Q2 2022 ESG MICRO Cap Opportunities Strategy Update

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Bottoming is a Process

Volatility continued in the second quarter for microcaps, driven by a slowing economy and an aggressive Federal Reserve. In previous quarterly letters we stated that we believed the Federal Reserve could not raise rates aggressively because if done when growth was slowing, it would create a likely recession. So far this appears to be happening with mortgage rates rising, credit spreads widening, ISM reports rolling over and consumer confidence hitting all-time lows. With inflation at roughly 8%, it will make it difficult for the Federal Reserve to change course, especially when their mandates of stable pricing and low unemployment are lagging indicators. This sets up an interesting second quarter earnings season where we will be listening closely to management teams on how their businesses are doing and what their outlook is for the second half of the year.

A market bottom is often more of a process and not a point in time, other than in retrospect. There are some key points to look for in this process that include a turning point in leading economic indicators from very bad to less bad, a policy pivot by the Federal Reserve, stimulus spending from the federal government, or if you are into technical analysis, the stock charts starting to make higher lows. As of today, we have not seen any of these bottoming processes happen but remain confident some of the indicators will turn in the upcoming quarter or two.

Microcap investing can be volatile and difficult on the psyche of an investor. Given limited liquidity, many individual stocks can see massive declines on no news other than the market selling off. It is important to not let emotions run your investment process. If the fundamentals have not changed in the business, investors should stick with sound investments and even potentially add on market dislocations.

Specific industries that we are most focused on today are Healthcare, Energy, and Consumer Staples. Basically, we are looking for companies that are defensive in factor analysis and have good earnings/FCF visibility at a cheap price. There are many single digit P/E stocks that are pricing in a Great Financial Crisis (GFC) type recession. We do not see that as likely happening because there is not as much debt on consumer and business balance sheets compared to that recession.

To summarize, it has been a tough quarter for news and economic indicators, but we believe there will be signs of (at least parts of) a bottoming process this quarter. This quarter could turn out to be a great opportunity to pick up very strong microcap businesses that are mispriced and misunderstood.

Top Contributors

The micro strategy outperformed the Russell 2000 Index for the quarter with the top contributors being USA Truck (USAK) and Unitil Corporation (UTL). USAK is one of North America's top 25 truckload carriers with two reportable segments, trucking and logistics. DB Schenker, one of the world's leading logistics service providers announced an agreement under which they will acquire all outstanding shares of USAK common stock for $31.72 per share in cash. At the time of the purchase, this was more than double USAK's stock price.

The other top contributor, Unitil Corporation (UTL), is a public utility holding company that engages in the distribution of electricity and natural gas. It operates through three segments: Utility Electric Operations, Utility Gas Operations, and Non-Regulated. Utilities are a defensive sector in the stock market, and UTL has held up very well during the selloff, especially relative to microcap names.

Largest Detractors

Our largest detractors from performance were Harvard Bioscience (HBIO) and Mawson Infrastructure Group (MIGI). Harvard Bioscience develops, manufactures, and sells technologies, products, and services that enable fundamental research, discovery, and pre-clinical testing for drug development in the United States and internationally. During the quarter HBIO had a less than stellar quarter mostly driven by weakness in China. After speaking with management and seeing some insider buying from the CEO, we feel comfortable that the China situation is temporary, and the turnaround is still on track.

Mawson Infrastructure Group, a digital infrastructure provider, operates in cryptocurrency mining in the United States and Australia. It owns and operates modular data centers. MIGI has been hit by the crypto currency selloff and announced a capital raise in the quarter, which we previously did not think was needed. Since the quarter end, we have exited this position and the stock has declined 50% since our sale.

Additions

We used this market volatility to add a few new names to the portfolio. We added ChannelAdvisor (ECOM), a leading e-commerce cloud platform software-as-a-service (SaaS) company whose mission is to connect and optimize the world's commerce in the following areas:

- **Marketplaces:** Connects customers to hundreds of global marketplaces (Amazon, eBay, Google, Newegg, Overstock.com, Target, TradeMe, Walmart, Zalando, Shopify, Magento)
- **Digital Marketing**: Allows customers to send product data feeds to advertising channels and to advertise on comparison shopping websites (Google, Bing, Facebook, Instagram, Pinterest)
- **Shoppable Media**: Allows brands to provide web visitors with easy path to purchase
- **Brand Analytics**: Provides customers with actionable insights on digital shelf across retailer websites and marketplaces

In 2016, new CEO David Spitz began to focus on servicing brands vs retailers. Brands wanted to take control of selling their products across platforms (brick-and-mortar and digital), understanding that consumers are becoming "channel agnostic" and are using new features like in-app purchasing, browsing for items based on their preferred shipping method, and buying online/picking up in store to inform their buying decisions. Today brands represent more than 50% of ECOM's revenues and 67% of bookings.

The Total Addressable Market (TAM) for e-commerce is expected to grow from $2 trillion in 2020 to $5 trillion in 2025. We believe ECOM is well-positioned to capitalize on this growth given its customer list, channel partners, and product offerings. The company is profitable, trades at a significant discount to its software peers, and for a small company, has robust sustainability policy and practice.

Lee Enterprises (LEE) is another new addition this quarter. LEE provides local news and information, and advertising services in the United States. LEE serves 77 mid-sized local communities and offers print and digital editions of daily, weekly, and monthly newspapers and publications. In January 2020, Lee announced an agreement with Berkshire Hathaway to acquire BH Media Group's publications and The Buffalo News. While Berkshire Hathaway is not an equity owner, they did provide the financing to pay down old debt and fund the new purchase. Warren Buffett has spoken highly of the management team at LEE in the past.

The newspaper business has been a struggling industry for some time, but LEE has been rapidly growing its digital subscription business that is more stable and better able to target advertising. We believe that national news is more likely to get disrupted than local news given it's the more personal content based around communities. LEE currently has 492,000 digital-only subscribers and management expects to reach more than 900,000 digital-only subscribers by 2026.

Another new addition was Talos Energy, Inc. (TALO). Talos is a Gulf of Mexico (GOM) oil and gas exploration and production company that is also developing one of the largest carbon capture storage systems (CCS) in the world. On an ESG basis we like that the GOM actually has the lowest carbon footprint per barrel in all of North and South America. TALO is working to lower its own carbon emissions intensity and has been successful with a 25% reduction since 2018 and is well on its way to achieving its 30% reduction goal by 2025.

TALO’s valuation is low, which is to be expected as it’s a commodity driven business; however, it is less levered than its peers and trades at a 25% discount with a PE of 2.9x, making it extremely undervalued, in our opinion. We think the Russian invasion of Ukraine has fundamentally changed the supply/demand dynamic for oil and gas, and should place a floor on oil in the $70-$80 area. We think TALO’s 29% FCF yield is sustainable and at $80 price of oil per barrel, the stock trades at more than a 50% discount on a PV-10 basis, which is a calculation of its net asset value.

Over 20% of the world’s 2000 largest companies have committed to net zero carbon emissions by 2050. There is and will be an ever-increasing drive to lower carbon emissions, which is in constant conflict with the world’s ever-increasing demand for energy. One way to solve this conundrum is to reinject carbon back into the earth where it came from. Talos is a leader in CCS and has partnered with very large companies like Chevron to make carbon capture happen. We believe the market opportunity is 16x larger than where it is today and that this opportunity is not currently reflected in the stock's valuation.

Gold Royalty Corp. (GROY) engages in the acquisition and management of additional royalties, streams and other interests on gold and other precious metals projects and offers financing solutions to the metals and mining industry. It currently has 200 royalties and 28 of them are cash flowing. GROY's flagship property is the Canadian Malartic, which is the largest operating gold mine in Canada. The management team consists of many top gold executives and investors from other successful companies like Goldcorp, Wheaton Precious Metals, and McEwen Mining, all of which were successful investments for shareholders. GROY was in the process of attempting to combine with Elemental Royalties to give the company better scale in the royalty market, but the offer was rejected by the board. Also, we thought the gold royalty business would be more defensive in an uncertain macro and volatile stock market scenario, but that has not been the case. While not during the second quarter, we did sell this small position recently.

Sales

We sold two other stocks during the quarter that experienced changes in the business or had a less favorable macro outlook. Orion Group's (ORN) CEO departure and concerns about a recession led us to sell the name. Usio Inc. (USIO) was also caught up in the crypto selloff even though it only handles transactions for trading platforms. This also led to uncertainty surrounding the company's growth outlook and potential to return to negative earnings. One facet of our sell discipline is based on fundamental changes in the business. When the fundamentals change from our initial purchase we prefer to not sit around and hope for things to go our way. The third quarter is shaping up to be another volatile investing period but should provide ample opportunities to find diamonds in the rough.

(Disclosures and chart showing ESG MICRO Opportunities Strategy Largest Contributors and Detractors on next page).

ESG MICRO Opportunities Strategy

Largest Contributors and Detractors – Q2 2022

5 Best - Absolute Contribution				
Ticker	**Company**	**Average Weight**	**Contribution**	
USAK	USA Truck, Inc	3.79%	281	bps
UTL	Until Corp	4.34%	73	bps
VIVO	Meridian Bioscience, Inc.	3.91%	69	bps
LMAT	LeMaitre Vascular, Inc.	3.07%	5	bps
INFU	InfuSystem Holdings, Inc.	3.92%	4	bps
	5 Best Total	**15.17%**	**435**	bps

5 Worst - Absolute Contribution				
Ticker	**Company**	**Average Weight**	**Contribution**	
AKTS	Akoustis Technologies	2.43%	-133	bps
VECO	Veeco Instruments	4.39%	-145	bps
FARM	Farmer Bros. Co.	4.18%	-180	bps
MIGI	Mawson Infrastructure	1.50%	-190	bps
HBIO	Harvard Bioscience	4.25%	-228	bps
	5 Worst Total	**16.75%**	**-877**	bps

Disclosures:

Reader should not assume that investments in the securities identified were or will be profitable. Timing differences of purchases and sales may have a modest impact on the actual contribution numbers presented. The holdings identified do not represent all of the securities purchased, sold, or recommended. The calculation's methodology along with details on all holding's contribution to the overall account's performance during the measurement period are available upon request. Past performance does not guarantee future results.