

# THB US Micro Cap Fund

## Quarterly Report – June 2020

### Market commentary

The Russell Microcap® Index (Index) returned 16.0% (AUD) in Q2 2020.

There was sharp divergence in micro cap sector returns during Q2 2020. Consumer Discretionary (+65.8%) was the best performing sector followed by Health Care (+44.1%) and Information Technology (+34.4%). Energy (+1.9%) was the worst performing sector, followed by Utilities (+4.5%) and Financials (+11.2%).

In aggregate, US equities rallied as extreme views regarding the pandemic gave way to a more balanced approach and the full impact of the fiscal and monetary response to the crisis became clear. Equities were led by strong performance from small and micro cap stocks as the Russell 2000 and Russell Microcap indices returned 25.4% and 30.5%, respectively. US large cap stocks delivered a 20.5% return as measured by the S&P 500. The Equal Weighted S&P 500 outperformed the cap weighted index by returning 21.7%, highlighting good breadth in market returns.

From the outset, THB believed that the worst of the impact of COVID-19 would be transitory. In that respect it has elements of a natural disaster, with a brief sharp draw down in economic activity. So far that has proven to be the case, but one should not think that complete recovery is just around the corner.

On the positive side there is an incredible amount of capital, bright minds and all the best medical technologies working towards a vaccine and/or therapeutic. Further mitigation efforts are in place, treatment procedures have been improved and the normal time element associated with all viral outbreaks is taking place. Thus THB continues to believe that there exists a high probability that some end to COVID-19 is in the near future.

However quite clearly there has been a significant economic cost and a significant economic dislocation. Further economic recovery will take time. The economy and markets will have to respond to these dislocations and unexpected consequences. The duration function of COVID-19 is therefore sensitive to the ebb and flow of news. Positive news (vaccine, therapeutic, lower cases/mortality) shortens duration while negative news (higher infection rates, higher mortality rates, pushback of vaccine or therapeutic) elongates duration.

Thus while THB believes the sharp move higher since the March lows confirms that we are closer to the end of COVID-19, it plans to use news flow-related pullbacks to add to its highest conviction positions. THB also recognises there may be no plain sailing and it will have to take care to adjust the portfolio to take advantage of new realities.

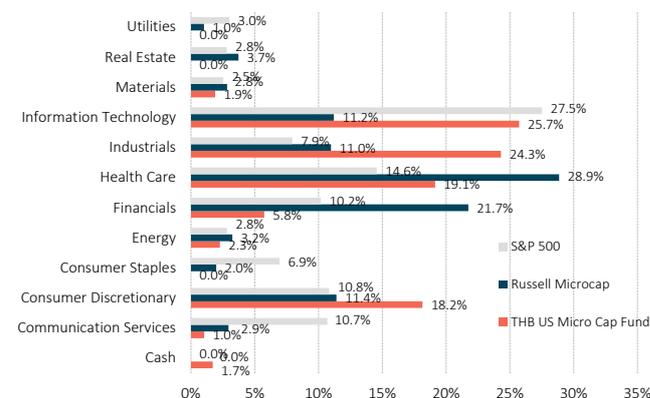
Fund details	
Benchmark	Russell Microcap® Index <sup>3</sup>
Inception date	5 September 2014
Fund size	A\$78 million

Performance <sup>1</sup> – 30 June 2020			
	Fund <sup>2</sup>	Russell Microcap®	Difference
1 month	(0.7%)	2.4%	(3.1%)
3 months	16.2%	16.0%	0.1%
1 year	(10.9%)	(2.9%)	(7.9%)
2 years p.a.	(7.4%)	(4.3%)	(3.1%)
3 years p.a.	1.8%	4.6%	(2.8%)
Since inception p.a. <sup>2</sup>	8.1%	10.0%	(1.8%)

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

The THB US Micro Cap Fund returned 16.2% in AUD (net of fees) in Q2, outperforming the Index by 0.1%.

The portfolio saw positive contribution from overallocation to Consumer Discretionary (+2.5%), underallocation to Financials (-4.2%) and stock selection in Information Technology (1.2%). Negative contribution came mainly from selection in Health Care (-4.2%), underallocation to Health Care (-2.2%), and stock selection in Consumer Discretionary (-1.2%).

THB's top five performing stocks (from a contribution standpoint) were PAR Technology Corporation (Information Technology, +2.5%), Cardlytics, Inc. (Communication Services, +2.0%), Century Communities, Inc. (Consumer Discretionary, +1.4%), Jack in the Box, Inc. (Consumer Discretionary, +1.3%), and Ultra Clean Holdings, Inc. (Information Technology, +1.2%).

The bottom five performing stocks (from a contribution standpoint) were Hyster-Yale Materials Handling, Inc. (Industrials, -0.2%), ANI Pharmaceuticals, Inc. (Health Care, -0.1%), TimkenSteel Corp. (Materials, -0.1%), Graham Corporation (Industrials, -0.1%) and Frank's International NV (Energy, -0.1%).

For active managers, the panoply of company specific and industry drivers and risks creates a target rich universe. This is especially true for smaller companies whose businesses are sensitive to small changes and can quickly pivot their firms based on market and economic dynamics. Additionally, COVID-19 did create elements of a normal business cycle in which creative destruction has allowed small, well capitalised and well managed firms to grow by acquiring weakened competitors or taking market share. THB is finding companies who are benefiting from some COVID-19 related changes and ones that are quickly adapting and will prosper through COVID-19 and beyond.

As other countries realign their trade flows and allegiances, there is a clear chance for reshoring to take place in the US on a very large scale. Bi-partisan support of numerous reshoring legislation exists and recent polling highlights a majority (80+) of Americans are willing to pay more for domestically produced products and believe the US relies too heavily on foreign countries for production of various goods and components.

The sharp recovery in equity markets reflects the optimism that the worst may be behind us. That optimism has been confirmed in better than expected employment data, improvements in high frequency data and increasing confidence levels. Optimism is a necessary ingredient for the US economy to continue to improve as both consumers and businesses make decisions on whether to spend or save. Household balance sheets are flush with cash and confidence levels are increasing, leading THB to believe this key pillar of the US economy will resume pre COVID-19 levels of spending in a timely manner. Well capitalised corporations are beginning to invest excess cash flows through acquisitions of weakened competitors or expanding their market share.

THB believes well managed and strongly capitalised companies will continue to adapt and thrive in an ever-changing macro environment.

## Stocks in focus<sup>5</sup>

Two new portfolio positions detailed below are examples of new growth drivers and adaptation.

### Digital Turbine (APPS)

Digital Turbine helps wireless carriers and smartphone OEMs monetise Android home screens. The company's main product, Dynamic Installs, automatically preloads apps when a phone is first purchased and booted up. Brands and app developers can pay to have their apps preloaded on smartphones to circumvent the Google Play Store, thus cutting costs and increasing conversion.

Digital Turbine's technology platform has been adopted by more than 30 mobile operators and OEMs worldwide and has delivered more than one billion app preloads for tens of thousands of advertising campaigns. The company has an installed base on more than 300M total devices and is growing revenue per device with adjacent product offerings which expand the opportunity for screen monetisation beyond the phone activation. The company is also growing its recurring revenue base through revenue share contracts where it receives a percentage of subscription revenue of the customer app if installed through Digital Turbine's platform. APPS reported strong business trends for April and May with double digit sales growth and no negative impact from COVID-19.

### BJ's Restaurants, Inc. (BJRI)

BJ's Restaurants, Inc. is a national brand with brewhouse roots and a menu with over 140 offerings. It has 209 locations in 28 states, 57% of which are in Florida, California and Texas. BJ's has well-established craft beer operations in five states and benefits from a differentiated brand position in a growing craft beer category. It stands out with an industry leading AUV (avg. unit volume) of \$5.5M among the top 3 in casual dining and attractive unit growth opportunity to double its footprint from 209 to 400 locations.

The resilience of the business and strength of its brand was proven during the pandemic. The company successfully increased its off-premise business 3x from \$550K to \$1.5M per restaurant during the closure of dining rooms across the country. When the reopenings started, restaurants saw double-digit weekly sequential improvements in sales. The company had 85% of its locations dining rooms reopened as of 9 June 2020 and continues to generate elevated off-premise sales.

BJ's is also well-capitalised to weather the challenging environment. Act III, a PE fund formed by former Panera Bread CEO and founder, Ron Shaich, led a \$70M private placement of common stock on 1 May 2020 at \$20 per share, after THB initiated a position at \$9.63. Shaich is an industry veteran who engineered one of the largest restaurant industry deals with the sale of Panera to JAB Holdings in 2011.

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## Portfolio statistics<sup>5</sup>

As at 30 June 2020		
	Fund	Russell Microcap®
Weighted avg market cap	US\$890m	US\$459m
Price/sales	0.8x	0.6x
Price/book	1.8x	1.2x
Dividend yield	0.6%	1.6%
Number of securities	100	1,323
Standard deviation	20.3%	20.5%
Sharpe ratio	0.2	0.3
Beta	1.0	
Tracking error	5.6	
Information ratio	(0.2)	

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

## Companies by market capitalisation



Source: THB Asset Management

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## Investment strategy

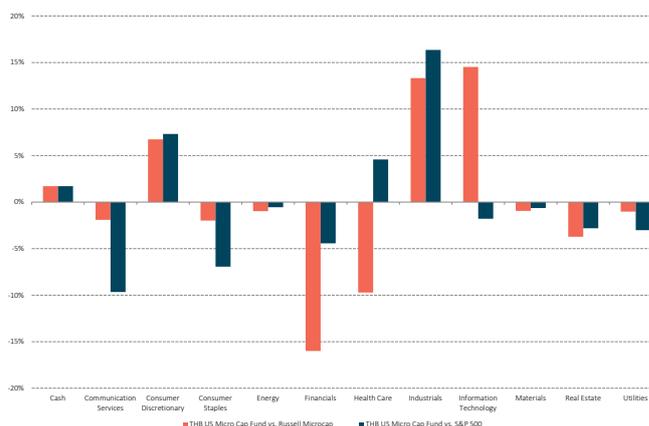
THB Asset Management (THB) is an employee-owned boutique investment management firm based in Connecticut specialising in smaller company strategies. THB's US Micro Cap strategy is based on the belief that there are inefficiencies in the micro cap segment of the market due to lack of analyst coverage, 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.

## Top 10 holdings<sup>5</sup>

Stock	Sector	Weight
PAR Technology	Technology	2.8%
Perficient	Technology	2.7%
TPI Composites	Industrials	2.3%
Upland Software	Technology	2.2%
Ultra Clean Holdings	Technology	2.2%
Century Communities	Consumer Disc	2.1%
Ping Identity Holding Corp	Technology	2.1%
BJ/s Restaurants	Consumer Disc	2.0%
Eplus Inc	Technology	2.0%
Digital Turbine	Technology	1.9%

Source: THB Asset Management

## Active sector positioning



Source: THB Asset Management

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