Alluvial
FUND, LP

email: info@alluvialcapital.com
website: alluvial.capital
phone: (412) 368-2321

Letter to Limited Partners First Quarter 2022

The cover image shows a CRJ200 jet owned and operated by Air Wisconsin. Air Wisconsin is owned by Harbor Diversified, a newer "special situation" holding for Alluvial Fund.

Photo Credit
Air Wisconsin Aircraft

Alluvial

CAPITAL MANAGEMENT, LLC

Dear Partners,

For the first quarter of 2022, Alluvial Fund fell 7.3%, slightly better than relevant benchmarks. Coming off an excellent year, the market's mood has taken a turn for the dour. And why not? The wind has come out of tech stocks, US consumers are feeling the pinch of inflation despite excellent employment trends, interest rates are on the rise, and Europe has been rocked by Putin's brutal and indefensible invasion of Ukraine. Bad news is not hard to find. However, investor pessimism is what winds up creating opportunities. Inevitably, some high-quality businesses will be sold indiscriminately by fearful investors, and attractive special situations will develop while investors are obsessing over the latest CPI print or jobs report. Alluvial Fund is full of just such opportunities, and I spend every day looking for more.

TABLE I: Alluvial Fund LP Returns (%) as of March 31, 2022

	2022	2021	2020	2019	2018	Cumul.	Annual.
Alluvial Fund LP NET	-7.3	31.0	28.4	18.4	-9.0	117.7	16.0
Russell MicroCap TR	-7.6	19.3	21.0	22.4	-13.1	60.6	9.4
Russell 2000 TR	-7.5	14.8	20.0	25.7	-11.2	62.8	9.7
MSCI World Sm+MicroCap NR	-6.5	15.8	16.5	25.7	-14.3	67.5	10.3

Partnership began operations 01/01/2017

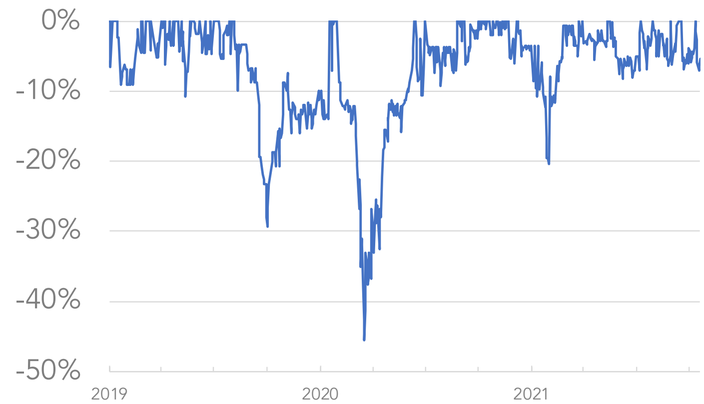
Alluvial Fund's largest holding, **P10 Inc.**, was a drag on performance this quarter. P10 fell 13% in the first quarter and is down 16% this year as I write. I have laid out the case for P10 multiple times over the years we have owned it, so I won't bore you once again with the intricacies. Suffice to say nothing has changed. P10 continues to possess supremely stable and predictable cash flows that will grow organically with zero associated capital expenditures. The company will use these cash flows to acquire additional alternative assets management cash flow streams. Management owns huge quantities of stock and is highly motivated to build the value of P10's franchise.

P10 ended the year with $17.3 billion in fee-paying assets under management and guided toward an additional $5 billion by year-end 2023, excluding any acquisitions the company may perform. Existing assets under management, assuming a 58% cash margin and the company's current debt structure, will produce $95 million in annual cash flow or almost 80 cents per share. $5 billion in incremental AUM could push that figure to $1.05 per share or more. I view 20x 2023 free cash flow, or $21, as a very modest short-term target for P10 stock.

Clearly, I think P10's future is as bright as ever. This drawdown doesn't concern me in the slightest. It has not been a fun experience, but it's also not the first time it has happened. In fact, P10 shares dipped more than 20% three times between January 2019 and the company's IPO and uplisting in late 2021.

Those declines were no sunny day at the park either, but we held on and enjoyed the rewards on the other side. Occasional declines, even steep ones, are an unpleasant but unavoidable fact of life that must be tolerated to enjoy the long-term compounding of high-quality companies. Imagine selling P10 in September 2019 when the stock fell from $1.40 to $1.06, only to watch it rise to $4 a year later. I did not make that mistake then, and I won't make it now.

CHART: P10 Drawdowns 2019-21



On International Investing

35% of the Alluvial Fund portfolio is invested in non-US stocks, almost entirely Western European and Scandinavian companies. I always tell partners to expect one third of the portfolio, give or take, to be invested in non-US markets depending on the opportunity set. But why? Why look internationally when the US stock market has produced so much wealth for shareholders? Few foreign markets have produced anywhere close to the long-term returns that investors in American stocks have enjoyed. Will that continue? Nobody can say for sure, but there are durable advantages that the American market enjoys. The United States, despite its flaws, is the world's premier economy with legal structures and institutions that encourage capital development.

But sadly, the US has done a poor job of late in encouraging small companies to become publicly traded or remain so. The regulatory burden and financial cost of public status is onerous for small companies. Companies too small to achieve inclusion in indexes or research coverage from sell-side firms do not experience the cost of capital advantages that accrue to larger public companies. As a result, the number of small public companies in the US has declined dramatically over time. There are now only a little over 2,000 companies with market capitalizations below $300 million trading on the NYSE and NASDAQ. Add OTC-traded companies of reasonable quality and you get to perhaps 2,800 American micro-caps. By contrast, Sweden has 600, France nearly 500, and Australia almost 1,600! Three countries with a combined GDP one-fifth that of the United States manage to offer nearly the same number of small companies for investors to assess. Then there are other major markets like Germany, Italy, Canada, Japan…the list goes on. And that's ignoring all the emerging and frontier economies out there. All told, foreign markets where Alluvial Fund is active feature more than six times as many small companies as US markets. And what's more, certain countries have figured out how to incentivize high quality small companies to go public using tax incentives and appropriate regulatory relief. While most small public US companies are of the more speculative variety, small companies in places like Sweden, Norway, Italy, and France are very often profitable and cash-producing with solid balance sheets and prospects. There seems to be no appetite in the US to make the public markets friendlier for small companies. Unless that changes, I fear that more and more small American companies will go private or never go public in the first place.

So that's why I look for value in foreign markets. Regardless of the performance of broad country indexes, there will be small companies that perform brilliantly for shareholders. Mathematically, I increase our chances of finding something special by expanding the opportunity set. Practically, I know that every economy has intelligent, entrepreneurial people doing their best to build something special in the public markets. I also know that from time to time, the market will fail to understand and appreciate their efforts and I can accumulate shares at very attractive prices. International investing has been good to Alluvial Fund, especially our forays into Sweden and Italy. And this comes against the backdrop of lackluster European economic growth and stock market performance. Europe has spent most of this century lurching from one economic and political crisis to the next. If we ever arrive at a time when the phrase "investing in Europe" elicits more intrigued looks than incredulous expressions, we could really see our foreign holdings fly. For now, I am quite happy with the returns our foreign holdings have generated for the fund, and for the useful diversification they provide.

Polish Stocks

In my last quarterly letter, I discussed opportunities in the Polish stock market and the fund's new investments there. I expressed enthusiasm over the high quality and low valuations of many Polish companies but recognized the need to limit our allocation based on the political and economic risks of investing in Poland. Sometimes risk arrives a lot quicker than you had hoped. With war raging to the east, the Polish market is down 9% year-to-date and worse in US Dollar terms. Alluvial Fund's Polish holdings have out-performed their indexes, with our largest holding **TIM SA** down 3% and our second-largest holding, **Auto Partner SA**, up 3%. Each company has a robust balance sheet and a business model that should allow it to grow even if local economic conditions worsen. Neither has seen its results affected by the Russian invasion of Ukraine. TIM SA's first quarter 2022 revenues rose 55% year-over-year, including an increase of an incredible 67% in March. The company served 19,000 customers in the month, nearly the same as it served in the entire first quarter of 2021. For its part, Auto Partner's first quarter revenues were up 34%. As distributors, both companies benefit from an inflationary environment and supply chain woes. Their customers are accelerating purchases to ensure adequate inventories and to avoid price increases.

TIM and Auto Partner are executing well, but it may be some time before the results are reflected in their share prices. Headlines out of Moscow and Kyiv, will weigh on Polish share prices for the foreseeable future. Nevertheless, I am confident that 2-3 years from now, shares of each will be considerably higher than today. As much as I wish our investments would commence a steady ascent toward fair value the minute we purchase them, markets are not always so cooperative. However, the stumbles along the way often present opportunities to acquire more shares at very attractive prices.

GEE Group

A newer holding for Alluvial Fund is **GEE Group**. GEE Group operates a simple and time-honored business: temporary labor and recruiting. The company focuses on professional markets like healthcare, technology, and finance/accounting. The employment agency industry isn't the world's most attractive business model, but it does have a few things going for it. Most agencies require little in the way of capital expenditure or physical assets and their cost structure is highly variable. Cash generation is counter-cyclical. On the other hand, agencies do require a good deal of working capital investment and there is little differentiation between firms; not a lot of value in brands, in other words.

TABLE II: Top Ten Holdings, 3/31/22 (%)

P10 Inc.	13.5
Unidata S.p.A.	10.8
Crawford United Corp.	5.6
Rand Worldwide Inc.	5.2
Garrett Motion Inc.	5.2
LICT Corporation	4.9
Butler National Corp.	4.4
GEE Group Inc.	4.2
Harbor Diversified Inc.	4.0
Pegroco Invest AB	3.7
Total, Top Ten	***61.5%***

Because most temp agencies are rather similar and the industry is fragmented, roll-up strategies are viable. That is exactly the strategy that CEO Derek Dewan pursued in his former role as CEO of AccuStaff/MPS Group, which was ultimately sold for $1.3 billion in 2010. GEE Group was pursuing the same strategy under Dewan's leadership but ran into trouble when COVID struck. The firm had funded acquisitions with high-cost debt and found itself at the brink of insolvency when demand for its services vanished. In April 2021, GEE Group remedied its debt woes by issuing a gigantic amount of equity at 60 cents per share. The capital raise was sufficient to pay off all of GEE Group's debt besides its PPP loans, which have since been forgiven.

Today, GEE Group is once again solidly profitable. The company has $12 million in cash and zero debt. Despite the remarkable improvement, GEE Group shares languish below last April's offering price. Shares trade at just 4.2x EBITDA and with a mid-teens free cash flow yield, cheap by any measure and less than half the valuation of similar companies. So, what gives? I think investors have two concerns:

- *Did GEE Group really learn a lesson or will it rush out to lever up once again, possibly overpaying for acquisitions in the process?* I suppose GEE Group could announce a $50 million debt-funded acquisition tomorrow, but I highly doubt it. GEE Group is aware of the need to rebuild investor confidence. I believe GEE Group will keep its first acquisitions on the smaller side to prove to investors it can grow in a responsible manner. GEE Group insiders saw their holdings diluted badly in the brush with bankruptcy. They are not in a hurry to revisit the experience.

- *GEE Group clearly wants to resume acquisitions activity, but its low valuation makes paying with stock a dilutive proposition. Can the company avoid the temptation to issue* *stock?* GEE Group management is aware of its depressed valuation and has indicated that stock-financed acquisitions are off the table at these levels. For now, the company will finance any acquisitions with a combination of cash on hand, bank financing, and/or seller financing. To that end, the company closed on a $20 million borrowing facility in March.

GEE Group is not the kind of company I would pay 20 or 25 times earnings to own. It's unlikely that the company will have a place in our portfolio for the long term unless management proves exceptionally adept in acquiring good quality staffing firms at good prices. But 4.2x EBITDA is just too cheap for a decent little company with zero debt and a workable plan. The factors driving this discounted valuation will dissipate as the company reports quarter after profitable quarter and shares will move toward a more justifiable valuation.

Harbor Diversified

We have added a new special situation to our collection: **Harbor Diversified**. Harbor is a holding company for Wisconsin Airlines. Ordinarily I have little interest in airlines of any kind, but Harbor Diversified is a special case. At around $2.40 per share, Harbor trades at a steep discount to liquidation value. Harbor trades so cheaply because Air Wisconsin's capacity agreement with United Airlines expires in February 2023 and United has declined to renew the contract on the same terms. Air Wisconsin is in discussions with United and other airlines on a new contract, but there is a material chance that a contract will not be secured and Air Wisconsin's fleet will be grounded come next February.

TABLE III: World Allocation, 3/31/22 (%)

United States	65.5
Eurozone	17.1
Poland	8.0
Sweden	7.1
Other	2.3
Total	***100%***

But even in the case that Air Wisconsin fails to achieve a new contract, Harbor's existing working capital, fleet, and remaining earnings are worth well in excess of the company's trading price. At year-end, the company had over $2 per share in cash, securities, and interest-bearing receivables net of debt, all future lease payments, and preferred stock liquidation preference. Air Wisconsin will produce pre-tax cash flow of nearly $90 million over the length of its remaining contract. And then there is the fleet itself. Air Wisconsin owns 64 Bombardier CRJ200s. These aircraft are old and the CRJ200 itself is not exactly a popular jet, but they are worth *something*. At even $250,000 each, less than 15% of book value, that's $16 million or 25 cents per share.

I expect that over the course of the year, Harbor Diversified will either announce a new contract for Air Wisconsin or will begin preparations for an orderly liquidation. In a liquidation scenario, shares are worth north of $3. If a new contract is secured, their value could be substantially higher as investors begin valuing the company as a going concern instead of a liquidation story. For its part, Air Wisconsin seems to be optimistic about securing a new contract. The company is very active on the hiring front, seeking pilots, flight attendants, and mechanics; not exactly the behavior of an airline that expects to shutter permanently in 10 months.

Concluding Thoughts

While 2022 is off to a disappointing start, I have high hopes for the remainder of the year. By and large our companies reported solid fourth quarter results, and we will soon begin receiving first quarter earnings reports. Declining markets and increased investor anxiety have created some promising scenarios, particularly in Europe. I have also begun building positions in a few US special situations that offer excellent return potential with limited risk. More to come on those.

As always, I thank you for the opportunity to manage capital on your behalf. All of my family's investable capital is invested in Alluvial Fund. Please don't hesitate to reach out with questions on the Alluvial Fund portfolio or strategy. I hope you and your families are well and I look forward to writing to you once again in a few months.

Best Regards,

Dave Waters, CFA
Alluvial Capital Management, LLC

Contact
Alluvial welcomes inquiries from clients and potential clients. Please visit our website at alluvialcapital.com, or contact Dave Waters at info@alluvialcapital.com or (412) 368-2321.