

# THB US Micro Cap Fund

## Quarterly Report – September 2019

### Market commentary

The Russell Microcap® Index (Index) returned -1.6% (AUD) in Q3 2019.

Utilities (+5.0%) was the best performing sector in the third quarter, followed by Real Estate (+4.2%) and Financials (+0.0%). Health Care (-14.8%) was the worst performing sector, followed by Energy (-13.6%) and Communication Services (-13.3%).

US equities had a mixed quarter, with smaller capitalisation equities posting negative returns while large caps were slightly positive. The quarter ended well, with positive performance in September largely driven by continued strong economic data and some thawing of the trade negotiations with China. Some noticeable shifts in style occurred. Value outperformed growth across all the capitalisation spectrums for the quarter.

The US Economy remained solid as low unemployment and wages gains buoy the US consumer. Financial conditions remain accommodative indicating businesses have access to capital if needed. Albeit the most recent (September) release of the NFIB Small Business Optimism Index registered a small decline versus the prior month, the reading remains within the top 15% of all readings since 1969. According to NFIB President and CEO Juanita D. Duggan: “Small business owners continue to invest, grow, and hire at historically high levels, and there is no indication of a coming recession.”

Nonetheless, the ongoing trade fight with China is not a positive for general economic conditions and the duration of which may start to erode confidence and economic activity. As of now, the US economy is firm, but companies are monitoring tariff negotiations for signs of clarity.

### Portfolio commentary

The THB US Micro Cap Fund returned -0.4% in AUD (net of fees) in Q3 outperforming the Index by 1.2%.

The portfolio had positive contributions from stock selection in Health Care (+3.3%), an underallocation to Communication Services (+0.3%), and overallocation to Information Technology (+0.3%). Negative contributions came mainly from selection in Information Technology (-1.2%), Consumer Discretionary (-0.7%) and underallocation to Financials (-0.4%).

THB's top five performing stocks (from a contribution standpoint) were Methode Electronics, Inc. (Information Technology, +0.4%), LeMaitre Vascular, Inc. (Health Care, +0.3%), M/I Homes, Inc. (Consumer Discretionary, +0.2%), Community Healthcare Trust, Inc. (Real Estate, +0.2%) and Century Communities, Inc. (Consumer Discretionary, +0.2%).

The bottom five performing stocks (from a contribution standpoint) were Johnson Outdoors, Inc. (Consumer Discretionary, -0.6%), PAR Technology Corp. (Information Technology, -0.5%), KLX Energy Services Holdings, Inc. (Energy, -0.5%), Vishay Precision Group, Inc. (Information Technology, -0.3%) and PRGX Global (Information Technology, -0.2%).

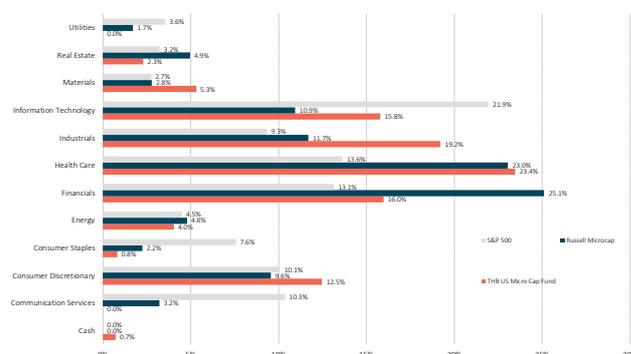
Fund details	
Benchmark	Russell Microcap® Index <sup>3</sup>
Inception date	5 September 2014
Fund size	A\$283 million

Performance <sup>1</sup> – 30 September 2019			
	Fund <sup>2</sup>	Russell Microcap®	Difference
1 month	3.8%	2.2%	1.6%
3 months	(0.4%)	(1.6%)	1.2%
1 year	(7.5%)	(9.9%)	2.4%
2 years p.a.	7.3%	5.4%	1.9%
3 years p.a.	12.4%	9.9%	2.6%
Since inception p.a. <sup>2</sup>	11.9%	11.8%	0.0%

1. Performance figures are presented in AUD on a net, pre-tax basis and assume the reinvestment of distributions. Past performance is not an indicator of future performance.

2. Fund inception date was 5 September 2014 however inception performance is calculated from 1 October 2014.

### Sector allocation<sup>4</sup>



3. The Russell Microcap Index is a capitalisation weighted index of 2,000 stocks that captures the smallest 1,000 companies in the Russell 2000 and 1,000 smaller US based listed stocks.

4. Portfolio holdings and allocations are subject to change and should not be considered as investment recommendations to trade individual securities. The securities identified and described do not represent all of the securities purchased, sold or recommended for client accounts. The reader should not assume that an investment in the securities identified were or will be profitable. There is no assurance that any securities discussed herein will remain in the portfolio at the time you receive this report, or that securities sold have not been repurchased. There can be no assurance that investment objectives will be achieved. A full list showing every holding's contribution to the overall account's performance during the measurement period and calculation methodology is available upon request.

## Portfolio commentary (continued)

THB's companies are well capitalised and (by and large) continue to deploy excess levels of cash flow stemming from decreased regulatory costs and lower taxes. Companies now have a 1+ year look-through to the true benefits from both of those measures and are in the beginning stages of deploying that capital to growth initiatives, acquisitions and share repurchases. Seven portfolio stocks announced share repurchases during the third quarter for a combined total of approximately \$160M.

Micro Cap equities remain one of the most inefficient areas to invest in, with abundant opportunities for active managers to add value. The two recent portfolio additions below reflect how infrastructure needs are a strong driver of the US Economy and these companies can play a meaningful role in the build out.

## Stocks in focus

### **TPI Composites, Inc. (TPIC)**

TPIC is the largest U.S. based independent manufacturer of composite wind blades for the wind energy market. The company has achieved impressive growth over the past 3 years increasing revenues from \$556M in 2015 to \$1,030M in 2018 driven by rising environmental concerns globally and the improving economic advantages of wind power. The company is benefitting from 1) declining wind energy generation cost per KWh which is driving higher adoption; 2) higher outsourcing of blades and other key components by original equipment manufacturers and 3) shift to larger wind turbines which requires larger wind blades. TPIC has strategically built a strong global footprint that takes advantage of proximity to large existing regional markets. Its products excel where high strength, light weight and durability is required to meet the evolving demands of the wind blade market. The company is progressing towards their goal of doubling revenue to \$2B per year and achieving 20% to 25% global market share. TPIC has a strong pipeline of new business with an estimated total potential contract value of up to approximately \$6.2 Billion through 2023.

### **RF Industries (RFIL)**

RFIL is a manufacturer of a wide selection of interconnection products and solutions primarily used in wireless network infrastructure and telecommunications. The company is well-positioned in the small cell market driven by the upcoming 5G infrastructure build-out. 5G is expected to provide much greater network capacity, lower latency for an immediate response, and an overall more uniform user experience. The 5G cellular towers will boost wireless signals to 10x the current speed of 4G. The new infrastructure will require a greater number of towers as 5G cells will need to be placed no more than 250-300 meters distance away from each other. The 5G build out and related spending on densification will provide RFIL with significant growth in its components and systems for small cell applications. Under their new CEO, Robert Dawson, who joined in 2017, the company is targeting to double its sales to \$100M over the next 3 years through a combination of organic growth and strategic M&A. RFIL has a strong balance sheet with a net cash position and no sell-side coverage.

## Portfolio statistics<sup>1</sup>

As at 30 September 2019		
	Fund	Russell Microcap®
Weighted avg market cap	US\$627m	US\$494m
Price/sales	1.0x	0.6x
Price/book	1.7x	1.5x
Dividend yield	0.7%	1.4%
Number of securities	100	1,476
Standard deviation	15.5%	16.9%
Sharpe ratio	0.5	0.4
Beta	0.9	
Tracking error	5.3	
Information ratio	0.2	

1. Portfolio statistics are reported in USD. Source: THB Asset Management

## Top 10 holdings

Stock	Sector	Weight
Mesa Laboratories	Health Care	2.5%
PAR Technology Corp	Technology	2.5%
Methode Electronics	Technology	2.3%
Old Second Bancorp	Financials	2.3%
Johnson Outdoors	Consumer Disc.	2.2%
Graham Corp	Industrials	2.1%
First Busey Corp	Financials	1.9%
Addus HomeCare Corp	Health Care	1.9%
Koppers Holdings	Materials	1.9%
LeMaitre Vascular	Health Care	1.9%

Source: THB Asset Management

## Companies by market capitalisation



Source: THB Asset Management

## Active sector positioning



Source: THB Asset Management

## Investment strategy

THB Asset Management (THB) is an employee-owned boutique investment management firm based in Connecticut specialising in smaller company strategies. THB's US Micro Cap strategy is based on the belief that there are inefficiencies in the micro cap segment of the market due to lack of analyst coverage, difficulty in identifying value and the impact that management skill has on the direction of smaller companies. THB utilises a disciplined, fundamental bottom-up approach that blends both qualitative and quantitative methods to construct a well-diversified portfolio of companies that possess attractive operating metrics, yet with comparable valuation to the Russell Microcap® Index.

**BROOKVINE**

**THB**  
Asset Management

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