Q2 2025 Quarterly Commentary

By Nathan Fredrick, CFA

Strategy Overview / Performance Summary

The Small Cap Strategy underperformed our benchmark in the second quarter of 2025. This underperformance can be primarily attributed to two factors. First, we maintain a more defensive positioning in the portfolio. This is borne out in our overweight position in Materials, Consumer Staples and Utilities and underweight Industrials and Information Technology.
Second, the market's strong preference for low-quality companies, as measured by negative earnings and high short interest plus a high beta factor, drove our underperformance during the period. In contrast, our portfolio is tilted toward higher-quality companies, typically those with positive free cash flow or poised to reach breakeven within the next few quarters.

As with our previous quarterly update, we find ourselves writing amid continued global tariff negotiations. Developments are unfolding rapidly, leaving many unknowns around which countries will be targeted, the scope of the tariffs, and whether deadlines will shift again. In light of this heightened uncertainty and the potential for sudden policy changes, we believe it is wise to maintain a defensive stance. At the same time, we are keeping the portfolio flexible to capitalize on market dislocations, positioning ourselves to invest in high-quality companies that we believe offer compelling long-term value.

Sector Highlights

Materials: Our top-performing sector in the quarter was Materials, driven by two holdings Centrus Energy (LEU) and Uranium Energy Corp (UEC). Both are part of our nuclear energy theme, which we believe has significant future potential as part of the energy grid. Nuclear power delivers reliable, carbon-free baseload electricity—accounting for roughly 50% of America’s clean power—and plays a critical role in stabilizing grids alongside intermittent renewables. This reduces greenhouse gas emissions and harmful air pollutants from fossil fuels.

Meanwhile, the soaring energy demands of AI data centers are spurring U.S. corporate and federal initiatives. Big tech firms including Meta, Google, Amazon, and Microsoft are securing long-term nuclear power deals and investing in new SMR deployments to power their AI infrastructure while meeting emissions goals. Recent executive actions have reformed licensing, expanded federal backing for advanced reactors, and promoted digital innovation in energy systems with federal loan guarantees—signaling an intent to quadruple nuclear electricity by 2050. The policy environment is now geared toward accelerating a nuclear-AI synergy, positioning nuclear power as a linchpin of both national decarbonization and advanced technology infrastructure.

Industrials: The industrials sector underperformed the broader market in the second quarter of 2025, weighed down by escalating trade tensions and a slowing global economy. The announcement and phased rollout of broad-based U.S. tariffs can potentially raise input costs and create uncertainty for exporters/importers and supply chains. At the same time, weakening manufacturing activity and softer capital spending signaled a deceleration in industrial demand. Rising interest rates and tighter financial conditions can further pressure sentiment, as investors grow more cautious on cyclical sectors with high operating leverage. Our top detractor Vestis Corporation (VSTS), which we discuss below, was especially hit by tariffs and a slowing economy. There are some bright spots that we do like within the industrial sector. This includes Modine Manufacturing Company (MOD) and Tecnoglass Inc. (TGLS) which both have idiosyncratic opportunities that will be beneficial to the companies long into the future, even if there is near term disruption.

Top Contributors & Detractors

Top Contributors

Centrus Energy (LEU) was our top contributor for Q2 and a new addition to the portfolio in the quarter. LEU supplies nuclear fuel components for the nuclear power industry. The stock returned roughly 181% in Q2, driven by a strong earnings report, positive news flow on the nuclear industry from the US administration, large investment bank buy initiation reports with high price targets, and likely some short covering. LEU surged from the $60s—where we initiated our position—to over $200 per share by quarter-end. While we did not establish a full position initially, we continue to believe there are meaningful catalysts ahead that could drive further upside. Given the rapid price appreciation, we took the opportunity to trim a small portion of the position in the $200s, maintaining a core stake in anticipation of continued momentum.

Top Detractors

Vestis Corporation (VSTS) significantly underperformed in Q2 2025, weighed down by a sharp decline in revenue and a surprising swing to a net loss. Revenue dropped more than analysts anticipated—driven by lower rental volumes and direct sales from existing customers. The company incurred a loss in net income, missing expectations for a modest profit and taking a hit from a one-time bad-debt charge. In response, Vestis eliminated its dividend and amended its credit agreement to shore up liquidity, but these moves highlighted both financial stress and diminished investor confidence in the near-term outlook. We still hold a small position in the stock but could look to sell in the future if the situation does not improve.

Strategy Additions & Sales

New Positions

We initiated positions in several companies during the quarter that align with our focus on quality businesses trading at attractive valuations.

Knife River Corporation (KNF): KNF is a vertically integrated construction materials and contracting firm operating across 14 U.S. states, with leadership positions in aggregates, ready-mix concrete, and asphalt production. Backed by 1.2 billion tons of aggregate reserves and a network of over 360 material sites, KNF plays a critical role in supplying infrastructure projects such as roads, bridges, and airport runways. The company benefits from durable demand trends driven by the Infrastructure Investment and Jobs Act, with 62% of allocated funds yet to be spent in its core markets and a $938.7 million backlog heavily skewed toward public-sector projects. Since its 2023 spin-off from MDU Resources Group, Inc. (MDU), KNF has expanded EBITDA margins by 460 bps, with further upside guided by The EDGE program's pricing, throughput, and efficiency initiatives as well as accretive M&A activity. With stable public revenue exposure, significant operating leverage, and improving margins versus peers, KNF offers compelling long-term value amid the nation's urgent infrastructure upgrade cycle.

HealthStream (HSTM): Founded in 1990, HSTM originally pioneered the use of online learning to hospitals, with courses specifically tailored to educate healthcare professionals and meet hospitals' required regulatory needs, i.e., Red Cross training. Today, HealthStream's solutions help hospitals effectively onboard, retain, engage, educate, manage, and develop workforce talent; meet rigorous GRC requirements; optimize staff scheduling and capacity management; and automate the management of medical staff credentialing, privileging, and enrollment. To achieve this, HSTM has developed its proprietary hStream SaaS technology platform, which is designed to create interoperability among the various applications in its ecosystem. HealthStream serves a large and growing TAM of approximately 22 million health care service providers employed in the healthcare and social services segment of the economy. The 5.4 million hospital-based healthcare professionals registered with Medicare are required by federal and state mandates and accrediting bodies to complete training, including OSHA safety training, HIPAA confidentiality training, etc. Additionally, ongoing pressure to reduce costs by healthcare organizations has driven interest in help with scheduling, capacity management, credentialing, and privileging for healthcare employees. HealthStream's new platform enables customers to leverage the information on these segments and gain efficiencies.

Founder Robert A. Frist, Jr., has been achieving his vision to help healthcare providers effectively manage their most important asset – their people – since the company's founding in 1990. The company is projected to grow revenue and EBITDA by 6-8% and 10-12% annually. This accelerating growth profile and reasonable multiple should enable HealthStream to be a good compounder over time.

Atricure Inc. (ATRC): ATRC is a leading innovator of treatments for atrial fibrillation (Afib), left atrial appendage (LAA) management and post-operative pain management. Afib is an irregular heartbeat, or arrhythmia, which affects over 37 million people worldwide, including more than eight million people in the United States, and is a growing epidemic. It is the most common cardiac arrhythmia encountered in clinical practice and results in high utilization of healthcare services and significant cost burden. ATRC serves the Cardiac (open-heart) and Minimally-Invasive Ablation and LAAM markets. ATRC's cardiac ablation and LAAM products are used by physicians during open-heart and minimally invasive surgical procedures.

Minimally invasive procedures (MIA) are performed on a standalone basis and often include multidisciplinary or "hybrid" approaches, combining surgical procedures using AtriCure ablation and AtriCure LAAM products with catheter ablation performed by an electrophysiologist. ATRC's pain management solutions are used by physicians to freeze nerves during cardiothoracic or thoracic surgical procedures. Many surgeons use multimodal pain management strategies that include oral delivery of opioid and non-opioid pain medications. ATRC cryoICE cryoSPHERE probe for pain management (Cryo Nerve Block) provides temporary relief of postoperative pain, allowing the patient's body to heal after surgery while the nerves regenerate and sensation is regained.

ATRC expects revenue to grow 14-16% annually, and will be cash flow positive going forward. The stock sold off during 2024 as newly introduced pulse-field ablation (PFA) procedures took most of the cardiology lab's attention during 2024, causing surgical ablation/LAAM procedures to fall, negatively impacting ATRC. Using the EU's previous experience with PFA taking mindshare and market share a few years ago, and then returning to cardiac ablation and LAAM as an example, ATRC should be well-positioned to resume this growth trend in 2025.

Centrus Energy Corp. (LEU): Centrus represents a unique investment opportunity at the intersection of national security, nuclear energy independence, and next-generation reactor technology. As the only U.S.-owned and licensed producer of both Low-Enriched Uranium (LEU) and High-Assay Low-Enriched Uranium (HALEU), Centrus is poised to fill a critical supply gap in a market historically dependent on Russian imports. The company's strategic transformation from a broker of foreign-sourced nuclear fuel to a domestic producer is underpinned by strong government support, demonstrated by multi-billion-dollar DOE contracts worth up to $3.4 billion and a growing backlog of $3.8 billion.

With an unmatched regulatory position and commercial partnerships with major players like TerraPower and Oklo, Centrus stands to benefit from both near-term LEU demand and long-term HALEU-driven growth. However, execution risks around scale-up, funding, and geopolitical volatility remain key factors to monitor as the U.S. nuclear renaissance unfolds.

Position Exits

Magnite, Inc. (MGNI), was the only sale in the quarter. MGNI operates an independent omni-channel sell-side advertising platform in the United States and internationally. Post Liberation Day we saw a large pull back in advertising due to tariff uncertainty that would also hurt MGNI's business. We decided to sell as we had no visibility into when advertising would come back.

Outlook

Looking ahead, we remain confident in our portfolio positioning despite near-term market volatility. Small-cap valuations appear attractive relative to historical levels and large-cap peers, particularly for companies with strong fundamentals and secular growth drivers.
We continue to favor companies benefiting from domestic energy production (natural gas), infrastructure modernization, and technological innovation (AI picks and shovels). Our focus on businesses with strong competitive moats and experienced management teams positions us well for various economic scenarios.
Key factors we're monitoring include tariff policy, Federal Reserve policy decisions, geopolitical developments affecting energy markets, and evolving regulatory frameworks impacting our technology and financial services holdings. While timing can vary, we believe our disciplined approach to identifying undervalued quality companies will drive attractive long-term returns.

Despite the challenging quarter, we remain optimistic about the long-term potential for small-cap stocks to outperform as market conditions normalize and fundamental value recognition occurs.

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

Nathan Fredrick, CFA
Portfolio Manager

Small Cap Strategy
Largest Contributors and Detractors – Q2 2025

5 Best - Absolute Contribution			
Ticker	Company	Average Weight	Contribution
LEU	Centrus Energy Corp.	1.28%	179 bps
UEC	Uranium Energy	3.11%	130 bps
SNEX	Stonex Group	5.24%	120 bps
MOD	Modine Manufacturing	2.63%	70 bps
PLMR	Palomar Holdings	4.88%	63 bps
	Top 5 Total	**17.14%**	**562 bps**

5 Worst - Absolute Contribution			
Ticker	Company	Average Weight	Contribution
VSTS	Vestis	1.21%	-99 bps
LMNR	Limoneira	3.43%	-52 bps
MMSI	Merit Medical Systems	3.00%	-45 bps
MGNI	Magnite	0.10%	-37 bps
HSTM	Healthstream	1.18%	-36 bps
	Top 5 Total	**8.92%**	**-269 bps**

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