Sterling Partners Equity Advisors
Portfolio Commentary – Spring 2022

Stormy Weather

Kevin E. Silverman, CFA

The Fed, the War, inflation, the yield curve inversion, spiking commodity prices, among other events, have all helped put the future on sale and near-term certainty at a premium. The long bond and mortgage rate, both of which affect our portfolio in a myriad of ways, jumped at the fastest relative pace in 40 years! (view chart). As we've written about before, it is usually the case that at times when the market price for certainty is rising, a portfolio such as ours, designed for long-term returns, is under near-term performance pressure. Our experience navigating market cycles leads us to believe that during these periods of high uncertainty, the potential returns are often the highest.

SOURCE:
FRED Graph Observations
Federal Reserve Economic Data
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Help: https://fredhelp.stlouisfed.org
Economic Research Division
Federal Reserve Bank of St. Louis

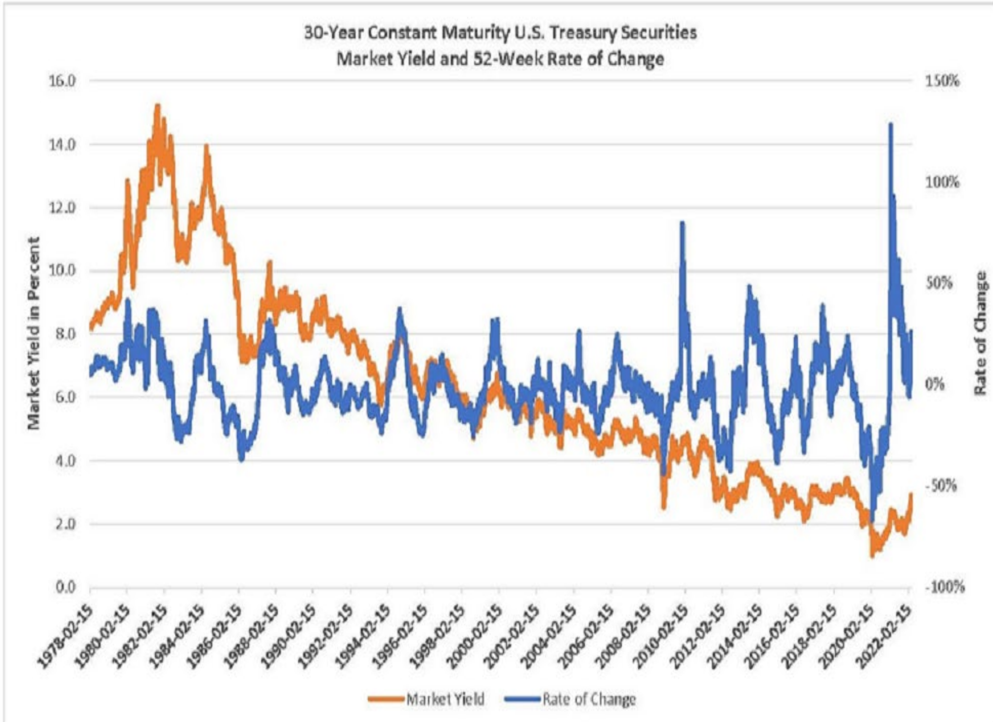
MORTGAGE: 30-Year Fixed Rate Mortgage Average in the United States, Percent, Weekly, Not Seasonally Adjusted

What Happened?

Our long-duration assets have had the largest negative impact on our performance this past quarter. More specifically, cotton price surges, recession fears affecting the lending business, potential trade issues in China, and short-term supply issues resulting from COVID, among others, have negatively affected our strategy's short-term performance. We offer detail later in this report. Ultimately, we believe it is often life-cycle choices that drive consumer behavior in the long run, and they can be predicted, but the cost of these predictions is recognizing that patience is required in the short run.

What are we Doing?

We are always opportunistic in the quest for risk-adjusted returns, our proudest accomplishment for long-term clients, which sometimes means reducing risk. For example, we reduced a bit of exposure to European business directly because of the War. We also began to adjust near-term earnings estimates as general recession risks rose, but mostly we watched the average long-term expected return of the names in our strategies rise as their stock prices fell. As a result, while the portfolio remains under near-term performance pressure, we see well-above-average expected return estimates for our existing holdings.



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Market Yield on U.S. Treasury Securities at 30-Year Constant Maturity, Percent, Daily, Not Seasonally Adjusted

We don't overtly attempt to predict the timing of recessions, although it does seem more likely in the near term than usual, primarily because rising prices can slow demand. But we do understand that for companies to have a chance to realize our future forecasts, they must first successfully navigate the present. So, we take to heart Ben Graham's "margin of safety" and are pleased to say the strategies have delivered good risk/return results over the long run. We achieve that by owning companies that offer strategically differentiated products and/or distribution that maintain the good cost and capital structures necessary to win against higher-cost competitors during difficult times. We own almost entirely U.S.-based companies with good balance sheets and products and services that we expect to be winning in the marketplace over the long term.

Among other businesses, we are attracted to niches and eddies of the economy that are gaining share with products that are faster, better, or cheaper than alternatives - companies that we think of as having the wind at their back. We try to buy them when they are misunderstood by the marketplace in the short run, during periods that often feel like right now.

Over the years, this has led us to try to understand the cycles of demographics and the life cycles of consumer and household buying habits to build conviction around longer trends and milestones during short-term periods of uncertainty. While we are value investors first, this approach has led to successful long-term investment themes like healthcare, leisure, internet, software, cloud, content, and, more recently, housing; where we periodically can take advantage of flights away from perceived long-term uncertainty, and buy what we believe is good long-term value for our investors.

What's Ahead?

We are never immune to falling market prices that give up the uncertain long-term potential for the immediate security of receiving a cash-on-sale. Still, we have complete confidence in the underlying long-term value of the good businesses we own, most of which generate free cash and real cash-on-cash yields. As is often a good check on stock market rationality, we estimate that all our holdings would deliver higher than historical real cash-on-cash equity return spreads to private owners, as the bond market currently offers near-zero, inflation-adjusted returns along all maturities on the yield curve.

Our holdings sell at meaningful discounts to our estimate of "true value" or "intrinsic value." When the market overvalues near-term certainty, we patiently wait for a better price to sell while our companies continue to earn their return on equity, increasing their value while we wait. We continue to look for great new ideas, and when there is a compelling value for a business, we tend to buy a little bit. With an average holding period of four to five years by design, our strategies don't invest for short-term liquidity but rather for long-term returns, which we have delivered and believe will continue to deliver. It is periods like this, periods of most uncertainly, when the potential returns are the highest, at least in my humble opinion.

Click here for our most recent performance, and please keep reading to see our Director of Research's thoughts about our best and worst contributors to our performance in the quarter.

Thank you for your interest in Sterling Partners Equity Advisors.

Best Regards,

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Sterling Small-Cap Value Diversified
1Q 2022 Summary*

Listed from highest to lowest contribution within the performance category

Top Contributors	Bottom Contributors
1. Dril-Quip, Inc.	1. Meritage Homes, Corp.
2. Atlas Technical Consultants, Inc.	2. Patrick Industries, Inc.
3. Century Aluminum Company	3. QuinStreet, Inc.
4. Haemonetics Corporation	4. Viad Corp.
5. FONAR Corporation	5. Enova International, Inc.

Sterling Small-Cap Value Focus
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5. Meridian Bioscience, Inc.	5. Skyline Champion Corporation

Top Contributors

Dril-Quip, Inc. (DRQ)

Sterling Small-Cap Value Diversified
Sterling Small-Cap Value Focus

Dril-Quip designs, manufactures, sells, and services engineered drilling and production equipment for use in deepwater, harsh environments, and severe service applications worldwide. Principal products include subsea and surface wellheads, subsea and surface production trees, mudline hanger systems, drilling and production riser systems, liner hangers, wellhead connectors, diverters, and safety valves. It also provides technical advisory services and tool rental options.

The company's products are used to explore oil and gas from offshore drilling rigs, such as floating rigs and jack-up rigs, and to drill and produce oil and gas wells on offshore platforms and moored vessels.

Dril-Quip benefited from heightened uncertainty in global energy markets during the quarter, as crude oil prices rallied sharply. In addition, the U.S. oil/gas rig count increased 15% during the quarter, which represented a more impactful 57% increase than the prior year. As a result, we continue to view Dril-Quip as one of the best service providers in the deepwater space.

Atlas Technical Consultants, Inc. (ATCX)

Sterling Small-Cap Value Diversified
Sterling Small-Cap Value Focus

Atlas Technical Consultants is a leading infrastructure and environmental services provider with solutions to public and private sector clients in the transportation, commercial water, government, education, and industrial markets. They specialize in testing, inspection, engineering, environmental impact, and program management consulting services.

Backlog reached another new record high at $808 million, driven by crucial infrastructure and environmental-related contact wins that offset what is historically a higher backlog burn rate quarter.

Our thesis is that Atlas Technical Consultants is positioned well to benefit from increased domestic infrastructure spending as a growing consultant and service provider to industrial markets and, notably, government.

Haemonetics Corporation (HAE)

Sterling Small-Cap Value Diversified
Sterling Small-Cap Value Focus

Haemonetics is a global healthcare company providing innovative hematology products and solutions in the blood & plasma component collection and hospital transfusion services. It operates across three segments: Plasma, Blood Center, and Hospital. Last year Haemonetics acquired Cardiva Medical for $475 million, aiming to grow their hospital product offering in a fast-growing vertical, vascular closure system.

This upcoming quarter, Haemonetics will begin to see the planned loss of a significant contract with CSL Plasma. Still, management is optimistic about maintaining its current leading market share position in the plasma industry.

We like companies that can improve costs in healthcare, which continue to grow their share of GDP. Therefore, we believe that blood and plasma collection technology will be important for all of Haemonetics' business segments and expect newer machines to continue improving collection yield while lowering costs.

FONAR Corporation (FONR)

Sterling Small-Cap Value Diversified
Sterling Small-Cap Value Focus

FONAR Corp develops, manufactures, and services FONAR MRI machines in addition to the management of MRI centers through its subsidiary, Health Management Company of America. It provides Upright MRI scanners that allow patients to be scanned in weight-bearing conditions, such as standing, sitting, bending, or lying down. The company owns and operates five diagnostic imaging facilities in Florida; and manages 39 MRI scanning facilities, including 25 facilities located in New York and 14 in Florida.

With a strong balance sheet, consistent facility profitability, and low EBITDA multiple, FONAR continues to represent an attractive investment in the health care facility space. In addition, we believe that management has a steady and straightforward path to building additional MRI centers while maintaining balance sheet flexibility.

Meridian Bioscience, Inc. (VIVO)

Sterling Small-Cap Value Focus

Meridian Bioscience is a fully integrated life science company that develops, manufactures, markets, and distributes a broad range of innovative diagnostic products. Meridian primarily sells diagnostic test kits for gastrointestinal and respiratory infectious diseases.

The Life Science segment offers bulk antigens, antibodies, PCR/qPCR reagents, nucleotides, and bioresearch reagents used by in vitro diagnostic manufacturers; and researchers in immunological and molecular tests for human, animal, plant, and environmental applications. The Diagnostics segment offers testing platforms under proprietary branded Meridian products and respiratory illness assays, such as tests for Group A strep, mycoplasma pneumonia, and influenza.

Meridian continues to benefit from increased COVID testing as a provider of PCR reagents used in the test manufacturing process, but revenue growth has slowed since the 2020 fall acceleration. Nevertheless, we continue to view low-cost preventative testing as an area for long-term growth in the health care space and believe Meridian is well-positioned to offer unique and standard testing services.

Century Aluminum Company (CENX)

Sterling Small-Cap Value Diversified

Century Aluminum is a producer of aluminum and operates aluminum reduction facilities, or smelters, in the United States and Iceland. Its products include standard ingots, T-ingot, extrusion billet, horizontal direct chill ingot, molten, slab, and sow. Century Aluminum operates three U.S. aluminum smelters (two in Kentucky and one in South Carolina) and one additional smelter in Iceland. Their principal aluminum facilities produce standard grade and value-added primary aluminum products.

This year, revenue is expected to increase by over 40%, while aluminum demand is expected to grow by over 7% in North America. We own the stock on the belief that Century Aluminum remains a low-cost aluminum producer to value-added resellers.

Bottom Contributors continued next page…

Bottom Contributors

Meritage Homes, Corp. (MTH)

Sterling Small-Cap Value Diversified
Sterling Small-Cap Value Focus

Meritage Homes Corporation designs and builds single-family homes in the United States. It acquires and develops land; and constructs, markets, and sells homes for first-time and first move-up buyers. The company also offers homebuyers title insurance and closing/settlement services. Under the Meritage Homes brand name, it builds and sells homes in Texas, Arizona, California, Colorado, Florida, North Carolina, South Carolina, Georgia, and Tennessee.

Management believes the housing market remains solid from continued demand and historically low supply of homes on the market. However, recent increases in home prices and interest rates have caused pullbacks in the homebuilder space. The increased near-term demand uncertainty combined with supply chain constraints have many homebuilders trading at what we believe are very attractive valuations.

Meritage's geographic footprint remains particularly attractive compared to peers with regard to underlying population growth. Accordingly, we own the stock on the simple thesis that the demographics of household formation combined with the current supply-demand imbalance make home construction an attractive long-term market for competitive suppliers.

Viad Corp. (VVI)

Sterling Small-Cap Value Diversified
Sterling Small-Cap Value Focus

Viad Corp provides experiential leisure travel and face-to-face events and marketing experiences. The company operates two businesses: Pursuit, a collection of travel experiences in Alaska, Montana, the Canadian Rockies, Vancouver, and Reykjavik, Iceland; and GES, a global, full-service live events company offering a comprehensive range of services to the world's leading brands and event organizers. In addition, Viad offers event accommodation solutions, including researching and selecting local hotels, negotiating and contracting, room block management, group reservation management, rate integrity and monitoring, marketing, and on-site and post-event reporting.

Viad continues to improve cost structure as capacity begins to normalize post-COVID, with Pursuit revenue exceeding pre-pandemic levels. However, Viad's GES segment struggles as large-scale events have yet to resume fully.

Travel demand has increased post-COVID, and we expect sizeable corporate and commercial events to resume near term. As a result, we own the stock on the thesis that experience events will continue to grow and gain popularity in society, and the company will continue to expand its global experience offering and gain share.

Patrick Industries, Inc. (PATK)

Sterling Small-Cap Value Diversified
Sterling Small-Cap Value Focus

Patrick Industries manufactures and distributes components, building products, and materials for the recreational vehicle, marine, manufactured housing, and industrial markets in the United States and Canada. Its manufacturing segment sells furniture, shelving, wall, countertop, fiberglass bath fixture, hardwood furniture, RV paint, fiberglass and plastic component, and electrical system components. The Distribution segment distributes and offers logistic services for pre-finished wall and ceiling panels, drywall, wiring, electrical and plumbing, laminate and ceramic flooring, interior and exterior lighting, and other products.

Patrick's manufacturing revenue increased 70% during the past year. They continue to benefit from increased content spend per vehicle/boat/housing unit and market growth, a long history of accretive acquisitions, and a growing share of wallet among its customer base.

Our thesis on Patrick again views that leisure is in a long cycle of gaining a share of the economy as they are suppliers for multiple recreational vehicle companies. We see Patrick as a beneficiary of entrenched favorable trends in recreational vehicles and marine markets, and we will be patient while the management team executes on their strategic plan in modular housing and other niche construction markets where economies of scale matter.

Guess?, Inc. (GES)

Sterling Small-Cap Value Focus

Guess? Inc. designs, markets, distributes and licenses a lifestyle collection of contemporary apparel, denim, handbags, watches, eyewear, footwear, and other related consumer products. Guess? products are distributed through branded Guess? stores as well as better department and specialty stores around the world. The company directly operated 1,068 retail stores in the Americas, Europe, and Asia.

Guess? generates just over 50% of revenue from Europe and recently underperformed in a similar fashion to other European discretionary names during the quarter. In addition, increased commodity and energy prices have negatively impacted discretionary expenditure expectations in the near term. However, management recently indicated that significant progress is being made on its brand elevation strategy; therefore, ROI targets are expected to deliver 12% operating margins by fiscal 2024 with a return on capital of over 30%.

Strong brands are attractive to us as a long-term holding primarily because of economies of scale in advertising. In recent years Guess? has improved its balance sheet and cash flow, increasing license fees as a percentage of sales, and we believe the brand's popularity will continue to drive its success.

Skyline Champion Corporation (SKY)

Sterling Small-Cap Value Focus

Skyline Champion Corporation operates as a factory-built housing company in North America. The company offers manufactured and modular homes, park model RVs, accessory dwelling units, and modular buildings for the multi-family, hospitality, and senior and workforce housing sectors. The company also operates a factory-direct manufactured home retail business, Titan Factory Direct, with 18 sales centers in the southern United States.

Recent increases in interest rates and commodity prices have put homebuilders under pressure, but management sees 'very few' order cancellations. Instead, manufactured housing sees demand from millennials seeking affordable housing, REITs, homebuilders for communities, and rental institutions.

Our thesis on Skyline Champion is a low-cost producer producing shelter for individuals and families in areas where land is not a high cost, and traditional home affordability is a concern.

QuinStreet, Inc. (QNST)

Sterling Small-Cap Value Diversified

QuinStreet Inc is an online performance marketing company that provides customer acquisition services for clients in the United States and internationally, primarily in the auto insurance and home services industries. The company offers online marketing services to its clients through qualified clicks, leads, calls, applications, or customers through its websites or third-party publishers.

During the quarter, QuinStreet lowered guidance due to externalities relating to the automotive insurance industry. As used car sales accelerated last year, the insurance industry underwriting quality declined, leading to a near-term pullback in advertising spending. Management expects this decline to be in the low double digits this year before growth resumes next year.

We own the stock on the thesis that industry advertising spending is continuing its migration to digital while generating more valuable data around the end customer that ultimately improves ad productivity. In addition, we believe that QuinStreet's proprietary software and the ability for average Americans to save money on auto insurance routinely provide a sustainable SaaS model with attractive margins.

Enova International, Inc. (ENVA)

Sterling Small-Cap Value Diversified

Enova International is a technology and analytics company that provides online financial services in the United States, Brazil, Australia, England, and Canada. In addition, the company offers installment loans, line of credit accounts, receivables purchase agreements, and income share agreements. Enova's online financial services to non-prime consumers and small businesses allow access to credit with underwriting and target marketing powered by advanced analytics, innovative technology, and a world-class online platform.

Enova's revenue of $1.58 billion increased 30% from the prior year, primarily driven by Small Business Loans and Finance Receivables growth of 60% during the same period.

The geofenced advertising model Enova uses continues to help them find and maintain profitable clients. 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 winning share.

Nathan Schmidt, CFA
Director of Research

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*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, during the quarter.

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.