated: Otis Worldwide (OTIS)** – OTIS is the world's largest elevator and escalator producer and service company. About 75% of revenues are derived internationally, and revenue mix from services is 50-60%. Since OTIS is the largest player globally, it benefits from scale advantages, resulting in best-in-class margins. The business is very capital-light, because assembly takes place at the customer premise, and combined with upfront payments translates into negative working capital needs. As a result, OTIS operates with very high cash conversion ratios and returns on capital. Leading the industry with service contracts, OTIS enjoys stable recurring revenues and maintains a strong balance sheet.
- **Initiated: AptarGroup (ATR)** – ATR is the leader in consumer dispensing and drug delivery systems, offering specialized and turnkey products (e.g. aerosol valves, pumps, closures, etc.). ATR primarily sells in the beauty, personal care, prescription, and food end markets with #1 or #2 market share in its product categories. The size, breadth and quality of ATR's product portfolio is impressively differentiated, and they lead the industry in innovation and patents. Its pharma segment is responsible for the majority of ATR's profits, where its moat is reinforced by big barriers to entry and high regularity switching costs. It is well positioned to expand internationally and experience growth in both defensive (pharma) and cyclical markets (personal care, beauty, home & food). ATR's balance sheet is strong, and we believe the valuation is attractive.

Looking Ahead

We maintain a positive view on the economy and expect strong real GDP growth in 2021. The reopening of parts of the economy, continued success with the rollout of vaccines to help eliminate the coronavirus, additional fiscal stimulus, and accommodative policies from the Federal Reserve are all positives. However, the coronavirus remains an issue. In terms of the equity market, we recognize valuations are on the rich side, while interest rates will likely remain low vs. history. At current valuations along with various short term risks to the economic outlook, we expect greater volatility and possibly more muted returns in the near term. Longer-term, we continue to believe quality attributes and solid company fundamentals will lead to strong risk adjusted returns over time.

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Performance

As of March 31, 2021

	QTD	YTD	One Year	Three Years	Five Years	Inception to Date
Mid Cap (Gross)	6.2	6.2	55.2	16.7	16.9	15.0
Mid Cap (Net)	6.1	6.1	54.8	16.3	16.5	14.5
Russell Mid Cap Value	13.1	13.1	73.8	10.7	11.6	12.1

Inception date: 3/31/2012

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Disclosure notes

The London Company's performances are size weighted and annualized based on calculations for the period ending March 31, 2021. 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. The Mid Cap product is typically compared to the Russell Mid Cap Index. Any comparison to the Russell Mid Cap Value is for illustrative purposes only.

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 investments, calculating performance, and preparing GIPS Reports are available upon request.

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