ENHANCING QUALITY:

PROXY VOTING & DIRECTOR ELECTIONS

NOVEMBER 2021

RANGER INVESTMENTS

This paper is intended for one-on-one presentations to institutional investors or investment professionals only.

ABOUT RANGER INVESTMENTS

Ranger Investment Management, LP is a 100% employee-owned, long-only institutional investment boutique specializing in U.S. Small and Micro Cap strategies since 2003. We invest in high-quality, growing businesses at compelling valuations and formally integrate ESG analysis into our approach. We are passionate about doing deep original research on smaller companies that are often uncovered by Wall Street.

We believe that companies who consider material ESG risks and opportunities in their businesses are equipped to create shareholder value with less risk over time. Our original ESG analysis and proprietary scoring assessments are integrated into our investment process and directly inform our investment decisions. We believe this is an important tool in our quest to uncover quality companies. Ranger Investments is a signatory to the Investor Stewardship Group (ISG) and the United Nations Principles for Responsible Investing (PRI).

The PRI is the world's leading proponent of responsible investment. It works: to understand the investment implications of environmental, social and governance factors; and to support its international network of investor signatories in incorporating these factors into their investment and ownership decisions. As part of our commitment to the PRI six principles, we formally report our progress for ESG integration and active ownership annually to the PRI, who evaluates asset managers across three broad categories: Strategy & Governance, Listed Equity – Incorporation, and Listed Equity – Active Ownership. See our 2020 Assessment scores for each category below:

Signatory of:

PRI Principles for Responsible Investment

	RIM SCORE
Strategy & Governance	A+
Listed Equities - Incorporation	A+
Listed Equities - Active Ownership	A

ALTHOUGH ROOTED IN ENCOURAGING BEST PRACTICES, THE ONE-SIZE-FITS-ALL APPROACH OF PROXY ADVISORY FIRMS CAN WORK AGAINST ESG ADVANCEMENT AT SMALLER COMPANIES.

Proxy advisors ("advisors") have substantial influence on institutional investor voting. By extension, they often help shape the corporate governance profile of companies. Most institutional investors subscribe to services provided by one of the two primary independent advisory firms, who together control over 95% of the advisory market in the U.S. The largest provider's 1,500 institutional clients vote on approximately 12 million ballots representing 3.9 trillion shares. Many investors mechanically vote in lockstep with their recommendations on most ballot proposals. The increased importance of these services has been driven by institutional investors' fiduciary duty to vote shares in clients' best interests along with resource constraints, as most managers do not have in-house teams to evaluate potentially thousands of proxy proposals at hundreds of companies. This influence is further fueled by the duopoly-like market, in which the two primary advisors' recommendations are highly correlated. The combination of these factors has resulted in advisors playing a significant role in advancing corporate governance principles at publicly traded companies. With an increased focus from the SEC on the role of proxy advisors, there is no shortage of debate from the investment community related to proxy voting in recent years. Beyond the scope of those issues and debates, we believe there is an important issue that is largely going unaddressed in the broader discussion.

For PRI signatories and other managers formally integrating ESG into their investment work, active ownership is an important component of a holistic ESG approach and in the fulfillment of their duties as fiduciaries. Advisors increasingly emphasize environmental and social factors in their guidelines, however it is still often unclear how those factors are weighed against routine governance topics. Sometimes advisor recommendations, while rooted in best practices, work against the advancement of broader ESG goals such as improving diversity at the board level. Going a step further, these recommendations can even raise the risk profile of a company. If a director is potentially removed due to a proxy recommendation, which is often based on a technicality, a company risks losing key strategic skills and diverse perspectives at the board level. We believe this practice of applying rules-based standards has greater consequences on smaller companies, where a "one-size fits all" approach to proxy voting, by definition, often neglects to evaluate company-specific dynamics, such as the composition of a company's board. Investors must take the time to fill this information gap to help make more informed decisions during proxy voting season.

"We believe investors should take the time to understand the skills and perspective each director brings to the company and weigh those against the topics under consideration."

VOTING AGAINST DIRECTORS CAN BE COUNTERPRODUCTIVE

For company-specific proposals such as executive compensation plans, auditor changes, restructuring, or environmental and social issues, advisor recommendations are typically straightforward because the vote relates specifically to the matter in question. However, advisor recommendations and rationales for the election of directors can be more complicated. These recommendations have become the avenue through which advisors voice their concerns over a multitude of governance items by recommending an Against or Withhold vote. In some cases, this is due to obvious director-specific shortfalls such as lack of risk oversight, poor accounting practices from the audit committee, or lack of attendance. But more often we see Against/Withhold recommendations for directors where the advisors cite broader governance topics at companies such as classified board structures, dual class share structures with unequal voting rights, and supermajority or plurality voting standards related to governing documents or director changes. Advisors' guidelines generally dictate that Against/Withhold votes are warranted for directors standing for re-election if the company exhibits any of these traits.

While we agree that a declassified board structure, a single share class, and majority voting standards represent best practices, we believe that voting against directors because of these issues can sometimes lead to a one-step forward, two-steps back dynamic. For example, advisors may recommend withholding votes for a particular director who plays a strong strategic role and/or improves the board's diversity. We believe investors should take the time to understand the skills and perspective each director brings to the company and weigh those against the topics under consideration. Admittedly, a thorough analysis of the skill sets that a board member brings to a company is outside the scope of what we should expect from an advisor. However, we often find that the loss of a particular director presents more risk than that posed by a particular governance issue. We provide several examples below that highlight how board composition and diversity would have been negatively impacted.

Company Example 1 | Workiva (WK)

Advisors recommended Withhold votes for two directors up for re-election recently, citing the supermajority vote requirement to enact changes to governing documents, along with the classified board structure. While we agree that an eventual sunset of these items represents best practices, one of the directors in question is not only a key resource to Workiva's business, but also a strong proponent of advancing the company's ESG practices. Workiva is a cloud-based enterprise software provider with compliance and reporting platforms that customers use to report data to a variety of stakeholders. ESG reporting is a large long-term opportunity for the company. This director has previously served as chairman of the Financial Accounting Standards Board (FASB) and also served on the board of directors of the Sustainability Accounting Standards Board (SASB), which arguably provides Workiva with a unique and ideal advisory resource for its business. In our engagement with Workiva's management, they described this director as someone with "unmatched skills" in the area. He will serve as a primary resource, as they recently launched an ESG reporting solution for clients. In our view, this director's skillset and the value he brings to the company outweigh the risks presented by a classified board structure and supermajority vote requirement – items which we believe will be addressed over time through active engagement with the company.

Company Example 2 | e.l.f. Beauty (ELF)

Advisors recommended Withhold votes for three directors up for re-election recently, again citing the supermajority vote requirement to enact changes to governing documents, along with the classified board structure. We note that two of these directors are women and represent diversity at the board level. Notably, e.l.f. Beauty is one of only five public companies in the U.S. with a board that has over 55% women and over 20% Black or African American representation. Diversity within the organization is an integral part of the e.l.f. brand, which legitimizes and connects the company with its customer and ultimately leads to their ability to grow ahead of the market and gain share. Perhaps even more integral than in other industries, e.l.f. is reliant on social media as a primary means of engagement with their core customer and their products are marketed as affordable with mass appeal to millennials. Without diverse representation at the board level, we believe the company would lose social media credibility and suffer reputational risk. The company is aware of ESG risks and opportunities in their business, and their efforts to address them are reflected in areas such as expanding board-level responsibility of ESG processes, reducing packaging waste, and increased ESG disclosures. We regularly engage with management on these topics and appreciate their focus on continued improvement. We believe the issues raised by advisors will be addressed over time and that a vote against these directors could have resulted in a significant step backwards for the company.

Company Example 3 | i3 Verticals (IIIV)

Advisors recently recommended that investors Withhold votes for two directors of i3 Verticals due to the company's previous lack of an independent nominating committee, which it has now adopted. Although the company has a declassified board and therefore all eight of its directors were standing for re-election, it is notable that the Withhold recommendations only concerned the company's two non-independent directors. The two directors in question include the CEO (who is also the board chair and founder of the company) and the CFO. We engaged with the company's CEO and General Counsel on this question prior to their annual meeting. We learned that the previous nomination process was exclusively handled by the company's six independent directors in the same manner as any formal committee would, and it was headed by the company's lead independent director. While we are pleased that the company now has a formal committee and that this point of contention with the advisors has been removed, we believe the previous structure described in detail in the company's proxy was a practical solution and sufficient to meet its needs. To this point, it's worth noting that there were no previous controversies related to nominating independent directors cited by the advisors. The recommendation of withholding votes for the CEO and founder of the company on what was essentially a technicality is shortsighted and is an example of why investors should dig deeper into the rationale behind proxy vote recommendations.

BOARD DIVERSITY IS OFTEN AT STAKE

For the 2021 proxy season, we reviewed our Small and Micro cap portfolios and found 15 companies whose director elections were impacted by Withhold/Against recommendations from our advisor. This amounted to 33 directors in total, 11 of whom were women. If removed from their respective boards, collective gender diversity at these companies would decline from 25% to 16%. We believe this would be disastrous, especially with gender diversity being a priority for most public-company boards. Beginning in 2022, NASDAQ's Board Diversity Disclosure Rule will go into effect, requiring listed companies to disclose board-level diversity statistics. Indeed, advisors have placed more focus on board diversity with benchmark voting policy changes coming in 2022, but given this year's trends, it is unclear how that factor is prioritized compared to other governance metrics. One of the examples below would indicate that it only comes into play when a company has no women on the board. This inconsistency outlines the importance of investors needing further examination to understand the nuances of proxy proposals at each company.

RANGER INVESTMENTS' APPROACH

Historically, management teams and their boards were less proactive in communicating with investors on proxy voting resolutions, even when the resolution dealt with the election of directors. As a result, in years past Ranger Investments relied more heavily on the advice of advisors in making voting decisions.

Over the course of this year, we have taken a more active role in evaluating whether to vote for directors in cases where advisors and management teams differed in their recommendations. In about half the cases listed below, we chose to vote in favor of the directors in question. This represents an evolution in our process, and we plan to monitor the companies in question to determine whether this method of engagement will prove more successful in our evaluation of future proxy proposals. In each of the cases listed, our advisor recommended Withhold or Against votes for directors.

	# of Directors Impacted in Election	# of Women Directors Impacted in Election	Proxy Advisor Rationale	# of Directors	# of Women Directors	RIM Vote
i3 Verticals	2	0	Lack of nominating committee	8	1	For
AppFolio	3	1	Supermajority voting standard; Classified board	8	3	Withhold
EVO Payments	3	0	Supermajority voting standard; Classified board	10	2	Withhold
TPI Composites	2	1	Supermajority voting standard; Classified board	11	3	Withhold
YETI	1	0	Supermajority voting standard; Classified board	8	3	Withhold
Brigham Minerals	1	0	Supermajority voting standard; Classified board	8	0	For
Ranpak Holdings	3	0	Supermajority voting standard; Classified board	10	2	Withhold
Green Brick Partners	3	2	Single-trigger provision in employment agreement	7	2	For
Workiva	2	0	Supermajority voting standard; Classified board	7	2	For
Grocery Outlet	3	1	Supermajority voting standard; Classified board	12	4	Withhold
iRadimed	1	0	Lack of nominating committee; Failure to establish diversity on board	4	0	For
QAD, Inc.	2	1	Lack of nominating committee; Failure to establish diversity on board	5	2	Withhold
Phreesia	2	2	Supermajority voting standard; Classified board	7	2	For
Repay Holdings	2	1	Supermajority voting standard; Classified board	8	1	For
e.l.f. Beauty	3	2	Supermajority voting standard; Classified board	9	5	For

"ONE-SIZE FITS ALL" CAN DISPROPORTIONATELY AFFECT SMALL COMPANIES

We wrote previously on the challenges that small cap investors face when integrating ESG research into their process, largely due to the lack of ESG disclosures relative to larger cap peers and the resulting need to overcome the large cap bias in third-party rating agency scores. We believe the advisor dynamic represents an additional challenge, albeit a less obvious one, for small cap investors. Small and micro cap companies are more likely to exhibit some of the governance traits that garner Withhold/Against votes from advisors compared to their larger cap peers. Smaller companies typically have smaller boards, making the addition or subtraction of a director more impactful when assessing director independence and diversity. Classified boards are also more common in smaller companies. According to Bloomberg, about 36% of Russell 2000 members have classified boards, compared to only 12% of the S&P 500. This is partly explained by a higher number of newly public companies in lower market cap ranges. In a study conducted by Field and Lowry that looked at the S&P 1500, approximately 80% of IPOs in 2018 had classified board structures, up from approximately 60% in 2005. Meanwhile, the study found the number of "mature" companies (those being public for at least five years) with classified boards declined from ~55% to ~35% during that time. This trend supports our view that companies often adopt more shareholder-friendly structures over time.

Below, we divide the Russell 3000 into quintiles based on market cap, with the largest companies falling into quintile 1. The data depicts how smaller companies (those in quintiles 4 and 5) have relatively smaller boards, fewer women on the board, a lower percentage of independent directors, and are more likely to have a classified board structure than the largest companies in the index. Further, the number of companies with no women directors is significantly higher in the smallest 40% of the index. Gender diversity for the bottom two quintiles is 20.0% and 16.7%, respectively, which compares to 14.3% and 12.5% just two years ago.

Quintile	Median Market Cap	# Directors	% Women	% Independent	% Classified	# With No Women
1	$32.3b	11	27.3%	87.5%	19.7%	3
2	$6.7b	10	25.0%	85.7%	32.1%	8
3	$2.8b	9	22.2%	85.7%	35.8%	19
4	$1.2b	9	20.0%	83.3%	34.8%	29
5	$451m	8	16.7%	81.8%	39.7%	54

**All data displayed above represent Bloomberg median values as of 11/5/2021*

"Companies with diverse boards and workforces are typically better positioned to capture market share by having a stronger understanding of their customers in a global setting. These critical priorities shouldn't be impeded simply to voice investor concerns about the board structure or voting rights, which can be addressed through other means."

While gender diversity on boards continues to improve and the smallest companies are making the big improvements, it remains lacking. Before COVID-19, there had been slow, steady progress in the workplace for women, with increased numbers in overall workforce and leadership roles. However, the impacts of the pandemic have disproportionately affected working women, according to the *Women in the Workplace* 2020 study. Further research from the McKinsey Global Institute found that women's jobs were almost twice as vulnerable compared to those of men. Through our ESG engagement, we will continue advocating for greater board and C-Suite diversity as we believe companies with leadership diversity demonstrate two distinct quality characteristics which bring advantages to those companies. First, they can more fully develop their employee base as they are more likely to be responsive to the needs of all their employees. These needs include everything from mentoring and professional advocacy programs to parental leave policies. Companies who make all employees feel supported build happier and more productive teams in our experience. Second, consumers increasingly look for companies with authenticity and purpose. It's almost self-evident that a company can never fully resonate with a diverse customer base unless the board and senior management contains diverse voices as well.

Companies with diverse boards and workforces are typically better positioned to capture market share by having a stronger understanding of their customers in a global setting. These critical priorities shouldn't be impeded simply to voice investor concerns about the board structure or voting rights, which can be addressed through other means.

While classified boards are viewed as less shareholder-friendly because they are defensive and an impediment to effecting change at a company, many companies adopt the structure early to ensure board continuity and to allow the board to focus on a longer-term vision. These companies are often still led by their founders. As small cap investors who see these structures frequently, we evaluate each situation and weigh the risks of maintaining the board structure or replacing a large portion of the directors, who may be key resources from a strategic or diversity perspective.

A BETTER WAY: DIRECT ENGAGEMENT WITH COMPANY MANAGEMENT

In our engagements with company management teams, we find that small companies are receptive to investor concerns on the governance issues raised by advisors. In most cases, the governance structures under consideration have been in place since the company came public. By engaging management teams and boards on these topics, investors can get a sense for how management perceives its relationship to its investors. By digging deeper into a company's long-term priorities, investors can get a feel for whether the governance issues in question may be resolved over time. We view engagement on ESG topics as multi-faceted. Our approach for small companies is to seek out more information on how they manage ESG risks and opportunities in their businesses to form a more robust ESG profile. This often involves encouraging companies to increase their ESG-related disclosures or adopt a framework for reporting such as SASB. As part of those discussions, we address governance topics such as board structure, board diversity, and executive compensation, and voice our concerns on those topics as needed.

For small companies who are becoming more "ESG-aware," tackling all these issues at once is often unrealistic. Therefore, we place a high value on companies making steady improvements. We find that engaging companies on these topics, rather than voting against their directors, is a more productive approach that is more likely to lead to ESG improvements. Engagement allows investors to voice their concerns on these topics to management and gain insight into how they see their board structure evolving over time. In recent years, we have seen companies in our portfolios declassify their boards or remove supermajority voting rights, which we encourage and applaud. This often coincides with improvement in ESG disclosures and environmental and social initiatives.

KEY TAKEAWAY

Many small companies are moving in the right direction in terms of managing ESG risks and opportunities. However, change is typically slower than investors would like to see. Investors should not ignore the issues raised by advisors in electing directors but should do more digging to fully understand the nuances of each proposal and take those into consideration in their voting decisions. We believe that asking, "what is our end goal?" can be useful when assessing the removal of directors. Ultimately when investors seek to advance ESG goals without changing the composition of a board of directors, change can come at a faster pace than might happen otherwise.