RIVERWATERPARTNERS LLC

January 18, 2017

Dear Friends,

2016 was a tumultuous year for the election pollsters and odd makers. What was more improbable: the Chicago Cubs winning the World Series or a billionaire winning the White House? Surprisingly, the Cubs held better odds in April at 16% (after 108 years of missing the World Series) vs. Trump at 14% odds in October.

Trump's victory propelled the market, already at the high end of its historic valuation, to all-time highs ending up for 13 straight days after the election. These gains could continue depending on the policies of the new administration. A decrease in the corporate tax rate could cause a 15% rise[1] based on 2017 earnings alone if tax rates are lowered from the current 35% to somewhere around 25%. How long could these gains last? While is not unfathomable that we could end up with a Democratic sweep in four years reverting tax rates back to the old structure, the market today doesn't look out any farther than two to three quarters. Party on investors!

In the short-term, market participants have traded around sectors and positions they believe will be affected by the new administration. Betting that the demise of Obamacare would bring in fewer patients and more bad debts, hospitals were down following the election. Specifically, HCA and Tenet, two of the largest public hospitals, were both down over 10%. In contrast, for-profit education rallied on the prospect of a less hostile regulatory environment. The three largest for-profit education companies were up an average of 9.7% in the two days following the Trump victory and continued to appreciate throughout the quarter.

While we do own a for-profit university (Grand Canyon University) in our SMID cap portfolio, Trump's win was not a factor when we structured our portfolios (nor was the Cubs' for that matter). We remain laser focused on owning great businesses run by exceptional management teams with the stock price trading at what we deem to be an attractive valuation. Finding such businesses continues to be challenging with the market at the high end of its historical valuation. Notwithstanding, by maintaining true to our focus on fundamentals, we are still uncovering ideas we believe can deliver in this run-away bull market as well as in any other regulatory or political environment.

Our response to the election has not been to chase assumed winners of the new administration. Instead, we took cash down from 20% at the end of Q3 to an average of about 9% in both strategies and added

[1] If you make $100 pre-tax in the current tax regime you would take home $65. Dropping to 25% it would jump to $75. MATH: $75 ÷ $65 =15.4%. Assuming the same earnings multiple stocks should rise 15%.

three new names in both the Large and the SMID cap portfolios. Our focus continues to be companies we feel have bright outlooks and attractive valuations.

Two of these companies are JM Smucker and Church & Dwight (*Arm & Hammer, OxiClean, and Nair*). Both are consumer stocks with large portfolios of name brand products that you likely use. In fact, 93% of all US households have a JM Smucker brand at home. Think *Folgers, Crisco, JIF peanut butter, Pillsbury, Kibbles 'n Bits, 9 Lives, Milkbone* to name a few… and of course *Smuckers* jelly. We like JM Smucker because it trades at a large discount to other packaged goods companies and has a free cash flow yield of 6.7%. We also like Church and Dwight because of its free cash flow yield of 5.6%. Further, the CEO bought over $200,000 of stock in November and studies have shown that insider purchasing is correlated with market outperformance[2]. Neither of these companies ran with the market post-election; in fact, both were actually down one month later.

We also added to two existing positions in the SMID (AgroFresh Solutions & Rite Aid) and two in the Large (TE Connectivity & Zimmer Biomet). Only one position was sold in the large, Teva Pharmaceuticals. With Teva, we reached our 20% loss limit, triggering an automatic review. After review, we decided to liquidate based upon a negative legal overhang (US Government is charging six generic drug makers over price fixing) and the resignation of Siggi Olafsson, the architect of a major acquisition that significantly added to the debt on their balance sheet. If the guy responsible for the biggest deal in Teva's history was jumping ship, we were going to join him.

We are guided by the words of American economist turned social theorist Thomas Sowell; *"it is hard to imagine a more stupid or more dangerous way of making decisions than by putting those decisions in the hands of people who pay no price for being wrong."* This quote explains why believe it is so important for management to have skin in the game. The Church & Dwight CEO had been buying stock in the open market and this activity is what lead us to investigate the company. We are no exception to this rule; we invest beside our clients, ensuring our interests are aligned with yours.

Emotions are an investor's worst enemy. Behavioral scientists have documented that our brains are geared to feel pain of loss more acutely than the pleasure of gains (or wins). *"Psychologists, using new brain scanning technologies to map how the brain works, have learned that an investor's perception of gain and loss is not linear. Multiple substantiating studies suggest that* ***the pain associated with a $1 loss is twice that associated with the pleasure of a $1 gain."***[3]

It is natural human tendency to jump out of stocks when they are going down so as to avoid or minimize that pain of loss[4]. Unfortunately, investors don't know the right time to get back in, and usually sit on the sidelines as the market climbs back up. The worst case is jumping back in near another peak and then

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[2] *The Review of Economics and Statistics,* "Estimating the Returns to Insider Trading," June 2002, by Jeng, Metrick and Zeckhauser

[3] *Financial Planning Association Journal*, May 2005, "Missing the Ten Best" by Paul J. Gire, CFP

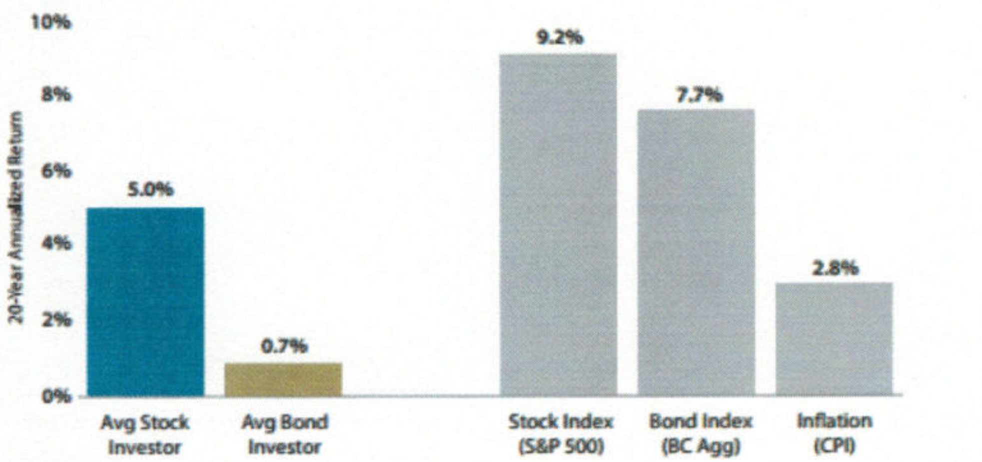
[4] While the loss in TEVA was not what we wanted, we sold not because it was painful, but rather because the outlook had changed.

jumping back out on the next market correction. Instead of following the sage advice to "buy low and sell high," investors find themselves doing just the opposite.

The data below illustrates this point. A 2013 study and found that the average investor has a return that is just over half of the market's return over a 20-year period. Pretty scary.

GRAPH 1:

Performance of the Average Investor



Source: Dalbar, for the 20-year period ending 12/31/13. Please refer to page 7 for information.

Our worst performing stock, AgroFresh, a holding In the SMID portfolio, is a quintessential example of why keeping a level head is paramount to success in the stock picking business. AgroFresh was down 44% in the fourth quarter after they reported third quarter earnings. Using analysis instead of emotion, we concluded that the numbers were not as bad as they seemed and doubled down on our position. With sales down 1% and earnings in @ $.15 vs. a loss the year before, AgroFresh's problem was they talked about competition being an issue for the first time and lowered guidance. We estimate they had to cut pricing by 2% to maintain some customer relationships. Not great, but not a death knell either.

AgroFresh has roughly 90% of the market share for spraying apples with a chemical called 1-MCP to keep apples from ripening and rotting. 1-MCP is similar to naturally occurring ethylene which triggers ripening and spoilage in most fruits and veggies. Growers dissolve the SmartFresh sugar-based powder in water and allow it to permeate the cold rooms where farmers store the apples. The ingredient biodegrades naturally and is not present after 24 hours (the wax on apples is NOT 1-MCP).

Any apple you eat grown in the Northern Hemisphere was likely last on a tree in the fall. The best way to eat apples that crunch in the winter, spring, and summer is to treat them with SmartFresh. The Rockefeller Foundation has estimated that 46% of all fruits and vegetables are lost and wasted totaling about $660 billion per year!

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The current opportunity for AgroFresh is to expand from apples to other fresh fruit products such as bananas. We think a mass investor exodus was largely caused by mistakes the company made in how they communicated with the street. However, they recently hired a new CEO (whom we've met and have confidence in) and a veteran CFO. Together, we believe they have the ability to provide a much brighter future for the company. Insiders seem to agree with us as they have been buying the stock at its current depressed level. The CEO, CFO, General Counsel and multiple board members all bought in the open market in the fourth quarter.

We estimate that AgroFresh can generate around $40 million in free cash flow in 2017. This gives the stock a free cash flow yield of 25% or 4x free cash vs. the market which has a free cash yield of less than 5%. The yield is only this high because AgroFresh has a fair amount of debt, but no substantial amount matures until July 2021 and we think they could pay down half of the debt before it actually comes due.

Given our defensive nature, we are pleased with our Q4 performance. Our SMID strategy outperformed the Russell 2500 Index and our Large strategy outperformed the S&P 500 with most of the relative outperformance occurring in October when the market was down. It is a fool's errand to make macro predictions on what lies ahead in the coming year. The only prediction we offer is to expect the unexpected for the market and know that we will continue to manage your capital like it is our own, focused on company fundamentals instead of political trends.

Best wishes for a prosperous 2017! We would appreciate the opportunity to share our story should you think of anyone you would like to introduce us to.

Thank you,

Adam J. Peck, CFA | Mike DiStefano | Matt Drvaric | Laura L. Peck