Q1 | 2021

SMID 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 Small-Mid Cap portfolio returned 8.3% gross (8.1% net) during the quarter vs. a 16.8% increase in the Russell 2500 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 (the weakest performing sector) & overweight Cons. Discretionary (a better performing sector)
  - *What Hurt*: Underweight Energy (the 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 Small-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 in 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.
- **MBIA (MBI)** – MBI was up 45% during Q1. MBI is no longer writing business, but is running off its book. Part of its run-off strategy is returning cash to shareholders via share repurchase. MBI trades at a discount to adjusted book value and we believe MBI will continue to return excess capital to shareholders.
- **Hanover Insurance Group (THG)** – In Q1, we initiated our position, and it subsequently benefited from a rise in interest rate expectations, like most other financial services companies..

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.
- **Cannae Holdings (CNNE)** – After a strong rally to end 2020, CNNE underperformed in Q1. CNNE's investments in Dun & Bradstreet and Ceridian pulled back during the period. CNNE's largest investment, DNB is in a turnaround and still suffering from COVID-related headwinds. We maintain confidence in management and believe CNNE is attractively valued.
- **STORE Capital (STOR)** – STOR underperformed along other triple-net REIT peers on rising interest rates. Fundamentals continue to improve with collections now above 90% and investment activity rebounding. STOR also announced the pending retirement its CFO. We maintain confidence in the management team and our favorable view of STOR.

Trades During the Quarter

- **Exited: Dollar Tree (DLTR) –** Sale reflects DLTR's strong performance and its higher market cap, which now exceeds $20B. At that size, we start to move holdings out of the portfolio.
- **Reduced: Old Dominion Freight Line (ODFL), Martin Marietta (MLM) & CarMax (KMX)** – Similar to DLTR, the trims reflect the recent rally in these holdings and the increase in market cap, which are now roughly $20B for each company.
- **Initiated: Hanover Insurance Group (THG)** – THG is an underwriter of property and casualty insurance, and distributes its policies exclusively via independent agencies. We believe the overall P&C industry is in the early stages of a hard market, which means increasing pricing across most lines, and we think THG should disproportionately benefit given its superior underwriting capabilities. THG possesses unprecedented visibility into its end-markets via its unique customer data collection technology that plugs into its partners' agency management systems. This system provides improved risk selection capabilities and allows THG to be very discerning in where it wants to compete. Management has an excellent track record of capital allocation decisions and improving ROE. Further, we estimate THG's balance sheet has never been stronger and it trades at a discount to its peers.
- **Initiated: Jack Henry (JKHY)** – JKHY provides core processing services and add-on products to banks and credit unions. These systems are the key technology infrastructure that provide the primary accounting tools for the financial institution. It is a consolidated industry with top players controlling more than 75% of the market. The basic business model is very attractive with 85% reoccurring revenue, 5-10 year contracts and high switching costs. This translates into high incremental margins and attractive return on capital. JKHY maintains a very strong balance sheet. We believe JKHY trades at an attractive valuation and the recent purchase from long term director gave us additional confidence in the stock.

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 Fed 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 that 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	Ten Years	Inception to Date
SMID Cap (Gross)	8.3	8.3	56.6	14.7	13.9	12.9	17.2
SMID Cap (Net)	8.1	8.1	55.4	13.9	13.0	12.0	16.3
Russell 2500 Value	16.8	16.8	87.5	10.9	12.2	10.2	15.1

Inception date: 3/31/2009

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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, 2009

Composite Definition: The Small-Mid Cap strategy is an extension of our Small Cap strategy with weighted market capitalization higher than our Small Cap portfolio, and is within the market capitalization ranges of the major domestic small to mid cap indices. Accounts in this product composite are fully discretionary taxable and tax-exempt portfolios with a minimum of $100,000 in assets. The product is measured against the Russell 2500 Index and has a creation and inception date of March 31, 2009. 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 2500 Index measures the performance of the small to mid-cap segment of the U.S. equity universe, commonly referred to as "smid" cap. Russell 2500 is a subset of the Russell 3000 Index. It includes approximately 2500 of the smallest securities based on a combination of their market cap and current index membership. Secondary: Russell 2500 Value Index measures the performance of the small to mid-cap segment of the U.S equity universe. It includes those Russell 2500 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 SMID Cap product is typically compared to the Russell 2500 Index. Any comparison to the Russell 2500 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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