Punch

Small Cap Commentary
First Quarter, 2021

Overview

We saw a continuation of the strong trends from the previous quarter during the first quarter of 2021, with the Russell 2000 Index advancing 12.7% on the back of continued recovery in the economy and capital market generally. Small cap stocks have returned 95% over the past year compared to 56% for large cap stocks (as measured by the S&P 500 Index).

Notably, value stocks significantly outperformed growth stocks in the quarter, with the Russell 2000 Value Index rising 21.2% compared to a 4.9% gain for the Russell 2000 Growth Index. According to Furey Research, this was the second-best relative return for small cap value stocks ever. Growth stocks have started to lag value stocks since September of 2020 after multi-year outperformance.

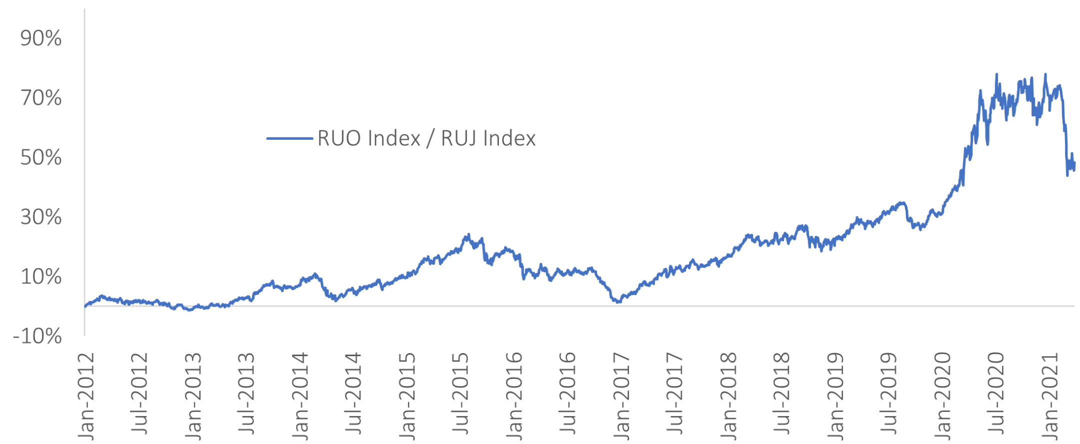
Our portfolio generally benefitted from rising interest rates in the quarter due to our exposure to financials, industrials, and materials which we believe positively correlate with higher rates. Should interest rates continue to rise over the coming years, we believe we are positioned well.

Attribution

The Punch Small Cap Strategy returned 20.5% in the first quarter, ahead of its benchmark index return of 12.7%. This outperformance was driven by both security selection and sector allocation.

Our overweight exposure to the consumer discretionary sector (12.4% average overweight), the second best-performing index group in the quarter, helped performance, while our underweight exposure to healthcare (10.2% average underweight), the worst-performing group, also helped. Our minimal exposure to the energy sector (up 41% in the first quarter) hurt our relative performance.

Growth vs. Value



Source: Bloomberg LP and Punch & Associates

Bottom Contributors to Performance

The global pandemic impacted companies differently for a variety of reasons. Some businesses lost demand, while others, like **Addus HomeCare Corporation (ADUS, $1.7 billion market cap)**, experienced accelerated demand.

Addus provides in-home personal care to the elderly and to those with chronic medical conditions. Despite the demand increase for businesses like Addus, the company suffered a hiccup in the first quarter of 2021. When the company reported fourth quarter 2020 results in the first quarter, it became apparent Addus might lose some of its New York state business based on an open bidding process. This disclosure caused the stock to decline. After talking with management however, we are confident the New York situation is isolated and the company may be able to retain the business after all, which represents less than 7% of its total revenue.

Bottom Contributors: First Quarter 2021			
Holding	Average Weight	Total Return	CTR** (bps)
Addus Homecare Corp	2.71%	-10.68%	-32
Green Brick Partners Inc.	3.16%	-1.22%	-10
HealthStream Inc.	1.43%	0.00%	-5
Par Pacific Holdings Inc.	1.61%	1.00%	1
Digi International Inc.	2.55%	0.48%	6

***CTR represents the contribution to total return in basis points. Contribution data is reflective of a representative account in the Punch Small Cap Equity Strategy.*

Given its in-home healthcare business model, we believe Addus is well situated to capture the broader healthcare trend shifting from treating patients in hospitals to treating them at outpatient facilities and in the home. COVID-19 helped accelerate this trend as payors are beginning to support more outpatient treatment and in-home care. In addition to the favorable healthcare tailwinds, we think Addus continues to do a nice job expanding its platform through acquisitions. Addus has a robust deal pipeline, and we expect the company to be aggressive in taking out financially weaker players in the space.

We frequently discuss **StoneX Group Inc. (SNEX, $1.3 billion market cap)** in our small cap commentaries because it is a core holding of our strategy. We view StoneX, a global brokerage and financial services firm for commercial customers, as a long-term compounder given its consistent mid-teen return on equity.

When StoneX reported first quarter 2021 results in early February, the company beat estimates on the top and bottom lines, but the stock traded down. A headwind in the first quarter, we expect interest rates to become a tailwind for StoneX as rates normalize. With the various business lines, the company has many moving parts making quarterly estimates hard to nail down accurately for its one covering analyst.

We continue to keep the company as a top holding in the Punch Small Cap Strategy, believing the company has room to grow given the scalability of its platform and attractive incremental margins. We think the management team members are great communicators and are well-aligned with shareholders. We anticipate the company will continue to take market share both organically and through continued acquisitions.

Our final bottom contributor to first quarter returns had more to do with capital markets challenges than business fundamentals. Capital markets activity was frothy in the first quarter of 2021 with the strong small cap appreciation in late 2020 and into the new year. During the first quarter, **Digi International Inc. (DGII, $630 million market cap)** took advantage of its highest stock price since 1998 with its first equity raise since 1991, but the offering itself was not well executed.

Digi sells services and components used in “internet of things” applications and cellular communications. Digi’s stock took a beating on its less than fully subscribed deal. Despite the sell off driven by capital markets, we believe the fundamentals

Annualized Performance as of 3/31/2021 (net of fees)						
	Q1 2021	1 Year	3 Years	5 Years	10 Years	Since Inception*
Punch Small Cap	20.5%	118.5%	15.2%	16.2%	12.6%	11.4%
Russell 2000 Index	12.7%	94.8%	14.7%	16.3%	11.7%	9.5%

**Inception date is 3/31/2002. Figures over one year are annualized.*

of the business remain intact. We not only participated in the equity offering, but we also added to our position in the secondary market based on our view that the dislocation in current valuation is temporary. Recurring revenue is growing at Digi, which should help the company attract a higher multiple as it becomes a bigger portion of total revenue over time.

Top Contributors to Performance

In what was a strong quarter for most small cap companies, the top contributors to our strategy are all underappreciated beneficiaries of the continued transition to a digital first economy.

Sleep Number Corporation (SNBR, $3.6 billion market cap), a premium mattress manufacturer, continued to benefit from consumers' focus on the home. During the first quarter, Sleep Number reported a strong end to 2020 and expects the momentum to continue in 2021. As a vertically integrated retailer, the company is well-positioned to sell to customers online and in stores. In addition, the company reported improving success with its digital marketing initiatives, translating to expanding operating margins, and increasing engagement with a broader (younger) audience. With marketing efficiencies expected to continue, the company provided 2021 guidance far exceeding sell-side expectations.

Sleep Number remains a core holding of the Punch Small Cap Strategy because we believe the company is well-positioned to benefit from several market tailwinds including interest in health and wellness, a strong housing market, and consumers' robust personal finance position after increased savings during the COVID-19 pandemic.

Ranpak Holdings Corp. (PACK, $1.5 billion market cap) is a protective packaging solutions company serving e-commerce and industrial customers. E-commerce and automation growth are two of the major market drivers for the company, and COVID-19 likely accelerated both trends. During the quarter, the company reported higher than expected growth in its e-commerce segment.

Despite benefitting from several in-demand investor themes like e-commerce, automation, and sustainability, the company remains under the radar of most investors with only two sell-side analysts covering it. The company's razor/razor-blade business model results in most of its profitability coming from selling paper, not the machines customers use. The earnings power of the company is not quantitatively obvious because the company is currently focused on getting its machines to more customers. As the business scales, we think Ranpak's economics will become clearer and investors will continue to be rewarded.

The E.W. Scripps Company (SSP, $1.6 billion market cap) is an operator of television stations and national media assets. The stock languished the last few years due to unclear strategy, several non-core assets in the portfolio, and investor concern about consumers' changing media preferences. Over the last six months, Scripps divested its podcast assets and acquired a leading digital media company. These moves resulted in more clarity on the company's focus and competitive differentiation. We (along with other investors) were happy to see the company divest non-core assets. The digital media acquisition could drive impressive returns for Scripps because it nicely compliments an existing business segment that shares infrastructure and broadcast spectrum. Scripps is also an economy re-opening beneficiary. As advertisers grow increasingly confident that consumers are ready to spend, they will turn to companies like Scripps to target customers.

Top Contributors: First Quarter 2021

Holding	Average Weight	Total Return	CTR** (bps)
B. Riley Financial Inc.	6.11%	35.33%	219
Sleep Number Corp.	3.08%	75.29%	186
Ranpak Holdings Corp.	2.97%	49.26%	125
Avid Bioservices Inc.	2.26%	57.97%	108
Lithia Motors Inc.	2.74%	33.39%	88

***CTR represents the contribution to total return in basis points. Contribution data is reflective of a representative account in the Punch Small Cap Equity Strategy.*

Portfolio Activity in the Quarter

During a busy first quarter, we added three new positions to the Punch Small Cap Strategy.

The first addition to the portfolio was **HealthStream, Inc. (HSTM, $704 million market cap)**, a solutions provider that helps train, credential, and organize healthcare providers in hospitals and other healthcare facilities. Some of these offerings include CPR training, OSHA training, and a newly introduced scheduling tool for nurses.

In recent years, the company began transitioning from one-time sales to a recurring revenue model that should make the business more predictable over time. This transition was disrupted during the pandemic as hospitals temporarily limited investment into their operations, creating an opportunity for us to initiate a position at a compelling valuation. We believe that COVID-19 has masked the underlying strength of the business and the benefits from the ongoing transition will become more apparent to investors as hospitals begin investing in their operations again.

Today, the founder and CEO owns over 17% of the business and is someone whom we believe is especially well connected throughout the industry. Additionally, the business has a strong balance sheet and a long runway for growth with limited penetration within existing customers and plenty of opportunities to add new customers. We believe the company will return to growth in the coming years and investors will begin to appreciate the transition that HealthStream has made.

The second new position during the quarter is **Sprouts Farmers Market, Inc. (SFM, $3.1 billion market cap)**. This U.S. grocery store chain has 360 stores across 23 states predominately focused in the south. The unique concept focuses on fresh, natural produce at affordable prices with a farmers market feel. With over half of the sales in perishable products, we believe the company is well-positioned to benefit from consumers' increased focus on healthier eating while maintaining lower costs than competitors like Whole Foods.

In 2019 the company hired a new and passionate CEO that had previously run grocery operations at Walmart. He has since recruited former colleagues to join the Sprouts business. In the last year, the company has accelerated several initiatives around e-commerce and marketing that we believe will benefit the business for years to come. We believe other investors have mistakenly dismissed both the recent improvements to the business and large growth opportunities as one-time benefits from elevated COVID-19 sales.

Looking forward, Sprouts has a strategy to grow the number of stores by 10% annually as they see ample room for the concept throughout the U.S. The company is self-funding this expansion strategy through strong cash flows from existing operations, making the growth sustainable. Today, the stock trades at an attractive valuation with 10% free cash flow yield.

The final new position during the quarter is **Global Ship Lease, Inc. (GSL, $512 million market cap)**, an owner and lessor of 43 mid-size containerships. On average, the company contracts its ships out to operators for over two and a half years, giving the company forward visibility into earnings and some isolation from industry events such as the recent blockage of the Suez Canal. Containerships are logistically integral to supply chains, shipping 80% of the world's physical goods by sea. These vessels carry a very diversified basket of products internationally at rates well below that of air cargo.

In 2018, Global Ship Lease caught our attention after acquiring a fleet of 19 younger containerships that essentially doubled the size of the business. Currently, strong demand for ships has reduced idle capacity within the industry to 1% while order books for new vessels remain near zero. In January, the company refinanced its debt from the containership acquisition, saving significant interest expense, and quickly commenced paying a regular dividend. We initiated a position after observing positive actions at the company, strong industry supply and demand dynamics, and a reasonable valuation of 5.6x price to earnings.

We exited **Varex Imaging Corporation (VREX, $803 million market cap)** during the quarter. Varex designs and manufactures x-ray imaging components for the healthcare and industrial sectors. Its offerings are used in CT scans, mammography imaging, and security detection. We were attracted to the company due to its strong market share, long-standing customer relationships, and valuation relative to other medical device companies. The company was a spin out of from a faster growing cancer treatment company, and we believed there was an opportunity as the shareholder base transitioned from large cap to small cap investors. Ahead of the spin-out, Varex made a large acquisition to further increase its market share.

Since purchasing Varex, the company has several restructurings related to the acquisition. It is apparent the management team underestimated the work required to integrate it. Finally, the company ran into several macro headwinds including a

U.S.-China trade war while the company was targeting China as a strategic growth market, weakening industrial customers tied to the declining price of oil, and the COVID 19 pandemic's reduction of elective surgeries that use several of Varex's offerings. With our lack of confidence in the management team and multiple market headwinds, we elected to exit our position.

Conclusion

A few weekends ago, a friend of one of our portfolio manager's son stopped him on the boy's way to the neighborhood skate park. "You work in investments, right?" he asked. "So how have you done on GameStop?" The dad patiently explained that his work was investing, not gambling, and that we have never traded GameStop or any other stock just because we found it on an internet message board. Brushing off the lecture, or perhaps not really grasping the nuances, the friend asked his opinion on Dogecoin, a cryptocurrency that bills itself as "the fun and friendly internet currency" and whose logo is a Japanese dog. "I told my parents to buy it," he proudly declared, "and it's up like ten times since then." He has certainly outperformed anything we own over the past two weeks.

Stories like these abound today. Suddenly, everyone is a stock market genius, and even thirteen-year-olds double or triple their money in days. One cannot help but think back to the shoeshine boys of the roaring 1920s with their hot stock tips and hours spent near the ticker tape to wonder if this is an ill omen for the stock market. The saga of GameStop—a dying mall-based retailer of video game cartridges that was briefly worth more than Delta Air Lines in January—is the poster child for the excesses, irrationality, and downright lunacy that exists in pockets of the market today.

The proximate causes of this madness of the crowds are not hard to identify. A bored, underemployed, locked-down investing public was offered commission-free trading by online brokers like Robinhood that purposefully created a casino-like experience for their "investors." This gamification of investing has hoodwinked a whole generation of young investors who did not experience the great financial crisis of 2008-09 (and who may not have even been alive in 1999-2000) into thinking that the stock market is a giant roulette wheel. We all know how this story ends for these folks…the house always wins.

The distinction between investing and speculating is an important one. Benjamin Graham, the father of value investing, elucidated in 1934: "An investment operation is one which, upon thorough analysis, promises safety of principal and a satisfactory return." A speculative operation, then, would be the opposite: no analysis, no safety of principal, and a return based purely on chance. Serious investing that is meant to build permanent wealth over a lifetime requires intelligence, a healthy appreciation for risk, an even temperament, and a large dose of patience.

> *"Serious investing that is meant to build permanent wealth over a lifetime requires intelligence, a healthy appreciation for risk, an even temperament, and a large dose of patience."*

While this should surprise no one, it's worth saying that we do not own GameStop or any other such companies in the Punch Small Cap Strategy. While we do focus on smaller publicly traded companies, we do not invest in penny stocks or speculative enterprises. We look to own a diversified portfolio of small cap companies with long histories of growth, profitability, and cash flow that are well-capitalized and run by management teams who themselves have track records of success. We also seek to acquire their shares when we believe prices offer a margin of safety. In all cases, we rely on our best reason, analysis, and judgment to attempt to produce a "satisfactory return" over time.

While obvious pockets of excess exist in the market today, we are not having difficulty finding compelling, reasonably priced investment ideas, particularly in the small cap arena.

In all these cases, our team of research analysts and portfolio managers has spent significant time, energy, and attention getting to know these businesses and their management teams well, and in our view, we've made well-reasoned, professional judgements on their prospects in the years to come. Investing is difficult, important work whose risks and potential returns should not be taken lightly. We would favor our approach over Dogecoin any day.

7701 France Avenue South, Suite 300
Edina, MN 55435
(952) 224-4350

See disclosures at the end of this commentary

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Composite performance is shown net of fees and brokerage commissions paid by the underlying client accounts. Certain client accounts have directed us to reinvest income and dividends, while others have directed us to not reinvest such earnings. As such, performance data shown includes or excludes the reinvestment of income and dividends as appropriate, depending on whether the account has directed us to reinvest income and dividends. Past performance is no guarantee of future results, and investing in securities may result in a loss of principal.

Please refer to the attached Composite Profile and Schedule of Performance for information regarding Punch & Associates' compliance with GIPS® standards.

The reference to the top five and bottom five performers within the Punch Small Cap Equity Strategy portfolio is shown to demonstrate the effect of these securities on the strategy's return during the period identified. Punch & Associates calculated this attribution data using a representative institutional client account which: 1) imposed no material restrictions related to investments made; and 2) was fully invested in the Punch Small Cap Equity Strategy during the entire time period shown. The holdings identified do not represent all of the securities purchased, sold, or recommended for advisory clients during the period of time shown. Past performance does not guarantee future results; therefore, it should not be assumed that recommendations made in the future will be profitable or will equal the performance of the securities in this list. Please contact Punch & Associates at andy@punchinvest.com or (952) 224-4350 to obtain details regarding our calculation methodology or to obtain a list showing every holding's contribution to the overall strategy's performance during the period of time shown.

We compile company specific information referenced in this commentary from a variety of sources including SEC filings, quarterly and annual reports, conference calls, conversations with management teams, and Bloomberg LP.

Any benchmark indices shown are for illustrative and/or comparative purposes and have only been included to show the general trend in the markets in the periods indicated. Such indices have limitations when used for comparison or other purposes because they may have volatility, credit, or other material characteristics (such as number and types of securities or instruments represented) that are different from those of the Composite and/or any client account, and they do not reflect the Composite investment strategy or any other investment strategies generally employed by Punch & Associates. For example, the Composite, or a particular client investment portfolio will generally hold substantially fewer securities than are contained in a particular index. *Inception of the Punch Small Cap Equity Strategy was March 31, 2002. **CTR represents the contribution to total attribution.

Punch & Associates Investment Management Inc.
Punch Small Cap Composite
Performance as of 6/30/2019

Punch

Year	Annual Performance History: Gross of Fees	Net of Model Fees	Benchmark[1]	3-Year Standard Deviation: Composite[2]	Benchmark	As of December 31st: Composite Accounts	Composite Assets (mil)	Firm Assets (mil)	Dispersion[2]
2009	32.78%	31.52%	27.17%	20.88%	24.83%	264	$86.0	$340.4	3.28%
2010	18.88%	17.79%	26.85%	23.19%	27.69%	273	$104.2	$395.6	1.03%
2011	0.80%	-0.12%	-4.18%	20.44%	24.99%	281	$104.8	$475.6	0.66%
2012	20.12%	19.07%	16.35%	17.15%	20.20%	290	$152.3	$613.6	0.63%
2013	42.64%	41.53%	38.82%	13.49%	16.45%	323	$267.6	$832.7	0.47%
2014	-0.23%	-1.07%	4.89%	12.61%	13.12%	333	$266.3	$905.7	0.25%
2015	0.52%	-0.38%	-4.41%	15.46%	13.96%	335	$256.2	$938.1	0.65%
2016	20.96%	19.84%	21.31%	17.20%	15.76%	353	$308.7	$1,101.0	0.50%
2017	12.93%	11.92%	14.65%	16.36%	13.91%	380	$357.0	$1,241.6	0.32%
2018	-9.88%	-10.79%	-11.01%	16.40%	15.79%	387	$293.5	$1,157.8	0.53%
2019 (through 6/30/2019)	16.97%	16.43%	16.98%	N/A	N/A	N/A	N/A	N/A	N/A

Period	Annualized Performance History: Gross of Fees	Net of Model Fees	Benchmark[1]
1 Year	-5.48%	-6.45%	-3.31%
3 Year	12.82%	11.75%	12.30%
5 Year	7.62%	6.64%	7.06%
Since Inception (3/31/2002)	11.00%	9.96%	8.20%

[1] The Russell 2000 Index is the Composite's benchmark. The returns of this index do not include any transaction costs, management fees or other fees.

[2] 3-Year Standard Deviation and Dispersion calculations for the composite are based on gross of fee returns.

Notes:

1. Punch & Associates Investment Management, Inc. (Punch) claims compliance with the Global Investment Performance Standards (GIPS®) and has prepared and presented this report in compliance with the GIPS standards. Punch has been independently verified for the periods from April 1, 2002 through June 30, 2019. Verification assesses whether (1) the Firm has complied with all the composite construction requirements of the GIPS standards on a firm-wide basis and (2) the Firm's policies and procedures are designed to calculate and present performance in compliance with the GIPS standards. The Small Cap Composite has been examined for the periods from April 1, 2002 through June 30, 2019. The verification and performance examination reports are available upon request.
2. Punch & Associates Investment Management, Inc. (Punch) is an investment adviser registered with the Securities and Exchange Commission under the Investment Advisers Act of 1940.
3. The Punch Small Cap Composite was created December 31, 2005 and includes discretionary, fee paying accounts over $100,000 invested in the firm's Small Cap strategy (Strategy). The Strategy invests in small cap companies that are typically between $250 million and $2 billion in market capitalization. The Strategy is benchmarked to the Russell 2000. The Strategy has been open since firm inception (March 31, 2002). Accounts are removed from the composite for cash flows exceeding 10% of the account's monthly beginning market value.
4. The portfolio returns for the period are based in U.S. dollars and reflect the reinvestment of dividends and other earnings. After June 30, 2018 net of fee performance was calculated by deducting one quarter of one percent from each quarter's gross performance and geometrically linking the resulting returns. Prior to June 30, 2018 net of fees performance figures are reflective of quarterly gross of fee returns minus actual investment fees paid by the underlying accounts in the composite for the period. The dispersion of the annual returns of the Composite is measured by the asset-weighted standard deviation method. Only portfolios that have been managed for the full year have been included in the annual dispersion calculation of the Composite. The three-year annualized ex-post standard deviation measures the volatility of returns for the Composite and benchmark over the preceding 36-month period. Punch's policies for valuing portfolios, calculating performance, and preparing compliant presentations and a list of composite descriptions are available upon request.
5. Punch has updated the historical performance results provided in this presentation to more precisely illustrate composite performance based on revised accounts' composite membership exit dates. For more information about the revisions and performance update, please contact us.
6. Past performance is not an indication or a guarantee of future results. Investments are subject to risk and may lose value.