RIVERWATER PARTNERS

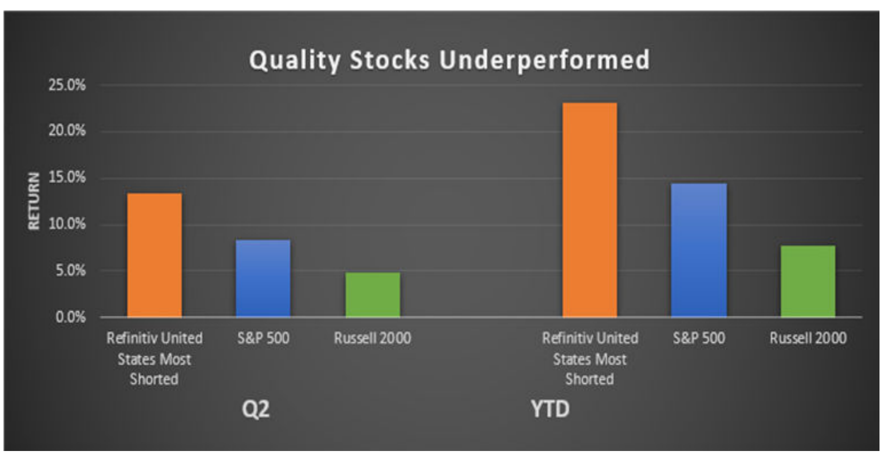
Q2 2023 MICRO OPPORTUNITIES STRATEGY UPDATE

By Nathan Fredrick

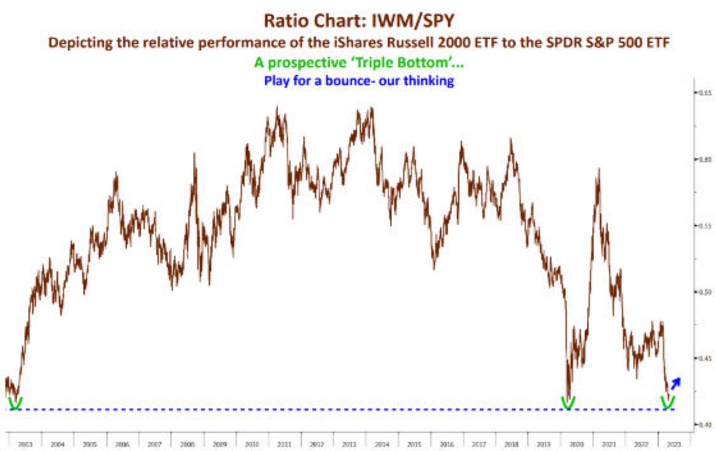
The Case for Microcaps

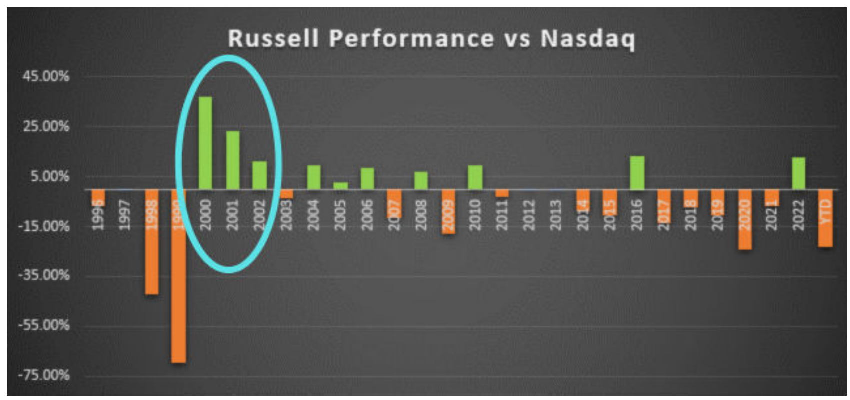
The Riverwater Micro Opportunities Strategy underperformed the Russell 2000 Index in the second quarter. At the beginning of the quarter, large cap tech stocks rallied, while small caps moved sideways. Small caps started to catch up later in the quarter when the Federal Reserve appeared to pause rate hikes and economic data looked better than feared. Price performance for most of the Nasdaq's performance, as well as the largest weighted stocks in the S&P 500, has been driven by multiple expansion and not earnings growth. For example, Apple has had negative net income growth for the last two quarters and is projected by analysts to have another quarter of negative net income growth this quarter, according to Factset. Apple has not reported earnings yet this quarter analysts anticipate three straight quarters of negative net income growth. It's rare to get multiple expansion on negative to no growth earnings.

This quarter was difficult for small caps as the best performing market factors did not align with our investment style. The market has gone back to pricing in a "No Landing" which basically means no recession. This caused many of the lower quality stocks to rally the most. This last quarter was reminiscent of the meme stock rally of early 2021. We can track this by following the performance of Refinitiv's most shorted basket of companies. The most shorted stocks usually have some of the worst fundamentals or don't make a profit at all. You can see in the chart how much these companies outperformed both the S&P 500 and the Russell 2000. We skew to more quality companies that are fairly priced. Low quality stocks can have short periods of outperformance as short sellers are squeezed out of their positions on any type of good news. We believe, as during the meme stock moment, this is unlikely to last. Once reality starts to set in, these shorted companies will need to report improved earnings to justify their higher valued businesses.



We do believe this is a good time to allocate to small and microcap stocks over large caps, especially the Nasdaq. Even if you are negative on the economy, the performance skew between the Russell 2000 and the Nasdaq has only previously been this wide during the late 90s tech bubble and the depths of the Coronavirus selloff in 2020. Outperformance by small caps followed each time we hit this market indicator. You can see this in the chart provided by Carter Worth of Worth Charting. The chart on the right shows the outperformance of the Russell 2000 in the green bars compared to Nasdaq performance in the orange bars. Notice the three years after the tech bubble where the Russell outperformed the Nasdaq.





We believe that a similar set up could be forming, setting the stage for small and microcaps to outperform for a few years. It might not be this quarter, but we believe we have to be pretty close based on the preceding chart. The setup is favorable for small caps because it is difficult for large cap stocks to continue to rise like this without commensurate earnings growth. Apple ended the quarter with a $3 trillion market cap. That is bigger than all of the Russell 2000 companies combined and roughly the same size as France and the UK's GDP. If Apple were to double again, it would be ranked as the third largest country's GDP in the world only behind the United States and China. A very difficult task when you look at the numbers.

Riverwater believes it is much less daunting to find microcap companies that have an easier path to double or more. Through our Three Pillar Approach, we can find companies that are fairly valued, have earnings growth, and are run by good management teams that have not yet been discovered by Wall Street. This sounds like a better investment to us than hoping large caps can continue to grow to the sky. History would tell us otherwise.

Company Deep Dive: LeMaitre Vascular, Inc.

The LeMaitre (LMAT) story began when George D. LeMaitre, MD, a vascular surgeon, sought to develop a better way to treat lower extremity arterial disease in his patients. Working with an engineer, he designed a valvulotome that could be used to cut valves in peripheral veins without the burdensome requirement of direct vision. Pleased with the performance of his valvulotome, Dr. LeMaitre felt other surgeons might also benefit from it. In 1983, he founded what would become LeMaitre. Over time, Dr. LeMaitre ' s son George W. LeMaitre joined the company, helping to grow it from a family-owned business to a publicly held global provider of innovative devices for the treatment of peripheral vascular disease.

Today, LMAT is a leading manufacturer and distributor of vascular surgical disposable devices and biologic patches and grafts. LMAT 's products are used by roughly half of the cardiac and vascular surgeons around the globe. LMAT is the #1 or #2 supplier of products in its niche markets and has 25% share of its current $800 million TAM.

LMAT has a dual strategy for growth: inorganic growth via acquisition of new products, and organic growth via increased distribution of these products alongside its current products. The Company's " R&D - light " strategy is focused on securing and maintaining regulatory approval of its biologic patches/grafts and disposable devices. Examples include renewal of MDR approvals for all products in the EU (which changed its regulatory requirements for medical devices), securing approval of its lead product Xenosure in China, and approval for its newly - acquired Allograft product in the EU.

LMAT has grown its sales presence to 29 countries, with 128 sales representatives, and counting. Additionally, LMAT has bought out its distributors in Switzerland, Norway, Korea, Malaysia, Singapore, China, and Australia, to sell direct in those locations. LMAT has been able to take pricing given the superiority of its biologic vs. synthetic products and given the fact that a typical hospital spends only $33,000/year with LMAT – a miniscule amount compared to spend on other equipment/supplies used by surgeons.

LMAT's margin profile reflects the value of its products and its solid execution. Gross margins of 65% are expected to return to pre-pandemic 70% levels after the completion of the manufacturing optimization. Additionally, the more seasoned salesforce and new regulatory approvals should allow operating margins to improve toward 20% from current 18%. This should result in revenue growth of 7 - 8%, EPS growth of 12 - 15%, and ROIC moving back towards 20% (well above their cost of capital). LMAT has no debt and ample cash to fund the business, including new acquisitions. The Company is also a " Dividend Champion," having increased its dividend each year over the past 12 years.

George W. LeMaitre is the current CEO and Chairman of the Board. LMAT's C-suite has 75 years combined experience and the executive committee has 18 years average experience.

The executive team's compensation is aligned with value creation and executives and directors own 12.4% (George W. LeMaitre owns 11.4%) of LMAT shares.

LMAT has recently hired Dave Hissong, General Counsel, who will lead LMAT 's efforts to sharpen its focus on/report on its sustainability efforts. Riverwater has offered tools and advice for the journey.

We believe LMAT offers shareholders the opportunity for long-term financial and real-world impact.

Top Detractors

The top detractors in Q2 2023 were Perion Network Ltd. (PERI) and Mayville Engineering Company, Inc. (MEC). PERI goes from being a top contributor in the first quarter to a top detractor in the second quarter. Perion benefited in the first quarter from the fanfare around ChatGPT and AI being integrated into Bing, where they have an advertising partnership with Microsoft. While they continued their beat and raise performance in the quarterly earnings, there was a lot of AI hype in the name that probably disappointed fast money that had bought in this year. Also, macro headwinds around advertising spend have been an overhang. The stock still trades at an attractive valuation with a net cash position of roughly $430 million.

MEC's underperformance was driven by macro headwinds from some of their large customers around orders for class 8 trucks and other heavy machinery used in agriculture and construction. Also, in its earnings call, MEC highlighted startup costs at their new plant in Michigan dragging on earnings for the rest of the year as it ramps capacity. MEC made a purchase near the end of the quarter that will increase debt, but will help diversify their product lines and give them cross-sell opportunities. MEC's long term prospects still look on track even though they had some growing pains in the quarter.

Top Contributors

The top contributors for Q1 2023 were Tecnoglass Inc. (TGLS) and LeMaitre Vascular, Inc. (LMAT). TGLS has now been a top contributor for three quarters in a row and we did a deep dive on the company two quarters ago. TGLS once again had a beat and raise quarter, and also benefited from more positive sentiment and numbers in the housing market. It is still very attractively valued which is why it remains our top holding for now. However, as TGLS grows so does its market cap, and unfortunately we will need to trim the position down if its stock price and portfolio weight continues to go up. LMAT handily beat earnings and gave guidance that was above Wall Street expectations, which sent the stock soaring after the earnings release.

Sales
In the quarter we sold two names: First Internet Bancorp (INBK), and Farmer Bros. Co. (FARM).

INBK, is as its name implies, an online bank. They were not immune from the selloff in the banking sector and we used this as an opportunity to sell INBK and move into a bank we liked more in CCB, which we will discuss below. FARM engages in the roasting, wholesaling, equipment servicing, and distribution of coffee, tea, and other products. While we believed they had a defensible moat with their distribution network, the coffee business did not recover as fast as we thought it would post Covid. Plus they had put a lot of debt on the balance sheet that gives them very little room for error. We believe we can find better opportunities in the market currently.

Additions
In the quarter we added four new names to the micro-cap strategy: Utah Medical Products, Inc. (UTMD), Coastal Financial Corporation (CCB), Perella Weinberg Partners (PWP), and TechTarget, Inc. (TTGT).

Utah Medical Products (UTMD), founded in 1978 focuses on health care for women and their babies. It develops, manufactures, and markets a broad range of disposable and reusable specialty medical devices recognized by clinicians as the standard for obtaining optimal long-term outcomes for their patients. Specialties include:

- Critical Care (arterial blood collection, blood pressure monitoring)
- Gynecology (permanent female contraception, uterine manipulation, etc.)
- Neonatology/Pediatrics (blood filtration, lumbar puncture, respiratory care, umbilical catheterization, Hemo-Nate, etc.)
- Obstetrics/Perinatology (fetal monitoring, umbilical cord management, etc.)

Additionally, UTMD has been supplying over 100 medical device companies throughout the world with high quality electronic and plastic components and assemblies – pressure transducers, pressure monitor cables, and pressure monitoring lines. UTMD also offers subcontract manufacturing and molding services.

Utah Medical has generated above-industry-average gross margins of 62% and ROIC of 15%, evidence of the value-add of its products and superior execution by its management team. The company has steadily grown revenue and improved profitability, and EPS, over time, resulting in a total shareholder return of 12.3% annually over the past 20 years. We believe UTMD is well-positioned to offer continued financial outperformance.

Coastal Financial Corporation (CCB) is a bank holding company headquartered in Everett Washington, that operates through its wholly owned subsidiary, Coastal Community Bank.

The Bank also provides banking as a service ("BaaS") that allow CCB's broker dealers and digital financial service partners to offer their customers banking services. CCB has been a high quality banking stock with a fintech type business attached to it for some time. We were able to take advantage of the banking turmoil to add a high quality company at a reasonable price.

CCB has a ROE around 20% and an efficiency ratio in the mid 40s which are both top tier for the banking sector. They have been able to do this by being conservative on the banking side of the business while taking more opportunities on the BaaS business. For example, they are the banking partner for a company called ONE that is backed by Walmart and will be marketed to every Walmart employee (there are 2 million plus Walmart employees). We were able to purchase CCB for less than 7x what we think they will earn next year.

Perella Weinberg Partners (PWP), an independent investment banking company, provides strategic and financial advice services in the United States and internationally. They combined with leading energy investment banking boutique, Tudor, Pickering & Holt in November 2016. Today, the firm has 62 advisory partners (with an average tenure of ~25 years) and ~600 employees across ten offices in five countries. The firm operates in six core industry verticals, which include: 1) Consumer & Retail, 2) Energy, 3) Financials, 4) Healthcare, 5) Industrials, and 6) TMT.

Recently, PWP has been adding managing directors to grow their business. Based on management's projections of $15 million on average of productivity for each managing director, in the next few years, PWP could be doing $1bil in revenue and $1.75 in EPS. This would significantly undervalue the company today. Most of PWP's business is driven by M&A activity, which has been declining the last three to four quarters. We think this last quarter will mark the bottom and M&A activity will incrementally improve throughout the year. These cycles usually last four to six quarters, so, if history is our guide, we have likely seen the worst. Plus, private equity is sitting on over $2 trillion in dry powder that will need to be put to work.

TechTarget (TTGT), founded in 1999**,** is a leading provider of data-driven marketing analytics and sales-enablement solutions. TTGT allows IT purchasers to get factual information (white papers, webcasts, content sponsorship) regarding tech solutions by subscribing to their 140+ websites, in exchange for providing their contact information to IT vendors.

TTGT provides sector-specific content from three sources: industry experts, peers, and vendors. Key areas of interest for IT buyers include: Security, Networking, Storage, Data Center and Virtualization Technologies.. What makes TTGT unique is that it is business to business focused and users need to register with TTGT to use content. This is different from what Facebook and Google do, using your personal information and selling it to advertisers. TTGT doesn't have to deal with any of the privacy problems and has better information when targeting its users with useful information on TTGT's customers (the IT vendors).

We have followed TTGT for many years but the valuation was always a little stretched for our process. The stock has come down significantly as IT budgets have been slashed, but we believe we are close to a bottom in IT spending cuts. IT spending went into a recession early to mid 2022, so much of the bad news has been priced in. We are looking to see marketing spend on IT reaccelerate in the second half of 2023, especially with all the hype around AI.

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

Micro Opportunities Strategy
Largest Contributors and Detractors – Q2 2023

5 Best - Absolute Contribution			
Ticker	Company	Average Weight	Contribution
TGLS	Tecnoglass Inc.	6.84%	141 bps
LMAT	LeMaitre Vascular, Inc.	4.09%	115 bps
HBIO	Harvard Bioscience, Inc.	3.98%	109 bps
VECO	Veeco Instruments Inc.	4.19%	95 bps
IRMD	IRadimed Corp.	4.66%	93 bps
	5 Best Total	**23.76%**	**553 bps**

5 Worst - Absolute Contribution			
Ticker	Company	Average Weight	Contribution
PERI	Perion Network Ltd	3.83%	-129 bps
MEC	Mayville Engineering Company, Inc.	4.48%	-89 bps
INBK	First Internet Bancorp	0.67%	-74 bps
FARM	Farmer Bros. Co.	0.52%	-63 bps
UTL	Unitil Corporation	4.34%	-47 bps
	5 Best Total	**13.84%**	**-402 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.