Heptagon Kettle Hill US L/S Equity Fund

Q1 2024 Commentary

Portfolio Management

Andrew Kurita

Investment Objective

The Fund aims to achieve long-term capital growth through investing primarily in US small-capitalization stocks. The Fund's Sub-Investment Manager, Kettle Hill Capital Management, is a long/short equity fund manager, established by Andrew Kurita in 2003 and is in New York, USA.

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Opinions expressed whether in general or in both on the performance of individual investments and in a wider economic context represent the views of the contributor at the time of preparation.

The **Heptagon Kettle Hill US L/S Equity Fund** (the "Fund") is a sub-fund of Heptagon Fund ICAV which is an open-ended umbrella type investment vehicle authorised pursuant to UCITS regulations. Heptagon Capital Limited ("Heptagon") is the Investment Manager and Kettle Hill Capital Management, LLC ("Kettle Hill") is the Sub-Investment Manager, meaning Kettle Hill exercises discretionary investment authority over the Fund.

The Fund was launched on October 5, 2017 and had AUM of USD 95m as of March 31, 2024. Since launch to the end of Q1 2024, the Fund has returned 5.9% (Y USD share class) compared to 3.9% for the HFRX Equity Hedge Index, on an annualised basis. During the first quarter of 2024, the Fund returned 2.6% compared to 3.4% for the HFRX Equity Hedge Index.

For the quarter ended March 31, 2024, Kettle Hill Partners, LP had a gain of 2.2%, net of all fees. Longs contributed 4.1% and shorts subtracted 1.9%. Ending exposure was 94% gross and 34% net, 64% gross long and -30% gross short, resulting in a long/short ratio of 2.14:1.

1Q24 Winners and Losers

Best-Performing Long—Everbridge, Inc. (EVBG)
Everbridge is a critical-event-management software company based in Burlington, Massachusetts. It provides mass-emergency notification and event-response logistics for corporate and government clients. The stock was a former highflier that crashed after growth slowed and competition increased. We believed the market overreacted, and that Everbridge was fundamentally undervalued. Our judgement was proven to be correct after Thoma Bravo, a leading technology private equity firm, ultimately acquired Everbridge on a second, raised offer of $35 per share. We were encouraged that this buyout occurred at the same level as our estimated private market valuation. This was another validation of our software investing strategy. We believe that there are numerous small-cap software stocks that have been improperly valued within the public markets, and that more opportunities remain to capitalize on potential public-versus-private market valuation dislocations.

Past performance is no guide to future performance, and the value of investments and income from them can fall as well as rise

Worst-Performing Long—Unity Software Inc. (U)
Unity makes video game development and marketing software and is based in San Francisco, California. The company had a difficult 2023 after the former management team raised prices in a clumsy manner, angering their customer base. We were optimistic about the appointment of James Whitehurst as CEO. He has a great resume, was responsible for the turnaround of Red Hat and is highly regarded in Silicon Valley and on Wall Street as an honest and effective manager. Unity is a rare asset that was poorly managed and under-monetized. It is one of only two scaled gaming engines in the world, and we believe they will become more valuable as AI functionality enables any company with limited development experience to "gamify" advertising.

Unity made too many acquisitions, had too many R&D projects with questionable economics, underpriced their engine and lost technological leadership in their marketing division. We think the strategy to rebuild the company is sound, but that it will take years, not months, to turn the company around. The company's new pricing will take time to layer in, and the marketing division needs to overcome technological debt. The stock spiked in the fourth quarter as other investors saw the potential in their plan. The stock fell in 1Q24 when they announced disappointing earnings, and investors realized how long it will take to actualize the turnaround. As per our risk management guidelines, we reduced the position size in response to a 20% drop in the stock. We continue to hold a smaller position, as we believe they will succeed in improving the profitability of the company.

Best-Performing Short—YETI Holdings, Inc. (YETI)
YETI makes premium insulated coolers, cups and outdoor gear and is based in Austin, Texas. YETI is losing market share in the cup and cooler market to Stanley. It is our belief that the company sold too much product into the wholesale channel. We were surprised to see Dick's Sporting Goods erect a massive end cap in their stores to promote Stanley product. We fought with this short all through 2023, and we were finally rewarded in 1Q24 after the company cut guidance. We think their share loss will continue in 2024, and that the stock is still overvalued.

Worst-Performing Short— SPDR S&P 500 ETF (SPY)
We actively manage the net and gross exposure for the fund, and we will use ETFs to change exposure expeditiously in anticipation of future market moves in the short term.

1Q24 Review

2023 ended on a high note, as the consensus view was for inflation to decline to the Fed's target level of 2%, with several interest-rate cuts and no decline in economic activity. Many strategists were recommending a "risk-on" approach and also advocating increasing allocations to small-cap stocks. Consensus then shifted from that optimistic view, as inflation readings were higher than expectations, and the market began to expect fewer rate cuts. We gave back some gains as the small-cap market fell in January, but the portfolio rebounded in February and March. Technology, energy and consumer discretionary were our strongest performing sectors on a net-return basis. Positive returns in software and social media were complemented by identifying a positive change in supply-and-demand dynamics in the offshore drilling market and good trading in consumer stocks. Short bets against credit-exposed financials, raw-materials companies and ETF hedges were the main detractors.

Investment Outlook

We believe that the market is fully valued, investors are complacent, and there are many geopolitical, macroeconomic and election risks that are not priced in. We will proceed cautiously. We think the fears about sticky inflation are overblown. The headline numbers are being driven by quirky individual factors, and our companies are telling us about a mild slowdown in demand and greater availability of labour. We think that artificial intelligence will have a negative impact on jobs, and that the risk is tilted toward recession. As the Fed keeps rates higher for longer, there is greater risk of keeping monetary policy restrictive for too long. Corporate and consumer cash flow will be negatively impacted as low-cost debt rolls over to higher market interest rates. Consumer debt is back to pre-pandemic levels, cash balances for lower-income households have normalized, and lenders are beginning to see higher levels of credit delinquencies emerge. We think rates will decline, but there may be negative revisions to earnings as the year progresses. We think we have positioned the portfolio accordingly, with longs with recurring revenues in software, REITs and utilities. We have long investments in companies with idiosyncratic catalysts and positive management change. We are short cyclicals and financials that are exposed to worsening net-interest margins and declining credit quality.

Operational Update

There were no changes to personnel in the quarter and no material changes to the overall business.

Conclusion

We believe the small-cap market has become more inefficient, and the opportunity set is attractive; the current structure of the stock market creates more glaring valuation dislocations to exploit. Our goal is to manage the portfolio prudently to generate alpha and produce equity-like returns with lower volatility over the long run. Thank you for your continued support and trust.

Sincerely,
Heptagon Capital and Kettle Hill Management

Annualized Total Returns as of 31st March 2024, net of fees

	Q1 24	YTD	1-Year	3-Year	5-Year	10-Year
Kettle Hill Partners, LP	2.2%	2.2%	12.6%	3.6%	7.5%	6.2%
HFRX Equity Hedge Index	3.4%	3.4%	9.7%	5.3%	5.6%	3.1%

Source: Kettle Hill, Morningstar

Kettle Hill manages the Irish regulated Heptagon Kettle Hill US L/S Equity UCITS Fund according to the same investment principals, philosophy and execution of approach as it manages Kettle Hill Partners, LP, a Delaware Limited Partnership available for U.S. accredited investors that launched in June 2003. However, it should be noted that due to different regulation, fees, taxes, charges, and other expenses there can be variances between the investment returns demonstrated by each portfolio. Kettle Hill Partners, LP performance is provided in the table above to show a longer track record for the underlying strategy.

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Risk Warnings

The Fund is subject to special risk considerations including geographic concentration risk, portfolio concentration risk and operational risk. The investment return and principal value of an investment will fluctuate so that the investor's shares, when redeemed, may be worth more or less than their original cost. Any investor should consider the investment objectives, risks and charges and expenses of the fund carefully before investing. Where an investment is denominated in a currency other than the investor's currency, changes in rates of exchange may have an adverse effect on the value, price of, or income derived from the investment.

SFDR

The Fund takes sustainability risks into account within the investment process, and this is disclosed in accordance with Article 6 requirements of the Sustainable Finance Disclosure Regulation ('SFDR') in the Fund's Prospectus. However, the Fund does not have as its objective sustainable investment and does not promote environmental or social characteristics for the purposes of the SFDR. Sustainability risks may occur in a manner that is not anticipated by the Sub-Investment Manager, there may be a sudden, material negative impact on the value of an investment and hence the returns of the Fund. As a result of the assessment of the impact of sustainability risks on the returns of the Fund, the Sub-Investment Manager aims to identified that the Fund may be exposed to sustainability risks and will aim to mitigate those risks.

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For all definitions of the financial terms used within this document, please refer to the glossary on our website: https://www.heptagon-capital.com/glossary

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