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DF Dent Small Cap Growth Strategy

July 2017 Commentary

Portfolio Thoughts

Most major U.S. stock market indices gained in the second quarter of 2017, as the year has exceeded our expectations for equity returns. The D.F. Dent Small Cap Growth strategy returned 5.38% for the second quarter of 2017, outperforming the Russell 2000 Growth Index which returned 4.39%. The strong second quarter puts our year to date performance at 8%, underperforming the Russell 2000 Growth Index return of 9.97%.

Performance for the second quarter was positively impacted by stock selection in the Technology, Consumer Staples, Financial, and Industrial sectors. Technology stocks continued their strong advance from last quarter as their contribution was broad based. Performance was also helped in 1Q17 by being underweight the Energy and Materials sectors. These positive areas were offset by stock selection in the Consumer Discretionary. The portfolio was also adversely impacted by being overweight the Industrial sector and underweight the Healthcare and Telecom Services sectors.

2Q17

Ticker		Contribution To Return
	5 Highest	**3.23**
ATRI	Atrion Corporation	0.78
CSGP	CoStar Group, Inc.	0.73
W	Wayfair, Inc. Class A	0.62
TYL	Tyler Technologies, Inc.	0.58
TDOC	Teladoc Inc	0.53
	5 Lowest	**-2.40**
IMAX	IMAX Corporation	-0.97
MNRO	Monro Muffler Brake, Inc.	-0.41
MIDD	Middleby Corporation	-0.35
AAC	AAC Holdings, Inc.	-0.35
ZOES	Zoe's Kitchen, Inc.	-0.32

The top three contributors during 2Q were:

- **Atrion Corporation**, a well-managed medical device component maker, appreciated 37% in the second quarter on no material news. ATRI is very illiquid and has a history of periodic extreme price swings. The stock's rapid ascent may have resulted from a "short squeeze" and/or investors' fully capitalizing the option exercise tax benefit recognized in the 1Q per new accounting standards. Our confidence in management and ATRI's business remains strong. We believe, however, that recent appreciation has meaningfully reduced our expectation of future returns so we significantly reduced our position during the 2Q.

- **CoStar Group, Inc. (CSGP),** the leading provider of information, analytic and marketing services to the commercial real estate market, reported first quarter results that surpassed analyst expectations across the board. After disappointing investors with increased expenses and lower profitability in 2016, these results provided investors with some confidence in CoStar's ability to achieve their long-term goals. Specifically, net new bookings were up nicely from the previous quarter. The LoopNet integration was completed and the salesforce was trained and ready to begin selling in the 2nd quarter. Also, the new facility in Richmond, VA was not only well ahead of schedule in hiring, but also in productivity. We trimmed CSGP on the stock's strength in the second quarter.

- **Wayfair, Inc. (W),** a leading e-commerce company in the furniture segment, has had a strong 2017 as investors have started to appreciate the competitive advantages of its logistical and delivery network and as the market's concern about potential competition from Amazon has waned somewhat. While we trimmed the position on stock strength, we have continued to hold a core position on the prospects of future growth.

The top three detractors during 2Q were:

- **IMAX Corporation (IMAX)**, a global provider of premium cinematic content and theater systems, reported global box office results below expectations in the second quarter. While IMAX management maintains this softness is a movie-content-specific problem, the market's concern that there is a more systemic issue, caused downward pressure on theater stocks, including IMAX, during the quarter. During the quarter we trimmed the position and we are evaluating future moves.

- **Monro Muffler Brake, Inc. (MNRO**), a niche-focused provider of automotive repair and tire services, reported weak operating results in the quarter, exacerbated by news that Monro's CEO will step down later this year. The company has relied heavily on acquisitions for growth so a management change is not surprising. While we continue to see MNRO as a superior operator with significant scale advantages, we acknowledge that the competitive environment has become more challenged as new and used car dealerships have increased focus on the service and repair business. We are evaluating the position and look to get to know the new CEO when he joins later this year if we still own the stock.

- **Middleby Corporation (MIDD)**, was weak in the quarter due to weak reported organic growth in the first quarter and its 2017 growth will be more back-end loaded. At the same time, investors became increasingly concerned about the health of the restaurant industry, which is the largest customer group for MIDD. The company has not made any sizeable acquisitions recently, indicating that it will not have strong acquisition driven growth to offset weak organic growth. We believe many of these headwinds are cyclical and as long-term investors, we still think MIDD's stock will generate very good returns over time.

The top five performing names in the D.F. Dent Small Cap Growth strategy have all returned over 39% year to date. Many of the top performing stocks have experienced periods of flat returns in recent years due to increased long-term investments, which resulted in short-term pressure on growth or margins. Rather than sell these stocks and risk missing the upside, we maintained and, in many cases, added to our positions in these stocks through the flat period because of our confidence in management and the strong prospects for long-term growth in the future. Over time, this strategy has benefitted your portfolio.

CoStar Group (CSGP), the leading provider of information and analytic services to the commercial real estate market, is a good example of this strategy. CoStar is exiting a period of heavy investment in their sales force, data and marketing products and services, the returns on which should be meaningful. CoStar has developed the nation's leading marketplace for apartment leasing, data and analytics through the acquisition of Apartments.com and significant additional investments in the platform. All of these investments sacrificed margin (and earnings) in the short term with the goal of extending strong revenue growth and higher earnings for many years into the future. The stock declined -8.8% in 2016, and we added to the position twice at lower prices. Investments in long-term growth probably will continue, but likely at a slower pace, and more in keeping with CoStar's significantly larger revenue base. We note that if the strong reported 1Q17 bookings remains elevated and the company should enjoy accelerating organic revenue growth for the rest of the year. For the first six months of 2017, the stock is up 39.8% and we recently trimmed the position on this strength..

Market Thoughts

The U.S. expansion is in its ninth year, making it the third longest expansion in the post-war era. We are now in a period when fundamentals may matter more than they have over the past few years. The rising tide may not continue to lift all boats. Margin expansion will be tougher to achieve. Management decisions, like handling rising labor costs, will be vital to a company's success. Your D.F. Dent portfolio is invested in high-quality growth equities, with excellent management teams that we think can successfully navigate this environment. We have spent time with these management teams and know how they think and operate. Additionally, the Technology and Financial sectors will deliver the fastest earnings growth in 2017 outside of the recovery in energy, and your portfolio is overweight both these sectors. We are focused on stocks that will deliver revenue and earnings growth. We continue to monitor our portfolio companies very closely and weight the portfolio in favor of those stocks with the best prospects for above average returns. We are being mindful to trim names that have done well and to rebalance the portfolio.

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We appreciate the confidence you have placed in D.F. Dent and Co. We will continue to work diligently on your behalf.

This commentary can be found on our website (www.dfdent.com). We encourage you to refer to our website for other information about our firm and our investment products, including our mutual funds, the DF Dent Premier Growth Fund (DFDPX), the DF Dent Midcap Growth Fund (DFDMX) and our new DF Dent Small Cap Growth Fund (DFDSX)