

THB US Micro Cap Fund

Quarterly Report – March 2019

Market Commentary

The Russell Microcap® Index returned +12.1% (AUD) in Q1 with all sectors exhibiting positive returns.

Health Care (+19.0%) was the best performing sector in Q1, followed by Real Estate (+18.6%) and Information Technology (+17.4%). Utilities (+5.5%) was the worst performing sector, followed by Financials (+6.9%) and Communication Services (+7.5%).

The U.S. equity markets rebounded during Q1 following a tumultuous end to 2018. Many of the concerns that contributed to the broad selloff late last year were replaced with optimism regarding a potential U.S./China trade resolution, solid corporate earnings, and a more dovish stance from the Federal Reserve that left interest rates unchanged and scaled back projections for further rate hikes in 2019. The U.S. federal government shutdown earlier in the year had some effect on consumer and business confidence indicators, but recent measures are off the intra-quarter lows and THB believes it will continue to see higher levels of confidence as the U.S. moves further away from the shutdown.

Employment is strong and will continue to drive the economy. The next leg of economic expansion will be supported by capital spending on technology to enhance automation, improve efficiency, and combat wage pressure as businesses find it more difficult to squeeze margins out of the labour force. Increased capex triggered by tax reform and deregulation efforts takes time to flow through the economy and the U.S. may be in the early days of witnessing the related economic growth benefits of these initiatives.

Portfolio Commentary

The THB Micro Cap Fund returned +6.2% in AUD (net of fees) in Q1, underperforming the Index by 5.9%.

Negative contribution came primarily from selection in Health Care (-1.5%), Information Technology (-1.5%), Financials (-1.4%), and Industrials (-1.0%). Underallocation to Health Care (-0.5%) was also a detractor. Positive contribution came largely from stock selection in Real Estate (+0.4%) and Materials (+0.3%), as well as overallocation to Information Technology (+0.3%).

Biotechnology stocks (which THB does not own) contributed approximately 40% of THB's underperformance. The balance of the underperformance stemming from stock selection is reflective of THB's focus on higher quality, lower risk stocks. Lower quality and higher risk companies that underperformed during the selloff in Q4 2018 rebounded disproportionately in Q1. For example, 12 out of the top 20 largest Index movers in Q1 are biotechnology companies.

THB's top five performing stocks (from a contribution standpoint) were Innovative Industrial Properties Inc. (Real Estate, +0.5%), UFP Technologies, Inc. (Materials, +0.4%), LeMaitre Vascular, Inc. (Health Care, +0.4%), Ultralife Corporation (Industrials, +0.4%), and Century Communities Inc. (Consumer Discretionary, +0.4%).

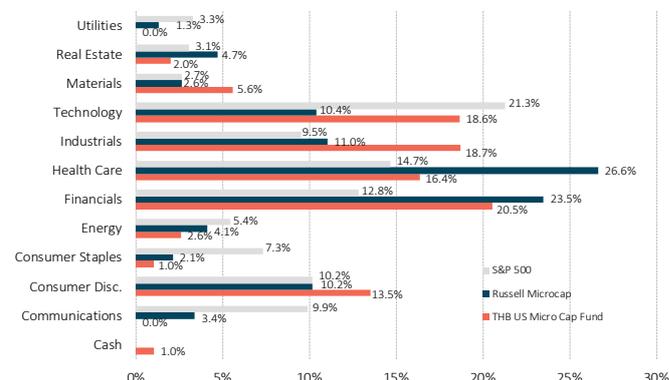
Fund Details	
Benchmark	Russell Microcap® Index ³
Inception Date	5 September 2014
Fund Size	A\$281.9 million

Performance ¹ – 31 March 2019			
	Fund ²	Russell Microcap®	Difference
1 Month	(3.8%)	(2.8%)	(1.0%)
3 Months	6.2%	12.1%	(5.9%)
1 Year	6.0%	5.4%	0.6%
2 Years p.a.	9.3%	9.1%	0.2%
3 Years p.a.	17.1%	15.4%	1.8%
Since Inception p.a. ²	12.8%	13.1%	(0.3%)

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 Allocation⁴



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 bottom five performing stocks (from a contribution standpoint) were Graham Corporation (Industrials,-0.3%), Allied Motion Technologies, Inc. (Industrials,-0.3%), PRGX Global, Inc. (Information Technologies,-0.3%), Insteel Industries, Inc. (Industrials,-0.2%), and Fiesta Restaurant Group, Inc. (Consumer Discretionary,-0.2%).

Even with the solid rebound in Q1, THB believes there is still room for additional gains, particularly when considered in the context of prior drawdowns similar in magnitude to the one that occurred in Q4 2018 in which 50% of all companies within the U.S. micro cap universe were down more than 15% in the trailing 12 months. In addition, the price-to-sales valuation gap between large cap and micro cap remains close to an all-time high and the absolute price-to-sales valuation of micro cap is not too far off long term trough levels (excluding the period during the great financial crisis).

Stocks in Focus

Zix Corporation (ZIXI)

Zix produces a software suite that provides email encryption and security solutions to defend against malware threats and data loss. High-profile data breaches have highlighted the necessity to invest in protection for email and other data. Founded in 1988, the company has since become a leading email encryption provider in the healthcare and financial services industries. Zix is also a trusted partner of Google and Cisco, which integrate Zix's solutions into their applications.

In January 2019, Zix announced the acquisition of AppRiver, a cybersecurity and productivity services company that more than doubled annual revenues and grew EBITDA more than 50%. This is expanding its reach into new products and customers. In a competitive security software industry, Zix has performed well due to its recurring cloud-based revenues, which carry high margins. As with AppRiver, it has been strategically acquiring products that complement its product suite, which provides bundle solutions that create competitive and hard-to-replicate offerings. THB believes Zix has upside potential as adoption of digital security solutions continues to grow rapidly, bundling opportunities increase cross-selling opportunities, and cost synergies are realised with the integration of AppRiver.

Nanometrics (NANO)

Nanometrics is a leading provider of process control metrology systems used in the fabrication of semiconductors, HBLEDs, data storage devices and solar photovoltaics. It specialises in Optical Critical Dimension (OCD) metrology, which is wafer fab equipment that is used to inspect and detect errors in 3D semiconductor architectures for yield enhancement. NANO is increasing its penetration of the 3D NAND and DRAM memory spaces with its Atlas III OCD metrology tool and taking share from competitors such as KLA-Tencor. Memory demand is being driven by the tremendous amount of data generated by cell phones, enterprise storage, the "Internet of Things", and autonomous driving, among other applications. Major customers include Samsung, SK Hynix, Micron, Intel, Toshiba, and Taiwan Semiconductor.

THB believes the pullback during Q4 created an attractive entry point at NANO's current valuation. NANO has a strong balance sheet with \$150 million in cash and no debt which, combined with solid cash flow from operations, provides it with financial flexibility for tuck in acquisitions and share buybacks. The company announced a new \$80 million stock buyback plan in March after completing its previous \$50 million plan in early 2018.

Portfolio Statistics¹

As at 31 March 2019		
	Fund	Russell Microcap®
Weighted Avg Market Cap	US\$582m	US\$644m
Price/Sales	1.1x	0.9x
Price/Book	1.7x	1.7x
Dividend Yield	0.8%	1.2%
Number of Securities	100	1,557
Standard Deviation	15.3%	16.9%
Sharpe Ratio	0.6	0.5
Beta	0.9	
Tracking Error	5.5	
Information Ratio	0.1	

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

Top 10 Holdings

Stock	Sector	Weight
Jonhson Outdoors Inc	Consumer Disc.	2.5%
PAR Technology Corp	Technology	2.5%
Old Second Bancorp	Financials	2.3%
Mesa Laboratories	Technology	2.2%
UFP Technology Inc	Materials	2.0%
Graham Corp	Industrials	2.0%
Luminex Corp	Health Care	1.9%
Argan Inc	Industrials	1.8%
MarineMax Inc	Consumer Disc.	1.8%
US Physical Therapy	Health Care	1.7%

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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