

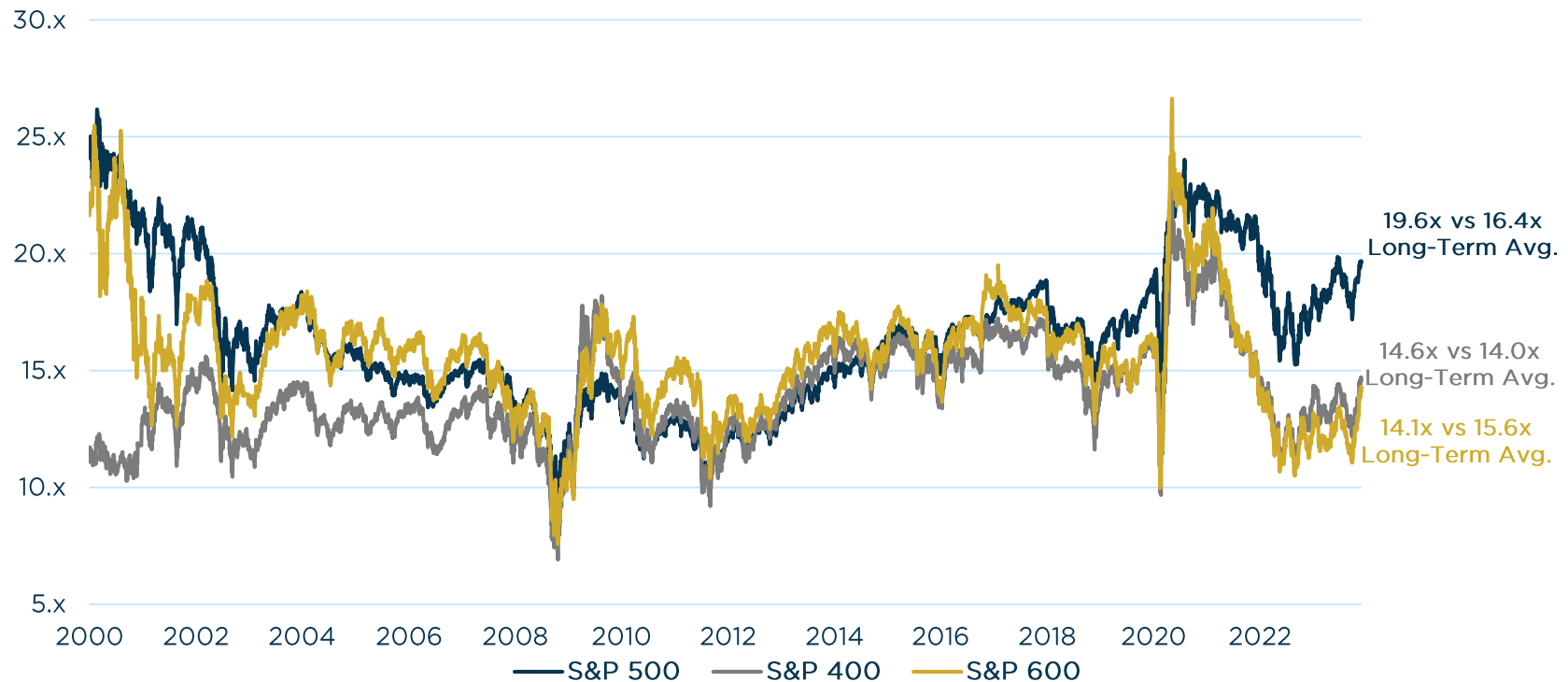
# A Time for Quality Down Cap

As of December 31, 2023

# Observations Down the Market Cap Spectrum

Valuations for Small & Mid cap stocks trade at wide relative discounts to Large Caps and attractive levels respective to historical averages, presenting a compelling opportunity for long-term investors.

### Forward P/E Valuation Multiples Over Time

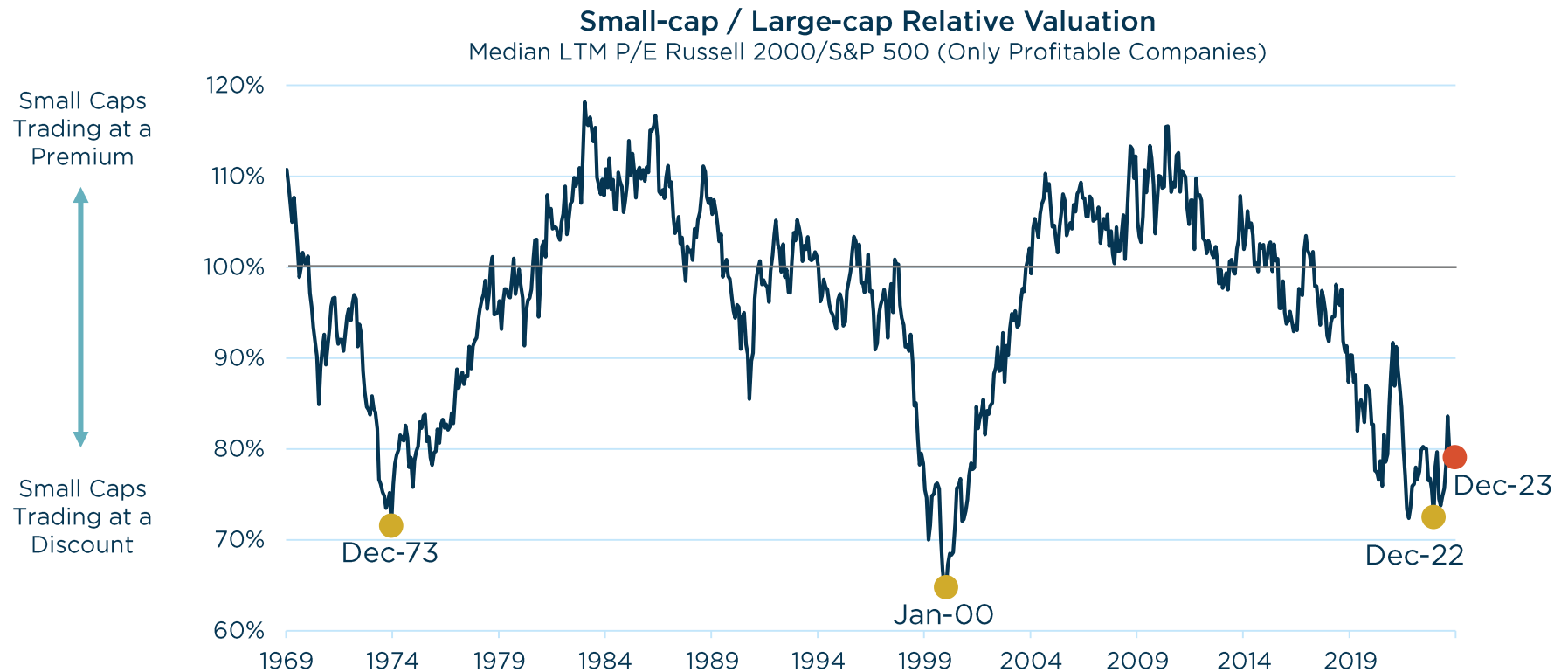


Source: FactSet. Data as of 1/31/00 - 12/31/23

# The Good News

## Small Cap Valuations Appear Attractive

Looking back over the past 50+ years, valuations of Small Cap stocks relative to Large Caps are historically attractive and at levels not seen since the early 2000s.



Source: Furey Research Partners as of 12/31/23

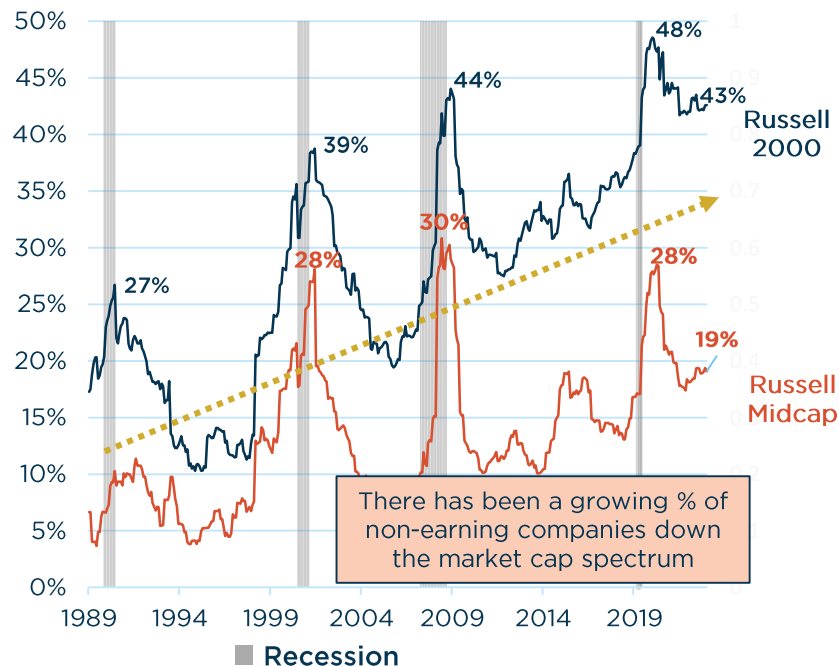
# BUT...

## There are significant challenges & key considerations

The percent of smaller cap companies with no earnings has risen significantly over the last decade. Additionally, quality has deteriorated, as leverage ratios have been increasing.

### Percent of Mid & Small Cap Non-Earners

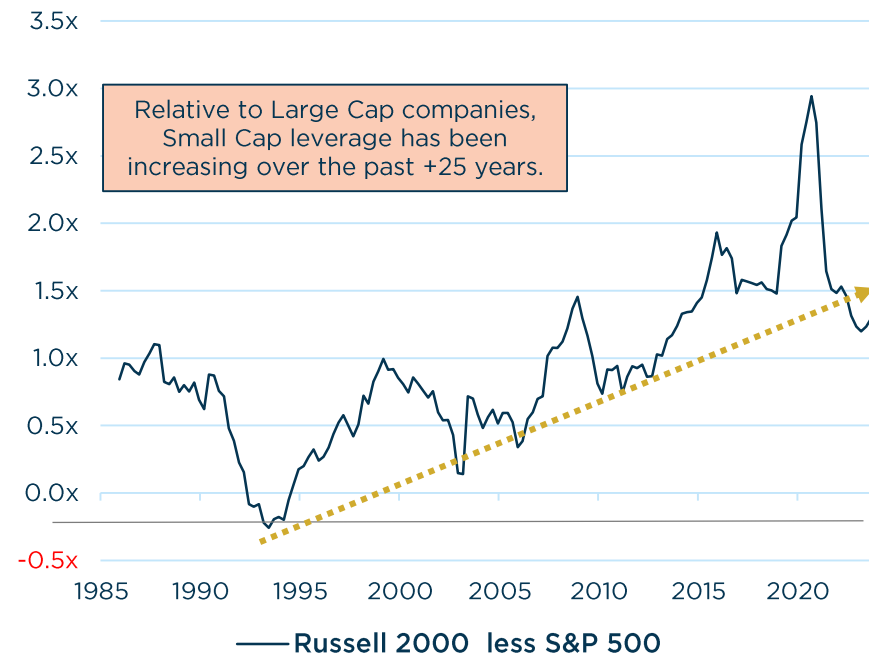
(based on companies with available data)



Source: Strategas as of 12/31/2023

### Leverage Ratio Spread

Small Caps less Large (ex. Financials)



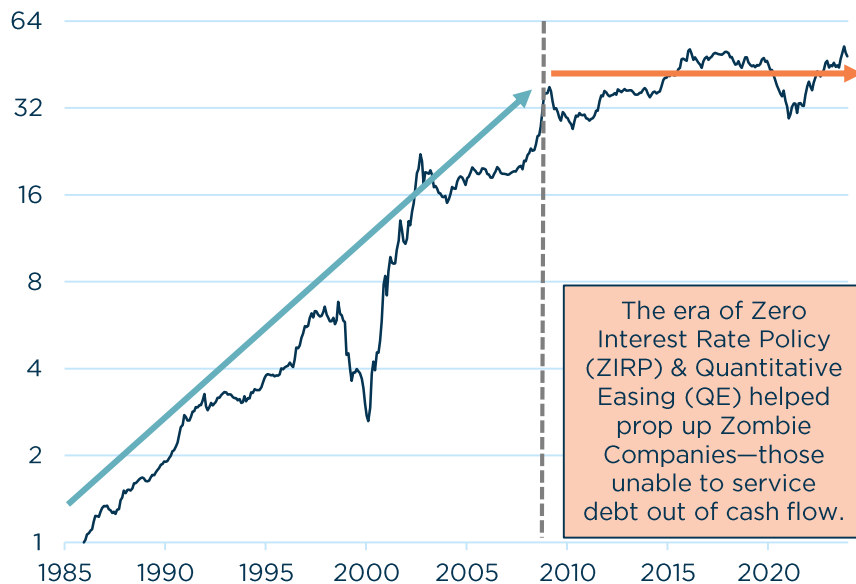
Source: Furey Research Partners as of 12/31/2023  
The leverage ratio represents Net Debt/EBITDA

# Cost of Capital in Perspective

## Historical Influence & Implications Moving Forward

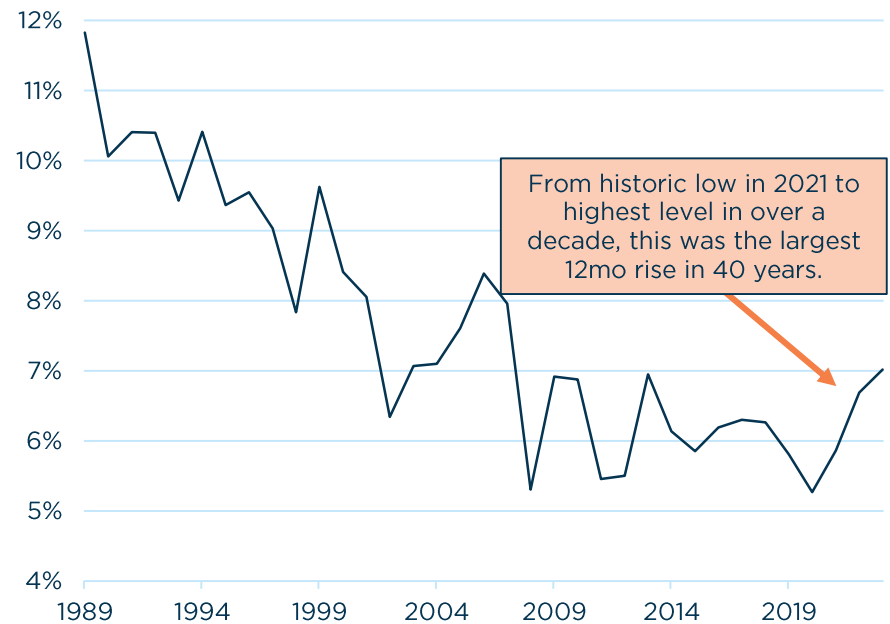
Over the past 10+ years, abundant access to cheap debt largely eliminated any performance differential between high and low quality Small Cap companies. That may be set to change.

**Russell 2000: Profitable/Unprofitable**  
Relative Performance Index (Log Scale)



Source: Furey Research Partners as of 12/31/2023

**Russell 2000 WAVG Cost of Capital (WACC)**



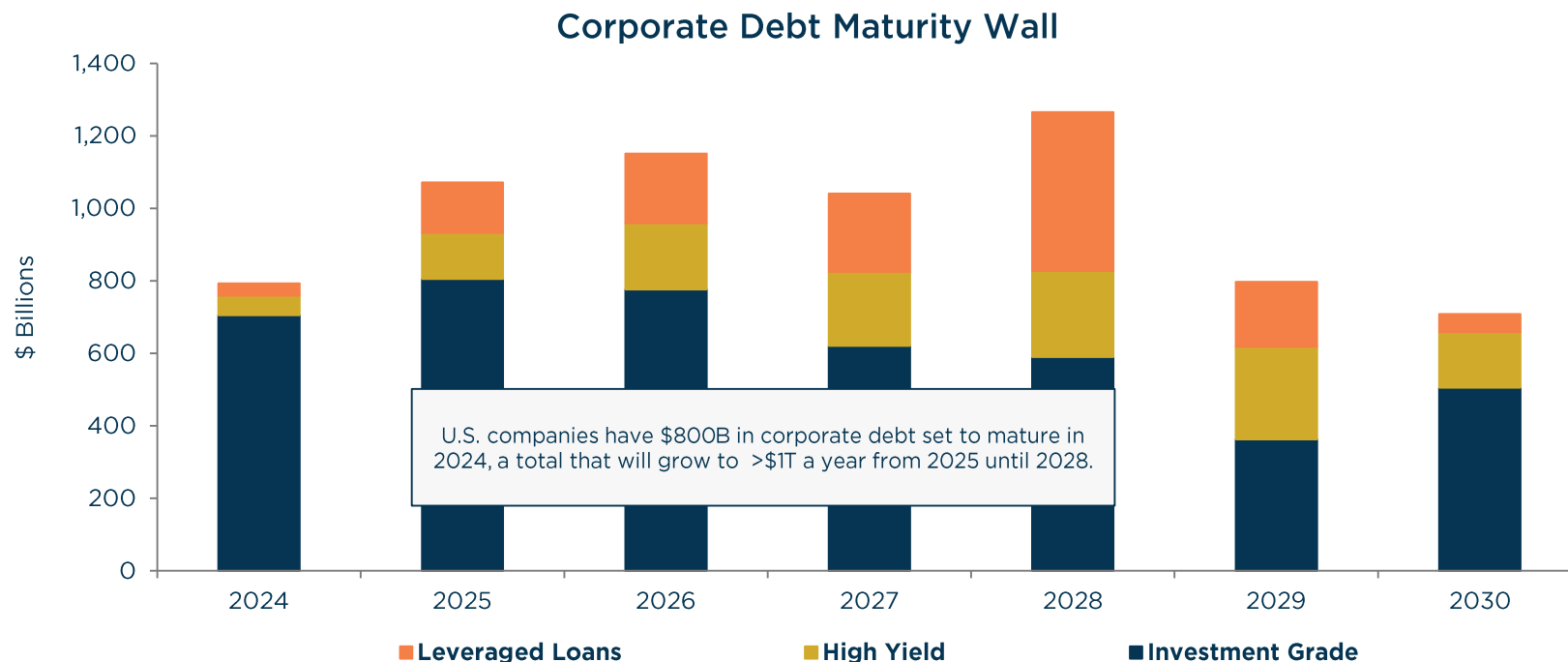
Source: Furey Research Partners as of 12/31/2023

Now that the decade of abnormally suppressed interest rates is over, the cost of capital is on the rise AND nearly 50% of S&P 1500 debt matures in the next five years when refinancing will be much more expensive.

# Looking Ahead: Debt Maturity Wall Creeping Into View

While there are still no signs of a credit crunch, rising debt servicing costs will likely become a growing part of the macro conversation, especially if rates stay ‘higher for longer.’

- Elevated debt loads coupled with the higher rates presents major refinancing risk going forward. Servicing that debt may cut into corporate profits, capital spending, hiring, economic growth and investor returns.
- Tight credit spreads are an artifact of the now-expiring stimulus effects. With the era of cheap money over, the interest burden will be going up, which will likely favor higher quality businesses with healthy balance sheets.



# Why The London Company Down Cap?

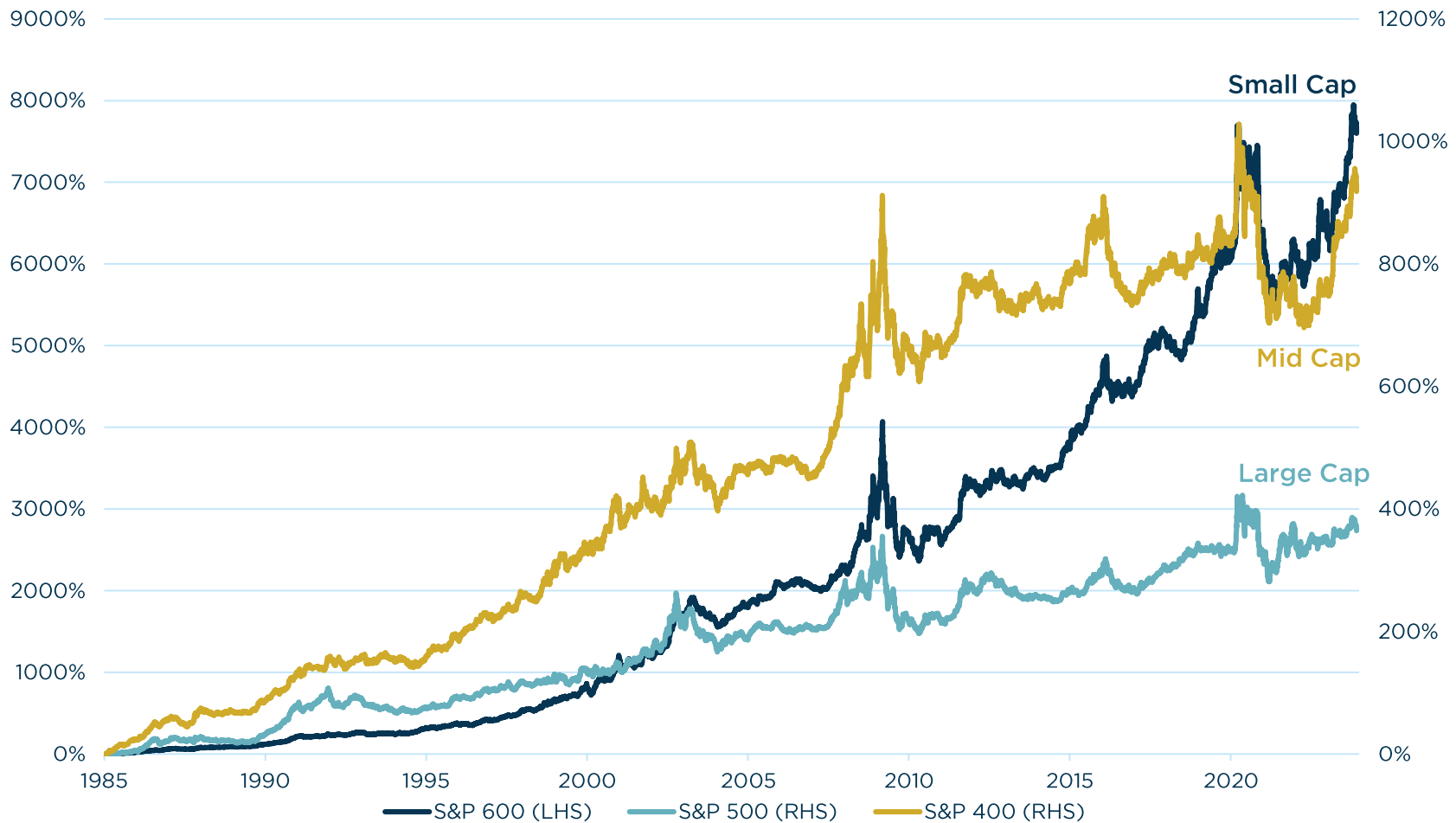
We believe our Small, SMID and Mid Cap portfolios are well positioned to capitalize on attractive relative valuations while avoiding the pitfalls associated with low-quality, smaller cap companies.

- Companies with sustainably high and improving returns on capital provide downside protection and have outperformed over the long term.
- Attributes like a strong balance sheet and the ability to self-finance operations are poised to stand out as tangible competitive advantages in a higher cost of capital environment.
- Pricing power allows companies to pass through inflationary costs

Quality Portfolio Metrics As of 12/31/2023	Higher Returns on Capital	Stronger Balance Sheets	Reasonable Valuation
	Pre-Tax Return on Invested Capital (%)	Net Debt/EBITDA	Enterprise Value/EBITDA
<b>Mid Cap Portfolio</b>	19.2	2.4x	17.1x
Russell Mid Cap	10.9	2.8x	13.8x
<b>SMID Portfolio</b>	16.0	2.4x	16.5x
Russell 2500	8.8	3.2x	13.0x
<b>Small Cap Portfolio</b>	16.4	1.7x	14.2x
Russell 2000	6.7	3.3x	13.6x

# Benefits of Down Cap Quality Over Time

ROIC (High - Low) Cumulative Performance By Market Cap



Source: Piper Sandler as of 12/31/23

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



# Lost Decade Analog & Historical Precedent

Should the next decade more closely resemble a period of interest rate normalization & elevated volatility, a higher quality approach to smaller cap investing could stand out in a meaningful way.

- Going forward, as the Fed normalizes policy, a higher cost of capital environment will likely shape the contours of the investment landscape for years to come.
  - This comes at a time when quality among smaller cap companies has eroded over the past decade.
- **The last time relative valuations were as attractive (*early 2000*) and the interest rate environment was more normalized (*a period much like the one we may be entering*), The London Company's Small Cap portfolio generated meaningful excess returns and substantially lower levels of volatility over the ensuing decade.**

## Small Cap vs Russell 2000 Peer Group Ranking

October 1999 – September 2009

	Return	Standard Deviation	Sharpe Ratio	Beta v. R2000	Alpha v. R2000	Max Drawdown	Up Market Capture	Down Market Capture
TLC Small Cap (Net)	14.0%	16.6	0.66	0.52	11.4	-43.9%	70.0%	48.7%
Russell 2000	4.9%	21.6	0.09	1.0	-	-52.9%	-	-
Peer Group Ranking	1	95	1	100	1	6	94	1

Source: eVestment

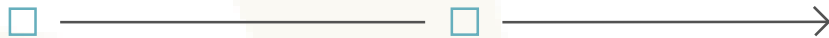
Rankings for the period were pulled on 2/9/2023. Peer ranking based on eVestment US Small Cap Core Equity Universe.

# A Quality Value Approach to Small & Mid Cap Investing

1

## High-Quality Companies

**100% Bottom-Up Approach to Find Quality, Sustainable Businesses** with durable competitive advantages, consistently high and improving returns on capital and cash flow.



2

## Balance Sheet Optimization

**A Novel Approach to Valuation** that assesses strength and flexibility of the balance sheet to create a more concrete margin of safety.

3

## Focused Portfolio Construction

**Solving the Problem of Over-Diversification** by targeting 25-35 high-conviction, long-term holdings resulting in high active share and low turnover.



4

## Sell Discipline

**Help Avoid Large Losses to Maximize Return** by selling when fundamentals deteriorate and not averaging down, reinforced by a quantitative soft stop-loss.

### Minimizing Risk:

- Bottom-Up Search for High Quality
- Focus on the Balance Sheet

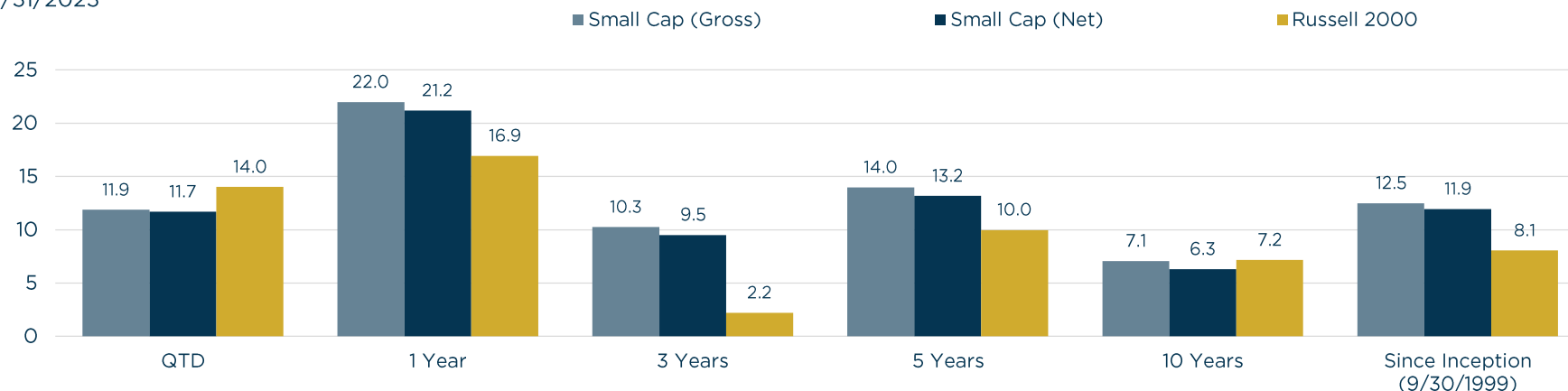
### Maximizing Return:

- Avoiding Over-Diversification
- Helping Prevent Large Losses

# Small Cap Performance Review

## Annualized Returns (%)

As of 12/31/2023



## Calendar Year Returns

	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023
Small Cap (Gross)	42.4	7.6	-31.8	40.6	24.4	7.0	21.6	34.2	-0.4	-6.6	12.8	7.3	-8.7	28.0	12.2	20.9	-9.1	22.0
Small Cap (Net)	41.6	6.7	-32.2	40.1	23.7	6.4	20.9	33.3	-1.1	-7.3	12.1	6.5	-9.3	27.0	11.3	20.0	-9.7	21.2
Russell 2000	18.4	-1.6	-33.8	27.2	26.9	-4.2	16.4	38.8	4.9	-4.4	21.3	14.7	-11.0	25.5	20.0	14.8	-20.4	16.9

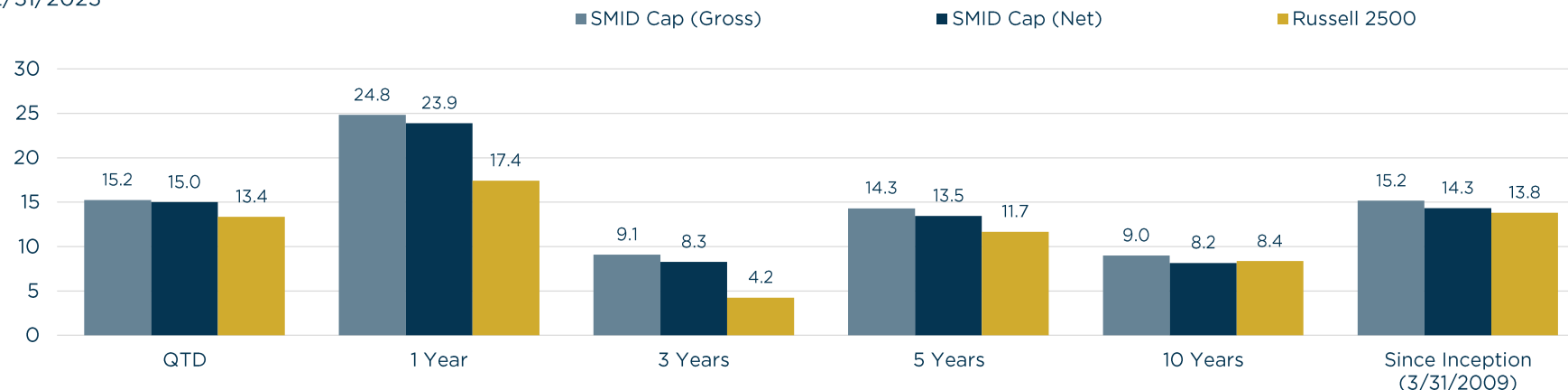
Long-term orientation: can deliver outperformance over full market cycles

Performance is preliminary. Subject to change. Past performance should not be taken as a guarantee of future performance.

# SMID Cap Performance Review

## Annualized Returns (%)

As of 12/31/2023



## Calendar Year Returns

	2009 <sup>1</sup>	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023
SMID Cap (Gross)	52.2	22.6	11.8	16.7	39.4	1.3	-5.7	16.5	14.9	-5.3	34.2	11.9	20.7	-13.8	24.8
SMID Cap (Net)	51.8	21.8	11.1	15.8	38.4	0.4	-6.3	15.6	14.1	-6.1	33.3	11.1	19.8	-14.4	23.9
Russell 2500	51.7	26.7	-2.5	17.9	36.8	7.1	-2.9	17.6	16.8	-10.0	27.8	20.0	18.2	-18.4	17.4

Long-term orientation: can deliver outperformance over full market cycles

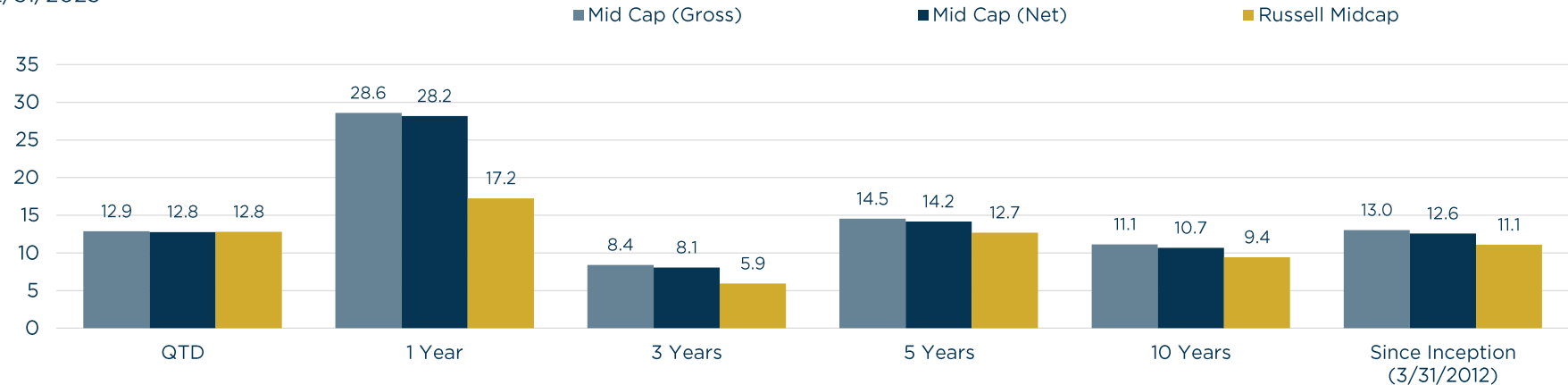
<sup>1</sup>Year ending 12/31/2009 represents nine months of returns.

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# Mid Cap Performance Review

## Annualized Returns (%)

As of 12/31/2023



## Calendar Year Returns

	2012 <sup>1</sup>	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023
Mid Cap (Gross)	8.2	35.8	10.6	-4.8	16.7	21.4	-2.4	37.5	12.5	16.4	-14.9	28.6
Mid Cap (Net)	7.8	35.2	10.1	-5.2	16.2	20.9	-2.8	37.0	12.1	16.0	-15.1	28.2
Russell Midcap	3.8	34.8	13.2	-2.4	13.8	18.5	-9.1	30.5	17.1	22.6	-17.3	17.2

Long-term orientation: can deliver outperformance over full market cycles

<sup>1</sup>Year ending 12/31/2012 represents nine months of returns.

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# Disclosures

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The London Company was founded in 1994 in Richmond, Virginia and provides equity portfolio management services to pension, profit-sharing, foundation, corporate, investment companies, and individual investors. The firm, which is majority employee-owned, is an independent, autonomous investment management organization. The London Company of Virginia is a registered investment advisor. Registration does not imply a certain level of skill or training. More information about the advisor, including its investment strategies, fees and objectives are more fully described in the firm's Form ADV Part 2, which is available upon request by calling (804) 775-0317, or can be found by visiting [www.TLCadvisory.com](http://www.TLCadvisory.com).

The London Company's performances are size weighted and annualized based on calculations for the period ending December 31, 2023, unless noted otherwise. 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.

**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 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. Returns are calculated gross of withholding taxes on foreign dividends and interest. 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.

**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 loss of principal. Referenced strategies may not be suitable for all investors. The appropriateness of a certain 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.

## Composite Definitions

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

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.

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. As of July 1, 2022 The London Company redefined the composites to exclude all dual contract relationships and any potentially bundled fee scenarios.

# Index Definitions

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Inclusion of these indices is for illustrative purposes only. Indices are not available for direct investment. Any investor who attempts to mimic the performance of an index would incur fees and expenses which would reduce returns.

The **S&P 500\*** is an unmanaged index of 500 widely held stocks that is generally considered representative of the U.S. stock market.

The **S&P SmallCap 600\*** Index is a modified capitalization-weighted index composed of 600 small-cap stocks chosen by the Standard & Poor's Corporation for market size, liquidity and industry group representation.

The **S&P MidCap 400\*** Index is designed to measure the performance of 400 mid-sized companies, reflecting the distinctive risk and return characteristics of this market segment.

**Russell Mid Cap Index** measures the performance of the mid-cap segment of the U.S. equity universe. The Russell Mid Cap 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.

**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 2,500 of the smallest securities based on a combination of their market cap and current index membership.

**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.