

Sterling Partners Equity Advisors

Portfolio Commentary-Spring 2021

All is Good Except For This M2 Chart

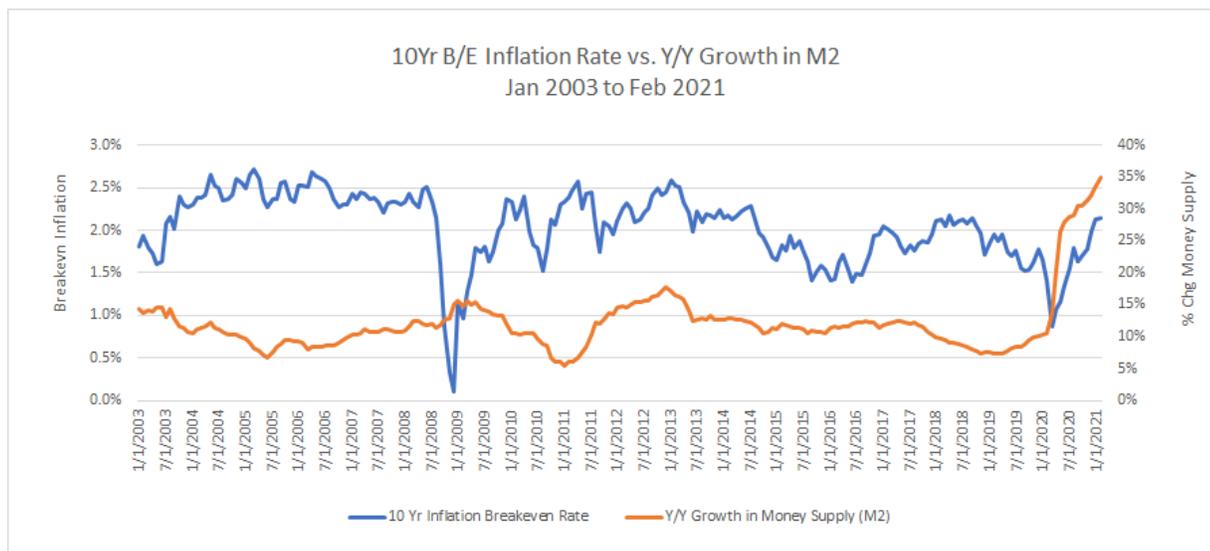


Kevin E. Silverman, CFA

Another crazy quarter and another quarterly letter. What's new is that the value space and particularly the small value space is finally getting its 15 minutes of fame with a 20%+ year-to-date gain in the Russell 2000 Value. While it is admittedly tough to predict the future, it is sometimes also hard to believe the past. Our strategies are performing well, and here's a [link to our recent performance](#). A discussion of our top and bottom contributors to performance follows this commentary.

With the market up so much, and GDP revisions moving higher, I am pleased to report that everything is great. The market itself is the best predictor of a strong economy ahead, and that's what we see. It is a great awakening of productivity from the boundaries of daily commuting for billions of people, and the realization that all the knowledge of the world is connected in real time to fuel new ideas. New ideas drive productivity which lead to better lives. It's a time when less incremental capital is needed to drive the capacity and distribution of goods and services that are increasingly digital and idea driven just at the time that value added ideas are evolving faster and spreading at a faster rate and at lower cost. Capital is increasingly abundant and therefore cheap, while great ideas remain scarce, raising the cashflow multiple on high conviction annuities. The U.S. 10-Year Treasury bond yield of 1.5% means a 66.7 multiple on the pretax coupon, for example.

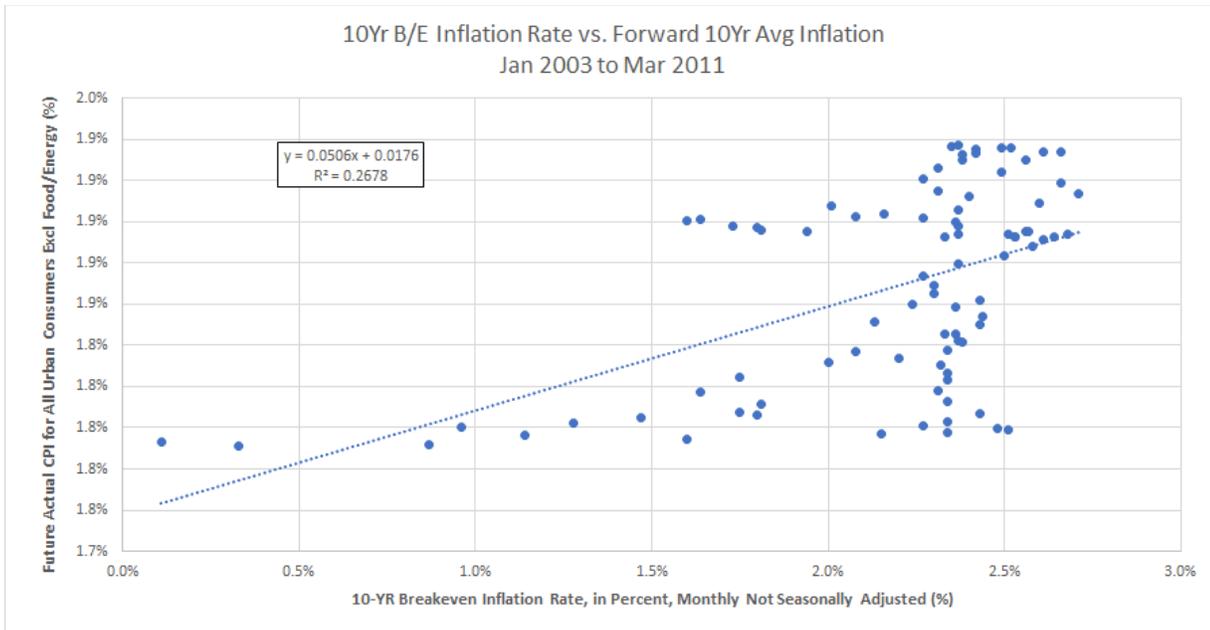
So, everything is looking pretty good. Except for this money supply graph we dug out.



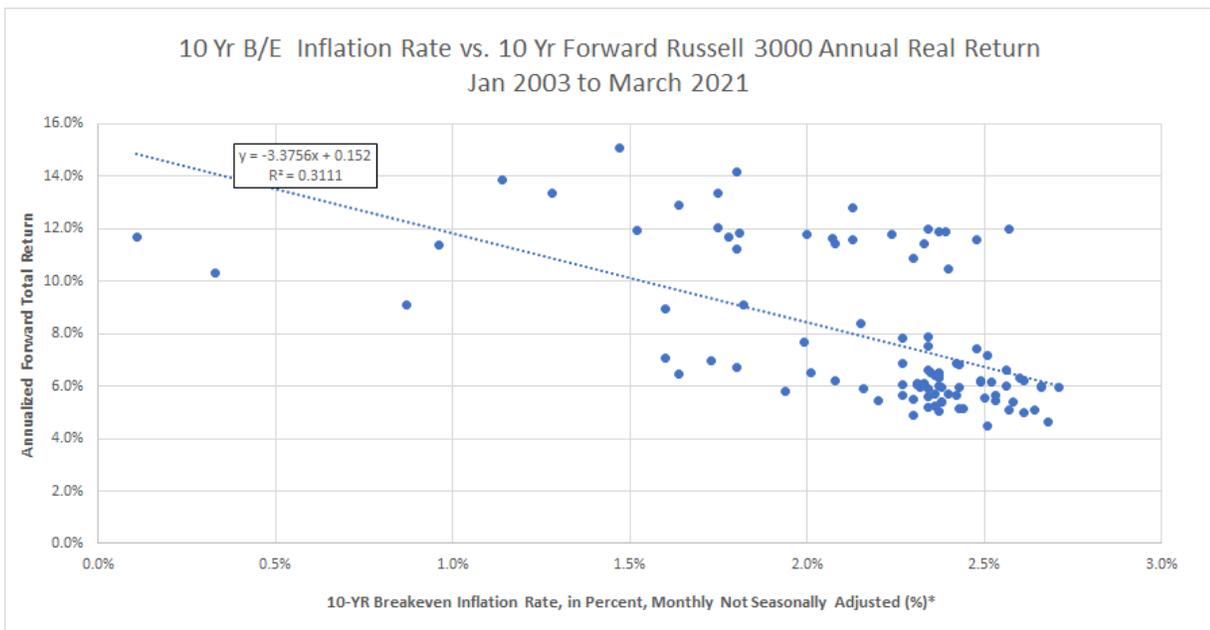
Isn't that an interesting chart? Inflation that erodes the future purchasing power of investors is one of the few things that could creep into the landscape of our good times and cause some bad feelings among asset owners. It turns out that adding money to the money supply at a faster pace than the dollar growth in GDP is viewed by some as potentially inflationary.

A reason to mention it even though everything's great according to the stock market, is that there is a pretty good inflation forecasting metric, namely the 10-year breakeven inflation rate* published by the Federal Reserve, that has been going straight up. A good economy and an uptick in inflation certainly do not have to be mutually exclusive, as 10-year inflation could tick

up a bit, now estimated around 2.2%, and returns over that period could still overcome that hurdle, or maybe not. If the current trend continues, history suggests that could be a little headwind to equity markets due to pressure on real returns.



The 10-yr B/E metric turns out to be a pretty good predictor, at least up to the most recent 10-year prediction in 2011, with an r-squared of 27%. And therefore, unfortunately, it is also a pretty good predictor of real equity returns.



It's been an interesting time to navigate equity markets, and inflation is the kind of thing we worry about. When we think about the themes that are apt to deliver good returns over the next decade, our attention is drawn to companies that sell products that, in addition to being proprietary, are also necessary. These tend to be the type of products that can raise prices faster than their factor input costs rise. Products that improve productivity will tend to gain share faster during inflationary

periods, in our view, so we look for that. Sometimes small companies are quicker to benefit from one or two great products gaining share and are also easier to identify, since the gainers can more quickly become a reportable percentage of total revenue.

Our portfolio is always filled with companies that we believe hold proprietary niches, and we find there is typically a permanent margin advantage because of it. Owning companies that earn long term sustainable excess returns based on economic competitive advantages is a theme that has helped us earn good returns for clients over time, and which some data suggests may be even more important in the years just ahead. Thank you for your interest in Sterling Partners Equity Advisors.

*Chart Sources:

Consumer Price Index for All Urban Consumers: All Items Less Food and Energy in U.S. City Average, Percent Change from Year Ago of (Index 1982-1984=100), Monthly, Seasonally Adjusted

Federal Reserve Bank of St. Louis, 10-Year Breakeven Inflation Rate [T10YIE], retrieved from FRED, Federal Reserve Bank of St. Louis; <https://fred.stlouisfed.org/series/T10YIE>, April 22, 2021

The breakeven inflation rate represents a measure of expected inflation derived from 10-Year Treasury Constant Maturity Securities and 10-Year Treasury Inflation-Indexed Constant Maturity Securities (TC_10YEAR). The latest value implies what market participants expect inflation to be in the next 10 years, on average.

Following is a discussion of our top and bottom contributors to performance.



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Top and Bottom Contributors to Performance

Sterling Small-Cap Value Diversified 1Q 2021 Summary*		Sterling Small-Cap Value Focus 1Q 2021 Summary*	
Listed from highest to lowest contribution within the performance category		Listed from highest to lowest contribution within the performance category	
Top Contributors	Bottom Contributors	Top Contributors	Bottom Contributors
1. U.S. Concrete, Inc.	1. The Pennant Group, Inc.	1. U.S. Concrete, Inc.	1. The Pennant Group, Inc.
2. Criteo, S.A.	2. Green Dot Corp.	2. Criteo, S.A.	2. Green Dot Corp.
3. Usio, Inc.	3. QuinStreet, Inc.	3. Enova Int'l, Inc.	3. Easterly Govt Properties
4. Enova Int'l, Inc.	4. CTS Corp.	4. Glu Mobile, Inc.	4. Fonar Corp.
5. The Bancorp, Inc.	5. Easterly Govt Properties	5. Patrick Industries, Inc.	5. NetScout Systems, Inc.

Top Contributors

U.S. Concrete, Inc. (USCR) **Sterling Small-Cap Value Diversified** **Sterling Small-Cap Value Focus**

U.S. Concrete is a leading supplier of concrete and aggregates for large-scale commercial, residential and infrastructure projects across the country. The company holds leading market positions in the metropolitan markets of New York, San Francisco, Dallas/Fort Worth and Washington D.C.

U.S. Concrete continued to post increased profitability due to the company's cost containment efforts. In addition, during the first quarter more speculation about a large federal infrastructure investment continues to help positive expectations.

We have a long history of owning cement and concrete companies on the evidence that owners enjoy a bit of local monopoly as a result of transportation costs limiting the physical area that can be served from a particular quarry. We believe USCR is a low-cost producer in its market area. Our thesis includes the view that both commercial and residential construction activity will benefit from the current strong economy and employment.

Criteo, S.A (CRTO) **Sterling Small-Cap Value Diversified** **Sterling Small-Cap Value Focus**

Criteo is an advertising platform designed to deliver advertising across all channels. Our thesis is that advertising spending will continue to migrate to online and mobile from TV, and Criteo is positioned to benefit from that continuing migration.

Criteo continues to hold a strong balance sheet that makes it attractive during their transition to a commerce media platform. Criteo reported a 6% increase in total clients year-over-year, reaching the highest level in over three years. Management believes its transformation into a Commerce Media Platform, building on its unique Commerce data and Reach assets, positions the company well for a period of durable growth.

Usio, Inc. (USIO)**Sterling Small-Cap Value Diversified**

Usio is an integrated payment solutions provider with a wide range of payment solutions to merchants, billers, banks, service bureaus, crypto exchanges and card issuers. The company provides credit, debit/prepaid, and ACH payment processing platforms to deliver payment solutions and services.

Usio acquired Output Solutions later in the fourth quarter of 2020 which contributed to strong growth in operating metrics. Management is committed to continued investment in its technology, sales and marketing to further capitalize on growth opportunities in the space.

Our thesis on Usio is that digital transactions will continue to move toward a dominant share of the financial industry, with a low-cost, high-service model.

Enova International, Inc. (ENVA)**Sterling Small-Cap Value Diversified****Sterling Small-Cap Value Focus**

Enova is a provider of online financial services to non-prime consumers and small businesses, providing access to credit powered by its advanced analytics, innovative technology, and world-class online platform.

Management believes that the earnings capacity and balance sheet flexibility have the company well positioned to leverage its machine learning driven analytics to continue to capture increased demand at attractive unit economics as the economy improves. The company reported a strong balance sheet with Cash & Equivalents of \$388 million with additional capacity on credit facilities.

Our thesis on Enova is that digital transactions will continue to move toward a dominant share of the financial industry, with a low-cost, high-service model.

The Bancorp, Inc. (TBBK)**Sterling Small-Cap Value Diversified**

The Bancorp is a provider of financial services to non-bank financial service companies. We enjoy owning companies involved with non-banking services with card and other payment processing fees. The Bancorp is recognized in the payments industry as a top issuer of prepaid cards and top ACH originator.

Book value per share was up 19% versus the prior quarter year-over-year. Average loans and leases increased 72% to \$4.34 billion for the quarter ended, December 2020 versus the prior year. Management continues to be focused on building the best payments ecosystem in the financial services industry including integrated analysis of the market and competitors allowing partners to innovate and grow.

Glu Mobile, Inc. (GLUU)
Sterling Small-Cap Value Focus

Glu Mobile is a leading creator of mobile games. With a diverse portfolio of original and licensed IP titles including Covet Fashion, Deer Hunter, Design Home, Diner DASH Adventures, Disney Sorcerer's Arena and Kim Kardashian Hollywood and MLB Tap Sports Baseball.

Glu reported a strong 2020 year during the quarter with a strong balance sheet but the news of being acquired by Electronic Arts has added to the company's stock performance.

We have long believed in the video game space over the long-term, as the category continues to gain share of leisure. GLU has much multiple expansion potential ahead as it is comfortably cashflow neutral to positive as we wait for the probabilities to work to deliver a few great hits in the years ahead, including the potential associated with its new Disney relationship, an expansion of the advertising platform within Design Home, among other things in the lab.

Patrick Industries, Inc. (PATK)
Sterling Small-Cap Value Focus

Patrick Industries is a manufacturer and distributor of component and building products for the recreational vehicle, manufactured housing, marine and industrial markets. Our thesis on PATK is again a view that leisure is in a long cycle of gaining share of the economy as Patrick Industries is a supplier for multiple recreational vehicle companies.

Patrick has benefited from rising demand in Recreational Vehicle, Marine and Manufactured Housing because of increase in interest from new customers. The surge in retail demand in these markets has reduced dealer inventories from what management considered a low point. Management expects this momentum to continue into the second half of 2020.

We see PATK as a beneficiary of entrenched favorable trends in recreational vehicles and marine markets and will be patient while the management team executes on their strategic plan.

Bottom Contributors**The Pennant Group, Inc. (PNTG)**
Sterling Small-Cap Value Diversified
Sterling Small-Cap Value Focus

The Pennant Group is a holding company of operating subsidiaries that provide healthcare services through 80 home health and hospice agencies and 54 senior living communities located throughout the United States.

The Company amended its credit facility to double its revolving line of credit. Management continues to see tremendous opportunities for acquisitions both within its existing footprint and in new markets. Management has indicated that the company is poised to accelerate its disciplined growth strategy with a strong balance sheet, and talented local leaders that manage its facilities to bring quality care to patients.

This business benefits from the aging demographics of the U.S. population, a thesis in which we have strong conviction, providing a broad spectrum of skilled nursing and assisted living services, physical, occupational and speech therapies, home health and hospice services and other rehabilitative and healthcare services.

Green Dot Corp. (GDOT)
Sterling Small-Cap Value Diversified
Sterling Small-Cap Value Focus

Green Dot is a consumer financial services providing a range of reloadable prepaid debit cards and cash reload processing services with a mission to provide a full range of affordable and accessible financial services to customers.

Green Dot's management anticipates steady gains as it has invested considerably in operational efficiencies and improvements, primarily in core banking and card management, and its customer experience. Management indicated that COVID accelerated the demand for digital payments and Green Dot's unique collection of assets deliver seamless payment and banking solutions to low to moderate-income consumers.

We own the stock on the thesis that the company would continue to gain market share with its no real estate, low-cost model and that customers would increasingly gravitate to the convenience of online commerce.

QuinStreet, Inc. (QNST)
Sterling Small-Cap Value Diversified

QuinStreet provides an online marketplace solution to match prospects searching for solutions with brands, Auto Insurance and Home Services being their two largest businesses, in digital media.

QuinStreet revenue growth was 36% year-over-year due to a successful execution of the integration and synergies with the Modernize acquisition. The company ended the quarter with \$103 million in cash with a strong operating cash flow.

We own the stock on the thesis that more advertising is moving to digital media and concurrently generating more useful data around the needs and wants of the end customer. We believe that software to optimize the advertising spend will reliably continue to outpace the growth in advertising itself because it delivers better ROI for its customers.

CTS Corp. (CTS)
Sterling Small-Cap Value Diversified

CTS is a designer and manufacturer of products including sensors, actuators, and electronic components in North America, Europe, and Asia across many industries.

CTS saw strength in most end markets in the fourth quarter of 2020 but remains mindful of market and supply chain uncertainties as the pandemic remains. Their recent SSI acquisition strengthens its position with medical customers and progress towards 10% annualized revenue growth.

CTS is a high margin business with large contracted booked business across many industries. We enjoy owning this business as it flies under the radar with little wall street coverage but continues to grow profitable business across strong industries which should lead to continued margin improvement and consistent performance in the portfolio.

Easterly Government Properties (DEA)
Sterling Small-Cap Value Diversified
Sterling Small-Cap Value Focus

Easterly Government Properties acquires, develops, and manages commercial properties that are leased to the U.S. Government and private tenants. Easterly owned 77 leased to the U.S. Government and 2 leased to private tenants. Operating properties in the United States, encompassing approximately 7.3 million square feet.

During the prior quarter, Easterly completed the acquisition of nine properties for an aggregate amount of \$251.4 million. The company assumes about \$200 million in acquisitions and \$25 million in development investments in 2021. Management continues to grow using its increasing cash flow.

We own the stock on the thesis that the company would maintain a high portfolio occupancy rate using its specialized strategy solving the needs of the mission-critical U.S. government agencies.

Fonar Corp. (FONR)
Sterling Small-Cap Value Focus

FONAR Corp develops, manufactures and services the FONAR MRI machines in addition to the management of MRI centers through its subsidiary, Health Management Company of America.

With a strong balance sheet and consistent profitability, the management has increased volume at existing facilities, established de novo centers and continues to make key acquisitions.

We believe that management has a steady and clear path to building its MRI centers while keeping a strong balance sheet.

NetScout Systems, Inc. (NTCT)
Sterling Small-Cap Value Focus

NetScout Systems provides real-time, pervasive visibility, and insights that customers need to accelerate and secure their digital business services against disruptions in availability and performance.

NetScout has recently been rolling out products exclusively for 5G application, while continuing to help customers better optimize their 4G networks. Wireless providers still heavily rely on both 4G and 5G networks to handle the end customer's growing demand for data.

We own the stock on the thesis that internet traffic is gaining share of total communication (and encroaching on travel budgets as well) and companies will continue to need sophisticated software to optimize, defend, protect, and monitor their digital and cellular networks as the threat of attacks continues to evolve.

DISCLAIMER

*Top and Bottom Contributors were calculated by Sterling Partners Equity Advisors using data available for the holding's contribution to composite performance taking into account its composite weight, on an annualized basis.

The information contained herein has been obtained from sources believed to be reliable, but we do not guarantee its accuracy or completeness. The opinions and estimates reflect our best judgment as of the report date and are subject to change without notice.