

# Small Cap Strategy



1Q:23

## MISSION STATEMENT

At QSV Equity Investors we strive to deliver a smoother ride in good markets and bad, seeking to help our clients reach their long-term investment goals by setting clear expectations and through investment in high-quality small and mid cap value stocks.

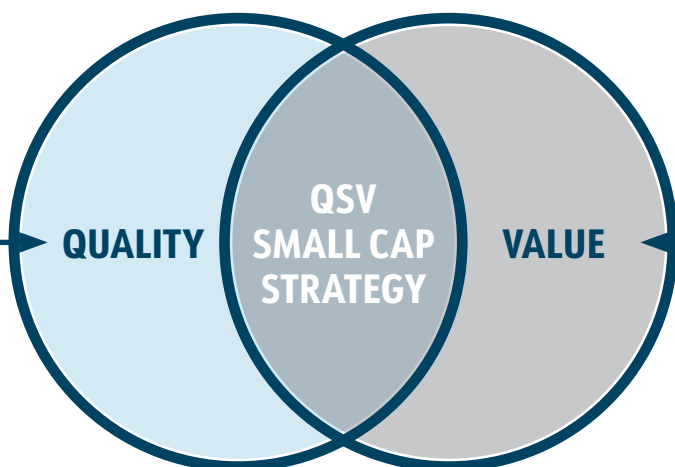


## INVESTMENT TEAM

QSV's investment team has navigated markets together for more than 20 years. Jeff Kautz and Randy Hughes founded QSV (formerly Ballast Equity Management) in 2016 and worked together previously at Perkins Investment Management, a subsidiary of Janus Henderson. While there, Jeff held roles including Portfolio Manager, CEO and Chief Investment Officer and Randy held the roles of Director of Research and Analytics and Equity Analyst. QSV is 100% employee owned and fosters a culture that marries independent thought with collaboration. Employee-owners invest alongside the clients of the firm in each of its strategies.

**QSV Quality Bias:** Invest in companies exhibiting strong balance sheets, stable and growing cash flows and returns on invested capital (ROIC) well in excess of their cost of capital (WACC).

Strong financial characteristics are sustained through the presence of a durable competitive advantage allowing the companies to drive economic profits well into the future.



QSV purposefully acts like business owners, focusing on a company's intrinsic value and blocking out day-to-day price moves.

QSV believes that buying wealth-creating businesses at discounts to intrinsic value will offer our clients stability, with less volatility and lower drawdowns, pursuing our goal to create long-term wealth.

# STRATEGY

**OBJECTIVE** QSV Equity Investors (QSV) Small Cap Strategy strives to deliver a smoother ride in good markets and bad, seeking to outperform the Russell 2000 Value Index and Russell 2000 Index with less risk over a full market cycle.

**OVERVIEW** QSV Small Cap Strategy invests with conviction in 50-70 high quality companies which can deliver high returns on invested capital well in excess of their cost of capital sustained through strong, durable competitive advantages. Identification and selection of these companies is supported by proprietary Quality Scores and fundamental research. QSV is patient and will only add a company to the Small Cap Strategy when its stock can be purchased at a reasonable valuation.

**PROCESS** QSV employs a research and screening process that includes four distinct steps:

 <b>SCREENING</b>	 <b>QUANTITATIVE ANALYSIS</b>	 <b>QUALITATIVE ANALYSIS</b>	 <b>VALUATION</b>
<p>QSV screens a universe of over 3000 small and mid cap stocks by charting the ratio of Enterprise Value to Invested Capital relative to the Return on Invested Capital for the companies. Investors should be willing to pay more for a business that earns high returns on capital; QSV only considers those that appear undervalued.</p>	<p>QSV ranks stocks in its universe according to its proprietary Quality Rankings Model, using factors that identify companies with strong financial flexibility, stable and growing cash flow and stable and improving profitability metrics. QSV focuses on stocks with Quality Rankings in the top two quintiles of its universe.</p>	<p>QSV believes strongly that high returns on capital are maintained and defended through proven, durable competitive advantages, such as economies of scale, strong intangible assets, high switching costs, network effects and cost advantages. QSV professionals carefully assess the durability of each business's competitive advantages.</p>	<p>QSV strongly believes that valuation plays a vital role in successful investing. Forecasting future economic profits and capital allocation decisions allows QSV to answer its primary question: "Does the company create wealth for investors over time?"</p>



<b>FUTURE ECONOMIC PROFITS</b>			
+			
<b>INVESTED CAPITAL</b>			
<b>MARKET VALUE</b>			
Y1	Y2	Y3	YN
EP	EP	EP	EP
$1+R$	$(1+R)^2$	$(1+R)^3$	$(1+R)^N$

Economic Profits (EP) =  
 ROIC - Cost of Capital Invested =  
 Total Investments in  
 the business from which  
 Economic Profits are derived

## 1Q:23 COMMENTARY

Equity markets finished the quarter with positive returns, while the path to those gains was a rocky one. January was marked by robust performance, with shares of lower-quality, higher beta companies showing significant gains. Markets were dampened in February with news that inflation, while cooling, persists and employment remains strong. March followed with the big story of the quarter, the “don’t say bailout” banking crisis, and the ninth in a string of interest rate increases from the Federal Reserve.

The **QSV Small Cap Strategy** led the returns of both the Russell 2000 Value and the Russell 2000 Indexes during the quarter. The most significant positive impact was made in Financials, where QSV added value in security selection and was underweight relative to the index, and in Communication Services, where QSV was overweight and outperformed the index. Our underweight and underperformance relative to the Consumer Discretionary sector detracted from performance.

### SMALL CAP TOP CONTRIBUTORS

**NAPCO SECURITY TECHNOLOGIES (NSSC)** was the leading contributor to performance during the quarter. Shares rose over 36% on better-than-expected revenues for the quarter and positive trends toward more recurring revenues. NAPCO manufactures security products for intrusion, fire, access control, and door locking systems. The company’s revenue primarily comes from commercial customers and products are sold through NAPCO’s ecosystem of 10,000 dealers and 2,000 integrators.

Shares of media company **WORLD WRESTLING ENTERTAINMENT (WWE)** were up more than 33% as expectations of a sale of the business rose. WWE has a strong brand within a niche audience, especially for its popular Raw and SmackDown content. Most revenues for WWE come from North America, but we believe there is an opportunity for growth outside the U.S. It was announced on April 3 that Endeavor Group (EDR) will form a new company, combining the UFC and WWE brands.

### TOP 10 HOLDINGS<sup>1</sup>

	% Weighting
NAPCO Security Technologies, Inc.	2.88%
Insperty, Inc.	2.51%
Simulations Plus, Inc.	2.29%
Primerica, Inc.	2.16%
Getty Realty Corp.	2.11%
Alamo Group Inc.	2.07%
RLI Corp.	2.07%
Innospec Inc.	1.98%
World Wrestling Entertainment, Inc. Class A	1.97%
Forward Air Corporation	1.95%
<b>TOTAL</b>	<b>21.99%</b>

### PERFORMANCE

	2Q:22	3Q:22	4Q:22	1Q:23	1 Year	3 Year (Ann)	5 Year (Ann)	Annual Total Return (since inception) 6/30/17
QSV Small Cap (Gross) <sup>3</sup>	-7.88%	-2.90%	6.58%	3.40%	-1.43%	17.14%	7.40%	7.65%
QSV Small Cap (Net) <sup>3</sup>	-7.96%	-3.04%	6.49%	3.31%	-1.83%	16.44%	6.60%	6.81%
Russell 2000 Value <sup>2</sup>	-15.28%	-4.61%	8.42%	-0.66%	-12.96%	21.01%	4.54%	4.73%
Russell 2000 <sup>2</sup>	-17.20%	-2.19%	6.23%	2.74%	-11.61%	17.51%	4.71%	5.67%

# 1Q:23 COMMENTARY – CONTINUED

## SMALL CAP TOP DETRACTORS

**SEACOAST BANKING CORP OF FLORIDA (SBCF)** was the leading detractor to performance for the quarter as shares dropped in tandem with the banking industry. SBCF offers commercial and consumer banking, wealth management, and mortgage and insurance services in the rapidly growing Florida market. While shares fell along with their regional bank peers, we see SBCF as a well-capitalized business with growing net interest margins, Returns on Tangible Equity of 10% and Returns on Equity of 7%.

Also in the banking industry, **HORIZON BANCORP (HBNC)**, fell during the quarter, detracting from performance. HBNC offers commercial and consumer banking, wealth management, and mortgage and insurance services to customers in Central Indiana and Michigan. Its network of branches includes those acquired from TCF Financial in 2021. While negatively impacted by the quarter’s banking crisis, we see HBNC as a strong enterprise, with Returns on Tangible Equity of 18% and Returns on Equity of 13%.

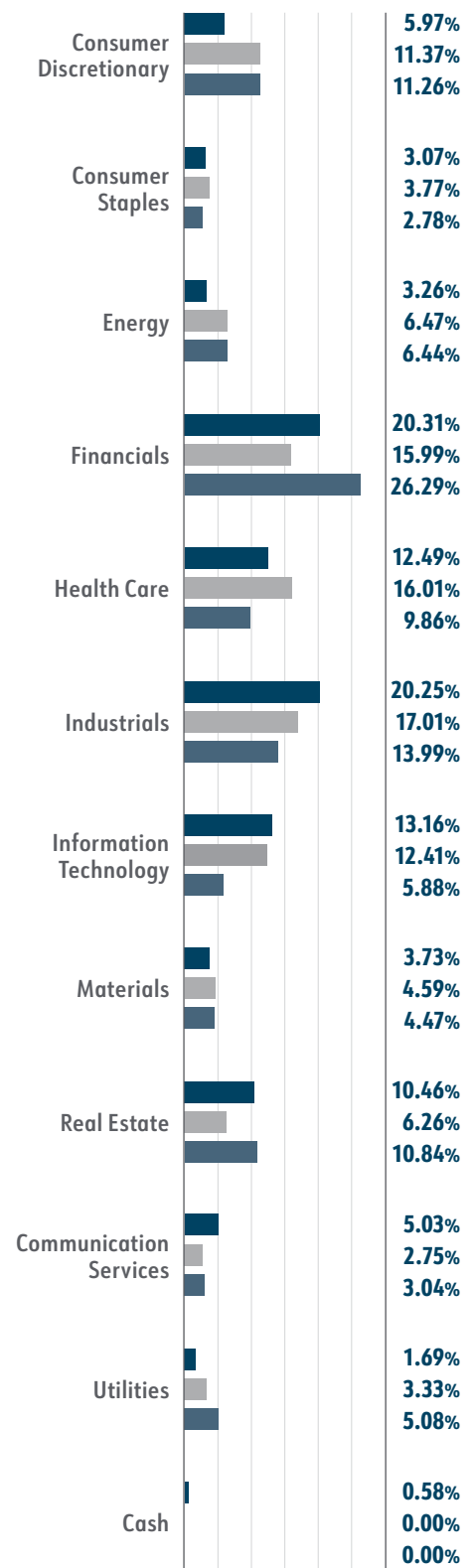
## SMALL CAP PORTFOLIO ACTIVITY

**AEROJET ROCKETDYNE HOLDINGS INC. (AJRD)** shares were sold early in Q1 as the company was acquired by L3Harris Technologies. QSV initiated new positions in investment banking and wealth management firm **EVERCORE EQUITY (EVR)**, **KULICKE & SOFFA INDUSTRIES (KLIC)**, a maker of capital equipment and tools for the semiconductor industry, and **NEXPOINT RESIDENTIAL TRUST (NXRT)**, an operator of multi-family properties in the southeastern U.S.

## OUR FOCUS ON THE LONG TERM

The banking crisis puts the Federal Reserve in a tenuous spot as it considers additional rate increases in the battle against inflation. Pressure on banks’ balance sheets caused by both the stresses on existing borrowers and the need to raise rates credited on deposits will lead to tightened lending standards and diminished lending. This, in turn, will put the brakes on growth and contribute to the risks of a recession. QSV cannot predict with any greater accuracy than the next person whether a recession occurs, but we do know that challenging times such as these generally favor quality businesses that can self-fund growth through free cash flows and less reliance on debt markets. Investors sought quality in a compact list of mega-cap tech companies in early 2023; we believe more compelling opportunities exist in small cap companies for investors able to dig out those with durable competitive advantages and reasonable valuations.

## SECTOR EXPOSURE<sup>^</sup>



QSV Small Cap<sup>1</sup>

Russell 2000<sup>2</sup>

Russell 2000 Value<sup>2</sup>

0 5 10 15 20 25 30 %

## PORTFOLIO CHARACTERISTICS

	QSV Small Cap	Russell 2000	Russell 2000 Value
Active Share		95.61	97.84
Number of Securities	61	1,922	1,364
Weighted Average Market Cap (MM)	2,865.19	2,829.95	2,319.13
Median Market Cap	2,450.08	905.54	795.27
Dividend Yield	1.72	1.93	2.87
ROIC	14.22	3.60	3.10
Debt/Capitalization	34.30	51.71	52.99
EV/EBITDA	15.47	10.89	10.38

## RISK METRICS

	QSV Small Cap	Relative to Russell 2000	Relative to Russell 2000 Value
Annualized Alpha		0.24	0.30
Beta		0.75	0.72
Up Capture		72.95	67.29
Down Capture		87.84	85.05
Standard Deviation*	17.40	22.35	23.19
Information Ratio		0.26	0.35
Sharpe Ratio	0.36	—	—

\*Standard Deviation is shown for the QSV Strategy and each respective Index.



For more information, please call  
**844.322.5527** or visit [qsvequity.com](http://qsvequity.com)

WE THANK OUR CLIENTS AND INVITE OTHER LIKE-MINDED INVESTORS TO CONTACT US IF WE MAY BE OF SERVICE.

## DISCLOSURES

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No client or potential client should assume that any information presented should be construed as personalized investment advice. Personalized investment advice can only be rendered after engagement of the firm for services, execution of the required documentation, and receipt of required disclosures. Investing carries risk of loss. You should consider the strategy's investment objectives, risks, charges and expenses carefully before investing.

<sup>^</sup> Sector classifications are generally determined by referencing the Global Industry Classification Standard (GICS<sup>®</sup>) and exclude cash. GICS was developed by and/or is the exclusive property of MSCI, Inc. and Standard & Poor's Financial Services LLC (S&P). GICS is a service mark of MSCI and S&P.

<sup>1</sup> Top ten holdings, sector weights and portfolio characteristics for the QSV Small Cap Strategy are taken from the model portfolio.

<sup>2</sup> The QSV Small Cap Strategy is compared to the Russell 2000 Indices as they are widely used benchmarks for small capitalization securities. An investment with QSV Equity Investors (QSV) should not be construed as an investment in a program that seeks to replicate, or correlate with, these indices. Market conditions vary between the QSV products and these indices. Furthermore, these indices do not include any transaction costs, management fees and other expenses, as do the QSV products. Lastly, QSV may invest in strategies and positions that are not included in these indices.

<sup>3</sup> QSV Small Cap returns are for the QSV Small Cap Composite. Net returns are calculated assuming the maximum advisory fee of 100bps is deducted from the quarterly gross composite return from inception through June 30, 2020. Starting July 1, 2020, actual fees charged are used to calculate net performance. Returns are net of both advisory fees and transaction costs. All dividends are assumed to be reinvested. The reporting currency is USD.

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