Macro Overview

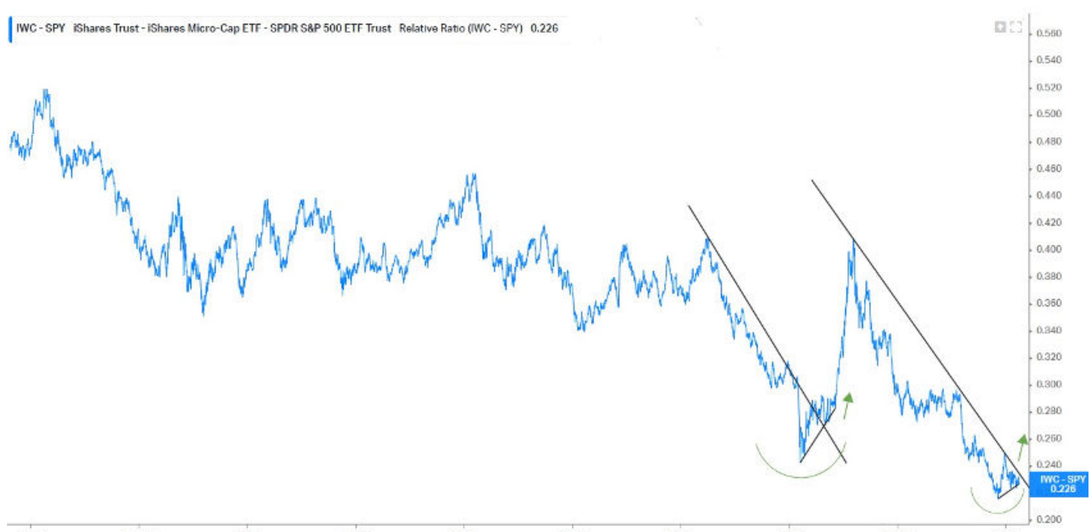
The Micro Opportunities Strategy began 2024 trailing its microcap benchmark. During the quarter, the performance of the benchmark was predominantly led by unprofitable and heavily shorted stocks, presenting a significant challenge for the strategy to outperform due to the high-quality focus of our portfolio. Additionally, our stock selection fell short of our usual standards. Nevertheless, our outlook for the portfolio remains optimistic, as we believe a number of our positions are materially undervalued. In addition, the macro backdrop is buoyed by factors such as stable inflation rates, declining unemployment claims, and an uptick in housing starts, all of which collectively diminish the prospects of a recession in 2024.

Sectors of Interest: Banking, Healthcare and Industrials

A particular concern within the microcap banking sector has been the challenges faced by specific lenders, notably New York Community Bancorp, Inc. (NYCB), especially concerning its commercial real estate (CRE) and multifamily loan portfolios. We assess this situation as a unique occurrence, predominantly linked to New York's CRE market and, more specifically, to rent-controlled multifamily units. Following a capital infusion aimed at stabilizing its operations, NYCB is on a path to recovery, yet significant efforts are required to fully rectify its standing. It is essential to approach this scenario with caution, avoiding parallels with pre-Great Financial Crisis sentiments regarding the containment of subprime issues. However, we view the CRE challenges as largely manageable, confined to major cities harboring lower-grade office spaces or multifamily units. We think this presents an opportunity to potentially add banks that have been unjustly discounted in the market turmoil.

We still like healthcare and industrials as the top sectors to look for opportunity. While most of the healthcare sector consists of unprofitable biotechs, we focus on quality compounders in the med-tech space. The industrials sector, on the other hand, has reaped benefits from a broad spectrum of economic enhancements, ranging from an uptick in single-family housing starts to the electrification of the grid and the burgeoning growth of data centers. In addition to exploring potential investments in the banking sector, provoked by the NYCB-related sell-off, we are also keenly observing opportunities within the beleaguered consumer discretionary segment and information technology sectors, particularly those linked to the advancements in artificial intelligence.

We maintain our confidence that the present moment offers a prime opportunity for investment in microcaps. This sector is poised to bridge the performance gap with large caps, which have dominated the market over the past few years. Specifically, we believe our portfolio of undervalued, high-quality stocks is well-positioned. To illustrate this point, please refer to the chart on the right comparing the relative performance of the microcaps against the S&P 500. The current setup mirrors the conditions that previously heralded a significant period of outperformance for microcaps in 2020, following years of lagging behind.



Source: Koyfin

In line with our last quarterly letter, our favored sectors remain healthcare, industrials, and energy. Additionally, we're growing increasingly bullish on financials, partly due to declining interest rates and a more accommodating Federal Reserve. However, it's important to note that our concentrated portfolio approach may lead to an overweight in specific sectors due to our preference for certain stocks, rather than a broad sectoral outlook. Beyond sectoral analysis, we're scouring opportunities among neglected stocks, including failed IPOs and defunct SPACs with potential residual value. We're also keen on companies that have underperformed since the pandemic or those whose earnings have temporarily plummeted but show signs of reacceleration. There's a wealth of opportunity amidst the debris of the post-pandemic bubble.

While our bullish outlook persists, and we view market dips as buying opportunities, it's crucial to acknowledge that small cap indices could still experience sell-offs. The significant upswing at the end of 2023 has led to overstretched technicals, and some rebalancing at the start of the year wouldn't be surprising. However, such movements should be seen as opportunities rather than indications of fundamental weakness.

Additions

Our one new buy was also a sell this quarter. Initially identified through a screening for undervalued SPACs, Pagaya Technologies (PGY) piqued our interest with its innovative white-label product technology platform, utilizing advanced data science and AI to enhance loan origination for financial institutions and to offer attractive asset-backed securities (ABS) or private credit securities for investors. A key differentiator for PGY was its asset-light business model, predicated on raising capital from investors before proceeding with the securitization of loans sourced from its financial partners.

The company's earnings call in the first quarter, coupled with positive guidance for 2024, seemed to mitigate previously identified risks, illustrating a path forward for sustained growth. However, regulatory requirements necessitate PGY to retain a 5% stake in the ABS on its balance sheet, introducing a need for an external funding source. This requirement contrasts with traditional banking operations, which fund loan originations through customer deposits at significantly lower costs. Our initial belief was that PGY would navigate this challenge by establishing an offtake agreement to manage the 5% capital requirement efficiently.

Regrettably, subsequent developments did not align with our expectations. Shortly after our discussions with PGY, the company initiated capital raise, diverging from the strategy outlined in our prior conversations. This move raised concerns about the transparency and strategic direction of PGY, prompting us to reevaluate our position. Faced with the potential misalignment of PGY’s business model and the strategic implications of utilizing equity as a primary funding source—arguably the most costly approach—we decided to divest our stake. This decision underscores our commitment to maintaining a portfolio built on trust, strategic coherence, and clear communication, principles we found compromised in this instance.

Sales

We also divested our remaining stake in AerSale Corporation (ASLE). This decision followed an initial reduction in our position last year, prompted by delays in achieving certain company objectives and revenue benchmarks. The most recent earnings report from ASLE fell short of management's projections, eroding our confidence in the company's capability to secure orders for its Aerware product. Additionally, a continued decline in ASLE's core business operations became evident, exacerbated by a scarcity of used serviceable materials and further deferrals in cargo plane transactions.

The inability to meet key performance indicators, coupled with the persistent postponement of major sales and the challenges facing their core business segments, led us to conclude that maintaining our investment in ASLE no longer aligned with our investment criteria.

Conversations with CRAI's management have further reinforced our confidence; historical trends indicate that Top Contributors

Our top contributor was CRA International, Inc. (CRAI), which we discussed in the company deep dive. Bottom line is that the company beat analyst earnings estimates and gave guidance for 2024 that was well ahead of our analyst's expectations. This was driven by realizing more of their pipeline in the quarter and for 2024.

Top Detractors

Centrus Energy Corp. (LEU) emerged as our top detractor, despite experiencing a notably successful 2023, buoyed by the spot price of uranium which saw an approximate fourfold increase. Despite this upsurge, LEU's stock experienced a downturn at the outset of 2024 due to falling uranium spot prices and a delay by the Department of Energy in providing cylinders for HALEU offtake. It's critical to note that LEU's operations are not directly influenced by uranium price fluctuations, which informed our strategy to judiciously trim our position during its peak irrational exuberance and subsequently augment our stake amidst its unwarranted decline.

Looking ahead into 2024, LEU is poised at the brink of several promising catalysts. Notably, the company is awaiting a decision on the funding for its HALEU (High-Assay Low-Enriched Uranium) production program, having submitted a proposal to the Department of Energy in March. Furthermore, LEU stands to potentially benefit from approximately $2 billion in new expenditures approved by Congress for the expansion of low enriched uranium production capabilities, aimed at reducing dependency on Russian uranium supplies. It boggles our mind that the US navy relies on Russia to power its nuclear fleet. Given that LEU's facilities were originally designed for the production of low enriched uranium, this positions the company favorably for securing a significant portion of this funding, underscoring its strategic advantage in the evolving uranium market landscape.

Mayville Engineering Company, Inc. (MEC) faced challenges due to a deceleration in demand from several of its key clients. However, a notable development on the horizon is the awaited substantial compensation from Peloton, pertaining to a contract disruption during the pandemic. This expected payment could provide a significant financial uplift for MEC. Furthermore, the completion of a new factory in 2023 marks a pivotal advancement for the company. With the bulk of capital expenditures (CAPEX) associated with this project now behind them, MEC anticipates a considerable increase in free cash flow (FCF) for 2024. This financial dynamic is poised to significantly enhance MEC's operational and financial flexibility in the coming year, offering a promising outlook for the company's performance.

Harvard Bioscience, Inc. (HBIO) is poised for a resurgence, driven by an anticipated uptick in pharmaceutical and biotechnology sector spending in the latter half of 2024. Following a careful analysis of their earnings call, and a conversation with the CEO, we seized the opportunity to augment our position, positioning us favorably for the company's expected growth trajectory.

Hudson Technologies, Inc. (HDSN) experienced a setback following its latest earnings report, which highlighted the non-recurring nature of a portion of its government contract for the current year. Despite this immediate concern, the broader investment thesis for HDSN remains intact, with the real catalyst expected to emerge with the onset of the HVAC cooling season this summer. This period is anticipated to trigger a surge in the prices for HFCs and reclaimed refrigerants, against the backdrop of virgin production cuts. Supporting this outlook, a recent report from a sell-side research firm, based on a survey of HVAC technicians, suggests that pricing remains stable. Moreover, the majority of technicians reported no preemptive stockpiling of refrigerants, reinforcing the potential for price adjustments as the market responds to production dynamics.

Limoneira Company (LMNR) showcased remarkable outperformance towards the close of 2023, buoyed by the announcement of a strategic initiative aimed at maximizing shareholder value through the divestiture of business segments that have been undervalued by the public markets. While the stock experienced a cooling period in the first quarter, our analysis suggests that the intrinsic value of the company's composite assets could be twice the current market price, with potential for significant monetization efforts to materialize within the year.

These examples represent just a fraction of the entities within our portfolio encountering a phase of under recognition, yet, based on our assessments, they harbor substantial upside potential for the remainder of the year. Our conviction in these companies underscores our strategic commitment to identifying and capitalizing on undervalued opportunities, ensuring that we remain poised to leverage the latent value within our diverse portfolio for the benefit of our investors.

Company Deep Dive: CRA International, Inc. (CRAI)

CRA International, Inc. (CRAI) is a leading global consulting firm that offers economic, financial, and strategic expertise to major law firms, corporations, accounting firms, and governments around the world. Consulting headcount exceeds 1,000 with approximately 75% of senior staff holding advanced degrees and 41% of advanced degrees being PhDs. Furthermore, CRAI demonstrates exceptional employee loyalty, with half of its senior staff maintaining tenure of more than five years, and a quarter surpassing ten years. Such remarkable retention rates are pivotal within the consulting industry, a sector inherently reliant on the expertise, relationships, and quality of service provided by its people, directly influencing the firm's capacity for revenue growth.

While CRAI operates across a vast spectrum of global business sectors, including life sciences, energy, forensic accounting/services, and financial economic analysis, its cornerstone remains the antitrust and competition domain. This segment makes up roughly 40% of sales and is becoming ever more important in the current business/political environment. Antitrust and competition are primarily fueled by merger and acquisition (M&A) activities, which, despite a slowdown following the post-pandemic surge, remain a vital area of focus for CRAI as large M&A transactions face increasing scrutiny from regulatory bodies such as the FTC and potentially the DOJ. CRAI played a significant role in the high-profile Microsoft/Activision Blizzard merger, a deal that, with CRAI's assistance, ultimately received approval. Highlighting the breadth of their capabilities and the trust placed in them, CRAI has the distinction of collaborating with 82 of the Fortune 100 companies and 97 of the top 100 law firms, an impressive feat for a company of its size, demonstrating their extensive reach and impact within the industry.

Our decision to invest in CRAI is underpinned by our anticipation of a revitalization in M&A activity. Over recent years, M&A transactions have been relatively subdued, attributed to a combination of factors including a hangover from the post-pandemic surge and the impact of rising interest rates. However, the landscape appears poised for a shift, spurred by declining ten-year treasury rates, more accommodative financial conditions, and the onset of an easing cycle by the Federal Reserve. Additionally, diminishing recessionary fears and the historical rarity of M&A transactions declining for three consecutive years further support our thesis.

With an upcoming election, one might speculate about potential shifts in these dynamics. However, our analysis suggests that the outcome of the election is unlikely to significantly alter the favorable conditions for CRAI. Under a Democratic administration, we have observed rigorous enforcement from the FTC against substantial deals, while the DOJ has actively pursued antitrust cases against major US tech companies. This regulatory environment has been beneficial for CRAI's business. Conversely, a Republican administration might introduce less regulatory oversight but could also stimulate an increase in overall M&A activity.

Notably, scrutiny of large tech firms is a bipartisan issue. Conversations with CRAI's management have further reinforced our confidence; historical trends indicate that neither political outcome has significantly impacted their business operations or lead generation, suggesting CRAI's resilience and adaptability in varying regulatory climates.

CRAI's business is driven by lead flow growth that has been growing double digits but has not been converted into sales yet. In the last quarter CRAI finally started to convert on the pipeline. This leads to higher utilization of consultants. Earnings for CRAI are driven by higher utilization. Basically, it is the number of CRAI's consultants that are working during a quarter. Historically management likes to target a mid 70s annual utilization, however this number has bounced around the 60s the past year. CRAI can do roughly 11% EBITDA margins and at times can get up to 12% in certain situations but do not maintain that margin.

CRAI's business momentum is primarily fueled by a significant growth in lead flow, which has been expanding at double-digit rates without an immediate translation into sales. However, the last quarter marked a pivotal shift as CRAI began effectively converting its burgeoning pipeline, leading to an increased utilization of its consultants. The core driver of CRAI's earnings is this very utilization rate—the proportion of consultants actively engaged in billable work during a quarter. While management historically targets an annual utilization rate in the mid-70s percentage range, this figure has fluctuated in the 60s over the past year. Higher utilization should drive higher margins and with it higher earnings.

Over the past six years, CRAI has achieved a revenue growth with a Compound Annual Growth Rate (CAGR) of 8% and set a sales record in 2023, even within a relatively subdued market environment. Furthermore, the company has exhibited a strong commitment to shareholder value, returning capital with an intention to distribute 50% of its cash flow from operations to investors. Notably, over the past decade, CRAI's management has effectively reduced the shares outstanding by more than 30%, underscoring a shareholder-friendly approach!

In summary, our investment thesis for CRAI hinges on several key pillars: exemplary leadership with whom we maintain regular quarterly communications, a business and financial profile at an inflection point, and the potential for sustained growth over time as a compounder. Our hope is that the only impetus for selling shares would be if CRAI's stock valuation becomes overly significant within our portfolio.

Thank you for your trust and confidence and please reach out with any questions.

Nathan Fredrick
Portfolio Manager

(Disclosures and chart showing strategy largest contributors and detractors on next page).

Micro Opportunities Strategy
Largest Contributors and Detractors – Q4 2023

5 Best - Absolute Contribution			
Ticker	Company	Average Weight	Contribution
CRAI	CRA International, Inc.	2.61%	116 bps
TGLS	Tecnoglass Inc.	7.09%	104 bps
VECO	Veeco Instruments Inc.	6.34%	88 bps
LMAT	LeMaitre Vascular, Inc.	4.14%	71 bps
PWP	Perella Weinberg Partners Class A	3.61%	59 bps
	5 Best Total	**23.79%**	**438 bps**

5 Worst - Absolute Contribution			
Ticker	Company	Average Weight	Contribution
LEU	Centrus Energy Corp. Class A	4.18%	-126 bps
ASLE	AerSale Corporation	1.18%	-99 bps
PGY	Pagaya Technologies Ltd Class A	0.13%	-92 bps
HDSN	Hudson Technologies, Inc.	3.41%	-85 bps
HBIO	Harvard Bioscience, Inc.	3.25%	-77 bps
	5 Worst Total	**12.15%**	**-479 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 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.