



# Heartland Value Fund 3Q20 Portfolio Manager Commentary

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## Executive Summary

- The Value Fund continued to beat the Russell 2000® Value Index for the quarter and added to its lead through the first nine months of the year.
- Investors' herding impulses are no different from past bubbles.
- We've stuck to our time-tested formula that emphasizes valuations first.

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Past performance does not guarantee future results. Performance represents past performance; current returns may be lower or higher. Performance information for institutional class shares of Funds that existed prior to their initial public offering is based on the performance of investor class shares. The investment return and principal value will fluctuate so that an investor's shares, when redeemed may be worth more or less than the original cost. All returns reflect reinvested dividends and capital gains distributions, but do not reflect the deduction of taxes that an investor would pay on distributions or redemptions. Subject to certain exceptions, shares of a Fund redeemed or exchanged within 10 days of purchase are subject to a 2% redemption fee. Performance does not reflect this fee, which if deducted would reduce an individual's return.

"The four most dangerous words in investing are: 'this time it's different.'"

—Sir John Templeton

The Value Fund continued to beat the Russell 2000® Value Index for the quarter, adding to its lead for the year.

If we had to pick one word to describe 2020 it would be, Unprecedented. From COVID-19, to the scope of the wildfires on the West Coast and nearly everything in between, it has been a year unlike any other.

Yet, while circumstances may be unique, reactions have a way of following familiar patterns. Take investing for instance. Whether it's the Nifty Fifty bubble of the 1970s, the Dotcom craze of the 1990s or the lead up to the Great Financial crisis a little more than a decade ago, investor emotion and groupthink resulted in a similar pattern—a blind rush into a narrow slice of the market, with little regard for valuations or risks.

Judging by the chart below, which shows the enormous gap in performance between the tech-driven Russell 1000® Growth and the Russell 1000® Value indices, it looks to us that we are once again seeing the same old response to the latest “different” backdrop for equities.

### Growth Pains



Source: The Leuthold Group and FactSet Research Systems Inc. 10/1/1990 to 9/30/2020 monthly. This chart shows relative strength between the Russell 1000 Growth and Russell 1000 Value Indices.

All indices are unmanaged. It is not possible to invest directly in an index.

Past performance does not guarantee future results.

### Keeping our Eye on the Ball

While investors have been clamoring to bid up large growth companies, we've stuck to our time-tested formula that emphasizes finding growing companies, with solid balance sheets that are trading at discounts to what we view as their intrinsic worth. One of the portfolio's bank holdings offers a vivid example of this approach.

## A Value Vault?

In contrast to the recent new highs by the popular market indices, shares of many small cap banks are off 50% or more. With interest rates at historic lows, investors have avoided this industry due to compression of net interest margin and potential credit risk.

In our view, widespread abandonment of the group has created opportunities in well-run, unique franchises. A long-time favorite of ours, TriState Capital Holdings Inc. (TSC), is an example of the bargains available.

Headquartered in Pittsburgh, TriState is a branchless bank with a terrific record of growth—driven by double-digit percentage gains in deposits and loans. In less than five years, assets have tripled to over \$9 billion. The bank's efficiency is outstanding with revenue per employee of \$650k, twice the median for peers.

TriState has a differentiated product line led by a unique private banking model with \$4 billion in assets serving a network of high net worth clients throughout America. The offering has been growing double digits and since inception has had zero losses. Fortune has ranked Tristate in their 100 fastest growing companies list three years in a row.

Overall loan quality is outstanding, with non-performing debt to total loans of just .09%. We believe the company has strong management and are impressed by their 9% stake in the company. During the recent selloff, leadership has continued to buy shares.

With shares priced below book value at a single-digit multiple to earnings, we believe TriState represents an exceptional opportunity.

## In the Right Light?

Industrials is another sector that has struggled to maintain traction and, despite a solid quarter, remains down double digits year to date. We've sought to capitalize on weakness in the space with holdings that are nimble and taking share from competitors. We've found one such example in our backyard, Manitowoc Wisconsin-based Orion Energy Systems Inc. (OESX).

Orion is an electrical supply company specializing in converting industrial and commercial properties to high-efficiency LED lighting solutions. Shares of the company have had an impressive run despite the COVID-19 selloff that hit many Industrial names. We view the company as a potential beneficiary of newly cost-conscious businesses.

The LED lights Orion installs are more efficient than the systems they replace, resulting in significant potential energy savings for customers. Additionally, the company enjoys a cost advantage through their use of an army of local contract electricians for installations. Their small size also allows management to be nimble in addressing new opportunities and adapting to the market.

A new CEO has beefed up Orion's sales force that is focused on winning larger contracts. Management has cut costs and initiated new products like mold and mildew killing UV lights. Early results have been impressive with the company notching major wins including Prologis—the real estate investment trust that operates Amazon's warehouses REIT.

Orion, in our view, should be able to build on recent momentum and gain additional market share in the LED lighting industry. We would not be surprised if the company landed numerous large contracts in the quarters ahead and saw its top and bottom line growth continue to move higher.

## Mask up

Information Technology (IT) was a source of strength for the portfolio during the period, and we added to one of our holdings as shares pulled back.

We featured Photronics Inc. (PLAB), an industry leading, global manufacturer of photomasks used to transfer circuit patterns onto semiconductor wafers and flat panel displays, in our June Commentary. Since then, the company

reported better than expected earnings, but shares faltered as the company forecasted a temporary softening in demand due to COVID-19.

Despite the pause in forecasted growth, we remain steadfast in our belief that Photronics is set to reap the benefits of several years of growth investments. Along with an expected jump in sales, margins should expand as capital improvements wind down leaving the company well situated to generate robust cash flow going forward. We also view the business' strong financial position, with almost \$3 a share in net cash, as a competitive advantage that provides management the flexibility to buy back shares as they see fit.

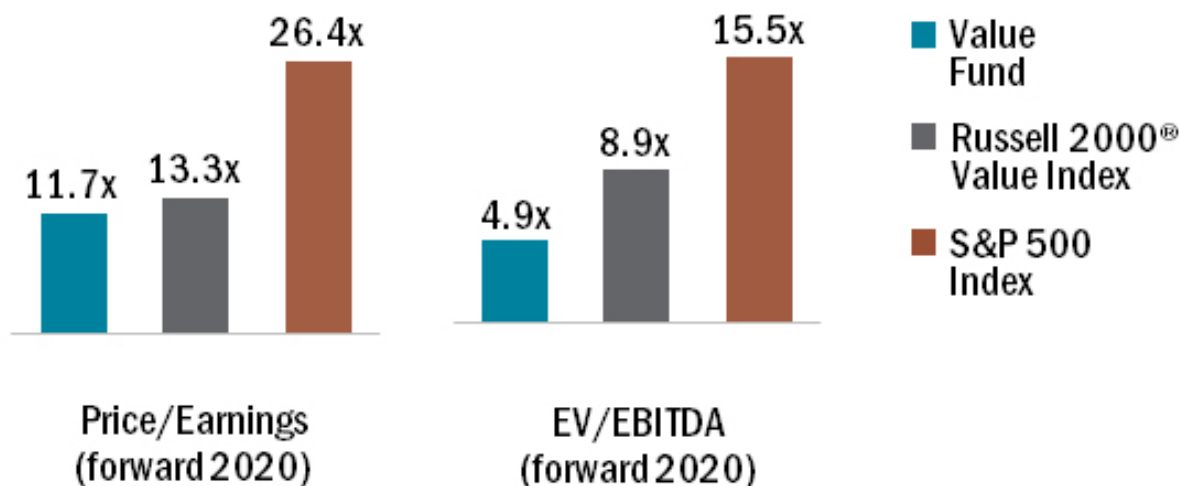
## Patience—The Forgotten Virtue

For those who judge investments based on headlines and the performance of a few broad indices, the case for small-cap stocks trading at attractive valuations may seem like a stretch. As a group, the asset class has lagged the large, growthy darlings of the market for longer than we'd thought possible. Yet, a closer look at fundamentals, balance sheets and growth potential, suggests that investors willing to put in the work can find meaningful opportunities.

In the past several quarters, our process and attention to detail has led us to winners in industries ranging from for-profit educators to gold miners to housing related stocks. While the catalysts for the portfolio's top performers have varied, they shared the common trait of valuations that we found far more compelling than the multiples paid by momentum investors for a handful of tech stocks.

We believe this fundamental approach can at times require patience but also is the best way to help our clients achieve their goal of capital appreciation. The valuations of your portfolio, shown below, are compelling, in our view, with solid sales and earnings growth which could exceed that of many ridiculously priced market darlings.

## Value Fund Valuations



Source: FactSet Research Systems Inc., Russell<sup>®</sup>, Standard & Poor's, and Heartland Advisors, Inc., as of 9/30/2020 Price/Earnings and EV/EBITDA are calculated as weighted harmonic average. Certain security valuations and forward estimates are based on Heartland Advisors' calculations. Certain outliers may be excluded. Any forecasts may not prove to be true. Economic predictions are based on estimates and are subject to change. All indices are unmanaged. It is not possible to invest directly in an index. Past performance does not guarantee future returns.

We remain unwavering in pursuit of investments that fit with our principles but also unrelenting in our commitment to improving. So to us, this time is no different. Our approach is particularly useful as we navigate a world with unprecedented challenges but where investor's reactions and herding impulses are hardly unique from past bubbles.

Thank you for your continued trust.

**Portfolio Management Team**



### Bill Nasgovitz

Nasgovitz is Chairman and Portfolio Manager of the Value Fund and its corresponding separately managed account strategy. He has 52 years of industry experience, 37 at Heartland.



### Will Nasgovitz

Nasgovitz is CEO and Portfolio Manager of the Opportunistic Value Equity Strategy, as well as the Mid Cap Value Fund, the Value Fund, and their corresponding Mid Cap Value and Small Cap Value Strategies. He also is President and Director of Heartland Funds. He has 20 years of industry experience, 16 at Heartland.

[View Fund Performance](#)

# Fund Returns

9/30/2020

&lt;&gt; Scroll over to view complete data

	Since Inception (%)	20-Year (%)	15-Year (%)	10-Year (%)	5-Year (%)	3-Year (%)	1-Year (%)	YTD* (%)	QTD* (%)
Value Investor Class	10.67	7.44	4.46	5.69	4.51	-2.06	-3.75	-10.17	6.62
Value Institutional Class	10.74	7.56	4.63	5.86	4.68	-1.90	-3.61	-10.06	6.69
Russell 2000® Value	9.92	7.40	4.93	7.09	4.11	-5.13	-14.88	-21.54	2.56

\*Not annualized

Source: FactSet Research Systems Inc., Russell®, and Heartland Advisors, Inc.

The inception date for the Value Fund is 12/28/1984 for the investor class and 5/1/2008 for the institutional class.

## Value Fund Quick Links

 [Factsheet](#)
[Commentary](#)
 [Attribution & Contribution Reports](#)
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## Email Sign Up

- I am a financial professional or institutional investor
- I am an individual investor



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In the [prospectus](#) (pdf) dated 5/1/2020, the Gross Fund Operating Expenses for the investor and institutional classes of the Value Fund are 1.10% and 0.92%, respectively. The Advisor has voluntarily agreed to waive fees and/or reimburse expenses with respect to the institutional class, to the extent necessary to maintain the institutional class' "Net Annual Operating Expenses" at a ratio not to exceed 0.99% of average daily net assets. This voluntary waiver/ reimbursement may be discontinued at any time. Without such waivers and/or reimbursements, total returns may have been lower.

Past performance does not guarantee future results. Performance represents past performance; current returns may be lower or higher. Performance information for institutional class shares of Funds that existed prior to their initial public offering is based on the performance of investor class shares. The investment return and principal value will fluctuate so that an investor's shares, when redeemed may be worth more or less than the original cost. All returns reflect reinvested dividends and capital gains distributions, but do not reflect the deduction of taxes that an investor would pay on distributions or redemptions. Subject to certain exceptions, shares of a Fund redeemed or exchanged within 10 days of purchase are subject to a 2% redemption fee. Performance does not reflect this fee, which if deducted would reduce an individual's return.

An investor should consider the Funds' investment objectives, risks, and charges and expenses carefully before investing or sending money. This and other important information may be found in the [prospectus](#) (pdf). To obtain a print prospectus, call 800-432-7856. Please read the prospectus carefully before investing.

As of 9/30/2020, Orion Energy Systems, Inc., Tristate Capital Holdings, Inc., and Photronics, Inc. represented 1.04%, 0.97%, and 0.92% of the Value Fund's net assets, respectively.

Statements regarding securities are not recommendations to buy or sell.

Portfolio holdings are subject to change without notice. Current and future portfolio holdings are subject to risk.

The Value Fund primarily invests in small companies selected on a value basis. Such securities generally are more volatile and less liquid than those of larger companies.

Value investments are subject to the risk that their intrinsic value may not be recognized by the broad market.

The Value Fund seeks long-term capital appreciation through investing in small companies.

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Economic predictions are based on estimates and are subject to change.

There is no guarantee that a particular investment strategy will be successful.

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Heartland Advisors defines market cap ranges by the following indices: micro-cap by the Russell Microcap®, small-cap by the Russell 2000®, mid-cap by the Russell Midcap®, large-cap by the Russell Top 200®.

Because of ongoing market volatility, performance may be subject to substantial short-term changes.

Dividends are not guaranteed and a company's future ability to pay dividends may be limited. A company currently paying dividends may cease paying dividends at any time.

There is no assurance that dividend-paying stocks will mitigate volatility.

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Book Value is the sum of all of a company's assets, minus its liabilities. Cash Per Share is calculated by dividing the free cash flow of a company by the number of shares outstanding. Dividend Yield is a ratio that shows how much a company pays out in dividends each year relative to its share price. Earnings Before Interest and Tax (EBIT) is an indicator of a company's profitability, calculated as revenue minus expenses, excluding tax and interest to eliminate the effect of different capital structures and tax rates used by different companies. Enterprise Value/Earnings Before Interest,

Taxes, Depreciation, and Amortization (EV/EBITDA) Ratio is a financial indicator used to determine the value of a company and is calculated by dividing the entire economic value of the company (enterprise value) by its earnings before interest, taxes, depreciation, and amortization (EBITDA). Price/Earnings Ratio of a stock is calculated by dividing the current price of the stock by its trailing or its forward 12 months' earnings per share. Russell 2000® Value Index measures the performance of those Russell 2000® companies with lower price/book ratios and lower forecasted growth characteristics. Russell 1000® Growth Index measures the performance of those Russell 1000® companies with higher price/book ratios and higher forecasted growth characteristics. All indices are unmanaged. It is not possible to invest directly in an index. Russell 1000® Value Index measures the performance of those Russell 1000® companies with lower price/book ratios and lower forecasted growth characteristics. All indices are unmanaged. It is not possible to invest directly in an index. Net Interest Margin is a performance metric that examines how successful a firm's investment decisions are compared to its debt situations. A negative value denotes that the firm did not make an optimal decision, because interest expenses were greater than the amount of returns generated by investments. Real Estate Investment Trust (REIT) is a security that sells like a stock on the major exchanges and invests in real estate directly, either through properties or mortgages. S&P 500 Index is an index of 500 U.S. stocks chosen for market size, liquidity and industry group representation and is a widely used U.S. equity benchmark. All indices are unmanaged. It is not possible to invest directly in an index.

Heartland's [investing glossary](#) provides definitions for several terms used on this page.