ValueInvestor INSIGHT

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Avoiding Crowds

VELA Investment Management's Ric Dillon, Jason Downey and Jenny Hubbard explain why the firm's portfolio managers retain research coverage, why they believe apathy toward small-caps is misguided, how they see AI creating opportunity, and why they think Sun Country Airlines, Bruker, Ingles, Worthington Enterprises and Jack Henry are mispriced.

INVESTOR INSIGHT

VELA Investment Management
Ric Dillon, Jason Downey, Jenny Hubbard

Investment Focus: Seeking companies whose stocks, primarily due to neglect or indifference, don't currently reflect their more normalized levels of earnings power.

"We've had countless client meetings over the last year and a half and almost unanimously people have little to no interest in small caps," says VELA Investment Management's Ric Dillon of his firm's best-performing strategy. "In a weird way that's encouraging and makes me that much more excited about the potential for small-cap outperformance going forward."

Targeting misunderstood Russell 2000 companies, Dillon and portfolio managers Jason Downey and Jenny Hubbard have since the inception of VELA's small-cap strategy in 2020 generated a net annualized 15.5% return, versus 11.8% for the Russell 2000. Today they're finding unrecognized upside in such diverse areas as regional airlines, life sciences, supermarkets, banking services and building products.

Five years ago [*VII*, December 30, 2020] we talked about the wide gap between how commonly defined "growth" and "value" stocks were being valued, how it was reminiscent of the Internet bubble, and how that set up well for value-centric investors going forward. Might this be a case of "the more things change, the more they stay the same?"

Ric Dillon: Time flies doesn't it. Five years ago there was a strong market recovery from Covid lows, as governments and central bankers did everything they could to address the economic impact of the pandemic. By December when we spoke the growth/value valuation disparity was high and then it went higher into 2021, hitting levels last seen in the Internet bubble.

In 2022 it seemed as if a correction in that might be underway and the market pulled back meaningfully in anticipation of a recession. That didn't last long and we morphed into the growth-stock narrative of the Magnificent Seven and then everything having to do with artificial intelligence. Despite some faint signs of correction in the past two months, that's where we still are today. So at the risk of sounding like a broken record, I think we're still in a period like the late 1990s and that a focus on value over the next ten years will serve investors very well. In any event, in the current market we've got more good ideas than ever, particularly at the smaller-cap end of the spectrum.

You've mentioned that it's rare today to find people interested in small caps. Have the traditional reasons for their potential mispricing – lack of coverage, higher growth upside, greater risk premium, takeover potential – become passé?

RD: We don't believe so. You will hear people say the nature of the economy has changed and that in the Internet age the spoils only go to the biggest players. People also talk about how there are just fewer small public companies out there and private equity has bought up most of the best ones.

We think all the reasons for historical long-term small-cap outperformance are intact and what's primarily behind the lack of interest in such stocks today is simply that they haven't done well versus large caps for quite some time and the momentum becomes self-fulfilling. That's resulted in what we think is a meaningful divergence in many cases between price and value. The S&P 500's forward P/E of 22x is about 40% above its long-run average, while the S&P SmallCap 600 index trades at a 15x forward P/E, right around its long-term average. I have very high conviction that over the next five years – and certainly the next ten years – small caps will do much better than the S&P 500. Not by a little, but by a lot.

Describe the types of small-cap companies that attract your interest.

Jenny Hubbard: We define our opportunity set as companies in the Russell 2000 index, at the low end of the range at $250 million or so in market cap and at the high end around $11-12 billion in market cap. The lower end is where you still find hidden gems where sell-side coverage is sparse or non-existent. At the higher end we're often taking advantage of corrections in share prices that take a mid-cap back into the small-cap range. That was a particularly fertile area for ideas in the post-Liberation Day selloff earlier this year, many of which have paid off quite well as the market has rebounded.

Jason Downey: Kirby Corp. [KEX], our largest holding and one we discussed when we spoke five years ago, is a good example of what attracts our interest. The main business and value driver for the company is its fleet of inland barges that primarily transport liquid cargo like petrochemicals, oil and refined oil products. It is by far the #1 player in that market with almost 30% market share and continues to use its scale to increase its share both organically and through opportunistic M&A. It has a strong balance sheet – net debt to EBITDA is just over 1x – giving it flexibility to operate and invest through industry cycles. Management rationally allocates capital, looking at organic growth, M&A, debt reduction and capital return all through the same return lens.

The business is cyclical, which makes the share price fairly volatile – the stock, for example, sold off 20% at the end of July after Q2 earnings – but we're fine taking cyclical risk in an industry leader with a great balance sheet and a willingness and ability to deploy capital in a countercyclical fashion. Kirby consistently since the inception of our small-cap strategy has been a or the top holding. The shares have done very well over that period but our estimate of intrinsic value has gone up right along with it.

Is deli-foods purveyor Mama's Creations [MAMA] an example of a small company no one seemed to be paying attention to?

JH: It is – when we got interested in it early last year there was no sell-side coverage and the market cap was around $250 million. Under a relatively new CEO who joined the company from Mondelez, it was successfully expanding its product line from primarily selling meatballs and was investing broadly in expanding its distribution in supermarkets and mass-market retailers like Costco and Walmart. We thought there would be an inflection in growth and margins much beyond what seemed to be priced into the stock.

Revenues have significantly increased, which has started to get the market's attention, but we think there's still a lot of room to grow and that somewhat disappointing margins will improve materially.

ON ORGANIZATION:

When research organizations get too hierarchical, communication and the level of collaboration can break down.

We've spent a lot of time with the management team and find them intensely passionate about the business and doing the right things to grow responsibly. There may be a couple of analysts following it now, but we think this is still well off the radar and the growth story isn't fully appreciated. [*Note*: Trading as low as $5.50 in the first quarter of 2024, MAMA shares closed recently at $13.65.]

When you set up VELA in 2019 you wanted all portfolio managers to retain industry research coverage. Why was that important to you?

JH: Like most PMs, we all started out as analysts following specific industries, sectors and companies. So one big reason for setting up the way we did was to keep that collective knowledge current and to better capitalize in our research on all our combined experience. We also wanted to have a flat research organization. We've found that when research organizations get too hierarchical, communication and the level of collaboration can break down. The fact that everyone on the investment team is an analyst facilitates better communication, and because everyone is learning from everyone else we believe that should produce the best research outcome.

Ric, as CEO and Chief Investment Officer, you don't have full analyst responsibilities but do still follow sectors you know well like energy. Are there any themes in your small-cap energy ideas today?

RD: One I would mention would be around U.S. natural gas, which we think is sometimes overlooked for how important at least over the medium term it will be for producing electricity. It has largely displaced coal in that regard here and is increasing market share in most places outside China as an important bridge fuel in the energy transition and to support new demand from AI.

U.S. natural gas is plentiful and even with the relatively rapid depletion of producing fields, advanced extraction techniques make it possible to access necessary replacement reserves and put them into production. That access to supply puts a ceiling on natural-gas prices, while the increasing demand puts in a secular floor. We see natural-gas prices in the $3 to $5 per Mcf range going forward, which even at the low end is nicely profitable for most producers. Given that backdrop, we own natural-gas producers such as Antero Resources [AR] and Range Resources [RRC], which would be beneficiaries of the pricing environment I've described because of their reserve positions in low-cost Appalachian Basin fields. I wouldn't consider the stocks overly cheap today, but in both cases they're returning a lot of cash to shareholders and we still find them attractive.

Are you seeing the rise of AI create investment opportunity?

JH: AI is obviously important and we have to assess in real time the positive or negative impacts it can have on our companies. I would say for now we're finding the most opportunity in companies that the market thinks will be severely disintermediated by AI, marking down the valuations, while we believe AI for them will be more positive than negative.

What would be an example or two?

JH: Two of our ten largest holdings, Criteo [CRTO] and Wix.com [WIX], fall in this category.

Criteo is a French company whose advertising technology platform is used by online advertising buyers and sellers for the efficient and effective buying and selling of ads. The increasing prevalence of AI and LLMs [Large Language Models] is considered a threat to the digital advertising industry if it drives down traffic to the open web – outside of walled-garden platforms like Google – which is where Criteo and other ad-tech players operate. We agree AI is going to be increasingly important in improving ad targeting and personalization, but we believe Criteo with its team of over 140 AI researchers, a database that tracks 720 million daily active users and over $1 trillion in annual transactions, and a balance sheet with $300 million in net cash and marketable securities (out of a $1.1 billion market cap) is well equipped to add value in that regard. The stock [at a recent $20.60] is down 50% this year and trades at only 5x our estimate of normalized earnings and at an 11% free-cash-flow yield.

Wix.com is a major player in SaaS CMS [Content Management System] software that allows anyone to build and manage professional-looking websites utilizing drag-and-drop tools, pre-made templates and user-friendly AI assistance. The fear here, as with Criteo, is that AI drives down traffic to the open web, essentially replacing what the company does rather than, as we believe, enhancing its value to customers. We think it will be very difficult for AI to replace the entire creative process and the infrastructure involved in creating and maintaining websites. Wix is spending heavily to implement AI-related improvements but has still been able to increase its share repurchases as the stock has fallen almost 60% from earlier this year. At today's price [of around $103.50] the shares trade at only 10-11x free cash flow.

Describe your investment case for airline operator Sun Country Airlines [SNCY].

JD: The company operates in three primary areas with relatively similar margin profiles. It runs scheduled passenger service, accounting for about 60% of total run-rate revenues, primarily into and out of Minneapolis. Another 20% of revenues come from providing cargo services, where its primary customer is Amazon. The remainder of the business is providing charter services, mostly on a contractual basis for customers like casinos, the federal government and sports leagues like Major League Soccer.

We have a long history with Sun Country's CEO Jude Bricker, who came to the company in 2017 when it was still private-equity owned. (The company came public in 2021.) He had been the COO of Allegiant Air, which we owned at a previous firm, and brought many of the operating principles from there with him, including using a single type of aircraft – in this case Boeing 737s – to lower ownership costs and increase flexibility in how the planes are used, staffed and maintained.

The bread and butter of the passenger service is leisure travel, with seasonality tilted toward the first quarter of the year when more people are flying out of Minneapolis to warm-weather destina-

INVESTMENT SNAPSHOT

Sun Country Airlines
(Nasdaq: SNCY)

Business: Minneapolis-based airline operating a fleet of only Boeing 737s that provide scheduled-passenger, cargo and charter flight services throughout the United States.

Share Information (@12/30/25):

Price	**14.39**
52-Week Range	8.10 – 18.59
Dividend Yield	0.0%
Market Cap	$758.6 million

Financials (TTM):

Revenue	$1.11 billion
Operating Profit Margin	10.0%
Net Profit Margin	5.3%

Valuation Metrics
(@12/30/25):

	SNCY	S&P 500
P/E (TTM)	13.7	25.7
Forward P/E (Est.)	11.1	22.3

Largest Institutional Owners
(@9/30/25 or latest filing):

Company	% Owned
BlackRock	14.5%
Barclays	9.9%
Vanguard Group	9.1%
Frontier Capital Mgmt	6.3%
T. Rowe Price	5.8%

Short Interest (as of 12/15/25):

Shares Short/Float	12.0%

SNCY PRICE HISTORY

THE BOTTOM LINE

As volumes in its cargo business increase from an expanding relationship with Amazon and as its passenger-service business improves due to a changed competitive environment, Jason Downey expects earnings to improve significantly from current depressed levels. Using a five-year DCF model, he pegs the shares' intrinsic value today in the mid-$20s.

Sources: S&P Capital IQ, company reports, other publicly available information

tions. The competitive environment in this business has improved as carriers like Spirit Airlines, Allegiant and JetBlue have pulled out of the market and Southwest and Frontier have reduced capacity. That leaves Sun Country mostly in competition with Delta, where it tends to be the lower-cost, lower-amenity choice. As the CEO says, "We're the airline you fly when you're paying with your own money." We think the more favorable competitive environment should have a positive impact on pricing and margins in this business going forward.

The cargo business this year significantly expanded its relationship with Amazon, increasing the number of cargo aircraft in the fleet – paid for by Amazon – and extending the contract through 2030, with options to extend further through 2037. That new business came on in late summer and the company has put considerable emphasis on making that work smoothly, even temporarily reducing passenger-service operations to make sure it has more than enough pilot availability as the cargo operations ramp. So far everything seems to be on track and we expect the passenger business to normalize as pilot availability is freed up.

The shares have been dead money over the past three years. How inexpensive do you think they are at today's $14.40 price?

JD: As annual cargo volumes move to a higher level and the passenger business improves – aided as well by their bringing two currently on-lease airplanes back into service – we believe by early 2027 the run-rate level of per-share earnings can be close to management's target of $2.50. So the shares on that basis trade at a less than 6x P/E multiple.

We value companies using a five-year discounted-cash-flow model. In this case we assume only modest growth in earnings per share from that $2.50 level by the fifth year, apply a low-double digit terminal multiple, assume a terminal growth rate of 1%, and apply a 10% discount rate. That gets us to a mid-$20s estimate of intrinsic value.

What brought about your recent interest in scientific-instrument company Bruker Corp. [BRKR]?

JH: Similar to what I described earlier with AI, we can often find opportunity when a sector sells off in indiscriminate fashion and that opens up in specific companies what we consider an attractive gap between the current share price and our estimate of intrinsic value. That was the case here.

Bruker is a leading provider of life-science instruments and diagnostics solutions to university, government and commercial research organizations. The majority of their products have #1 or #2 positions in their markets and the company is particularly well-known for its Nuclear Magnetic Resonance and Electron Paramagnetic Resonance systems, which are used to identify and better understand the nature, structure and interactions of materials at microscopic, molecular and cellular levels. This is very important in a wide variety of areas, including drug discovery, forensics, quality control and food safety.

We had established a smaller initial position in the stock late in 2024 but significantly increased it earlier this year when

INVESTMENT SNAPSHOT

Bruker Corp.
(Nasdaq: BRKR)

Business: Global provider of life-science instruments and diagnostics solutions primarily to end customers in university, government and commercial research organizations.

Share Information (@12/30/25):

Price	**47.51**
52-Week Range	28.53 – 64.64
Dividend Yield	0.4%
Market Cap	$7.22 billion

Financials (TTM):

Revenue	$3.44 billion
Operating Profit Margin	10.8%
Net Profit Margin	(-0.6%)

Valuation Metrics
(@12/30/25):

	BRKR	S&P 500
P/E (TTM)	n/a	25.7
Forward P/E (Est.)	23.7	22.3

Largest Institutional Owners
(@9/30/25 or latest filing):

Company	% Owned
Orbis Inv Mgmt	9.3%
BlackRock	7.2%
Fidelity Mgmt & Research	6.9%
Vanguard Group	6.8%
Pallas Capital Adv	6.2%

Short Interest (as of 12/15/25):

Shares Short/Float	11.1%

BRKR PRICE HISTORY

THE BOTTOM LINE

With its strong niche positions and sticky customer relationships, Jenny Hubbard expects the company to grow at above industry-average levels and to restore its operating margins to the high-teens. She doesn't think that's reflected in the current share price and is modeling an expected low-double-digit annual shareholder return over the next five years.

Sources: S&P Capital IQ, company reports, other publicly available information

the broader healthcare sector sold off both due to tariff concerns and the expectation of significant cuts in National Institutes of Health research funding. We thought the market in Bruker's case was discounting a worst-case scenario that was unlikely to happen. In fact, so far tariffs have not had a material impact on the company's business and NIH funding cuts have been far less drastic than originally expected. Even if such funding pulls back, Bruker should be relatively insulated with 40% of revenues coming from academic and government customers, and slightly less than 5% directly tied to NIH funding.

The company we think is also smartly diversifying, primarily through acquisition, by building its presence in biopharmaceutical end markets. Over the past two years they've made a number of smallish acquisitions of companies serving the sector and we expect biopharma's share of revenues to increase nicely from today's level of roughly 15%, with margins increasing in that business along with scale.

Our basic contention is that if you believe innovation in healthcare is going to continue to be important – we think it's a national imperative – Bruker with its strong niche positions and sticky customer relationships is well positioned to grow above industry averages and restore operating margins to high-teens normalized levels. We don't think that's reflected in the current share price.

The shares have come back fairly well from recent lows. At around $47.50, what upside do you see from here?

JH: Over our five-year horizon we expect annual revenue growth to return to mid-single-digit levels, with operating margins increasing from current depressed levels and also benefiting from a recently announced cost-cutting initiative. We estimate normalized earnings per share can grow over the next five years at a roughly mid-teens annual rate. If the shares at that point traded at an 18x multiple, that would give us from today's price a low-double-digit annual shareholder return over the period.

With the recent acquisitions net debt to EBITDA here has increased to around 3x. While we don't think that's excessive, it's high enough that for the time being we've kept our position size in Bruker at around 2%. They have been deleveraging and we'll continue to monitor that in assessing how to size the position going forward.

Turning to a smaller-cap, more sparsely followed ideas, what do you think the market is missing in Ingles Markets [IMKTA]?

JH: This is a regional grocery chain, with close to 200 stores located primarily in North Carolina, South Carolina, Georgia and Tennessee. They focus on smaller towns and rural areas, servicing all their stores from a single company-owned distribution center located near Asheville, N.C. They also produce their own milk through a wholly owned subsidiary called Milkco.

Another unique characteristic of the company is that Ingles owns almost all of the real estate for its stores, and in roughly half of the cases owns the entire shopping center around the stores as well. That not only generates considerable lease income, but it also allows the company to have

INVESTMENT SNAPSHOT

Ingles Markets
(Nasdaq: IMKTA)

Business: Regional grocery chain operating close to 200 stores located primarily in smaller towns and rural areas in North Carolina, South Carolina, Georgia and Tennessee.

Share Information (@12/30/25):

Price	**68.72**
52-Week Range	58.92 – 78.59
Dividend Yield	0.9%
Market Cap	$1.31 billion

Financials (TTM):

Revenue	$5.33 billion
Operating Profit Margin	2.2%
Net Profit Margin	1.6%

Valuation Metrics
(@12/30/25):

	IMKTA	S&P 500
P/E (TTM)	15.6	25.7
Forward P/E (Est.)	n/a	22.3

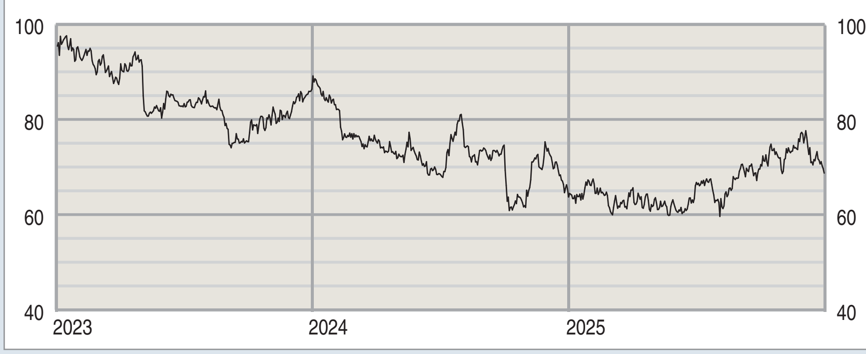
Largest Institutional Owners
(@9/30/25 or latest filing):

Company	% Owned
Vanguard Group	6.7%
BlackRock	6.4%
Brandes Inv	6.1%
River Road Asset Mgmt	5.2%
Gamco Investors	5.0%

Short Interest (as of 12/15/25):

Shares Short/Float	7.0%

IMKTA PRICE HISTORY



THE BOTTOM LINE

The market appears not to appreciate either the ability of the company's established grocery business to improve as consumer spending normalizes in its target markets or the true underlying value of its owned real estate. Accounting for both, she believes the closely held shares at today's price trade at well below half her estimate of intrinsic value.

Sources: S&P Capital IQ, company reports, other publicly available information

more control over their locations and the tenants that surround them.

All of this sounds rather old-school, likely related to the continued controlling ownership of the Ingles family. Do you consider that more positive or negative?

JH: The company was founded by Robert P. Ingle in 1963 and his son Bobby is now the board Chairman and controls with the family 22% of the outstanding shares and 72% of the voting control. They don't do investor presentations or host earnings calls, which is likely one reason the company isn't well followed. On the other hand, they've done an excellent job of building and maintaining their grocery franchise, resulting in consistently solid returns on invested capital.

Why do you consider the shares, now trading at $68.75, attractively priced?

JH: Ingles' grocery business has been struggling somewhat over the past 12 to 18 months, not for what we consider structural reasons but because consumer spending in the company's target markets has been broadly under pressure. Operating margins over the past two years have fallen from just under 5% to 2.2% for the fiscal year ending in September.

Based on our DCF analysis – assuming low-single-digit revenue growth, normalized operating margins of around 5%, a required return of 9% and a terminal multiple of 12x – we think the market price today significantly undervalues the company's grocery operation. Even if we assume there's no recovery to normalized margins, the grocery operation would be fairly valued. But that includes nothing for the real estate, which when we dig through the filings and make site-by-site estimates we value also at about the current market value – meaning the shares currently trade at well below half our estimate of their intrinsic value.

It's a fair question to ask for a closely held company like this when the gap to intrinsic value might close. We don't know, but we don't believe the family will forever be satisfied with the market so significantly undervaluing the stock. If we're right about the value, we can be patient in waiting for it to be realized.

Why are you high on the prospects for fellow Columbus-based company Worthington Enterprises [WOR]?

JD: This is a somewhat unusual business in that more than half of its earnings come from two primary unconsolidated joint ventures. The largest and best-performing one is a 50/50 joint venture with Armstrong World Industries that produces and sells suspended-ceiling fixtures for commercial buildings. The other is ClarkDietrich Building Systems, which makes light-gauge steel framing used primarily in building construction. Worthington has a 25% stake in that JV, with the rest owned by Japan's Marubeni-Itochu.

The company took its current shape two years ago when Worthington Industries spilt into two separate public companies, Worthington Enterprises and Worthington Steel. Worthington Steel took the company's legacy steel-processing operations and Worthington Enterprises took the building-products JVs and

INVESTMENT SNAPSHOT

Worthington Enterprises
(NYSE: WOR)

Business: Industrial conglomerate whose primary earnings producers are joint ventures, one selling suspended-ceiling fixtures and the other steel framing used in construction.

Share Information (@12/30/25):

Price	**51.91**
52-Week Range	38.63 – 70.91
Dividend Yield	1.5%
Market Cap	$2.58 billion

Financials (TTM):

Revenue	$1.25 billion
Operating Profit Margin	5.9%
Net Profit Margin	8.5%

Valuation Metrics
(@12/30/25):

	WOR	S&P 500
P/E (TTM)	24.4	25.7
Forward P/E (Est.)	13.8	22.3

Largest Institutional Owners
(@9/30/25 or latest filing):

Company	% Owned
BlackRock	10.3%
Vanguard Group	7.6%
Nomura Inv Mgmt	3.5%
Dimensional Fund Adv	3.4%
State Street	2.4%

Short Interest (as of 12/15/25):

Shares Short/Float	2.3%

WOR PRICE HISTORY

THE BOTTOM LINE

The company's building-products businesses have been hurt by slack new-build construction in the U.S. and its consumer-products lines have been impacted by inventory destocking following the pandemic, says Jason Downey. As those cyclical issues correct, he believes the shares from today's price can earn a 15% IRR over the next five years.

Sources: S&P Capital IQ, company reports, other publicly available information

a number of other consumer-product and sustainable energy-related business lines. The most prominent of those other businesses sell tools, outdoor cooking equipment and fuel tanks.

This is another business impacted by cyclical weakness, in the building-products joint ventures primarily tied to relatively slack new-build construction in the United States, and in the consumer-products areas tied to a long inventory-destocking period after the pandemic. In the consumer businesses the destocking appears to finally have run its course, and in building products we're confident in the leading market positions of both the Armstrong JV and ClarkDietrich and expect them to incrementally benefit as their end markets normalize.

Have tariffs been an issue here?

JD: They've been neutral to a slight positive. The company largely manufactures where it sells its products. In some tank product lines there appears to have been some dumping from China, but that has not been a big issue and tariffs may actually benefit Worthington going forward in those cases.

How do you see all this translating into positive news for the stock, now trading at just under $52?

JD: We see mid-single-digit revenue growth translating into high-single-digit aggregate earnings growth over the next five years. Assuming some multiple expansion, we're looking for close to a 15% expected return over that period.

We believe there's additional upside optionality here from capital allocation. The company generates $150-200 million per year in free cash flow on a normalized basis and in our view has an underleveraged balance sheet. There's plenty of room for increased share buybacks and dividends, and we could also imagine management continuing to pursue bolt-on acquisitions as they have successfully done both before and after the corporate split two years ago.

From building products to banking software, why do you think the shares of Jack Henry & Associates are mispriced?

JD: We've been admirers of the company for a long time, having followed it closely because other VELA strategies own shares in one its primary competitors, Fidelity National [FIS]. Jack Henry's stock typically traded at a relatively high valuation and until just a few months ago the market cap was beyond our small-cap range.

The company's legacy software business, accounting for about 30% of revenues, does what's called core processing for banks, providing the systems that administer the day-to-day business of booking loans, deposits and interest. To that they've added a significant number of additional capabilities over the years, now also providing software to run things like online and mobile banking, debit-card issuance, electronic funds transfer processing, risk management and fraud protection. Many of these areas have been growing faster than the core processing business as banks continue to digitize their product and service offerings.

The shares came under pressure starting in mid-summer for a number of poten-

INVESTMENT SNAPSHOT

Jack Henry & Associates
(Nasdaq: JKHY)

Business: Provider of software systems to smaller banks in the U.S. for handling a wide range of customer online and offline transactions and the related backend processing.

Share Information (@12/30/25):

Price	**184.55**
52-Week Range	144.12 – 196.00
Dividend Yield	1.2%
Market Cap	$13.36 billion

Financials (TTM):

Revenue	$2.42 billion
Operating Profit Margin	24.9%
Net Profit Margin	19.9%

Valuation Metrics
(@12/30/25):

	JKHY	S&P 500
P/E (TTM)	28.0	25.7
Forward P/E (Est.)	29.1	22.3

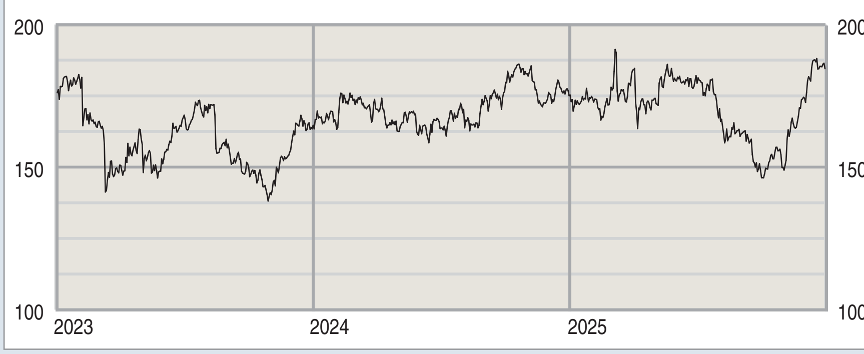
Largest Institutional Owners
(@9/30/25 or latest filing):

Company	% Owned
Vanguard Group	12.1%
BlackRock	8.4%
Kayne Anderson Rudnick	6.3%
State Street	5.7%
Geode Capital	3.0%

Short Interest (as of 12/15/25):

Shares Short/Float	5.1%

JKHY PRICE HISTORY



THE BOTTOM LINE

In part due to turmoil at large competitor Fiserv, Jason Downey believes the company can continue to take market share in a still-healthy end market as banks digitize their product and service offerings. While the stock trades at only a modest discount to his estimate of intrinsic value, he thinks it can generate from here a 10% or so compound annual return.

Sources: S&P Capital IQ, company reports, other publicly available information

tial reasons, including AI disruption, concerns over increasing bank consolidation resulting in lost contracts, and the company issuing guidance for 2026 that called for lower growth than analysts were expecting. We thought the share correction was overdone and believe Jack Henry is actually well positioned to take share over time in a still-healthy end market.

Unlike its primary competitors, the company's systems have been primarily built in-house on a narrower set of platforms, which allows for more seamless integration of new and improved functionality. It's known as an innovator in the market and spends 14-15% of revenues each year on research and development to maintain that edge. It has industry-leading customer satisfaction scores and very high customer retention. All that leads us to believe it will continue to take market share from its larger competitors.

We expect that to be even more of a possibility following Fiserv's debacle in October. [*Note*: Fiserv's stock fell 44% on October 29th after the company reported poor quarterly earnings, reducing full-year guidance and announcing a major leadership overhaul.] One change management described at the time was a multiyear effort to consolidate their disparate technology systems. We think that will spark a number of customers to put their business up for bid and that Jack Henry will, as it has been doing, win more than its fair share of that.

The shares in the past few weeks have come back from their recent swoon. How are you looking at valuation from today's price of around $184.50?

JD: We're modeling high-single-digit annual operating earnings growth over the next five years, from top-line growth and 100 basis points or so in margin expansion. Using an 8% discount rate and a terminal multiple in the mid-20s – below where the stock has historically traded – our intrinsic value estimate is just over $200 per share.

The discount to fair value has narrowed, but we're comfortable in owning the stock at this level given the compounding nature of the business. With dividends, we're looking at a 10% or so expected compound return. Management has done an excellent job at capital allocation and we think there's optionality on the upside from increasing share buybacks and dividends as well as from additional tuck-in acquisitions.

Describe some portfolio holdings you've recently sold and the thought processes behind.

JD: Coming back to what Jenny spoke about earlier with respect to finding opportunity in companies where we think concern about artificial intelligence has been overdone, we had a favorable outcome very recently with SEMrush Holdings [SEMR], which operates a software-as-a-service platform used for search engine optimization, content marketing and competitive research. It was generally perceived to be an AI loser, but earlier this month Adobe agreed to buy the company for $12 per share, a nearly 80% premium to the price on the day before the deal was announced.

On a less-happy note where we concluded the fundamental situation of the company had deteriorated, we recently exited our position in semi-trailer manufacturer Wabash National [WNC]. We're going on four years of a freight recession in the U.S. and as it has continued the company's leverage situation started to concern us. We still believe there is a lot of upside in the stock relative to normalized earnings power, but as EBITDA declined the net debt on the balance sheet went to 6x current EBITDA, which is well beyond what we were comfortable with. We still have freight-related exposure, but in companies with stronger balance sheets.

Ric, you came out of retirement from Diamond Hill Capital Management to start VELA in 2019. Has the second go-round been easier or harder than the first?

RD: I spent a little over a year retired and was perfectly happy. While I wasn't looking to come back, it came up opportunistically and in hindsight has easily been the best career decision I've made. One big reason is that I've been able to build a team with people that in most cases I've worked with before and I enjoy immensely. Having such experienced colleagues who are doing the heavy lifting has made coming back relatively easy for me. Another big reason I'm happy to be working again is that I have a young daughter and I like her to see I have a job and what that's like. I still very much enjoy the process of looking for new ideas and learning about companies and businesses and am just having a lot of fun.

As when I started at my previous firm in 2000, the investing environment hasn't been the greatest on a relative basis for value investors. But having experienced it before keeps me from being overly concerned about that. I'm quite confident the next decade will be much better for value investors than the last one has been, and I expect to still be here 10 years from now to benefit from that. VII

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The Russell 2000 Index is an unmanaged market capitalization-weighted index comprised of the smallest 2,000 companies by market capitalization in the Russell 3000 Index, which is comprised of the 3,000 largest U.S. companies by total market capitalization.

You cannot invest directly in an index.

The securities mentioned comprise the following percentages of the VELA Small Cap Strategy Composite as of 12/31/25: Antero Resources (AR): 2.04%; Bruker Corp. (BRKR): 2.13%; Criteo (CRTO): 3.93%; Fidelity National (FIS): 0.0%; Fiserv, Inc. (FISV): 0.0%; Ingles Markets (IMKTA): 1.06%; Jack Henry & Associates (JKHY): 1.51%; Kirby Corp. (KEX): 4.90%; Mama's Creations (MAMA): 1.90%; Range Resources (RRC): 1.39%; SEMrush Holdings (SEMR): 0.0%; Sun Country Airlines (SNCY): 2.14%; Wabash National (WNC): 0.0%; Wix.com (WIX): 2.70%; Worthington Enterprises (WOR): 1.97%. The companies identified above are example holdings and subject to change without notice. The companies above have been selected to help illustrate the firm's investment process and should not be considered a recommendation to purchase or sell any particular security.

Definitions:

Artificial Intelligence (AI) refers to the development of computer systems capable of performing tasks that typically require human intelligence. These tasks include reasoning, decision-making, problem-solving, and understanding natural language.

Intrinsic Value is a measure of what an asset is worth, arrived at by means of an objective calculation or complex financial model. Intrinsic value is different from the current market price of an asset. However, comparing it to that current price can give investors an idea of whether the asset is undervalued or overvalued.

Magnificent 7: Magnificent 7 stocks refer to Alphabet, Amazon.com, Apple, Meta Platforms, Microsoft, Nvidia, and Tesla.

McF stands for "thousand cubic feet", which is a standard unit of measurement used in the United States to quantify natural gas production and consumption.

Price-to-earnings (P/E) is a valuation ratio of a company's current share price compared to its per-share earnings. **Forward price-to-earnings (P/E) ratio** is a measure of the P/E ratio using forecasted earnings for the P/E calculation. **Multiple expansion** refers to the increase in a company's valuation multiple, such as the price-to-earnings (P/E) ratio, without a proportional rise in its earning or revenue. **Earnings per share (EPS)** is the portion of a company's profit allocated to each outstanding share of common stock. The **discounted cash flow model** is a financial method that estimates the value of an investment based on its expected future cash flows. The term **terminal multiple** refers to a method used in discounted cash flow (DCF) analysis to estimate a company's terminal value beyond the explicit forecast period. A **discount rate** is the rate of return used to discount future cash flows back to their present value. The **required rate of return** is the minimum return an investor expects to earn from an investment, compensating for its associated risk. **EBITDA** refers to Earnings Before the deduction of payments for Interest, Taxes, Depreciation and Amortization which is a measure of operating income. **Free cash flow (FCF)** represents the cash a company can generate after accounting for capital expenditures needed to maintain or maximize its asset base.