HEPTAGON
Capital

Heptagon Kettle Hill US L/S Equity Fund

Q1 2025 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 75m as of March 31, 2025. Since its launch until the end of Q1 2025, the Fund has returned 4.5% (I USD share class) on an annualised basis compared to 4.1% for the HFRX Equity Hedge Index. During the first quarter of 2025, the Fund returned -6.2% (I USD share class) compared to 0.2% for the HFRX Equity Hedge Index. In Q1 longs detracted 7.3%, and shorts contributed 1.0%. Ending exposure was 85.1% gross and 31.6% net, 58.3% gross long and -26.7% gross short resulting in a long/short ratio of 2.2 : 1.

The views expressed represent the opinions of Kettle Hill, as of 31st March 2025, are not intended as a forecast or guarantee of future results and are subject to change without notice.

1Q25 Review

Markets rose in the first half of the quarter in anticipation of business-friendly policies from the incoming President. Tariffs were announced, which initially appeared to be targeted at specific industries or used as a lever to impel Mexico, Canada and China to halt fentanyl smuggling and illegal immigration. Most of the portfolio's losses in the quarter were concentrated in early March as consumer discretionary holdings experienced sharp drawdowns. We initiated these positions in late February after they had already suffered price declines due to poor weather in January and February, the impact of closures from the L.A. wildfires and delayed tax receipts. The rationale was that these negative trends would reverse in early March. We believed Mexico and Canada made credible commitments to improve border security, and that there would be a period of respite from tariff drama in early March. That assumption of relative policy stability seemed to have been misplaced as the White House reversed course and ratcheted up the tariff and trade rhetoric. Markets suffered sharp losses as protective trade policy erratically increased, and consumer confidence fell. We responded by exercising our 5% portfolio-stop-loss guideline by lowering gross and net exposure while implementing 20% stop losses on individual positions and reducing net exposure to consumer discretionary stocks. The policy environment remains uncertain, and our priority is trying to preserve capital while attempting to carefully select individual stocks with highly attractive risk/reward ratios due to the highly dislocated environment.

1Q25 Winners and Losers

Best-Performing Long—Allegro MicroSystems, Inc. (ALGM)
Allegro Microsystems is an analog semiconductor business specializing in magnetic sensors in the automotive and industrial end markets. We've followed the analog semiconductor market for many years and some recent data points lead us to believe that this market, which had bottomed out, had the potential to turn positive in 2025. Also, ALGM had two insider buys from the CTO (now CEO) and the prior CEO in November 2024. We sold the majority of our position as it approached our price target. Later in the quarter, the shares declined as market volatility increased, before jumping higher after ON Semiconductor Corporation's bid for the company at $35.10 per share. We sold the remaining position, due to uncertainty around ALGM accepting this offer, and we were worried about potential tariffs hurting the automotive market and pausing multiple areas of the semiconductor supply chain.

Worst-Performing Long—Victoria's Secret & Co. (VSCO)
VSCO, the parent company of Victoria's Secret and Pink, is a leading women's intimates' retailer. In Q3 of 2024, the company hired a new CEO who planned to revitalize the company through new products, the relaunch of VS Sport and VS Swim and updated brand messaging, which drove a significant stock increase in the quarter. However, early 2025 brought challenges, slower retail sales and tariff concerns. This prompted us to initiate and add to our position on what we thought was a temporary stock pullback. Weaker-than-expected 2025 guidance in March led to a further stock decline. While we believe the CEO's strategy is sound, we exited our position due to our risk guidelines. We will monitor VSCO, as it could benefit from any tariff relief and a possible strong product launch schedule in the second half of 2025.

Best-Performing Short —Miller Industries, Inc. (MLR)
Miller Industries is a leading US manufacturer of auto towing and recovery equipment. The company navigated supply constraints during COVID and raised prices unsustainably to profit from the situation. With low rates, long lead times and, in our opinion, customer over-orders, MLR shares went on an incredible run from $20 in 2022 to $80 in 2024. Heading into 2025, sell-side analysts covering MLR believed revenues and earnings were going to continue to grow despite the over-ordering by tow-truck resellers, massive price increases by MLR and much higher interest rates. However, our industry and company analysis indicated that orders were at risk, given elevated reseller inventories, higher interest rates and continuing economic uncertainty. When the company reported earnings, it acknowledged these headwinds and gave guidance significantly below street estimates. The shares fell approximately 20% in one day, despite having already traded off into earnings. We still maintain a small short position, as we believe this market is in a multi-year downcycle.

Worst-Performing Short (Stock)—Magnite, Inc. (MGNI)
MGNI operates a supply-side platform (SSP) that automates the buying and selling of digital advertising for publishers and advertisers. We initiated a short position in late October, believing that expectations for 2025 revenue growth, driven by its partnership with NFLX, had become overextended. In our view, MGNI's 2024 performance benefited from several temporary tailwinds, including elevated political ad spending and Olympics-related revenue, both of which would not recur in 2025. We also believed there was a risk that a significant portion of NFLX's ad inventory could be sold directly by its in-house salesforce, and that the digital component of the partnership would take longer to scale than the market anticipated. On February 7th, MGNI announced a new agreement with Elon Musk's Twitter (now X), spiking the stock by 11%. We followed our risk-management framework and covered the position for a loss.

Investment Outlook

Financial markets have fallen because of the perception that there is a high risk of a policy error. We understand the goals of the administration and agree with some of the intended outcomes. Unfortunately, many of their objectives seem to be at cross purposes. Some actions could reduce inflation (negotiating additional OPEC oil capacity) while others may increase it (deportation, tariffs and weakening the dollar). Some actions attempt to reduce the deficit (DOGE, tariffs) while others potentially increase it (tax cuts). They have made efforts to stop or prevent wars (Russia-Ukraine, US-Iran, Israel-Hamas), while choosing to start a trade war with the rest of the world that has the potential to create global economic and geopolitical instability. In our opinion, there's no clear outcome for investors when policy objectives seem to be fundamentally misaligned from the start.

Our job is to pick stocks and manage the portfolio without losing sight of the risks and opportunities in the prevailing investment environment. Whilst being pragmatic, we must make certain assumptions regarding the strategy and agenda of the current administration in order to make decisions going forward. We also have to bear in mind that our current President has, and probably will continue, to make significant policy decisions, but also quickly reverse course. As a result, we must be ready to make changes based on policy turns in the short run. At present, we believe fair trade has little to do with the decision to impose tariffs of the magnitude imposed on "Liberation Day." We have made the following assumptions regarding policy objectives, which may change:

1. The current administration has unresolved issues following the first term with China. The current strategy is meant to directly impact China's economy and force its leaders to the table regarding trade, IP and other geopolitical issues. In their minds, China is a rival for global supremacy and must be defeated.
2. Tariff revenues are intended to pay for tax cuts. The administration intends to use leverage to extract money and concessions from our trading partners.
3. At present, the current administration is bargaining with trade partners under the assumption that all trade deficits are bad, and that we must run a trade surplus with every country in the world and reshore all domestic production.
4. There are numerous actions that are intended to induce recession in order to lower rates. Any option to lower the 10-year treasury rate would imply refinancing at lower rates.

We think the administration, in the short term, isn't overly concerned with unintended consequences or collateral damage to its current trade policies. It may also be naïve to think that a delicate system of interrelated economic and political relationships can be changed overnight without the possibility of suffering terrible consequences. As a result, we must manage the portfolio while considering some or possibly all of the following outcomes:

1. Countries can retaliate or form new alliances to combat us.
2. Foreign investors could lose confidence and may sell or avoid new investments in US financial and real assets.
3. Not all trade deficits are bad. Destroying mutually beneficial trading relationships based on comparative advantage will potentially have a negative economic impact.
4. Global consumers can decide to stop buying US goods and move to local or other non-US brands, e.g., buy Adidas, not Nike.
5. Tariffs, typically, are a regressive tax for already stretched US consumers. The President's base seems to be buying into the protectionist strategy. It remains to be seen if this could result in job losses and additional inflation, leading to political backlash.
6. Multi/Bilateral trade deals are complex and could take several months at a minimum to negotiate and ratify. Potential loss of trust with the leaders of other countries and political pressure from their constituents may make it difficult to make deals in a timely manner.

It appears that this raft of policies has a high risk of inducing a recession. Given our longevity at Kettle Hill and prior firms, we've invested in many uncertain and volatile market environments ranging from the Dot-com Bubble in 2000, 9/11 in 2001, the start of the Iraq War in 2003, the Global Financial Crisis in 2008, the Flash Crash in 2010 and COVID in 2020. The details may vary over time, but broader investor behaviour seldom changes. Our standard recession playbook is as follows, we attempt to:

1. Buy non-cyclical recurring revenue stocks when we feel they are being unjustifiably dislocated by extreme market selloffs.
2. Short cyclical stocks that have not lowered estimates and seem overvalued on the new numbers.
3. Buy cyclical stocks with good balance sheets that may have completely discounted a recession.
4. Stress test positions in the portfolio for downside earnings and financial liquidity.
5. Reduce position sizes and maintain liquidity.
6. Follow risk control guidelines.
7. Wait patiently for moments of extreme pain in the market to potentially add risk on a tactical basis.

This is not our first time managing money during a crisis, and it most likely won't be the last. We believe that there will come a time to add risk when the perceived risk/reward seems to be highly asymmetrical in our favour, and we can identify a non-consensus catalyst in the future. We're not sure that the time is right now. We think there is a lot of risk in the short term because we've not yet seen the tariff disruption reflected in earnings, and de-dollarization seems to have just started.

We are very aware that the current administration has shown, on numerous occasions, that it is willing to make significant decisions or course changes based on a wide range of inputs, including economic data, rates and even social media. So, we may need to change direction very quickly. We'll be alert and will aim to dynamically respond as events unfold and stock prices change. Current investor sentiment seems to be very pessimistic, yet the damage is self-inflicted, which means it can be undone with a tweet.

Looking forward to 2026, we expect a new Federal Reserve chair, who is likely to be a dove, in line with the current administration's plans. We'll probably be through the bulk of the government bond refinancings. We suspect the current administration would like the majority of the tariff and trade negotiations concluded by the end of 2025. This sets up easier comparisons economically and politically for 2026, with the administration deciding to be on their best behaviour for the upcoming mid-term elections.

We have an economy and political system that should still be the envy of the world. We are a country of technological advancement and progress. While current policy moves and objectives may challenge our economy and our longstanding relationships in the short run, overall, our economy will continue to attract businesses and investment capital.

Operational Update

There were no changes to personnel and no regulatory events during the quarter. The Firm has recently embarked on deploying some new analytical software to, hopefully, enhance our internal portfolio review and analysis processes.

Conclusion

We are of the view that this is a devilishly challenging market, requiring caution, conviction, discipline and courage. We believe in our research process and will strive to make the utmost effort on your behalf. We believe we are built to survive difficult markets and strive to find opportunities in times of great turmoil and uncertainty. Thank you for your continued support.

Sincerely,
Heptagon Capital and Kettle Hill Management

Annualized Total Returns as of 31st March 2025, net of fees

	Q1 25	1-Year	3-Year	5-Year
Heptagon Kettle Hill US L/S I USD	-6.2%	0.8%	3.4%	8.7%
HFRX Equity Hedge Index	0.2%	4.5%	3.9%	8.6%

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.

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

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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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