Portfolio Commentary

Market Update

U.S. stocks posted solid gains in 1Q as stable economic growth, decelerating inflation, and some weakening in the labor market suggest a greater chance of a soft landing. Still, sticky inflation data and a tight labor market pushed out the timeline for the Fed's first rate cut, leading to a rise in yields. Nevertheless, the S&P 500 notched its strongest start since 2019. For the quarter, the broader market, as measured by the Russell 3000 Index, rose 10%. Stocks were higher across the market cap spectrum, but larger companies exposed to growth factors posted the strongest gains. The Artificial Intelligence (AI) hype that powered 2023's market rally extended its momentum into 2024. Although there were signs of some rotation away from the dominance of mega-caps, leadership dynamics largely remained unchanged. Market performance continued to be driven by Momentum, Growth, and Volatility market factors, while Yield, Value, and Quality factors lagged behind.

Key Performance Takeaways

The London Company Small-Mid Cap portfolio gained 9.4% (9.2% net) during the quarter vs. a 6.9% increase in the Russell 2500 Index. Both stock selection and sector exposure aided relative performance.

The Small-Mid portfolio produced solid absolute and relative performance in 1Q, exceeding our upside capture expectations of 85-90%. Our Quality orientation continued to stand out down the market cap spectrum where earnings weakness was more pervasive. Company fundamentals continued to drive price, and the strong balance sheets of our companies—many with net cash—remained a significant advantage in this high rate environment.

Top 3 Contributors to Relative Performance

Deckers Outdoor (DECK) – DECK continued to produce strong performance in 1Q. DECK thoughtfully manages top brands in the footwear industry, which has allowed them to outperform other retailers in the current environment. UGG and HOKA are benefitting from brand heat, and management remains focused on acquiring and retaining customers. DECK continues to diversify revenue through the growth of HOKA (non-seasonal), and the expansion of UGG into new categories. The cash balance sheet with no debt provides an additional element of downside protection.

Armstrong World Industries (AWI) – AWI was up 27% in 1Q after reporting strong quarterly results while providing solid guidance. AWI is executing effectively on key growth initiatives, leveraging pricing power, and demonstrating earnings resiliency. We remain attracted to the business because of its strong pricing power, annuity-like nature of the remodel portion of the business (roughly 70% of revenue), and management's excellent capital allocation.

Lancaster Colony (LANC) – LANC was not immune to pressures across the packaged food industry last year, but began this year on a strong note. Margins in 4Q surprised to the upside, helped by commodity deflation in key ingredients. More importantly, both the Enterprise Resource Planning (ERP) implementation and capacity expansion projects are behind the company and we see an attractive runway for cash flow to expand in coming years. Trailing twelve-month free cash flow at LANC doubled from 2022 to 2023. The cash balance sheet with no debt provides an additional element of downside protection.

Top 3 Detractors from Relative Performance

Endava (DAVA) – DAVA's 4Q earnings were challenging and management reduced guidance due to client spend not materializing. We believe that can be attributed to high concentrations in the payments and financial services verticals, and those clients are being extra cautious with committing to new projects. However, the bigger issue to us was the announced acquisition of GalaxE, an offshore Indian outsourcer, which is a full pivot from their existing strategy and company identity.

Churchill Downs (CHDN) – CHDN underperformed during 1Q, but the business continued to perform well. With the exception of some softness in parts of the casino business, CHDN is executing well and demonstrating exemplary capital allocation. Ticket sales for the 2024 Kentucky Derby are on trend; the historical racing machine business is performing well, and TwinSpires (online horse betting) has been solid. The negative on CHDN is that leverage remains elevated following a meaningful 2022 acquisition. We view the deal as strategically sound, and we expect leverage to come down next year with robust cash generation and EBITDA growth.

Cable One (CABO) – The market environment remains challenging for CABO with greater competition and lower move activity. While the competitive threats from fixed wireless and fiber-to-the-home are not affecting CABO's existing customer base, the market's perception is that it will limit the growth opportunities for the broadband provider going forward. CABO's recent subscriber growth was driven by new pricing schemes and promotions, which negatively affected ARPU (average revenue per user) during the quarter. While investors fear this trend will continue, management remains disciplined with its pricing strategy to ensure durable free cash flow growth over the long-term. CABO remains well positioned as an advantaged provider of high-speed internet in rural markets. We believe its relatively low penetration, superior service, and M&A prowess are supportive of long-term earnings growth.

Sector Influence

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

- What Helped: Underweight Real Estate & Financials (weaker performing sectors)

- What Hurt: Underweight Energy (a better performing sector) & overweight Materials (a weaker performing sector)

Trades During the Quarter

- Reduced: **Deckers Outdoors (DECK) & Trex (TREX) –** We maintain a positive outlook for both companies, but we elected to trim our positions following very strong performance in 2023 (up 67% & 96%, respectively). With the proceeds from the trims, we initiated a position in Toro Company (TTC).
- Initiated: **Toro Company (TTC) -** TTC is a dominant player in outdoor equipment with a focus on professional-grade products. Equipment includes turf & landscape maintenance, snow & ice management, underground utility construction, specialty construction, irrigation, and outdoor lighting solutions. TTC operates through Professional & Residential segments (80% & 20% of revenues, respectively). TTC boasts an expansive dealer network, creating a natural entry barrier through exclusivities and scale. Nearly all its professional sales are non-discretionary; meanwhile, rentals & repairs constitute >25% of revenues. Brand dominance and product innovation has translated to leading market share in subcategories and impressive pricing power. TTC has a large install base with good visibility of replacement cycles (2-5 years). We're attracted to its resilient free cash flow, high ROIC, strong balance sheet, and disciplined approach to capital allocation that has increased shareholder value over time.

Looking Ahead

With slowing inflation, signs of better balance in the labor market, and normalized GDP growth expectations, the Fed will probably start to lower rates later this year. We believe the Fed will proceed with caution, attempting to balance the risk of easing policy too early against the risk of maintaining rates in a restrictive position for too long. While the odds of a recession in the near term have declined, risks remain. Longer term, we remain positive regarding the U.S. economy and expect real annualized GDP growth in the 2% range driven by growth in the labor force and improving productivity.

In terms of the equity market, we believe returns in the near term may be modest, with shareholder yield (dividends, share repurchase, debt reduction) comprising a significant percentage of the total return. After such a strong five-month rally, it's fair to question the sustainability of the market's strength. Narrow, top-heavy markets are fragile, and the recent surge in insider selling activity, especially in tech companies, likely reflects the extreme valuations and unsustainability of this AI momentum trade. The odds of a recession have come down, but our cautious posture persists due to high valuations, market concentration, looming debt challenges, and the lengthiest inversion of the yield curve in history. Continued multiple expansion in a higher rate environment is unlikely. We suspect the S&P 500 will eventually track earnings, so we would expect more volatility, especially in stocks where a lot of growth is already priced in. We see a greater opportunity for quality operators with durable cash flow generation, strong balance sheets, and attractive shareholder yields in the years ahead.

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Annualized Returns
As of 3/31/2024

	QTD	1Y	3Y	5Y	10Y	ITD
SMID Cap (Gross)	9.4%	30.0%	9.5%	13.4%	10.0%	15.6%
SMID Cap (Net)	9.2%	29.0%	8.6%	12.6%	9.2%	14.8%
Russell 2500	6.9%	21.4%	3.0%	9.9%	8.8%	14.1%

Inception date: 3/31/2009. Past performance should not be taken as a guarantee of future results. Performance is preliminary. Subject to change.

Disclosure Notes

The London Company's performances are size weighted and annualized based on calculations for the period ending March 31, 2024. 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.

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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. As of July 1, 2022 The London Company redefined the composites to exclude dual contract relationships and any potentially bundled fee scenarios. This policy is not retroactive, but will continue to apply going forward.

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.

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 London Company 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. Returns are calculated and stated in U.S. dollars. Prior to April 1, 2024 returns are calculated gross of withholding taxes on foreign dividends and interest. Starting April 1, 2024, performance is calculated net or gross of foreign withholding taxes on dividends and interest income dependent on custodian data. Dividends are reinvested. The accounts represented in the composite reflect actual London Company fees paid on the particular account which may be different from the fee normally offered to other clients. Policies for valuing investments, calculating performance, and preparing GIPS Reports are available upon request.

Past performance should not be taken as a guarantee of future results. The report is for informational purposes only. Data, while obtained from sources we believe to be reliable, cannot be guaranteed and all statistics are subject to change. The statements contained herein are solely based upon the opinions of The London Company and the data available at the time of publication of this report, and there is no assurance that any predicted results will actually occur. Information was obtained from third-party sources, which we believe to be reliable but are not guaranteed as to their accuracy or completeness. This report contains no recommendations to buy or sell any specific securities and should not be considered investment advice of any kind. An investment in a London Company strategy is subject to risks, including the loss of principal. Referenced strategies may not be suitable for all investors. The appropriateness of a particular strategy will depend on individual circumstances and objectives. In making an investment decision, individuals should utilize other information sources and the advice of their investment advisor.

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