Q2 | 2021

Mid Cap

THE LONDON COMPANY

Market Observations & Portfolio Commentary

Quarterly Market Update

US stocks posted mid to high single digit gains during Q2. Solid economic data and improving corporate earnings were positives, partially offset by concerns about rising inflation, the timing of potential changes to monetary policy from the Fed, and the possibility of future tax increases. Growth outperformed Value across the market cap spectrum except in the Small Cap space. For the most part, cyclical sectors outperformed defensive, though it was mixed among mid and Large Cap stocks. With regard to factors driving performance during Q2, the dynamics weren't linear down the market cap spectrum. Amid Large Cap stocks, Growth and Quality factors had the most positive impact on relative performance, while Value factors had a negative impact. Amid Mid and Small Cap stocks, Volatility and Yield had the most positive impact, while the remaining factors produced mixed results.

Key Performance Takeaways for the Quarter

- The London Company Mid Cap portfolio returned 3.3% gross (3.2% net) during the quarter vs. a 5.7% 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 & Comm. Services (two weaker performing sectors)
  - *What Hurt*: Underweight Energy (best performing sector) & overweight Info. Technology (a weaker performing sector)
- The Mid Cap portfolio trailed the benchmark in Q2, which isn't surprising given the continued low quality, high beta leadership environment amid Mid & Small Cap stocks. We did have a couple holdings stumble during the quarter, which detracted from short-term performance, but nearly all of the recent performance shortfall during this recovery can be attributed to what we don't own versus what we do.
- In our view, quality appears poised for relative strength, especially if volatility levels increase. As recoveries mature and approach mid-cycle, market breadth typically narrows and quality factors tend to shine. Further, as a result of outlier underperformance in this recovery, quality stocks are now trading at the biggest discount to the broader market in the past 20 years.

Top 3 Contributors to Relative Performance

- **Copart (CPRT)** – CPRT performed well in Q2, reflecting solid momentum and market share gains. Average selling prices remain strong, which helped the top and bottom line. CPRT benefits from structural shifts in the industry such as an increase in vehicle complexity, higher repair costs, and stronger auction involvement (international buyers). CPRT has leading market share in all of its markets and continues to widen its moat with capacity expansions, which is especially beneficial as volume returns. The fundamentals and trends remain strong.
- **Armstrong World Industries (AWI)** – AWI continued its rally in Q2 reflecting improving market conditions and an increased normalization of business/office space operations. The Architectural Billing Index (ABI) is a leading indicator for AWI's business and hit its highest score in April and May since pre-2008. Lastly, the company saw a quicker than expected recovery in pricing during the quarter.
- **Otis Elevators (OTIS)** – OTIS rallied roughly 20% in Q2. Recent results have been strong with organic growth over 10% and margin improvement. We remain attracted to the recurring revenue stream from long term contracts.

Top 3 Detractors from Relative Performance

- **Haemonetics (HAE)** – HAE declined roughly 40% during Q2 following the announcement of the pending loss of a large client. Investors remained concerned about the loss of a large client, but also the possibility that other clients won't want (or need) to pay up for the newer technology in Nexsys PCS. Following the significant drop in the share price, we decided to maintain the position. We continue to hold reflecting the opportunity for growth in the plasma division and pricing gains from the new system, Nexsys PCS. Many of HAE's clients have already upgraded to the new system, including three of the company's largest clients (Takeda, Grifols, and Octapharma) with no issues.
- **Citrix (CTXS)** – CTXS underperformed the broader market after reporting quarterly results that disappointed investors. Supply chain shortages were a challenge, plus renewal rates fell short of expectations for some of its limited-use short-term contracts signed at the beginning of COVID. CTXS' transition to a subscription model is complete, which should provide more consistency in results going forward. We remain attracted to the company' strong positioning in an environment that will likely value more flexible work solutions in the future.
- **Dollar Tree (DLTR) –** DLTR sold off following its 1Q earnings report where it revealed expectations for outsized pressure from freight inflation. Given the fixed $1 price point, DLTR has less ability than other retailers to combat inflation in the short-term. Management is optimistic about the growth potential and the balance sheet is being used for high-return initiatives such as new store growth and the multi-price point offering.

Trades During the Quarter

There were no trades during the quarter.

Looking Ahead

We maintain a positive view on the US economy and expect strong real GDP growth in 2021. Nearly half of the population has been vaccinated, and most of the economy has re-opened. The US consumer is in great shape and labor markets continue to improve. Separately, the manufacturing and services segments of the economy are firmly in expansionary territory. Fiscal and monetary policy should continue to be accommodative in the near-term. Despite the positives, we recognize that risks remain. Inflation concerns, talk of tax hikes, elevated equity valuations, some fiscal stimulus rolling off, and a more reactive Fed are noteworthy factors looming over markets. While we believe fundamental conditions remain positive, we note a confluence of market concerns could lead to increased volatility and more muted returns for equities in the near term. As we look at the characteristics of our portfolios today, the positioning is the best it's been in a number of years. Returns on capital and balance sheet strength continue to be very healthy. Given the level of quality, it is abnormal to see our portfolios trade at such attractive valuations relative to the respective benchmarks. We believe this will serve us well for both near-term volatility and long-term durability.

Past performance should not be taken as a guarantee of future results.

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Performance

As of June 30, 2021

	QTD	YTD	One Year	Three Years	Five Years	Inception to Date
Mid Cap (Gross)	3.3	9.7	35.4	16.3	16.9	15.0
Mid Cap (Net)	3.2	9.5	35.0	15.9	16.4	14.5
Russell Mid Cap Value	5.7	19.5	53.1	11.9	11.8	12.4

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Contact information

The London Company
of Virginia, LLC
1800 Bayberry Court, Suite 301
Richmond, VA 23226

T 804.709.1244
F 804.649.9447
info@TLCAdvisory.com
www.TLCAdvisory.com

Disclosure notes

The London Company's performances are size weighted and annualized based on calculations for the period ending June 30, 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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