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Letter to Limited Partners First Quarter 2023

The cover image shows the Mountain Laurel, the state flower of Pennsylvania whose beautiful (though poisonous!) blooms generally herald the arrival of summer in the eastern portion of the US. Though they have adapted to grow in a variety of climates, these flowers favor mountainous terrains, such as those found near Skytop Lodge, a new holding of Alluvial Fund. Read the letter for more information on this highland getaway located in the Pocono Mountains.

Detroit Photographic Co. produced the image in the early 20th century using a technique invented in Switzerland called Photocrom, which generated realistic full color renditions from black and white photo negatives. Popularized by the company, this process was mainly used to create postcards bearing a color image—a wildly popular novelty at the turn of the century. Unfortunately, at about the same time that Skytop Lodge was being built in the 1920s, the successor company to Detroit Photographic Co. was forced into bankruptcy, a victim of changing tastes and newer printing technology.

Photo Credit
Laurel Blossom, Detroit Photographic Co.

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CAPITAL MANAGEMENT, LLC

Dear Partners,

Alluvial Fund began the year on a positive note, rising 3.6%. By comparison, the Russell 2000 Index gained 2.7% and the Russell Micro-Cap Index fell by 2.8%. Looking at these figures, one might reasonably assume the market is having a quiet time, with little consequential news to trouble or excite investors. In fact, the market was rocked by a banking crisis that threatened to destabilize the financial sector and beyond before gradually dissipating. Small-cap indexes were up 10% at the end of January, only to give up those gains and then some in March before staging a recovery. In typical fashion, Alluvial Fund plotted a steadier course.

TABLE I: Alluvial Fund LP Returns (%) as of March 31, 2023

	2023	2022	2021	2020	2019	Cumul.	Annual.
Alluvial Fund LP NET	3.6	-14.9	31.0	28.4	18.4	107.0	12.3
Russell MicroCap TR	-2.8	-22.0	19.3	21.0	22.4	31.8	4.5
Russell 2000 TR	2.7	-20.4	14.8	20.0	25.7	43.9	6.0
MSCI World Sm+MicroCap NR	4.1	-19.1	15.8	16.5	25.7	51.0	6.8

Partnership began operations 01/01/2017

Small company shares remain out-of-favor compared to those of large companies. Despite this quarter's gain, the gulf between our securities' trading prices and their intrinsic values is as large as I have ever observed. Fourth quarter 2022 earnings were very good overall, but the market's reaction to even the best news was muted. In response, I made some moves in our portfolio this quarter, selling out of one holding and adding a few others.

I sold all our shares of **GEE Group** this quarter. In my last letter, I mentioned how GEE Group's place in our portfolio was dependent on management's commitment to using the company's balance sheet cash for the benefit of shareholders. Well, another quarter came and went with zero evidence that management's promises and assurances were anything but empty words. Despite earlier proclamations of "good things" to come, the company formally dismissed the idea of returning cash to shareholders and again failed to deliver on long-promised profitable acquisitions. I am happy to put our capital to better use elsewhere, and to use our experience with GEE Group as a reminder that a lack of urgency and integrity on the part of company management can negate almost any degree of good economics or valuation.

In happier news, I have identified another opportunity in the Canadian industrial sector. Small Canadian manufacturers have become something of a theme for Alluvial, first with Supremex and now with our new holding **Hammond Power Solutions**. For decades, Hammond Power Solutions has been producing transformers, the boring, but utterly essential components responsible for transferring energy between circuits in electrical installations. Though they are one of the oldest examples of electrical technology, transformers are required by virtually anything that creates or employs electrical energy. The high quality, dry-type transformers produced by Hammond are widely used in factories and commercial buildings, power grids, and renewable energy facilities as well as oil & gas, mining, and many other industries. Demand for transformers has exploded as the electrification of the world economy accelerates. Despite running its factories at full capacity, Hammond has been unable to keep pace with inbound orders. The company plans to invest $40 million to increase its production capacity, as it expects demand for its products to remain strong in the coming years.

TABLE II: Top Ten Holdings, 3/31/23 (%)

P10 Inc.	9.1
ECIP Bank Basket	8.8
Unidata S.p.A.	6.6
Rand Worldwide Inc.	6.3
Hammond Power Solutions Inc.	4.9
Fitlife Brands Inc.	4.8
Supremex Inc.	4.8
Garrett Motion Inc.	4.6
EACO Corp.	4.4
Companhia Brasileira de Distribuicao	3.5
Total, Top Ten	***57.8%***

Despite the stellar outlook, Hammond Power shares change hands at below 10x trailing earnings and the enterprise is valued at 7x operating income. 2023 earnings will increase from last year's as a result of price increases and continued strong demand. Hammond employs a conservative capital structure with zero debt and produces free cash flow like clockwork. There are few things I like more than finding a high-quality firm like Hammond trading at a pedestrian valuation. While Hammond shares have appreciated as the company's revenues and profits grow, the market has yet to fairly credit the company for its growth profile and profitability.

Banking Brouhaha

This year has been a rough one for many banks and bank stocks, as evidenced by the 25% drop in the S&P Regional Banking Index during the quarter. The collapse of Silicon Valley Bank and Signature Bank, as well as the ongoing precarious position of First Republic Bank and a few others, caused investors to question the safety and stability of nearly every American bank, no matter how sound.

We are invested in a handful of banks, all recipients of low-cost permanent capital courtesy of the US Treasury's Emergency Capital Investment Program. While the goal of this program was to encourage lending in economically disadvantaged areas, it also happened to make its recipients some of the nation's best-capitalized banks in terms of total equity to assets. For that reason, there is no cause for concern regarding the safety of any of the banks that Alluvial Fund holds. The market seems to agree as the share prices of our four banks fell just 1% on average this quarter.

Each of our banks trades at a mid-single digit multiple of this year's earnings and at a discount to economic book value, which I calculate by discounting the value of the ECIP capital infusion at market rates. I continue to believe that each bank will be valued at 2-3x current prices in a few years' time.

That is not to say our banks aren't experiencing the same challenges as other banks. The interest rate environment is causing a steady increase in funding costs, and credit quality will come under some pressure if the economy slips into recession. But our banks are well-positioned to weather the storm. The American banking industry is divided into roughly three segments. There are gigantic national "too-big-to-fail" money center banks, regional banks, and community banks. Of these, I believe that regional banks have the toughest path forward. They don't have the implicit government guarantee or national footprint that the giants have, nor can they build the personal relationships, local knowledge, and sticky deposit base that a good community bank can. There are plenty of reasons why a consumer or a business might choose a mega-bank or a micro-bank; I don't see many reasons for choosing an unspecialized regional bank. I expect that large banks will be the major beneficiaries of deposits and lending relationships that leave regional banks, but I also expect community banks to capture a surprising amount. I also expect them to avoid some of the additional regulatory measures that are no doubt coming.

TABLE III: World Allocation, 3/31/23 (%)

United States	72.3
Eurozone	11.6
Canada	7.8
Poland	5.0
Sweden	3.0
Other	0.3
Total	***100%***

Other Portfolio Updates

Our largest position remains **P10 Inc.**, which reported another quarter of growth in assets under management, bringing the total to $21.2 billion, up 23% year-over-year. P10 shares are down year-to-date, no doubt reflecting investor pessimism around the fundraising environment for alternative asset managers. And yet, P10 just announced that its subsidiary RCP Advisors succeeded in raising $328 million for RCP XVII, exceeding the targeted $300 million. Despite the headwinds, P10's managers are still attracting new capital. Though P10 has not found any suitable acquisitions of late, the company has found value in its own shares, repurchasing 1.6% of shares outstanding in the fourth quarter alone. The logic of these buybacks is unassailable; try as I might, I cannot find a better opportunity on a reward-per-unit-of-risk basis than P10 shares at under 12x perfectly visible, contractually guaranteed recurring free cash flow.

Unidata SpA remains a large holding and distinctly under-valued. Shares were pressured earlier this year by the company's equity offering in support of its acquisition of TWT Group. Adding TWT will be tremendously accretive to Unidata's earnings and cash flows, but the market is taking a "wait and see" approach. Unidata also announced it had signed a contract for the construction of its new undersea cable, which will be operational in two years' time. Finally, Unidata has applied to uplist to the Borsa Italiana's STAR segment, a more prominent segment with higher listing standards that should bring additional attention to the company and its shares.

The other day, an anonymous Twitter friend shared the picture below from Rome. This isn't just some nondescript metal hatch, it's Unidata's (and by extension, our) nondescript metal hatch! I always appreciate a reminder that the stocks and securities we invest in are far more than figures on a screen, they're ownership in and obligations of organizations run by and employing real people, with real assets, doing (hopefully!) profitable things in the world. And these things take time. While Unidata shares have disappointed lately, our investment has been an extraordinary success over our period of ownership. Unidata's revenues and earnings will continue to grow rapidly as the company brings broadband internet to thousands of businesses and households, many for the first time. In due time the market will realize the essential and irreplaceable infrastructure that Unidata builds and owns is worth more than 7x 2025 normalized free cash flow it fetches today.

PHOTO — Meanwhile in Rome

I must take a second to recognize **EACO Corp.**, which has quietly become a significant holding for Alluvial Fund. I last mentioned the company almost three years ago when shares were trading around $19. The company was valued around $100 million and had produced operating income of $12.3 million in the trailing year. Today, EACO shares change hands in the low $30s. The company is valued at $140 million and produced operating income of $28 million for the year ended February 28, 2023. Impressive, and still extremely cheap. It's likely that EACO's results will moderate. COVID-related supply chain issues resulted in improved margins for companies like EACO and their Bisco Industries subsidiary. But even if operating margins were to recede to 2019 levels, EACO shares would be trading at 9x normalized earnings net of cash and securities. I expect EACO's revenue growth to continue at a mid-teens pace. The basic electrical components and fasteners that Bisco Industries distributes are in high demand. The company is rising to the occasion, today employing 370 sales employees, 9.5% more than a year ago.

TIM SA, a member of our basket of Polish stocks, received a takeover offer in late March, causing shares to jump 28%. I sold our holdings in the following days. Our investment in TIM was successful but alas, too brief. I had hoped to hold our shares for quite some time and to sell them years down the road at a significantly higher price. However, I cannot blame management for wishing to engineer a fair outcome for shareholders when the market stubbornly refused to recognize TIM's progress. I am working to invest the proceeds of our TIM SA investment into other Polish securities, which offer some of the world's best valuations. Other stocks in the Polish basket include **Hortico SA**, a growing gardening supplier trading at <4x earnings; **Auto Partner SA**, a high-quality auto parts distributor growing at 30% but trading at 12x earnings; and a new holding in a software company that grew 90% in 2022 but trades at <8x normalized cash flow. Our Polish holdings have been strong contributors to Alluvial Fund since we began investing in Poland in 2019. It's a volatile market and prone to long periods where the general market mood overshadows individual company results, but buying quality holdings at great prices works, given enough time.

"One Day" Stocks

I have written before about the concept of "one day" stocks. These are stocks and securities that are so obscure, off-the-run, and/or illiquid that they are unlikely to approach their fair value in the short run, but nevertheless offer incredible value that will accrue to investors "one day"–and sometimes in literally one day-as the result of a buyout or merger, a balance sheet recapitalization, or some other catalyzing transaction. It's never wise to put too much of one's portfolio in any one of these securities, because "one day" could be a decade off. Still, a diverse basket of these securities offers attractive upside. I recently found a new addition for our "one day" collection.

Skytop Lodge is an historic Poconos hotel and resort, operating since 1928. The property includes 124 guest rooms and 5,500 acres of private woodlands, a lake, and a golf course. While Skytop's fortunes and those of the greater Poconos region have risen and fallen over time, the company's financials have improved significantly in recent years. Skytop has operated profitably, paid down debt, and performed major upgrades to its property, offering improved amenities and bettering the guest experience. Skytop is never going to appeal to travelers seeking the height of luxury and sophistication, but it does have a loyal base of vacationers who appreciate the seclusion and natural beauty of the property and the surrounding area. The reviews are in and they are good!

PHOTO — Skytop Lodge

Alluvial Fund has purchased just over 2% of **Skytop Lodge Corp**. On a look-through basis, we own 2.5 guest rooms and 112 acres of pristine forest. From a purely financial perspective, we invested at <6x normalized earnings and cash flows, a 27% cap rate, and at $82,000 per key, land value excluded. Using a very conservative 12.5% cap rate on the property's cash earnings and adjusting for some corporate overhead, I think Skytop shares would be worth at least $2,300 per share in a sale transaction. I have no idea when or if that transaction will occur, but I am happy to hold a stake in a cash-flowing enterprise where value will continue to accrue with each passing year. I have yet to visit Skytop, but I hope to make the trip later this year with my family. Until then, I'll just keep checking out their webcam and gallery.

Special Situations

I continue to seek out special situations that offer mid-teens or higher rates of return without meaningful market risks. Thus far in 2023, we have benefitted from two liquidating biotech companies, **Otonomy Inc.** and **Sio Gene Therapies**. We purchased our Otonomy shares at an average cost of $0.116, and have already received an initial liquidating distribution of $0.11 per share, with the potential for up to 2 additional cents per share as outstanding claims and contingencies are resolved. We purchased our shares of Sio Gene Therapies at an average of $0.414 per share. The company will soon distribute 38-42 cents per share and shareholders may receive additional value of as much as 9 cents per share in the course of the liquidation. In both cases, we will have received >90% of our initial investment in just a few weeks or months, setting up an attractive rate of return as additional liquidation proceeds are received.

Our largest liquidation investment, **Retail Value Inc.**, is proceeding well. In early April, we received $0.17 per share, meaning we have now received liquidating distributions in excess of the cost of some of our earlier purchases. I expect us to receive additional distributions totaling around 14 cents per share in coming years. Retail Value shares have been converted to interests in a liquidating trust and no longer trade.

We are invested in a few other liquidation scenarios that offer similar return profiles, but are too illiquid to mention for now. As attractive as liquidation scenarios can be, they are not the only type of special situations I seek for Alluvial Fund. Just last week we took advantage of a fast-moving special situation involving the direct listing of a former private REIT.

Private REITs, real estate-owning trusts that do not trade on a public exchange, are rightly regarded as slimy. They nearly always feature egregious insider compensation, unsustainable distribution policies, and badly-designed incentive structures. They are also highly illiquid. Much like a timeshare, a private REIT is easy to acquire but nearly impossible to sell. Because their performance is bad on average, most Private REITs have a long list of holders eager to exit. But there are few buyers, and none willing to pay anywhere close to the REIT's self-reported net asset value. Enter **Peakstone Realty Trust**. Founded as Griffin Realty Trust, this private REIT underwent a series of mergers and transactions in recent years and internalized its management, but still found itself unable to grow its net asset value. Peakstone considered liquidating, but ultimately decided to continue and to list its shares on the NYSE. And so, with little fanfare, Peakstone Realty Trust shares became publicly tradable. What happens when a highly illiquid asset with thousands of "trapped" holders suddenly becomes tradable? An avalanche of selling overwhelms the market. Peakstone shares held by the transfer agent, Computershare, were sold into the market by the millions without regard for price. Peakstone's self-calculated net asset value per share was $67 as of June 30, but shares traded as low as $8 on the first day of trading! I recognized the imbalance and was able to accumulate shares at high teens prices. The selling pressure abated in the following days, and shares rose to more reasonable levels in the high $30s and low $40s, where we took profits and moved on.

Situations where a short-term imbalance between buyers and sellers causes prices to diverge wildly from fair value can be highly lucrative, but they don't often occur. I am keeping my eyes open for the next to come along.

Thank you for reading and for entrusting a portion of your capital to Alluvial. There is no shortage of market opportunities out there and I will continue doing my utmost to identify the best of them for us. As always, our focus remains on the ignored, the overlooked, and the misunderstood. I am at your disposal to answer questions about our strategy and portfolio, so please don't hesitate to get in touch. Best wishes to you and your families and I look forward to writing to you again in July.

Best Regards,

Dave Waters, CFA
Alluvial Capital Management, LLC

Disclosures
Investment in Alluvial Fund are subject to risk, including the risk of permanent loss. Alluvial Fund's strategy may experience greater volatility and drawdowns than market indexes. An investment in Alluvial Fund is not intended to be a complete investment program and is not intended for short-term investment. Before investing, potential limited partners should carefully evaluate their financial situation and their ability to tolerate volatility. Alluvial Capital Management, LLC believes the figures, calculations and statistics included in this letter to be correct but provides no warranty against errors in calculation or transcription. Alluvial Capital Management, LLC is a Registered Investment Advisor. This communication does not constitute a recommendation to buy, sell, or hold any investment securities.

Performance Notes
Net performance figures are for a typical limited partner under the standard fee arrangement. Returns for partners' capital accounts may vary depending on individual fee arrangements. Alluvial Fund, LP has a fiscal year end of December 31, 2023 and is subject to an annual audit by Cohen & Company. Performance figures for year-to-date periods are calculated by NAV Consulting, Inc. Year-to-date figures are unaudited and are subject to change. Gross performance figures are reported net of all partnership expenses. Net performance figures for Alluvial Fund, LP are reported net of all partnership expenses, management fees, and performance incentive fees.

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