SIGNIA CAPITAL MANAGEMENT

Specializing in small & micro cap value investing

Commentary: Second Quarter | 2019

Signia Capital Management is a boutique money management firm specializing in value investing. The firm was founded in 2001 by the research professionals that serve as the managing partners. The senior members of our team have over two decades of investment experience and are dedicated to practicing a value investing discipline.

Our **Small-Micro Cap Value** strategy invests in high quality, catalyst rich companies that we expect will experience a significant improvement in earnings within the next 12 to 24 months. Our team identifies compelling investment opportunities through a rigorous bottom-up research process that includes direct dialogue with the management teams of each company under consideration. The process results in a concentrated portfolio of 25 to 35 individual investments, each with its own unique and compelling investment catalyst.

Investment Team

Richard Beaven, CFA	Lead Portfolio Manager
Colin Kelly, CFA	Director of Research, Portfolio Manager
Anthony Bennett, CFA	Portfolio Manager

Portfolio Characteristics

Investment Process	Value: Fundamental Bottom-Up
Mkt. Cap Range	$1b and Below
Median Market Capitalization	$315 M
Number of Holdings	25-35
Target Return: 3 to 5 yr Annualized	12%-14%

Top 10 Holdings (%) 8/15/19

North American Construction Group LTD	6.5%
Solaris Oilfield Infrastructure Inc	5.0%
Regional Management Corp	5.0%
Landec Corp	4.8%
Gain Capital	4.5%
Red Robin Gourment Burgers	4.5%
Sterling Construction	4.5%
Heritage Insurance Holdings	4.4%
Rent-A-Center Inc	4.2%
Amerigo Resources LTD	4.1%

Sectors Weightings (%) 8/15/19

Financial Services	25.6%
Consumer Discretionary	28.4%
Producer Durables	10.7%
Energy	11.9%
Materials & Processing	13.4%
Consumer Staples	3.3%
Autos & Transports	3.2%
Technology	2.5%
Cash	1.0%
Total Portfolio	100.0%

Portfolio Snapshot 8/15/19

Current Number of Holdings	27
EV/EBITDA	5.9
Price to Book	1.3
Price to Sales	1.4
Price to Cash Flow	8.2
L.T. Debt to Capital	1%
Price to Earnings (forward)	12.0
2019 Vs. 2018 EPS Growth	5%
Weighted Average Mkt. Cap	$379
Turnover (annual)	60%

This year small cap stocks have failed to participate in the broad market rally, in fact small and micro cap stocks began showing material weakness four quarters ago, significantly diverging from large cap and growth stocks. The S&P 600 Pure Value Index (small cap value stocks) has underperformed S&P 500 Index (large cap stocks) close to 27% over the last year. Given our focus on small and micro cap value, our portfolio has been challenged over the last four quarters. However, these cycles historically represent significant opportunities. In past cycles when small caps underperform large caps to a similar degree, small caps dramatically outperform over the next three and five year periods. Using data compiled by Furey Research going back to 1986, in periods where small caps, as measured by the Russell 2000 Value, have underperformed large cap stocks, measured by the Russell 1000, by 15% or more over a one year period, the future relative return for small caps is an outperformance of 37% over 3 years and 55% over 5 years vs. large caps. This relationship is positive over 88% of the time (Fig. 2). We believe this is one of the many reason to be optimistic about future returns for small caps and our portfolio on a relative basis. We also believe it makes a strong argument for investors with 3 to 5 year time horizons to consider allocating to small and micro cap value in today's environment.

Looking deeper into the relative performance data, stocks with the lowest valuation as measured by Enterprise Value to EBITDA have performed the WORST over the last year! The lowest EV/EBITDA quartile of the Russell 2000 Value Index (excluding REITS and Financials) declined by 26.8% over the last year. In other words, companies that trade at the lowest multiple of their operating earnings have performed the poorest in the market over the last four quarters (Fig. 1). As a value manager, Enterprise Value to EBITDA is one of the primary metrics we use to identify investment candidates for our portfolio. It is also a key multiple used by private equity funds to identify takeover and investment targets. Over the last three-and-a-half years, 14 of our portfolio holdings have been acquired by either private equity funds or strategic acquirers. So far this year, two of our holdings were acquired, Smart & Final (SFS) and Papa Murphy's (FRSH), and three more of our holdings are in the process of exploring strategic alternatives or are in active discussions with activist investors. Given the record amount of capital that has flowed to private equity funds over the last 5 years and the attractive valuations in small and micro cap stocks relative to large cap and growth, we would not be surprised to see takeout activity accelerate going forward. Signia's portfolio currently trades at just over 6x Enterprise Value to EBITDA. This compares to a 12.6x multiple for the S&P 500 and 15x for the NASDAQ 100. This spread demonstrates the significant discount and opportunity present in our portfolio today.

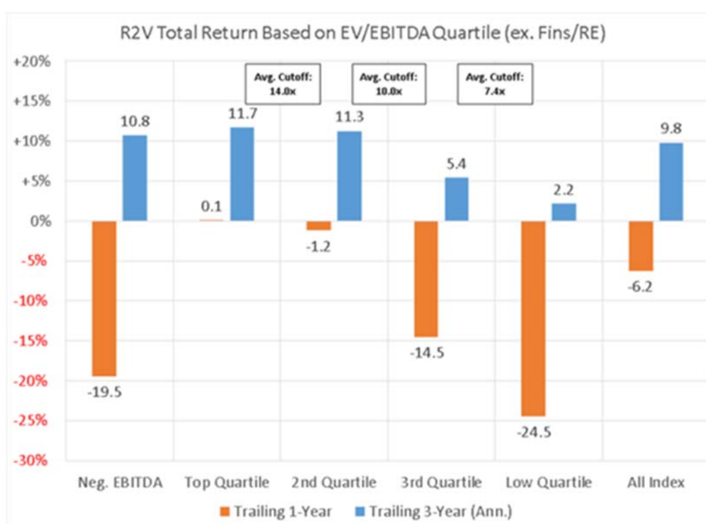

Figure 1 *Source: Furey Research Partners*

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In the most recent quarter we added three new positions to the portfolio, Cato Corp (CATO), Red Robin Gourmet Burgers (RRGB), and Gold Resources Group (GORO). Cato Corp is an example of the extreme opportunities present in the small and micro cap market today. The company operates 1,300 stores across 31 states in the South and North East regions of the United States. The company sells private label merchandise, primarily clothing, targeting women in the moderate to low price category. Cato has managed to remain profitable operating small and medium sized stores in a very tough environment for brick and mortar retailers. The company currently trades a 2.2x Enterprise Value to EBITDA, has $8 a share in net cash on its balance sheet, and pays out a $1.30 per share dividend which equates to a 10% yield on a $13 stock. A valuation like this would imply that the company is distressed or going out of business. In the case of Cato, the company is growing, same store sales are comping positively, and operating margins are improving over the prior year. The company generates positive earnings and free cash flow and yet it trades at a multiple of 2.2x operating earnings.

RRGB Red Robin Gourmet Burgers, another new portfolio holding, has attracted the interest of strategic investors. On June13th the private equity firm Vintage Capital disclosed it purchased 11.5% of Red Robin company stock. Vintage also published a letter to the board encouraging the company to review strategic alternatives in order to increase shareholder value. Additionally, Vintage said it is willing to participate in the sale process and would bid up to $40 per share for the company. We have been investors in several companies that Vintage Capital has invested in or acquired, most recently, Rent-A-Center (RCII) and Papa Murphy's (FRSH). Based on our history, we believe Vintage Capital has legitimate interest in RRGB. In addition to the possible transaction with Vintage, Red Robin has the opportunity to refranchise up to 100 of 480 company owned stores. We believe each store is worth $800,000 to $1.2 million, which would produce up to $100 million in additional capital for the company. From a valuation perspective we believe if Red Robin is acquired it would be worth 7-8x EV/EBITDA or $45-$50 per share.

GORO Another recent addition to the portfolio is Gold Resources Corp. Gold Resource Corporation produces gold and silver from its core operations in Oaxaca, Mexico. The company expects to double its gold production over the next two years as a newly constructed mine in Nevada comes online. Once at full production in 2022, total annual gold production is expected to grow to over 67,000 ounces per year. Over the next 24 months, the company expects significant growth in earnings and cash flow. The company management and board have a history of distributing earnings to shareholders through sizable dividends and they have communicated their intention to resume dividend payments in the next year.

In spite of the difficult environment over the last year, we continue to focus on identifying unique and attractive investments and believe the current environment offers plenty of opportunity. We view our portfolio of 30 companies similar to that of a private equity fund and believe that many of the "marks" on our portfolio companies do not reflect their fair market value. As discussed above, the valuation disparity between small and microcap value relative to large cap and growth provides a compelling investment opportunity. Prior to the last four quarter sell off our portfolio had generated 17% annualized returns from its inception in 2011. We expect over 3 and 5 year periods that our strategy should generate low to mid double digit returns. We see the current valuation set up in the market as a great opportunity to allocate to small and microcap value.

	R2000V less R1000 Relative Return		
	Trailing		
Month	**1Y**	**3Y**	**5Y**
Aug-86	(15.9)	(10.3)	(39.8)
Jan-87	(14.1)	(15.7)	(28.3)
Aug-89	(15.0)	(14.3)	10.0
Nov-89	(14.2)	(2.4)	14.3
Dec-89	(18.0)	4.3	20.9
Feb-90	(16.4)	9.4	15.4
Mar-90	(15.3)	10.3	10.2
May-90	(18.1)	18.3	17.0
Jun-90	(16.9)	18.3	18.2
Jul-90	(14.0)	27.4	25.9
Aug-90	(15.1)	38.3	42.5
Sep-90	(16.7)	53.6	49.0
Oct-90	(18.9)	71.9	56.7
Nov-90	(19.2)	65.2	56.2
Dec-90	(17.6)	66.8	59.6
Jan-91	(16.7)	59.0	42.4
Feb-91	(15.2)	51.7	32.7
Aug-98	(18.1)	28.2	62.5
Sep-98	(20.1)	21.9	59.4

	R2000V less R1000 Relative Return		
	Trailing		
Month	**1Y**	**3Y**	**5Y**
Oct-98	(27.4)	27.2	69.9
Nov-98	(28.1)	31.3	76.8
Dec-98	(33.5)	40.4	79.1
Jan-99	(37.5)	50.0	91.2
Feb-99	(36.2)	60.3	104.3
Mar-99	(38.7)	73.0	114.1
Apr-99	(35.6)	73.4	92.0
May-99	(29.8)	62.4	85.3
Jun-99	(27.6)	64.3	90.8
Jul-99	(19.8)	49.7	87.0
Aug-99	(25.3)	52.7	94.3
Sep-99	(21.1)	52.2	101.9
Oct-99	(24.9)	55.5	113.7
Nov-99	(22.7)	62.5	129.3
Dec-99	(22.4)	60.8	129.9
Nov-07	(16.0)	11.0	5.1
Dec-07	(15.6)	13.7	9.1
Sep-14	(14.9)	5.5	
Jan-18	(15.9)		
Jun-19	(16.3)		
Jul-19	(15.7)		
Average Return R2V over R1		37.3%	55.5%
% Postive		88.6%	94.3%

Figure 2 *Source: Furey Research Partners*

** Source: Signia Capital Management, LLC, Thomson Reuters Baseline and the Frank Russell Company. The information provided in this report should not be considered a recommendation to purchase or sell any particular security. There is no assurance that any securities discussed herein will remain in our composite at the time you receive this report or that securities sold have not been repurchased. Our portfolio characteristics and sector weightings are based on a representative account and may not be indicative of this strategy's current or future investments. It should not be assumed that any of the holdings discussed herein were or will be profitable or that the investment recommendations or decisions we make in the future will be profitable or will equal the investment performance of the securities discussed herein. This information is shown as supplemental information only and complements the full disclosure presentation (fully compliant GIPS presentation). Past performance is no guarantee of future results.

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