SNOWBALL RESEARCH

Project-X

Report

Issue -14

Snowball Research team

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Project-X

Dear clients:

We add value in two ways:

First, our publication takes unconventional ways to screen ideas. Let's take the "8-K" screen as an example. Our team reads hundreds of 8-K filings in a month and writes reports on a few interesting companies.

In the 2009 Grahan & Dodsville newsletter, Paul Sonkin (Hummingbird Value Fund) said that he likes to fish deep and alone. This is exactly how I approach the screening.

Secondly, I want my clients to spend only a few minutes reading a report on a company. That's why the report has plenty of bullet points. It doesn't stop there. It has headlines to "fasten" the reading experience. Even though James Cameron spent more than four years making the *Avatar* movie, the movie didn't run for 100 hours. Keep it short.

What is Project-X?

Our new publication focuses on a completely different set of screening methodologies.

We focus on the following:

1. Owner-operators: Research companies that are run by owner-operators.

2. Find ideas from fund letters and fund commentaries. I'm proud to say that our publication would be the first to focus on unearthing comments buried in mutual fund letters that are filed with the SEC. We are still learning and building a process.

3. 13F: Self-explanatory. I will comment on this in the future.

4. Segments: We find companies with multiple segments and flag the peculiar ones.

5. OTC: We pick one or two stocks trading in the OTC market.

6. Business: We focus on companies that generate recurring revenue and/or show "some sign" of competitive advantage.

FAQ:

- Market cap? Stocks under $5 billion market capitalization.
- Frequency? Even though I plan to publish once a month, my minimum guarantee is 9-10 reports in a year.
- How many stocks? At least 6-9 stocks in a month.

A final note

I want to take this opportunity to thank a client who constantly encouraged me to look at stocks that are discussed in fund letters. In this publication, we have a dedicated section for the same.

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Recently I spoke to an investor who praised me for having hyperlinks on the index page. Guess what? It was a suggestion from one of my clients.

We recently started sending out a weekly 13D summary. Why? A few clients suggested that I do it.

My message is simple: Please give suggestions. Even though I don't promise that all recommendations will be implemented, I do take them seriously.

I'm laser-focused on one thing – the publication should be "unique" and "highly valuable," not a "me too" project or another "low-cost" alternative.

Thank you.

Best,

Raghu

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Notes
1. The stocks are not listed in the order of “interesting”.
2. Each headline below is “clickable” – it is hyperlinked to the article.
3. At the top of each page, you can see “Go to Index” text. If you click that, you will be taken to the index page.

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Addus HomeCare (ADUS): The hospice segment is a crown jewel

- Market Cap: $1.2 billion | Addus HomeCare Corporation is a provider of home care services.
- Major shareholders: BLACKROCK - 16.5%| VANGUARD GROUP - 6.5%| CAPITAL WORLD INVESTORS - 5.9%| EATON VANCE MANAGEMENT - 3.8%
- Screen: Segment

I. BUSINESS

Personal care (85% of revenue) - Provides non-medical assistance with activities of daily living - dressing, personal hygiene, meal preparation, housekeeping, and transportation services.

- Hospice (13% of revenue) - Provides physical, emotional, and spiritual care for people who are terminally ill.
- Home health (2% of revenue) - Provides skilled nursing – physical therapy, speech therapy, occupational therapy.

II. WHAT WE LIKE:

1. Growing financials:

- 3.4X revenue growth: In the last decade, the company's revenue grew by 3.4X from $244mm in FY 2012 to $836mm in LTM Sept 2021 through organic growth and acquisitions. Since 2017, the company has acquired 13 companies. For the first nine months of 2021, net service revenues increased 12.5% to $639.9 million.
- Recent rapid acquisition after the management change
  - In 2016, the company appointed Dirk Allison as CEO. In early 2017, he hired Brian Jones to the leadership team to lead the company's acquisition efforts – Jones was appointed as the VP-M&A of the firm.
  - Massive acquisition under the new team: Between 2011 and 2016, the company spent roughly $70 million in cash towards acquisition. From 2017 till now, the company spent roughly $500 million in cash for acquisitions.
  - In fact, the company ventured into the hospice segment only through the acquisition executed by this management team.
- Improving margin: With the entry into the hospice and home health segments in 2018, the company's margin increased from 26% to 30%.
- 5X growth in adjusted EBITDA has increased consistently in the last decade – Adj. EBITDA increased from $18 million in 2012 to 91 million in LTM ended September 2021.
- Growing market size: The Company’s target customers are the aging population. The US population of persons aged 65 continues to grow. The US Census Bureau estimates that this population will nearly double in size by 2060 (from 56 million in 2020 to 98 million 2060).

2. Hospice segment has grown rapidly in the last 2.5 years

- Hospice segment accounted for roughly 14% of revenue in 2020.
- The segment provides physical, emotional, and spiritual care for people who are terminally ill as well as related services for their families.
- Generally, patients receiving hospice services have a life expectancy of six months or less.
- Entry and expansion through acquisition: In 2018, the company acquired Ambercare for roughly $40 million, which led to their entry into the hospice segment. Subsequently, in 2019

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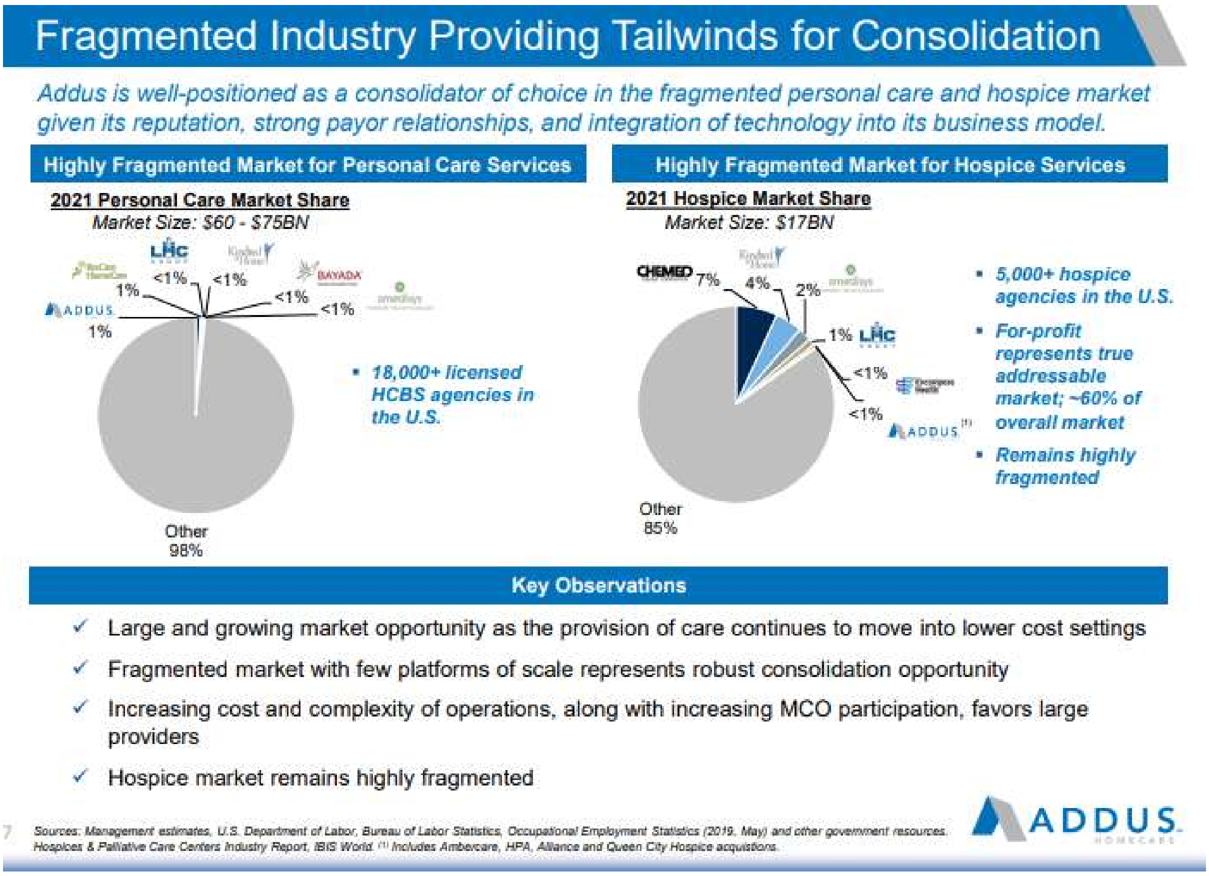
and 2020, the company acquired Hospice Partners ($136 million) and Queen City Hospice ($195 million).

- Three reasons why this is interesting?
  1. High margin: Hospice segment generates a high gross margin of approximately 50% compared to personal care's 25% margin and home health's 37% margin.
  2. Rapid growth – This segment accounted for roughly 6% of total operating income in FY 2018. Now, it accounts for 24% of operating income for LTM September 2021.
  3. Long runway? No competitor company holds more than 8% market share in this segment; Addus holds less than 1% market share. As such, there is a long run-way to grow through acquisition.
- Few metrics:
  - Admissions increased approximately 8X times: The number of admission in this segment increased from 1,061 in 2018 to 9,194 for the LTM ended September 2021.
  - Days of service given to the patients increased from 128,819 days in 2018 to 855,007 days for the LTM ended September 2021.



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Stable Reimbursement Environment

- Personal care reimbursement rates vary by state and service type but are typically based on an hourly or fractional hour unit-of-service basis
- Hospice and home health reimbursement rates vary based on the severity of the patient's condition
  - In general, hospice rates are paid on a per diem basis, while home health is paid on a 60-day episode driven by diagnosis and paid on 30-day intervals
- States do not want to reduce the viability of HCBS since this is the lowest cost solution when compared to more expensive institutional services
  - Wage increases have been historically offset in total or in part by reimbursement rate increases
- The Company's reimbursement rates have been relatively stable
  - Occasionally incremental reimbursement rate adjustments are provided through the annual state budget process
  - This has been evidenced by stable-to-increasing gross margins and adjusted EBITDA margins

Historical Margin Profile

($ in millions)	2017	2018	2019	2020	Annualized 2021 YTD
Revenue	$ 426.0	$ 516.6	$ 648.8	$ 764.8	$ 853,143
Gross Profit	115.9	136.6	179.2	226.3	262,737
Gross Margin	*27.2%*	*26.4%*	*27.6%*	*29.6%*	*30.8%*
Reported Adjusted EBITDA	$ 35.8	$ 42.5	$ 58.7	$ 76.9	$ 93,256
Adjusted EBITDA Margin	8.4%	8.2%	9.0%	10.1%	10.9%

[1] Annualized for the YTD period ended September 30, 2021

ADDUS HOMECARE

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Semler Scientific (SMLR): Strong FCF; 13F

- Market Cap: $511 million | Semler Scientific is a company that provides technology solutions to improve the clinical effectiveness and efficiency of healthcare providers.
- Major shareholders: PARK WEST ASSET MANAGEMENT - 8.2%| OPALEYE MANAGEMENT - 3.3%| PROSPECT CAPITAL - 2.9%| FMR LLC -2.8%
- Screen: 13F

($ in millions)	2014	2015	2016	2017	2018	2019	2020	LTM ended Sep '21
Revenue	3.6	7.0	7.4	12.4	21.4	32.7	38.6	53.5
EBIT	(4.3)	(8.4)	(2.1)	(0.8)	5.3	10.7	15.9	23.7
Net income	(4.5)	(8.5)	(2.5)	(1.5)	5.0	15.0	14.0	21.1

13F: The Company got relisted in NASDAQ in September 2021.
Top 10 shareholders -

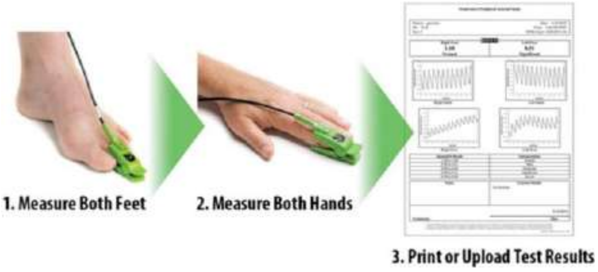
Fund Name	% of Portfolio	% Ownership
PROSPECT CAPITAL ADVISORS	8%	3%
OPALEYE MANAGEMENT	6%	3%
ARAVT GLOBAL	6%	2%
APIS CAPITAL ADVISORS	4%	1%
KENT LAKE CAPITAL	3%	1%
DIAMETRIC CAPITAL	3%	0%
ADIRONDACK RETIREMENT SPECIALISTS	2%	0%
CONNACHT ASSET MANAGEMENT	2%	0%
LEGAL ADVANTAGE INVESTMENTS	1%	0%
PUNCH & ASSOCIATES INVESTMENT MANAGEMENT	1%	2%

RESEARCH

1. PRODUCT

a) Peripheral Arterial Disease (PAD) testing kit

- QuantaFlo®, a four-minute in-office blood flow test, received FDA approval in March 2015 and started commercialization in August 2015.
- What is PAD? It occurs when cholesterol and other fats circulating in the blood collect on the walls of the arteries that supply blood to the limbs. This build-up narrows arteries, which often leads to reduced or blocked blood flow. PAD commonly occurs in the legs and can also be present in the arteries that carry blood from the heart to the head, arms, kidneys, and stomach.
- How does the company's product work? It has a sensor clamp that is placed on the toe or finger, much like pulse oximetry devices. QuantaFlo measures arterial blood flow to aid in the diagnosis of peripheral arterial disease, or PAD, by forming a blood flow waveform constructed by its proprietary software algorithm.
- Who uses this? It is currently in use at hospitals, clinics, physician offices, and home settings throughout the country.



b) Competing products

- The traditional ankle-brachial index, or ABI, with a Doppler test takes 15 minutes to perform and requires a vascular technician to be done properly.
- Detecting a pedal pulse has traditionally been used as a window view of overall cardiovascular health. Performed during a physical examination, a clinician will attempt to locate an arterial pulse, which can be felt on the top of the foot on the front part of the ankle. An absent or diminished pedal pulse may indicate PAD.
- X-ray technology or an MRI is used to obtain anatomic information about blood vessels in the legs.

c) So, how does the company compete?

- Because standard ABI devices require a better-trained operator, the products are usually sold to specialized vascular labs that are supervised by a vascular surgeon, with the tests performed by a licensed clinician.
- In comparison, the company's product can be used by internists and non-peripheral vascular experts.
- Imaging tests are much more expensive.

2. Business model

- Leasing model – recurring revenue: The Company's business is based on a leasing model rather than an outright sale of the products. The company has developed a license model, which eliminates the need to make a capital equipment sale.
- Approximately two-thirds of the company's customers are on the fixed-fee software licensing model, whereas just under one-third are on the variable fee model based on usage.
- The company is not in the business of performing QuantaFlo® measurements that require the company to seek reimbursement from third-party payors, including governmental healthcare programs, such as Medicare and Medicaid, and commercial health insurers.
- The company's testing product is licensed by healthcare providers. They may bill various third-party payors, including governmental healthcare programs, such as Medicare and Medicaid, private insurance plans, and managed care programs for procedures in which the company's vascular testing product is used.

3. Solid financial performance

- Revenue growth: The Company's revenue increased from $7 million in FY 2015 to $53.5 million in LTM ended September 2021.
- Consecutive quarterly profitability since the fourth quarter of 2017: The Company first achieved full-year profitability in 2018; it has remained profitable since then. The company's net income increased from $5 million in 2018 to $21.1 million in LTM ended September 2021.
- High gross margin: The Company's gross margin increased from 75% in 2016 to 91% in 2020.
- Positive free cash flow: From 2018 to September 2021, the company generated $43 million in free cash flow.
- No debt; cash balance: $36 million.
- Relisted on NASDAQ: The Company got relisted in NASDAQ in September 2021 after getting delisted from NASDAQ in 2016.

The recent stock price crash

- 50% crash: Since the first week of November 2021, the company's stock price has crashed by more than 50%. The stock price crashed after the financial performance fell short of expectations.

- Moreover, even though the company's recent quarterly revenue grew, the company's variable fee license revenues, which is a fee per test, decreased sequentially in the third quarter of 2021 compared to the second quarter of 2021. The company believes that the change may be either due to the effects of COVID-19 or due to a new seasonality in the in-home testing market, which the company's management hasn't seen in prior periods, or due to both.
- FCF/EV yield: 4.23% ($18.9 million/$447 million)

Punch Investment

- Punch Investment initiated a stake in the company in the third quarter of 2021. You can read the fund's commentary in the below link.
- https://punchinvest.com/institutions/third-quarter-2021/

Heads up

- Customer concentration: The Company's largest customer is a US diversified healthcare company. For the three months ended September 30, 2021, two customers accounted for 40% and 28% of the company's revenues, respectively.
- Patent expires in 2027: The company has one patented an FDA-cleared vascular-testing product, which expires on December 11, 2027.
- Massive insider sale: Since 2021, the company's CEO sold in excess of $1 million worth of shares.

Armanino Foods of Distinction (AMNF): Profitable, strong FCF generation

- Market Cap: $106 million | Armanino Foods of Distinction, Inc. is an international food company that manufactures and markets frozen Italian specialty food items such as pestos, Bolognese, Alfredo sauce and filled pastas to the foodservice, retail, and industrial markets.
- Major shareholders: SEIZERT CAPITAL PARTNERS - 0.59%| JAMES INVESTMENT RESEARCH - 0.06%
- Average share trading volume: 20,000
- Screen: OTC

1. Business

- The company is currently engaged in the production and marketing of upscale and innovative frozen and refrigerated food products, including pesto and other sauces, stuffed pasta products, and cooked meat products.
- These products are marketed through a network of food brokers and sold to retail and foodservice distributors, club-type stores, and industrial accounts.

2. Excellent financial performance

- The company's revenue grew consistently from roughly $25 million in FY 2011 to $42.6 million in FY 2019. In 2020, the company's revenue declined 25% due to the COVID-19 pandemic, and in the last nine months, the company's revenue increased by 37%.
- In the last ten years, the company was profitable and generated positive free cash flow.
- Even though the company's revenue declined by 25% in FY 2020, the company generated FCF of $5.5 million in FY 2020.
- It is rare to find a company that is small and consistently profitable and generates free cash flow.

3. More than 50% of FCF is distributed to shareholders: The Company distributed more than half of its free cash flow to its shareholders as dividends.

4. Availability of financial information

- Since August 2005, the company's common stock has been quoted on the OTC market.
- Even though the company is no longer required to file 10-K and 10-Q with the SEC following the deregistration, the company continues to audit and publish its quarterly and annual reports on otcmarkets.com.
- If you decide to study the company, please check the below two links:
  - https://www.otcmarkets.com/stock/AMNF/disclosure
  - https://www.otcmarkets.com/stock/AMNF/news

5. Other notes

- In March 2020, the company appointed Timothy W. Anderson as CEO. Mr. Anderson served as SVP at Challenge Dairy from 2006 to 2020, where he claims that he more than doubled the size of the regional butter brand, leading it to become the number two national brand.

($, mm)	FY 2014	FY 2015	FY 2016	FY 2017	FY 2018	FY 2019	FY 2020	LTM Sep 2021
Revenue	31.5	34.7	35.7	39.0	41.8	42.6	31.8	40.5
EBIT	6.0	6.3	6.4	7.1	8.0	8.2	2.3	6.0
Net income	3.8	4.0	4.2	5.1	6.3	6.5	2.0	4.8
FCF	3.6	3.2	2.9	0.2	5.3	5.2	5.5	5.5

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Napco Security Technologies (NSSC): Owner-operator; Strong FCF; New product launch

- Market Cap: $763 million | NAPCO Security Technologies is one of the leading manufacturers and designers of high-tech electronic security devices, wireless recurring communication services for intrusion and fire alarm systems as well as a leading provider of school safety
- Major shareholders: RICHARD SOLOWAY -40% | WASATCH ADVISORS -11.5%| THRIVENT FINANCIAL FOR LUTHERANS -10.5%| BLACKROCK - 10%| FMR LLC -8.7%
- Screen: Owner-operator

I. BASICS

The company offers an array of security products, encompassing access control systems, door-locking products, intrusion and fire alarm systems, and video surveillance products for commercial, residential, institutional, industrial, and governmental applications.

II. WHAT WE LIKE

1. Insiders hold 21%

- Richard L. Soloway is the founder of the company. Mr. Soloway served as secretary since 1975, chairman of the board since October 1981, and CEO since 1998.
- Mr. Soloway has held more than a 30% stake in the company since 2002, and he sold approximately 2.3 million shares in December 2020 through a secondary offering. He still holds a 19.9% stake in the company.
- Interview: https://www.napcosecurity.com/assets/images/pdf/TWSTNAPCO.pdf

2. Good governance

- Even though insiders hold a significant stake in the company, there is no significant family relationship between any directors or officers of the company except Donna A. Soloway, wife of the founder, Richard L. Soloway. She has been serving as a director since 2001.
- CEO compensation: Over the last decade, the CEO's compensation has increased approximately 100%, from $0.62 million in 2011 to $1.2 million in 2021.

3. Recurring revenue

- The company generates revenue from two sources - (a) selling the products by installing its cellular communication devices in the customer's premises and (b) monthly subscription fees for services to monitor security breaches and fire alarms.
- 30% revenue: In FY 2021, the 30% of its revenue was recurring in nature, i.e., through monthly subscriptions.
- High margin business: The subscription business generates roughly 86% gross margin in FY 2021 in comparison to a gross margin of 26% from the sale of security devices.
- Subscription revenue increased from $7.9 million in FY 2017 to $33.9 million in FY 2021. In Q1 FY2022, recurring revenue for the quarter increased 41% to $10.2 million as compared to $7.3 million for the same period last year.
- Recurring service revenue now has a prospective annual run rate of $42.6 million based on October 2021 recurring revenues.
- Goal: The Company's long-term goal is to generate recurring revenues of at least 50% of total revenue.

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4. Financial performance

- The company's revenue increased from $71 million in FY 2012 to $122 million in LTM Sep 2021. During the same period, the company's net income increased consistently from $2.3 million to $20.3 million.
- Strong free cash flow: In the last decade, the company generated positive free cash flow and a record free cash flow of $22 million in FY 2021.

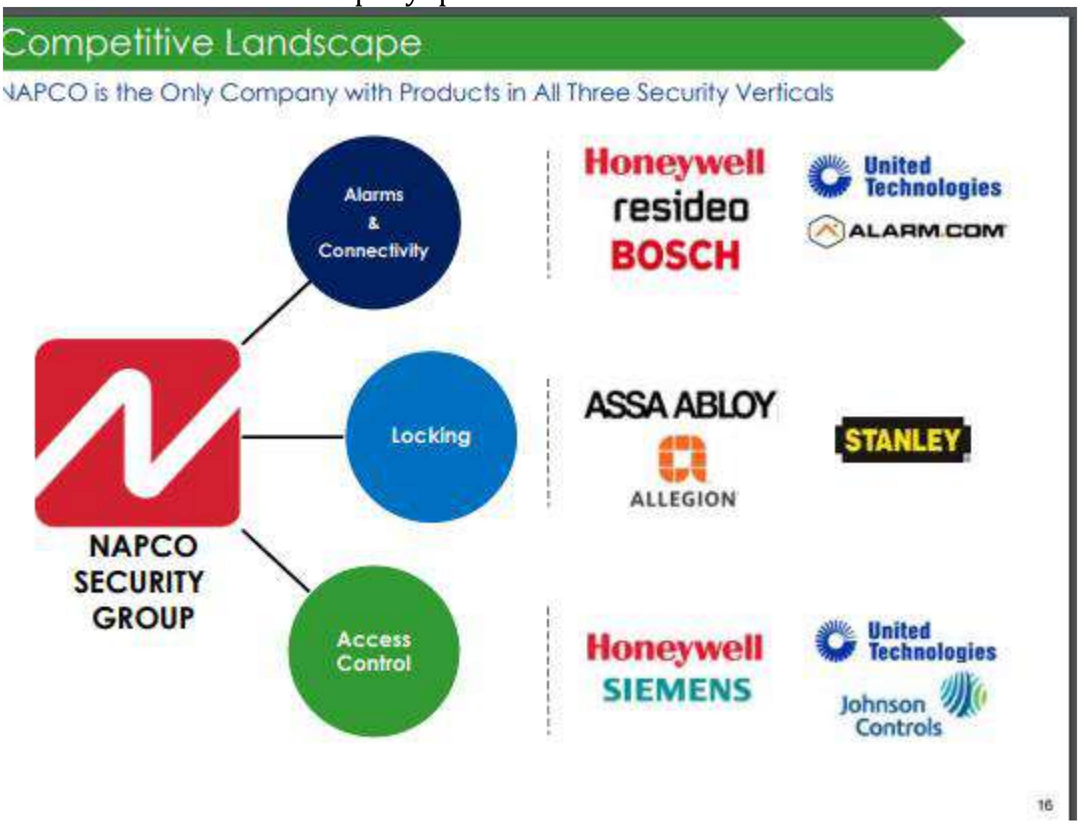
5. New product - Air Access – $1 billion market opportunity

Major Product Lines revenue ($ in millions)	FY 2019	FY 2020	FY 2021
Intrusion and access alarm products	31.5	31.3	36.7
Door locking devices	53.9	46.0	43.3
Services	17.4	24.0	33.9
Total revenue	102.9	101.3	113.9

- As of now, the company generates one-time sales from the locking and access control business –Door locking devices generated roughly 38% of total revenue. The company plans to generate recurring revenue for the service through its Air Access product.
- The benefits of Air Access include no need for upfront investment, expensive hardware or interference with the customer's IP networks.
- The CEO claims that Air Access is the industry's first cellular access control system, with a $1 billion market opportunity.

6. Others

- One among the top 12 companies - The Company's primary competitors are comprised of approximately 12 other companies that manufacture and market security equipment.
- Intellectual Property: The Company has approximately two dozen patents, proprietary software, and copyrights.
- Cost-effective manufacturing facility – The Company manufactures over 90% of its products in the Dominican Republic and is located in a free zone, which is a tax-advantaged location.



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iQSTEL (IQST): Plenty of concerns

- Market Cap: $95 million | iQSTEL, Inc. is a technology company offering a wide array of services to global telecommunications and technology industries with a presence in 13 countries.
- Major shareholders: Randy Brown – 2.0%
- Screen: Owner-operator

RESEARCH

1. Even though revenue grew from $1.5 million in FY 2015 to $62 million in LTM September 2021, the company earns a wafer-thin gross margin of 2.5%. In the LTM September 2021, the company generated $1.6 million in gross profit out of $62 million in revenue.

2. We are concerned that the management team is chasing too many high-tech businesses - EV, Blockchain, Fintech, IoT, Telecom. For example, EV motorcycle. In January 2022, the company announced that the first batch of EV motorcycles had rolled off the production line.

3) Loans are forgiven! Severance package for the director!!

- In March 2020, Oscar Brito resigned as director.
  - Forgiveness of amounts due to the company totaling $43,375.
  - Severance package: The company gave 2 million shares valued at $0.3 million and a cash payment of $15,000.
  - The company appointed Mr. Brito as an advisor to the board of directors and agreed to pay him $5,000 per month for such services.
- CEO: During the nine months ended September 30, 2021, the company loaned $180,000 to the CEO and wrote off amounts totaling $8,004. When a company itself is cash-strapped, why loan $180K to the CEO?

Dues from related parties

- During the nine months ended September 30, 2021, the company loaned $35,674 to a related party, who is a shareholder and a former director, and collected $226.
- As of September 30, 2021, the company had dues from related parties of $421,586.

Overall-

Even though insiders control 51% of voting rights, insiders own roughly 1.4% of Class A shares. As such, the insider's interest is not aligned with the common shareholder.

Overall, this company doesn't qualify to be included in our "watch list."

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Radware (RDWR): Strong product; recurring revenue; owner-operator; potential sale?

- Market Cap: $1.5 billion | Radware is a leading provider of cyber security and application delivery solutions.
- Major shareholders: ARTISAN PARTNERS LIMITED - 8.9%| SENVEST MANAGEMENT - 7.7%| LEGAL & GENERAL GROUP -5.7%| RENAISSANCE TECHNOLOGIES - 4.2%| ACADIAN ASSET MANAGEMENT -3.8%
- Screen: Business

I. BASICS

The company is a provider of cyber security and application delivery solutions. The company's arrangements typically contain various combinations of products and subscriptions and post-contract customer support (PCS),

- Products (53% of revenue) – Offers a range of physical, software-based products, product subscriptions, and cloud-based subscriptions.
- Customer Services (47% of revenue) - Offers technical support, professional services, managed services, and training and certification to customers.

II. WHAT WE LIKE

1. Signs of moat - Strong product, ranking from research firms, and recurring revenue

- Recognized as a leader:
  - Gartner recognizes the company in the Gartner Critical Capabilities for Cloud Web Application and API Protection. It is ranked #2 for API security and for the high-security use case.
  - "Technology Leader" in Quadrant Knowledge Solutions - 2020 Bot Management SPARK Matrix (December 2020). If you look at the chart on page 5, you will notice that there are only ten competitors shortlisted, and only five are named as "leaders" – one of the leaders is Radware. https://www.radwarebotmanager.com/web/wp-content/uploads/Knowledge-Brief_Radware_Bot-Management_2020_Quadrant-Knowledge-Solutions.pdf.
  - Forrester research - The Forrester Wave™: Web Application Firewalls - Strong Performer, February 2020.
  - Kuppinger-Cole Analysts - Market Compass for Web Application Firewalls - Radware Kubernetes WAF is featured for Innovation. February 2020
- A recent example of a business win: The largest rental company in the US (a Fortune 500 company) received a ransomware letter, followed immediately by a DDoS attack that exceeded their internet capacity and brought them down. The company's partner Cisco reached out to the company, and the company's tech team mitigated the attack. Following the success, the customer chose Radware hybrid cloud DDoS protection.
- It is clear that the company has a strong product, as evident from solid revenue growth, industry report, and business win.
- Suggested further reading
  - Review: https://www.gartner.com/reviews/market/ddos-mitigation-services/vendor/radware/reviews?marketSeoName=ddos-mitigation-services&vendorSeoName=radware

2. Owner-operator

The company's CEO, chairman, and co-founder collectively own a 13.7% stake.

- Yehuda Zisapel – Chairman/co-founder – 3.61%
- Roy Zisapel – CEO/co-founder – 3.6%
- Nava Zisapel – co-founder – 6.45%

3. Growing financials

- Except for two years, the company's revenue increased from $189 million in 2012 to $280 million in LTM ended September. (2016 revenue declined due to the shift to subscription revenue model; 2020 revenue declined due to the COVID-19 pandemic).
- In Q3 2021, the company had a record revenue of $73 million, 17% year-over-year growth.

4. ARR growth

- ARR is the annualized value of booked orders for term-based cloud services, subscription licenses, and maintenance contracts that are in effect at the end of a reporting period.
- ARR grows at a CAGR of 11%: The company's annual recurring revenue (ARR) has been increasing at a CAGR of 11% since 2019, from $155 million in Q4 2019 to $177 million in Q2 2021.
- In Q3 2021, ARR grew sequentially by $7 million and 9% year-over-year

5. Strong growth in subscription business: Subscription revenue increased from $18 million in 2016 to $65 million in 2020.

6. Excellent free cash flow generation

Year	FCF ($, mm)
2017	24.3
2018	40.4
2019	44.7
2020	55.2
LTM Sep 2021	55

7. Strong cash balance of $456 million

8. Outlook

- The company expects Q4 total revenue to be in the range of $74 million to $76 million, and full-year 2021 total revenue to be in the range of $284 million to $286 million.

9. Potential sale?

- In September 2021, CNBC reported that the company is in talks with Siris Capital, a private equity firm.
- https://www.cnbc.com/2021/09/13/siris-capital-in-talks-to-acquire-cybersecurity-firm-radware-sources.html

10. What is driving the future growth rate?

- The consistent drive in the number of cyber-attacks is fueling the demand for the company's product. Moreover, cyber-attacks are at record levels and are becoming larger and more complex.
- During the recent third quarter, the company blocked thirty percent more DDoS attacks, twice as many web application attacks and three times more bad bot requests compared to the same period last year.

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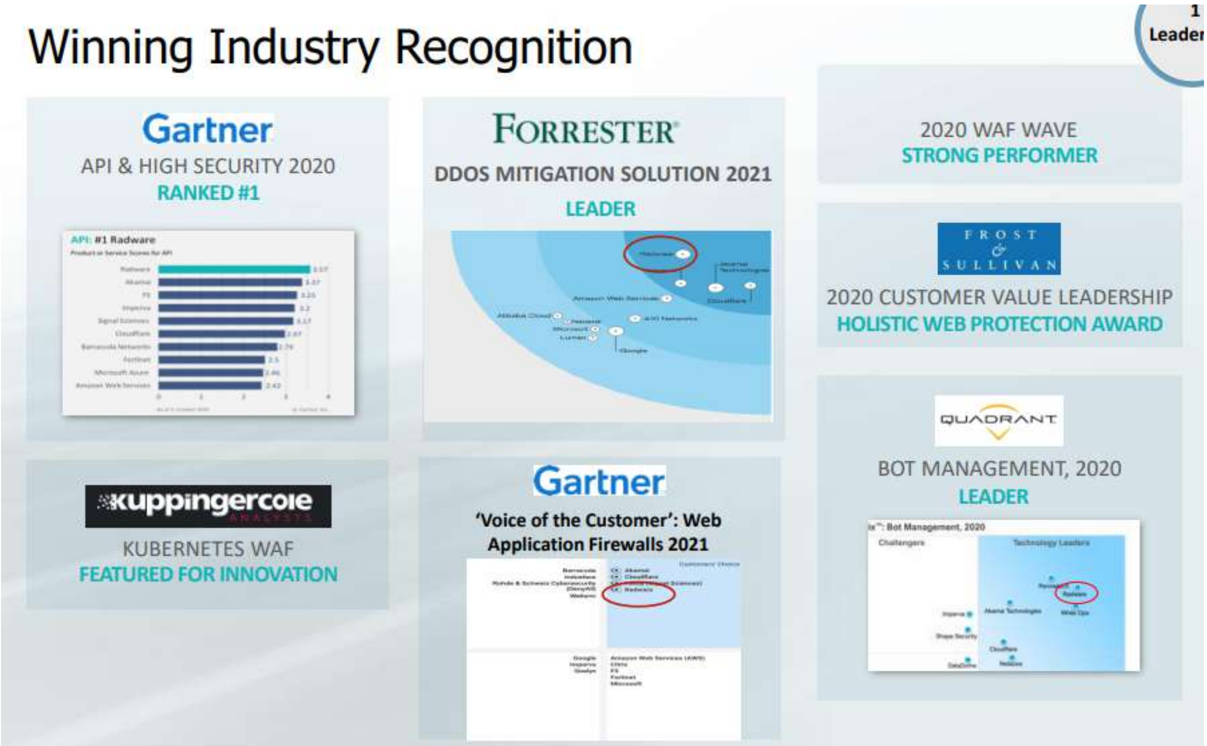

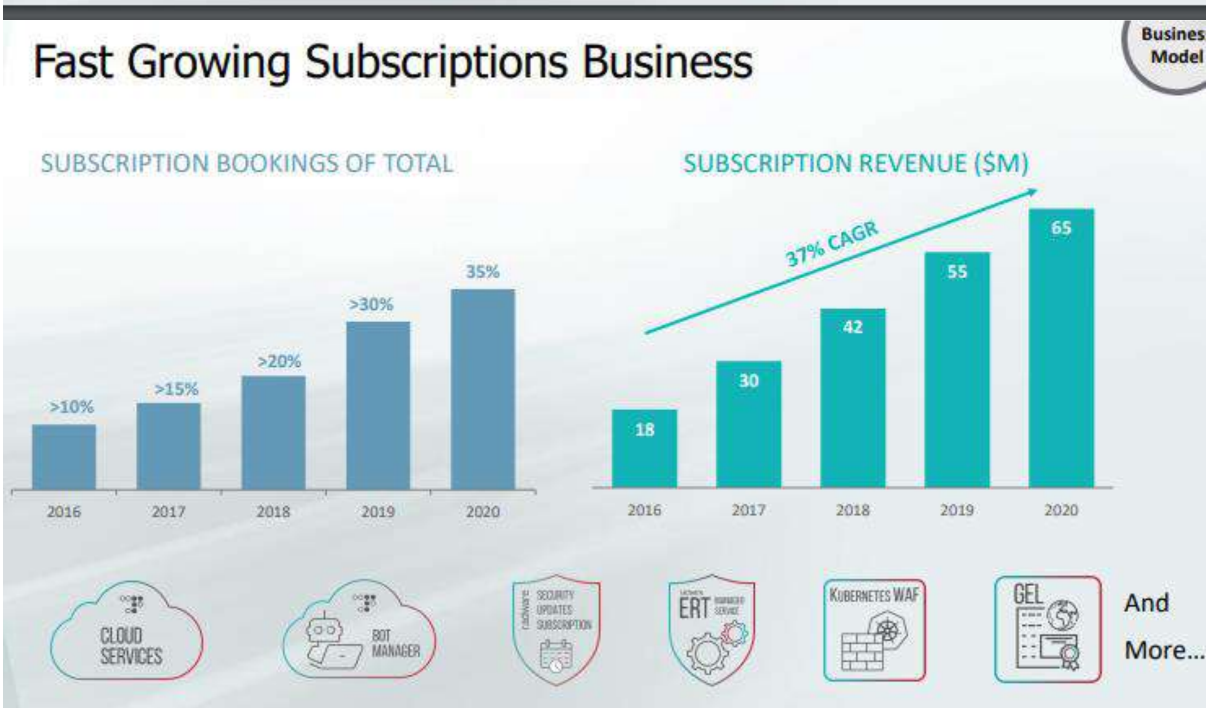

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Rocky Brands (RCKY): Significant improvement after 2017 management shakeup; Merion Capital thinks the company's stock price could double from the current price

- Market Cap: $312 million | Rocky Brands, Inc. is a leading designer, manufacturer, and marketer of premium quality footwear and apparel marketed under a portfolio of well-recognized brand names.
- Major shareholders: DIMENSIONAL FUND ADVISORS - 8.1%| BLACKROCK - 6.5%| FMR LLC - 5.3%| VANGUARD GROUP - 4.5%| RAYMOND JAMES & ASSOCIATES - 4.1%
- Screen: Fund letters/commentary

I. BASIC

The Company designs, manufactures, and markets premium quality footwear and apparel.

- The company's footwear products are positioned across a range of suggested retail price points from $44.00 (value-priced products) to $345.00 (premium products).

II. WHAT WE LIKE:

1. Excellent collection of brands

- The company's footwear brands are easily recognized in the market - Rocky, Georgia Boot, Durango, Lehigh, and Michelin brands.
- Some of the company's brands are very old: Lehigh brand (1922), Rocky (1932), Georgia Boot (1937).
- Moreover, the recent acquisition brought well recognized and established names like Muck, XTRATUF, Servus, NEOS, and Ranger Brands.

2. Significant changes after the appointment of new CEO

New CEO

- In 2017, the company promoted Jason Brooks as CEO when the company experienced declining sales and profitability.
- He joined the company in 1997 as an independent sales representative. Over the last two decades, he rose through the ranks and was promoted as President-Core brands in 2016 and was appointed as CEO in May 2017.

Significant changes after the appointment of new CEO

- Major management shakeup: Four out of five top executives were appointed in 2017 and 2018.
  - May 2017: CEO (interim CEO in Sep 2016)
  - March 2017: CFO
  - June 2017: President - Core operations
  - March 2018: President-Operations
- Digital marketing:
  - After the appointment of Brooks as CEO, he shifted his focus to drive higher traffic to the company's websites by shifting more marketing investments to online campaigns.
  - He launched several targeted digital marketing programs and personalized communications.
- Expansion with Amazon & Fulfilled Prime status: In 2019, the company expanded its direct-to-consumer efforts on marketplaces, such as Amazon and eBay, and gained "Seller Fulfilled Prime" status, which allowed the company to make its entire catalog "Prime Eligible."
- Field sales team: In 2019, the company realigned its field sales by allotting one rep per account to provide

better service to its retail partners and to increase cross-selling opportunities.

- <u>Big-ticket acquisition</u>
  - In March 2021, the company acquired the performance and lifestyle footwear business of Honeywell for $230 million.
  - In 2020, the acquired business had net revenue of $205 million and EBITDA of approximately $24.5 million.
- **<u>Improved financial performance</u>**

  <u>Strong revenue growth</u>
  - The company's total revenue increased from $253 million in FY 2017 to $432 million in LTM September 2021.
  - The increased revenue is due to the introduction of new products, organic sales and the Honeywell acquisition.
  - Recent quarterly growth: In Q3 2021, the company's net sales increased 61.4% to $125.5 million compared with $77.8 million in the third quarter of 2020.

  <u>Significant improvement in gross margin</u>:
  - Prior to the appointment of Brooks as CEO, the company's gross margin consistently declined from 35.2% in FY 2012 to 29.5% in FY 2016. Subsequently, the company's gross margin steadily increased to 39.2% in LTM September 2021.
  - The improved gross margin is due to several steps taken by the management team: improvement in manufacturing efficiency by automating cutting machines in Puerto Rico, divestment of Creative Rec brand in 2017, increase in direct to consumer sales that carry a higher margin, a higher-margin in newly launched products and less discounting.

3. Others

- <u>Shares repurchase</u>: In March 2021, the company announced a $7.5 million share repurchase program that will terminate on March 4, 2022.
- <u>Supply chain advantage:</u> Compared to some of its peers, the company's supply chain is quicker and more efficient due to nearshore sourcing with the Dominican and Puerto Rico manufacturing facility.

4. Merion Road Capital

<u>Background</u>
- Aaron Sallen is the founder of Merion Road Capital.
- Before founding MRCM, Aaron worked at Napier Park Global Capital, a multi-billion dollar hedge fund, where he was responsible for identifying, analyzing, and monitoring public equity investments using a value-oriented, special situations mandate. Prior to Napier, Aaron worked in a principal investing and private equity role at Macquarie Capital.

<u>Insight</u>
- Merion Road Capital first disclosed its position in Rocky Brands in 2017, the fund's first inaugural letter.
- In the latest Q3 2021 letter, Aaron explained his belief that the stock could double the current price.
- Here is his recent thesis-

> I've become increasingly more positive on our largest position, Rocky Brands ("RCKY"). As a reminder, RCKY recently doubled the company with their acquisition of Honeywell's outdoor boots business. From a big picture, it would make sense for there to be room for operating improvement as Honeywell, a $150bn conglomerate generating $35bn in annual sales, sold off non-core operations generating just $200mm in revenue. Digging in,

while the acquisition has strong consumer brands, it appears that their former owners left a lot on the table

RCKY is in the process of bringing the new business units over onto their ERP which is specifically designed for footwear – previously, the Honeywell brands would have to manually enter product specific information such as sizes and width. Furthermore, the prior owner did not provide the brands with software to predict demand, which meant that they were left to make manual forecasts by SKU. As you can imagine, this was operationally inefficient and most likely resulted in less accurate results. Along a similar vein, the prior owner ran inventory too lean, which left the brands unable to meet retail demand in a timely manner. E-commerce, the clear future of retail, was almost an afterthought. Operations were outsourced and designated "online" inventory was physically separated from inventory to be shipped to bricks and mortar. What this meant was that an online good could appear as sold out, even if there was plenty of stock on the other side of the warehouse. These anecdotes indicate that improved blocking and tackling should lead to both margin improvement and sales acceleration.

While not core to the thesis, management believes that they have a tremendous opportunity to build out the XTRATUF brand that came over with the acquisition. XTRATUF is a waterproof shoe brand that dates its origins to the Alaskan fishing industry. Even though consumers may not demand the performance characteristics of such a technical shoe, they do want authenticity. And XTRATUF screams authenticity. RCKY management has been pleasantly surprised to see just how much demand there is for this line. In fact, they have been refusing to open new accounts to protect the brand and manage supply. A quick search for top men's rain boots of 2021 yields the following results:

- GQ: XTRATUF Legacy Chelsea Boot
- NY Times: XTRATUF Ankle Deck Boot
- NYMag: Timberland White Ledge Mid Waterproof Ankle Boot
- Business Insider: XTRATUF Rubber Deck Boot

A search of ecommerce sites yields similar results. XTRATUF has strong ratings and is consistently sought out by consumers. While all of this bodes well for the core business, it does pose the question of how else to capitalize on this opportunity. Right now the company does very little outside of shoes and I would not be surprised to see them start testing the waters in ancillary products. In any case the company is trading at about 7x EBITDA and 9x FCF once integration is complete. At 9x EBITDA (which accounts for the higher quality "distribution" business hidden within their retail segment), the company would be worth about $70. If you are willing to look out a few years, I think there should be a pretty clear path to over $100, or roughly a double from current prices.

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John Barr's (Needham Funds) thoughts on semiconductor industry – A must read

- Screen: Fund letters/commentary

1. Notes

John Barr thinks the semiconductor industry has moved beyond a cyclical, PC-driven industry to one of strategic importance. An excellent & must read.

Source: https://www.sec.gov/Archives/edgar/data/1002537/000089853121000415/nf-ncsrs.htm

John Barr: Portfolio Manager, Needham Growth Fund & Needham Aggressive Growth Fund

More about John Barr:

https://www.needhamfunds.com/wp-content/uploads/2022/01/Meet-the-Manager-John-Barr-Needham-Funds-12.31.21-1.pdf

2. Content

2020 brought an unprecedented economic shutdown. The pandemic accelerated trends that we have been focused on for a long time; we call this the Great Digital and Life Sciences Acceleration.

I would like to zero in on the opportunities in semiconductor manufacturing. I've long felt the semiconductor industry has moved beyond a cyclical, PC-driven industry to one of strategic importance. The confluence of manufacturing semiconductors for automotive, data center, machine learning, and remote work electronic systems; remaking the supply chain, and securing supplies for geopolitical needs have created a positive scenario for semiconductor manufacturing technology companies.

What does the Opportunity in Semiconductor Manufacturing Mean for Needham Funds? Growth in advanced semiconductor manufacturing has been a dominant investment theme for Needham Funds for over 10 years. We have more dollars invested in semiconductor and semiconductor capital equipment companies than any other theme in our portfolios. We believe that our deep sector expertise, long-term positioning, and patience will result in wealth creation for our long-term investors, and we are excited about the future.

The Current Semiconductor Shortage

In March 2021, CNBC reported, "Ford is significantly cutting production at six plants in North America due to an ongoing global shortage of semiconductor chips. The actions vary by plant but range from overtime shift cancellations to facilities being closed for up to three weeks from April through June. The same is true at automakers around the world."

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What Types of Semiconductors Are In Short Supply?

Many types of semiconductors are experiencing a shortage, including microcontrollers, power chips, and even capacitors. Parts that are in short supply are manufactured on both advanced and older semiconductor manufacturing processes. Automotive and artificial intelligence/machine learning (AI/ML) are two areas that are short of supply. NVIDIA Corporation (NVDA) and Advanced Micro Devices, Inc. (AMD) are two of the leading suppliers of these parts and they manufacture at Taiwan Semiconductor Manufacturing Co., Ltd.

Adding capacity requires adding equipment and some of our equipment companies are sold out for quarters.

Why Did It Happen?

The auto industry has run on just-in-time manufacturing for decades. In February 2020, automakers started to cut back their semiconductor orders as the pandemic spread. When automakers cut back orders, that capacity was absorbed by remote work demand, which has not abated.

It was not until January 2021 that Ford (F) made its first disclosure of semiconductor shortages and talked of losing 10-20% of production. By then it was too late. Ford has recently said full recovery may extend into 2022.

Then came famine, pestilence, and fire. There was the general supply chain disruption from the COVID-19 pandemic, the February freeze in Texas that shut down manufacturing plants, a March fire at Renasas Electronics, a large Japanese chipmaker, and the Suez Canal shut down. All of these events disrupted semiconductor production and supply chains.

The End of Just-In-Time Inventory

In April, Taiwan Semiconductor Manufacturing (NYSE: TSM; the company name is abbreviated as TSMC) said it sees a "different approach to inventory management." "We don't think it's going to revert back." Ford said, "this will not happen again." The CEO of On Semiconductor (ON) said, "the JIT era is not sustainable."

The end of JIT likely means more semiconductor inventory and better terms for semiconductor makers. It means there's a need for better analytics to understand the supply chain.

Long-Term Growth Drivers In Semiconductor Manufacturing

Today, automotive semiconductors are used for advanced driver assistance systems (ADAS) applications, including blind-spot detection, automatic braking, 360-degree radar, and front and rear cameras. Future applications include infotainment (i.e. a Tesla dashboard display), electrical/ hybrid powertrains, and battery management.

Safety is paramount in the auto industry. Semiconductors going into cars cannot fail. Mobile phones are more tolerant of semiconductor failures as they are not putting users into life or death situations. Higher reliability requires advanced manufacturing process control, test, and inspection, which requires more spending on equipment.

Electric vehicles (EVs) are coming fast and bring a step-change in semiconductor content. General Motors (GM) expects to have 35 new EV models by 2025. Ford recently announced the exciting F150 Lightning EV EVs use over $1,200 of semiconductors per car, compared to $300 today. Level 3 autonomous cars will use over $2,000 and fully self-driving cars will use even more.

Industry Investment In Manufacturing Capacity

How is the semiconductor manufacturing industry responding to the shortages and increased demand? TSMC has a near-monopoly on leading-edge manufacturing for fabless chip companies like Apple, NVIDIA, Broadcom, Inc. (AVGO), and Advanced Micro Devices, Inc. (AMD). Leading-edge technology is important because it allows semiconductors to do more and use less power. TSMC recently announced a $100 billion, 3-year capital expenditure plan. This is an unprecedented length and amount of spending. The company expects 10-15% annual revenue growth. I believe this spending level may lead to over 20% annual growth. TSMC is a holding of the Needham Aggressive Growth Fund and the Needham Growth Fund.
Samsung Electronic Co., Ltd. (005930-KR) is TSMC's only close competitor in technology, but they are geared to manufacture for internal customers. There is talk of a new $10 billion Samsung plant in Texas.

Over the last 3-4 years, Intel Corporation (INTC) has fallen well behind TSMC, which means the US lacks leading-edge semiconductor manufacturing. At the beginning of 2021, industry observers wondered whether Intel should give up on advanced manufacturing. In February 2021, Intel announced the return of Pat Gelsinger as CEO. In March, Gelsinger announced an aggressive plan committing Intel to manufacturing. It includes $20 billion of capital expenditures in 2021 versus just $14 billion 2 years ago, and a $20 billion plan to build two new semiconductor fabrication plants in Arizona to serve fabless customers. However, TSMC is not just ahead on the technology but also knows how to develop the software and systems to support external customers.

Geopolitics Of Semiconductor Manufacturing

What do you think about almost all of the world's leading-edge semiconductors being manufactured on an island 100 miles off the shore of China? And that island is claimed by China; recently China has sent military aircraft over Taiwan and it has rattled the markets. I believe that the status quo in Taiwan will last for a long time, while Taiwan gradually moves into China's orbit.

With the pandemic, US businesses recognize that they need more resilient and closer supply chains. Politicians recognize that the United States should not be dependent on Taiwan. There is bipartisan support for a proposed $50 billion bill for US semiconductor manufacturing.

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In the fall of 2020, TSMC announced a 20,000 wafers per month facility in Arizona and bought 1,100 acres of land. Newly public SkyWater Technology, Inc. (SKYT) recently opened the first new semiconductor fab on US soil in 20 years. They have a special radiation-hardened process required for the aerospace industry.

Sovereign Buyers

While those industry investments are important, governments are recognizing the importance of having domestic manufacturing. There is bipartisan support in the US for the $50 billion CHIPS Act to invest in semiconductor manufacturing and research. China is way behind in semiconductor manufacturing and with the US banning sales to Huawei and other Chinese companies, they had a wake-up call. China has an ambitious plan to become self-sufficient in semiconductors by 2030.

Then there's Europe, which 30 years ago, produced 44% of the world's semiconductors. It is down to 10%, and the European Commission wants to double that.

There's also India, which completely lacks semiconductor manufacturing. As an emerging economic power, we believe it needs domestic manufacturing to go along with its nascent design companies.

Conclusion – The Opportunity We See In Semiconductor Manufacturing

Growth in advanced semiconductor manufacturing has been a dominant investment theme for Needham Funds for over 10 years. We have more dollars invested in semiconductor and semiconductor capital equipment companies than any other theme in our portfolios.