THB Asset Management
A VICTORY CAPITAL® INVESTMENT FRANCHISE

THB International Micro Cap Fund – Class W

Quarterly Report – Q3 2021

Market commentary

The MSCI World ex USA Small Cap® Index (Index) returned +4.7% (AUD) in Q3 2021.

Energy (+8.2%) was the best performing sector, followed by Financials (+3.4%) and Industrials (+2.5%). Materials (-2.8%) was the worst performing sector, followed by Consumer Discretionary (-2.6%) and Consumer Staples (-1.0%).

Israel (+5.0%) was the best performing country, followed by Japan (+3.4%) and Switzerland (+2.3%). Hong Kong (-13.8%), Finland (-7.8%) and Denmark (-3.1%) were the worst performing countries in the Index.

International small cap equities registered gains this quarter following the positive returns of the preceding two quarters. The strong performance leading into this quarter moderated as a confluence of fears hit the markets regarding the Delta variant, geopolitical risks, monetary support/trajectory, and inflation. Taken in context, moderation made sense, is healthy, and should be viewed opportunistically. Smaller capitalisation stocks led this quarter as the MSCI World ex USA Index registered a loss of-0.7% (net) whereas the MSCI World ex USA Small Cap Index registered a gain of 0.7% (net).

The IMF's latest World Economic Outlook left the 2021 global GDP growth forecast unchanged at 6.0%. The forecast includes an upward revision from the previous estimate for developed markets, while the emerging economies forecast was revised down with emerging Asia downgrades. Asia's coronavirus situation is prolonging supply chain disruptions, as China is seeing a resurgence in Covid-19 cases. Eurozone data remained positive, with the economy expanding at 2.0% q/q in Q2 after the 0.3% contraction in the first quarter. The Eurozone ESI (Economic Sentiment Indicator) hit an all-time record high of 119.0 in July and surprised to the upside in September. German unemployment rates fell sequentially each month throughout the quarter as businesses replenished their workforce and continued to recover from Covid-19 lockdowns. The jobless rate fell to 5.5%, which is the lowest level since March 2020.

Japan corporate survey capital spending rose 5.3% annually in Q2, marking the first return to positive growth since the pandemic began last year.

Portfolio commentary

The THB International (ex-USA) Micro Cap Fund returned +11.5% (net of fees) in Q3 2021.

Contributors to the portfolio's performance were positive stock selection in Japan, United Kingdom, and Sweden. Detractors from performance included stock selection in Netherlands, Canada, and Switzerland.

From a sector perspective, primary contributors to performance mainly came from stock selection in Industrials, selection in Consumer Discretionary, and overallocation to Information Technology. Stock selection in Financials, selection in materials, and underallocation to Energy were primary detractors of performance this quarter.

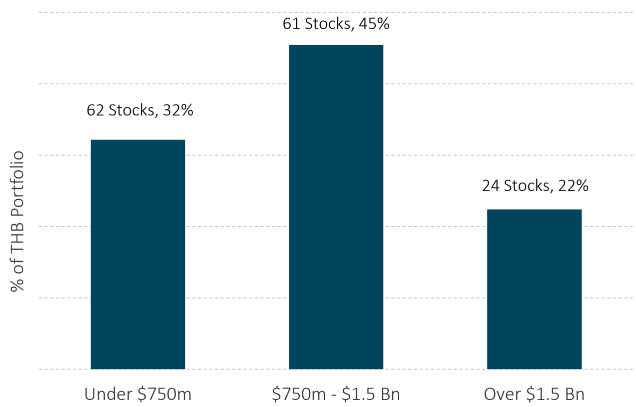
Fund details	
Benchmark	MSCI World ex USA Small Cap Total Return Index (AUD)[2]
Inception date	23 August 2018
Fund size	A$113.3 million

Net performance – 30 September 2021

	Fund[1]	MSCI World ex USA Small Cap®[2]	MSCI World ex USA Micro Cap®[3]
1 month	(1.6%)	(2.2%)	(0.1%)
3 months	11.5%	4.7%	3.7%
1 year	29.5%	29.1%	34.7%
2 years p.a.	21.1%	14.0%	19.5%
Since inception	12.3%	9.7%	11.6%

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. Fund inception date was 23 August 2018 however inception performance for this class is calculated from 7 September 2018.

Companies by market capitalisation



Source: THB Asset Management

2. The MSCI World ex-USA Small Cap Total Return Index (AUD) captures small cap representation across 22 of 23 Developed Markets (DM) countries (excluding the United States). With ~2,496 constituents, the Index covers approximately 14% of the free float-adjusted market capitalisation in each country. Source: MSCI

3. The MSCI World ex USA Micro Cap Index captures micro cap representation across 22 of 23 Developed Markets (DM) countries (excluding the United States). With ~4,735 constituents, the index covers approximately 1% of the free float-adjusted market capitalisation in each country.

Portfolio commentary (continued)

THB's top five performing stocks (from a contribution standpoint) were Hexatronic Group AB (Sweden, Industrials, +1.2%), GARO AB (Sweden, Industrials +0.5%), SHIFT, Inc. (Japan, Information Technology, +0.4%), Basler AG (Germany, Information Technology, +0.4%) and Focusrite PLC (United Kingdom, Consumer Discretionary, +0.4%).

The bottom five performing stocks (from a contribution standpoint) were Probi AB (Sweden, Health Care,-0.4%), Ramelius Resources Limited (Australia, Materials,-0.2%), Avon Protection PLC (United Kingdom, Industrials,-0.2%), CMC Markets Plc (United Kingdom, Financials,-0.2%), and Treatt Plc (United Kingdom, Materials-0.2%).

THB's portfolio companies continue to deploy capital with the goal of increasing shareholder value. They announced 23 share repurchase authorisations and 32 acquisitions. One of the holdings, Smart Group (SIQ) received a bid by a consortium led by TPG Global LLC.

Specialisation

Specialisation is not easy to quantify but is a change which is developing across multiple industries and creating sizable opportunities for small and medium sized companies. Decades of corporate vertical integration are being unwound as a confluence of factors force companies to rethink traditional methods of product production, marketing and distribution. Secular economic changes accelerated by the pandemic, combined with increasing diseconomies of scale, are quickly reshaping corporate structures.

Key drivers of these changes include complexity of products produced, need for shortened development/production times, and labour force requirements. Diverse industries such as semiconductor chip production, pharmaceuticals, medical equipment and industrials are utilising specialist companies in multiple ways. Such usage is creating sizable avenues of growth for existing small and medium sized companies as previously captive revenue is released outside of larger corporations.

The increasing need for very specialised human capital, shortage of such workers, and pockets of wage inflation are driving more companies to seek specialists to perform or aid in the production and/or development of their products. An example would include very specific, critical design elements of a semiconductor chip. A smaller company which has decades of IP related to semiconductor chip power management and the labour force needed for such design integration could provide their services to a much larger semiconductor chip manufacturer. The very specialised labour pool needed for this production is much better managed at a streamlined, focused company. Management is one issue; finding and retaining such talent (keeping them happy, shared culture) may present other problems for very large corporations. As the need for very specialised workers increases, finding and retaining such talent may be a job better suited for smaller, more nimble firms. For example, the human resources department at a large manufacturing corporation may not have the correct HR personnel to understand and source a large software design team. Post-pandemic, human capital is seeking higher wages, flexible work/life balance and other benefits, further complicating a difficult situation. Such friction points within corporate structures should continue to drive more opportunities to smaller, high-quality firms.

Needs for decreased production time to market, increasing numbers of SKUs, and more complex supply chains are creating new revenue sources for companies across multiple industries. Producing complex products in a shorter duration is driving demand for specialised production facilities, design teams, data sets and analytics. Pharmaceuticals and drug development are areas experiencing high levels of specialisation. The drug development process is a complex process that is highly regulated and must be tightly controlled. Once a drug is developed, tested and passes trials, it then must be manufactured in facilities which have been inspected and approved by various government agencies. Companies within this industry are relying on specialised partners in order to streamline their discovery and production processes.

One holding which is benefiting from the acceleration of these trends is ***Mirait Holdings.*** Mirait Holdings is the third largest provider of telecommunications engineering work, electrical work, civil engineering work, and construction work in Japan. Demand for its services is benefiting from the full-scale shift from 4G to 5G in wireless base station work as mobile carriers expand their commercial 5G service areas. They also have exposure to renewable energy projects such as building, operation and maintenance of solar power generation systems and EV charging stations. They have been focusing on growing the non-telecom business, with focus areas being IoT and 5G, energy management, data centre and drone business. Mirait has posted double-digit revenue growth with a 5-year revenue CAGR of 14%, is profitable and has made consistent dividend payments.

Energy Transition

The rapid adoption of green energy technologies and various standards of lowering carbon emissions is creating a wealth of investment opportunities, but also unintended consequences. There is little doubt that our future will be one with much lower carbon emissions, but the path may be less linear than anticipated. When the laws of supply-and-demand combine with government intervention and varying degrees of consumer adoption, a somewhat chaotic process is sure to follow.

Creating all the machinery and products needed for a lower carbon, greener future will also require massive amounts of materials whose production and extraction will require significant amounts of traditional energy. For example, the average wind turbine contains approximately 900 tons of steel and 2,500 tons of concrete. Extracting, processing and delivering these materials in a period of reduced supply is creating upward movements in prices across the commodity complex. The S&P GSCI Commodity Index has reached a five-year high. Beyond steel and cement, large amounts of rare metals such as lithium will be needed for EV batteries. Each new EV battery weighs approximately 1,000 pounds.

A current holding benefiting from increasing demand for reliable, clean energy sources is ***2G Energy AG***. 2G Energy AG is the largest independent developer and manufacturer of CHP (combined heat and power plants) in Germany, holding a 25% market share in natural gas and biogas applications. 2G has developed a CHP plant powered by pure hydrogen and capable of converting natural gas CHP to hydrogen operations. CHP is an energy-efficient technology that generates electricity and captures the heat that would otherwise be wasted to provide thermal energy such as steam or hot water used for space heating, cooling, and industrial processes. The technology can achieve up to 40% in primary energy savings and a 60% reduction in CO_2 emissions when using natural gas and 0% CO_2 emissions when using hydrogen compared to conventional power generation. To date, 2G has successfully installed several thousand CHP plants in 55 countries and has a blue-chip customer base. Demand for its products is expected to continue to benefit from decarbonisation trends and the resulting shift to renewable sources of energy. Service and maintenance accounts for 38% of net sales, providing a stable and recurring revenue stream, and in June 2021 the group acquired the remaining 50% stake in HJS, which specialises in maintenance and repair of gas-operated CHP systems, further strengthening the company's service expertise.

Portfolio statistics[4]

As at 30 September 2021	Fund	Benchmark
Weighted avg market cap	US$1,204m	US$3,291m
Price/sales	2.0x	1.3x
Price/Book	3.6x	1.7x
Dividend yield	1.3%	2.0%
Number of securities	147	2,574
Standard deviation	18.1%	16.2%
Sharpe ratio	1.0	
Beta	1.1	
Tracking error	5.9	
Information ratio	1.5	

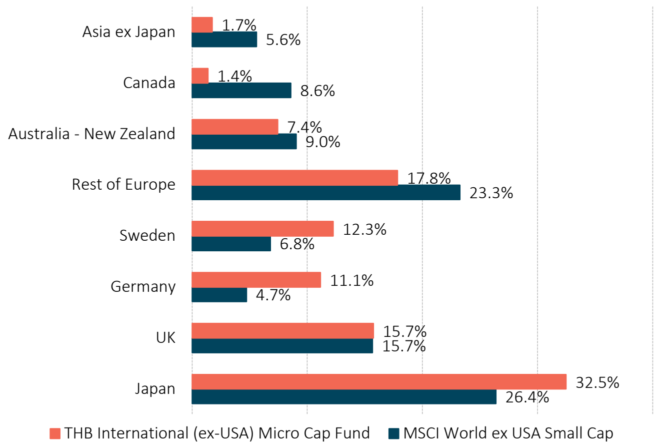
Source: THB Asset Management

Top 10 holdings[5]

Stock	Sector/Country	Portfolio weight
Focusrite PLC	Consumer Disc/UK	1.9%
SeSa S.p.A.	Technology/Italy	1.7%
Hexatronic Group AB	Industrials/Sweden	1.6%
El.En. S.p.A.	Health Care/Italy	1.6%
SHIFT Inc	Technology/Japan	1.4%
Kainos Group PLC	Technology/UK	1.4%
Basler AG	Technology/Germany	1.4%
Judges Scientific plc	Industrials/UK	1.3%
NEXUS AG	Health Care/Germany	1.3%
Eckert & Ziegler	Health Care/Germany	1.3%

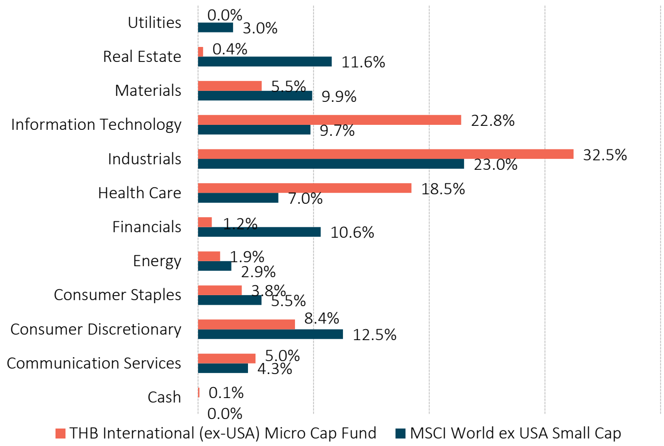
Source: THB Asset Management

Country allocation[5]



Source: THB Asset Management

Sector allocation[5]



Source: THB Asset Management

4.Portfolio statistics are reported in USD.
5. 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.

Investment strategy

THB Asset Management (THB), an investment franchise of Victory Capital Management Inc., is a dedicated micro and small cap specialist investment franchise based in Connecticut, USA. Founded in 1982, THB Asset Management has 39 years' experience investing in micro and small cap companies. THB's International Opportunities strategy is based on the belief that there are inefficiencies in the micro cap segment of the market due to lack of analyst coverage, limited investable options, resource constraints and difficulty in identifying value. THB utilises a disciplined, fundamental approach that blends both qualitative and quantitative methods to construct a well-diversified, low-risk portfolio of companies that possess attractive operating metrics, yet with comparable valuation to the MSCI World ex USA Small Cap® Index.

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