

DIAMOND HILL

INVESTED IN THE LONG RUN

Small Company Monthly Musings

Our Word is Our Bond

Nov 2024

We are often asked what sort of tidbits we look for each quarter as companies report earnings – numbers represent the fundamental results, but there are also qualitative elements that can serve as signposts that our long-term thesis is on track and that deepen our conviction. As we worked through the current earnings season, we found specific comments on two company calls that popped out as clear indicators of why we own these particular businesses and why we believe the growth is durable.



Aaron Monroe, CFA
Portfolio Manager

Being a smaller support player within an industry can be a challenging competitive position. However, companies that demonstrate they are reliable suppliers of quality components – particularly as manufacturing challenges persist across multiple industries – position themselves as essential partners. OEM (Original Equipment Manufacturers) and Prime (major contractors to the US Department of Defense) suppliers often rely on a small company’s ability to deliver on what they say they will do. There are few industries where a reputation for quality work and consistently delivering on time garners more growth opportunities for your business than aerospace and defense. The two companies below both fit this mold.

Our first example comes from Ducommun (DCO), a critical supplier of advanced material aerostructures and electrical components, primarily in defense and commercial aerospace markets. On this quarterly earnings call, DCO provided two examples of its ability to grow relationships:

- First, the company’s largest customer has historically been defense prime supplier, RTX Corporation, where DCO has become an integral part of their supply chain. Ducommun has looked to deepen its relationships with other defense prime suppliers. This quarter, Northrop Grumman grew over 100% from last year to become DCO’s second-largest customer in revenue.
- Part of our thesis on Ducommun is that disruption within the Boeing and Airbus supply chains will yield opportunities for market share consolidation with the most reliable suppliers. The second highlight from the call was a statement from the CEO that shows this is happening: “We are picking up more content on the Boeing 787 for all models due to a share shift from a competitor in 2025.” It is one small sentence, but this is precisely what we were looking for to further validate our thesis.

The second company is Graham Corporation (GHM), a critical component supplier for the Navy, among other industries. A few quotes from the earnings call that were particularly noteworthy:

- “We recognize that supply chain issues are creating concerns...our customers are urging us to maintain and even accelerate schedules. In fact, this environment presents an **opportunity for us to capture additional work where other suppliers may be struggling to meet demands.**”
- “Navy’s also talking to the shipbuilders about what are the opportunities to accelerate and **what can you reallocate to high performing supply chain partners** like Graham Corporation. So, we’re getting some of those inquiries that traditionally have been held within the Navy yards.”

These excerpts reinforce the importance of Graham’s quality and reliability within the supply chain and why the Navy supply chain partners financially supported the expansion of Graham’s Batavia, NY, facility and recently delivered the BlueForge grant supporting Graham’s defense welder training program. This type of support and investment demonstrates the value of Graham as a supplier and reinforces our conviction in the durability of the growth opportunities before the business.

As much as we would like to think investing is all about the numbers, at the end of the day, each investment is a company that is run by people. We prefer to do business with people who do what they say and can be relied upon. Companies are no different. Their word needs to be their bond – that is how good companies become great companies and deliver exceptional returns for the patient investor.

As of 31 October 2024, the Diamond Hill Small Cap Strategy owned shares of Ducommun Inc and Graham Corp.

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