

# THB US Micro Cap Fund

## Quarterly Report – December 2019

### Market commentary

The Russell Microcap® Index (Index) returned 8.8% (AUD) in Q4 2019.

Health Care (+28.7%) was the best performing sector in Q4 followed by Energy (+17.0%) and Communication Services (+13.5%). Real Estate (+0.5%) was the worst performing sector, followed by Utilities (+3.0%) and Consumer Discretionary (+6.5%).

Style was a major contributor to performance during the quarter as growth outperformed value across the capitalisation spectrums. The NYSE FANG Index (equal weight of FB, AAPL, AMZN, NF, GOOG) was up 22.3% while the Nasdaq Biotech Index was up 21.2% for the quarter. Both of those subsets' performance far outpaced broader market indices.

US Equities were broadly higher in the fourth quarter as economic data continued to surprise to the upside, earnings were mostly ahead of expectations and trade tensions with China took a positive turn. Investors' fears of a recession faded as the stronger earnings data was further confirmed by increases in both consumer and small business confidence indicators.

University of Michigan Consumer Sentiment and NFIB Small Business Optimism index both registered multi month highs during December of 99.3 and 104.7 respectively. Those two pillars of the US economy remain extremely strong. US and China agreed to sign Phase 1 on January 15, 2020 and will mark a positive development between the two countries. Trade issues have been frequently cited by consumers and businesses as one of the few concerns they have regarding future business and economic growth.

### Portfolio commentary

The THB US Micro Cap Fund returned 3.4% in AUD (net of fees) in Q4 underperforming the Index by 5.4%.

The portfolio saw negative contribution from stock selection to Health Care (-5.3%), underallocation to Health Care (-0.6%), and overallocation to Industrials (-0.6%). Positive contribution came mainly from selection in Information Technology (+0.7%), Materials (+0.7%) and underallocation to Real Estate (+0.4%).

THB's top five performing stocks (from a contribution standpoint) were Renewable Energy Group, Inc. (Energy, +1.5%), Ultra Clean Holdings, Inc. (Information Technology, +1.0%), PAR Technology Corporation (Information Technology, +0.7%), Johnson Outdoors, Inc. (Consumer Discretionary, +0.7%) and Koppers Holdings, Inc. (Materials, +0.6%).

The bottom five performing stocks (from a contribution standpoint) were CARBO Ceramics, Inc. (Energy, -0.4%), Orthofix Medical, Inc. (Health Care, -0.3%), Del Taco Restaurants, Inc. (Consumer Discretionary, -0.3%), Lantheus Holdings, Inc. (Health Care, -0.2%) and Exterran Corp. (Energy, -0.2%).

During the quarter, unprofitable companies were up 31% while profitable companies were up 9%. Biotechnology companies were the largest contributor to the benchmark performance and now comprise

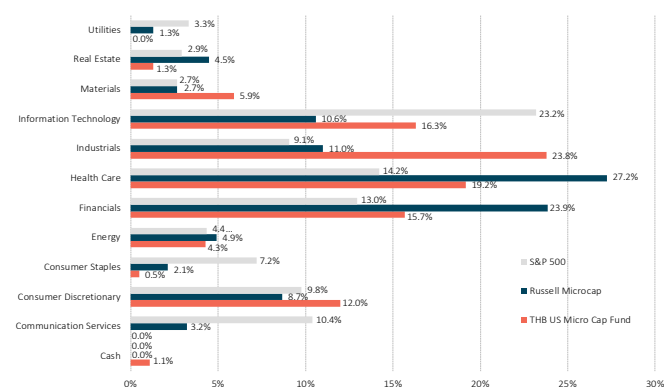
Fund details	
Benchmark	Russell Microcap® Index <sup>3</sup>
Inception date	5 September 2014
Fund size	A\$264 million

Performance <sup>1</sup> – 31 December 2019			
	Fund <sup>2</sup>	Russell Microcap®	Difference
1 month	(0.5%)	1.7%	(2.2%)
3 months	3.4%	8.8%	(5.4%)
1 year	12.0%	22.6%	(10.6%)
2 years p.a.	7.7%	8.8%	(1.1%)
3 years p.a.	6.1%	7.4%	(1.4%)
Since inception p.a. <sup>2</sup>	12.0%	13.0%	(1.1%)

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)

21% of the benchmark weighting. These companies are largely unprofitable and do not fit THB's investment philosophy of owning well capitalised companies which generate positive cash flow to self-fund their own growth. Not owning these companies cost the portfolio 5.9% relative to the index during the quarter.

THB remains confident that its time-tested philosophy of investing in profitable companies is the prudent approach to delivering alpha. Over 21 years of managing the strategy, THB have outperformed the Russell Micro Cap and Russell 2000 Small Cap by 6.0% and 6.1% annualised respectively. Time has taught THB that periods such as Q4 tend to be transitory and can quickly reverse. Unprofitable companies within the Small and Micro Cap indices have reached levels last seen during the technology bubble. They represent 35%, 24%, 35% of the Russell Micro Cap, Russell 2000 and Russell Small Cap Growth indices respectively. The need for active management is reinforced as the performance of the index is being driven by unprofitable companies that also represent a large proportion of the index.

The US Economy remains very strong and the main concern (trade issues between the US and China) cited by both consumers and businesses is quickly moving towards resolution. The removal of that concern should build upon the strong economic foundation which has been gaining strength from tax reform and deregulation efforts. Business conditions / interest rates are accommodative, consumers and businesses are reporting near record high levels of optimism and pent up capital spending (which may have been delayed due to trade tensions) should start to accelerate.

During the quarter, four of THB's holdings announced new share repurchase authorisations totalling \$27.2M. Such activity is indicative of the discounted valuations present within THB's universe of stocks.

## Stocks in focus

### Hyster-Yale Materials Handling, Inc. (HY)

Hyster-Yale is a leading, globally integrated, full-line lift truck manufacturer. The company offers a broad array of solutions aimed at meeting the specific materials handling needs of its customers, including attachments and hydrogen fuel cell power products, telematics, automation and fleet management services. HY is currently focusing on a multi-year restructuring initiative targeting higher profitability towards a 7% operating margin. Pivotal components include refreshing forklifts for interchangeable power solutions and modularity across product lines which is expected to reduce overall cost of ownership to customers and reaccelerate sales. HY holds minority investment in French robotic forklift company Balyo which announced in Jan '19 a seven-year contract with Amazon. Given Amazon's geographical warehouse locations and HY's exclusivity in North America with Balyo, THB believe the partnership provides an attractive call option on the shares. Current self-help story, trend toward higher warehouse automation, inexpensive valuation and significant insider buying activity over the past twelve months gives THB confidence in their positive outlook for the company.

### Heritage-Crystal Clean, Inc. (HCCI)

Heritage Crystal Clean is the second largest vertically integrated provider of full-service parts cleaning, hazardous and non-hazardous waste services and used oil collection services in North America. HCCI is also the second largest re-refiner of used oil in North America with capacity of 75M gallons which produces base-oil sold to blenders and compounders. Key catalyst for the shares over the next twelve months will be the impact of the International Maritime Organisation (IMO) in 2020. The IMO has ruled that from 1 January 2020, marine sector emissions in international waters be reduced from 3.5 to 0.5 (weight percent). The marine sector will have to

reduce sulphur emissions by over 80% by switching to lower sulphur fuels. The regulation is expected to essentially eliminate the use of used motor oil (UMO) in the marine bunker fuel market. Price of UMO, main feedstock for HCCI oil operations, is expected to drop as a result of the emerging supply/demand imbalance. Although, the magnitude of the price change is still uncertain, HCCI has significant operating leverage- every \$0.10 improvement in the feedstock costs results in \$6.5M increase in pretax income for its oil segment. The company is also driving growth with organic branch expansion and acquisitions and a highly scalable operating model.

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

As at 31 December 2019		
	Fund	Russell Microcap®
Weighted avg market cap	US\$708m	US\$651m
Price/sales	1.1x	0.7x
Price/book	2.0x	1.7x
Dividend yield	0.7%	1.2%
Number of securities	100	1,468
Standard deviation	15.2%	16.7%
Sharpe ratio	0.6	0.5
Beta	0.9	
Tracking error	5.4	
Information ratio	0.0	

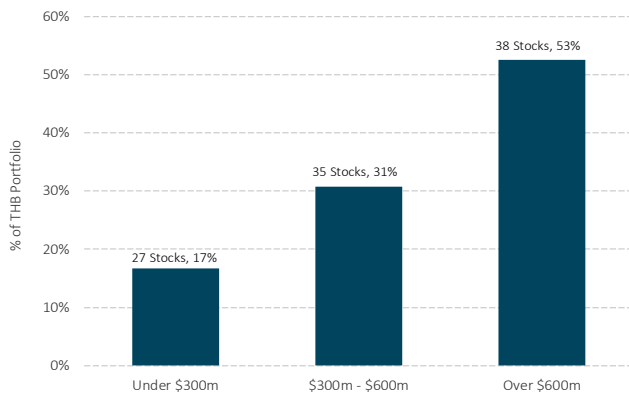
1. Portfolio statistics are reported in USD. Source: THB Asset Management

## Top 10 holdings

Stock	Sector	Weight
Renewable Energy Group	Energy	2.9%
PAR Technology	Technology	2.7%
Johnson Outdoors	Consumer Disc.	2.5%
Mesa Laboratories	Health Care	2.5%
Koppers Holdings	Materials	2.4%
Old Second Bancorp	Financials	2.3%
Graham Corporation	Industrials	2.3%
Methode Electronics	Technology	2.3%
Ultra Clean Holdings	Technology	2.3%
Addus HomeCare	Health Care	2.1%

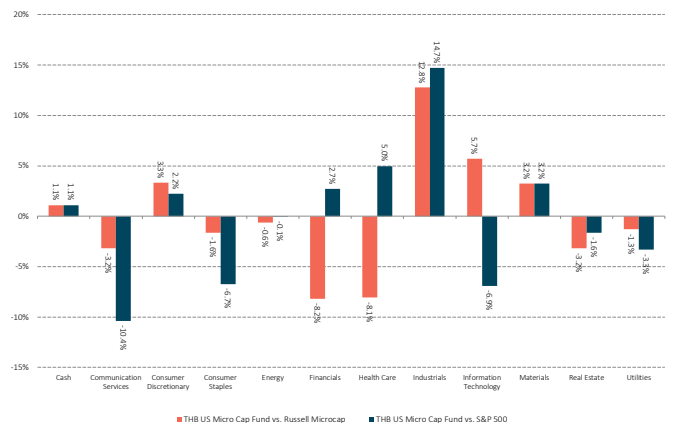
Source: THB Asset Management

## 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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