

Portfolio Commentary

2021 Market Update

US stocks posted another year of double-digit returns and new all-time highs. A strong rebound in the US economy in 2021 and historically strong earnings momentum offset concerns over COVID-19 variants, elevated inflation and pandemic related supply chain disruptions.

On balance, it was a micro-driven year, and the market rewarded profitability across sectors, size and styles. Large Cap stocks led Smaller Caps. Stylistically, Growth outperformed Value in the Large Cap space, while Value significantly led Growth among Small and Mid Caps. Defensive shares outperformed the more cyclical shares, but the difference in returns was more evident in the Small Cap space. With regard to factors driving performance, most categories had a positive influence on returns, but the results were mixed within Growth, Volatility, and Momentum factors.

Key Performance Takeaways

The London Company Small Cap portfolio returned 20.9% gross (20.0% net) for the year vs. a 14.8% increase in the Russell 2000 Index. Sector exposure contributed to relative outperformance, partially offset by stock selection.

We are bottom-up stock pickers, but sector exposures influenced relative performance as follows:

- What Helped: Underweight Healthcare (the weakest performing sector) & overweight Industrials (a better performing sector)
- What Hurt: Underweight Energy & Financials (two better performing sectors)

A strong rally in Q4 led to better than expected relative returns for the year. As the year progressed, the market rewarded profitable companies and penalized expensive, non-earners—which was a welcome reversal from 2020. Unprofitable, growth oriented Healthcare and Tech companies in the Small Cap space were among the hardest hit. The Small Cap portfolio participated in the Quality rebound, and our companies played particularly solid defense amidst second half volatility of 2021, leading to significant outperformance.

Top 3 Contributors to Relative Performance

Tempur-Sealy (TPX) – TPX experienced significant gains in 2021 as mattress demand outstripped supply. Sales growth was broad-based, largely driven by market share gains and expanded distribution. Industry dynamics have also benefitted from retail rationalization and a strong US housing market.

Penske Automotive (PAG) – PAG's outperformance in 2021 was primarily driven by the strong market backdrop for auto dealers. Resilient demand and attractive pricing for cars and trucks led to enhanced profitability and significant free cash flow generation throughout the year.

Murphy USA (MUSA) – MUSA outperformed in 2021 as the business continues to display fundamental improvement. Fuel margins are rising due to a more consolidated and rational industry. Plus, MUSA's push into food & beverages is having a positive impact on foot traffic and margins. Management continues to boast shareholder friendly capital allocation policies with the recent \$1B share repurchase authorization (25% of market cap) and 16% increase in the dividend.

Top 3 Detractors from Relative Performance

Haemonetics (HAE) – Shares of HAE underperformed the broader market following the announcement of the pending loss of a large client early in the year. Late in 2021, the surprise retirement of the CEO and lower guidance led to additional weakness in the shares. We continue to hold the stock reflecting the opportunity for growth in the plasma division and pricing gains from the new system, Nexsys PCS. HAE has attractive financial characteristics including mix toward consumables (low cyclical), attractive margins (high teens EBIT), and high ROIC.

NewMarket (NEU) – NEU shares declined in 2021 reflecting weaker earnings driven by rising oil and base oil prices combined with growing concerns over the ramp of hybrid and electric vehicles. NEU's margins tend to suffer in periods of rising base oil prices until they roll over and NEU can capture the lag in spreads. We remain attracted to NEU's positioning in the consolidated market for fuel additives and lubricants, its valuation and strong balance sheet.

Kaman (KAMN) – 2021 was a challenging year for KAMN given their exposure to commercial aviation (~35% of sales), which has yet to recover to pre-pandemic levels, and the lapping of peak fuze sales in 2020. The JPF fuze program is mature, so this decline was well communicated beforehand. There has been margin pressure as mix shifts away from this higher-margin item. KAMN is ramping up R&D in the space of highly engineered bearings, fuze technologies, and autonomous aircrafts to help offset pressure from the declining product line.

Portfolio Characteristics & Positioning

We believe the Small Cap strategy is well positioned based on the strength of the companies owned and the overall quality characteristics of the portfolio—measured by sustainably high returns on capital and modest leverage. The market is expensive by historical standards, but the portfolio still trades at a discount to the index. We feel this enhances our margin of safety on the downside, but also provides room for further upside should the market grind higher from these levels.

Portfolio Characteristics	Small Cap	Russell 2000
Pre-tax ROC (3 yr. avg.%)	13.5%	5.2%
Net Debt/EBITDA	1.4x	3.0x
Enterprise Value/EBITDA	15.3x	15.8x

Source: FactSet

Given this unique backdrop, we believe a long term-approach, with a focus on quality factors that may help dampen volatility, will reward investors.

Looking Ahead

We remain positive regarding the economic outlook. As we enter 2022, we expect solid, but moderating economic growth. COVID remains a risk; but fortunately, the latest Omicron wave appears to be having less of an impact on the broader economy than prior variants. Meanwhile, inflation is still elevated, and the Fed is set to reverse accommodative monetary policy, which could further weigh on economic growth. In terms of the equity market, we recognize valuations are on the rich side, while interest rates will likely remain low vs. history.

The Fed is expected to begin increasing the funds rate later in 2022, but the increases will likely be in small increments. At current valuations along with various short term risks to the economic outlook (rising inflation, higher interest rates, potential tax increases), we expect greater volatility and possibly more muted returns in the near term. Given this backdrop, we believe a long term-approach, with a focus on Quality factors that may help dampen volatility, will reward investors.

Annualized Returns

As of 12/31/2021

	QTD	1Y	3Y	5Y	10Y	ITD
Small Cap Gross	8.6%	20.9%	20.2%	11.2%	11.3%	13.2%
Small Cap Net	8.4%	20.0%	19.3%	10.4%	10.5%	12.6%
Russell 2000	2.1%	14.8%	20.0%	12.0%	13.2%	9.2%

Disclosure Notes

The London Company's performances are size weighted and annualized based on calculations for the period ending December 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 Advisor, 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: September 30, 1999

Composite Definition: The Small Cap strategy invests mainly in conservative, low-beta, small-cap equities with a focus on above-average downside protection. Primarily we seek profitable, financially stable small-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 small-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 2000 Index and has a creation and inception date of September 30, 1999. 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 2000 Index measures the performance of the small-cap segment of the U.S. equity universe. Russell 2000 is a subset of the Russell 3000 Index representing approximately 10% of the total market capitalization of that index. It includes approximately 2000 of the smallest securities based on a combination of their market cap and current index membership. Secondary: Russell 2000 Value Index measures the performance of the small-cap segment of the U.S. equity universe. It includes those Russell 2000 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 U.S. 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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