November 19, 2021

Dear Investor:

I hope this letter finds you well. Choice Equities Fund generated losses of -2.5% on a net basis in the quarter, bringing year-to-date gains to +33.8%. This compares to the Russell 2000's -4.4% loss in the quarter and +12.4% year-to-date return. The S&P 500 produced gains of +0.6% for the quarter and +15.9% for the year. Since inception in January 2017, our portfolio has generated net annualized returns of +28.9% versus +12.2% and +16.9% for the Russell 2000 and S&P 500, respectively.

EXECUTIVE SUMMARY

In this letter, we discuss the major drivers of performance for the quarter. This primarily includes a discussion of Farmer Brothers, Co. (FARM). We provide a brief update on existing portfolio holding Identiv, Inc. (INVE) and highlight new position GMS, Inc. (GMS). Finally, we provide a few thoughts on the outlook.

QUARTERLY COMMENTARY

At a headline level, markets were again fairly subdued in 3Q. However, much as described last quarter, the push and pull of an economy reopening in fits and starts led to another series of rotations under the surface. In generalized terms, small caps, value stocks and reopening plays mostly cycled out of favor, while resurgent reopening fears and moderate risk-off sentiment nudged market participants to again rotate back into their favored large tech leaders.

Against this backdrop, our 3Q performance was modestly negative. A few stocks were up meaningfully, while a few were down meaningfully. Farmer Bothers, currently our only microcap holding, was our worst performing position and was also the largest detractor of performance, deducting ~-3% from our returns for the quarter.

POSITION COMMENTARY

FARM – As noted above, shares of coffee roaster and distributor Farmer Brothers traded off nearly all quarter, at one point declining nearly more than 40% over the last few months. Clearly, this wasn't quite the start I envisioned when initiating this investment, as the level of originally anticipated improvement in company financials did not arrive on time this summer because many of their customers' doors remained shut due to the Covid-19 resurgence from the delta variant.

Despite the decline, I continue to focus on progress to date and the outlook. When I do, I find comfort in this fact: a few years ago, when the economy was open and people had coffee together, this was a $30+ stock – albeit then, the company had a lesser management team and its roasting operations relied upon a vastly inferior and inefficient, old plant. Admittedly, perhaps that statement is a bit backward looking. So, looking forward, the more relevant question becomes: can this company again achieve the level of cash flows that support such a valuation?

Progress to date suggests such performance remains achievable, if not likely. The company recently concluded the "fix" phase of management's "fix, optimize, grow" strategy. Progress is showing up in the financials, even though sales remain quite depressed from pre-Covid levels. As a case in point, in the prior quarter even with volumes still down some 25 percent from pre-Covid levels, the company has already returned to prior pre-Covid gross margins. The 85-year-old Houston plant, costly and inefficient, has been exited and sold. And the multiyear migration to the new Northlake Dallas plant, a facility which cost over $100M and is regarded as among the top roasting facilities in the US, has been successfully completed. Equally promisingly, the company is now seeing green shoots on volumes, with management reporting many days in the current quarter have been the best since the onset of the pandemic thus far.

Other initiatives such as expanding the product line by adding NuZee and High Brew and reinvigorating the company's own product innovations are also starting to bear fruit. The Coffee Brewing Equipment arm now called Revive, looks to be another smart way the company can deepen relationships with customers by providing expedient service for coffee brewing equipment. At this point, the company simply needs customer doors to open and stay open. Then the "optimize and grow" phases of their plan can unfold as originally anticipated.

INVE –Recent reports and field research each suggest Identiv is well-positioned to become a much a larger company. CEO Steve Humphries is having success building out the team. In the past quarter, he successfully lured Amir Khoshniyati away from SmarTrac at Avery Dennison to become VP of Business Development, who himself has since successfully convinced several of his former colleagues to help him expand the sales efforts alongside him at Identiv. The burgeoning sales team has been busy and productive, enabling further additions to the company's backlog, which was up 51% on a year-over-year basis in the quarter. And the pipeline of new business and potential new use cases is expanding rapidly. The elephant-sized, billion-plus unit opportunities such as the deployment of chips in syringes and cannabis continue to move forward and remain in sight as potential drivers next year. But perhaps more importantly as it relates to the likelihood of success for the market for radio-frequency identification (RFID) chips based on near field communications (NFC) technology, the long tail of new and small-to-medium sized use case opportunities has been the primary driver of unit growth thus far. Signs suggest continued reason for optimism for this small company and their market leading position in potentially massive end markets built around securely connecting physical things to the digital world.

GMS – Investors who have been with us a number of years will likely recognize our recently reinitiated position in GMS, a company we had previously owned and held in high regard. As the largest distributor of wallboard in the US, there is a lot to like. The company has a strong entrepreneurial culture and a proven yet young new management team that has been in place since 2019. GMS enjoys an advantaged industry structure where the top three distributors serve about half the market, positioning them as leaders with a firm grip on the market, but with runway for growth through accretive bolt-on acquisitions. The net result is a well-managed market leader with strong returns on capital and ample reinvestment opportunities.

With those attributes, it's not surprising to see that the company has generally been quite successful since coming public. Since its debut in 2016, GMS has grown earnings at a 25% CAGR. Despite this performance, its shares have underperformed its most relevant building product distributor peers substantially, resulting in valuation compression on both an absolute basis and versus peers. For those interested, I recently discussed the primary causes of this dynamic and elements that may be changing in a presentation for an investor event with BTIG this past month. That presentation was recently posted to our website and can be found here.

One factor at play in the underperformance has likely been wallboard pricing, which has generally been inconsistent over the years. This is primarily because the industry has been operating well below capacity ever since the Global Financial Crisis. But in recent years, demand has closed the gap with supply. And recent consolidation amongst the supplier base suggests the industry is likely to be more disciplined on pricing going forward. So rather than pricing being an unpredictable and potentially negative input on company results, strong and consistent pricing may become a reliable positive contributor going forward.

Additionally, I feel it is worth noting I've come to view company cash flows as being primarily influenced by four factors: wallboard pricing, residential volume growth, commercial volume growth and accretive acquisitions. Unfortunately for the company, it seems it has never had the benefit of having all four engines firing at the same time since going public. Until perhaps now. Trading at a double-digit free cash flow yield and just a single digit multiple of current year earnings, the company looks to have an intriguing opportunity to close the gap in shareholder performance with its peers in the years to come.

2021 OUTLOOK

Regarding the market at large, current conditions seem to offer something for everybody. On one hand, we have pockets of wildness in trading. There are soaring IPOs, meme stonks that continue to attract headlines and a number of electric vehicle companies currently making no vehicles with valuations that imply profit bonanzas. Yet, on the other hand, quality companies at reasonable and even cheap valuations seem plentiful. Many, like GMS, have strong outlooks and trade at single digit earnings' multiples.

Against this backdrop, our charge remains the same. We selectively focus on a few names where we can make reasonable judgements about their investment prospects while we attempt to tolerate and capitalize on volatility. On that score, we continue to find compelling pockets of value, and we continue to make efforts to position the portfolio with attractive risk and return characteristics.

CONCLUSION

As a reminder, we recently relocated our offices to a new building with a little more space, although we are still quite happily located here in Raleigh, NC. If you find yourself in the neighborhood, please come by and see us. We would welcome the opportunity to get together.

In closing, while I know our approach will not yield outperformance each and every quarter, I continue to believe it will be well worth our while over the long haul. Perhaps more importantly, given the overwhelming majority of our investable assets are invested alongside yours, we would never ask investors to assume risks we ourselves will not.

Thank you for your continued support as we work to grow our capital together. As always, we are happy to discuss our investment outlook with you at your convenience. Please reach out any time.

Best regards,

Mitchell Scott, CFA
Portfolio Manager

1. All market and company data is sourced from Factset and company filings and is current as of 9/30/21.
2. CEF uses the S&P 500, Russell 2000 and the Barclays Hedged Long/Short indices as its primary benchmarks. The S&P 500 and Russell 2000 are common large and small cap US equities-based indices. The Barclays Hedged Long/Short index (an index of equities-based hedge funds) serves as an appropriate benchmark over the long-term given the index has a similar long-term goal of capital appreciation through equities investing.
3. CEF Net Returns are consistent with the 1% management fee and 18% performance fee offered to clients.

APPENDIX 1

CEF GOALS, PHILOSOPHY, APPROACH AND ALIGNMENT

GOALS – We seek to generate market-beating returns over any rolling multiyear investment horizon while minimizing the risk of permanent impairment of capital. Additionally, we seek to communicate with our investors in a transparent and straightforward manner and ask only that they accept investment risks that we ourselves are willing to take. *Given the majority of our investable capital is invested alongside theirs, we invest our limited partners' capital as if it were our own, because it is.*

PHILOSOPHY - We approach investing in public equities as an opportunistic businessman would. We spend most of our time studying businesses and building circles of competence in areas likely to offer attractive investment prospects and invest in only our most compelling opportunities. We view risk primarily as the likelihood of a permanent impairment of capital and pursue a carefully balanced willingness to trade some short-term portfolio fluctuations for the opportunity to earn higher returns over the long-term. We focus on growing, understandable businesses and seek to buy them at a substantial discount to our estimate of their intrinsic value. When we find them trading at attractive prices, we often act in size and weight our best ideas accordingly. And all things being equal, we prefer to devote more of our efforts to small stocks where we believe greater price/informational inefficiencies can often be found.

APPROACH – We invest via a long-bias hedge fund structure and concentrate our long investments in our best 10 to 15 ideas. Our work begins with a two or three-year outlook, and we only pursue investments we believe are likely to offer us a reasonable chance to generate an annualized return of 20% or better. While we pursue long-term oriented investments and seek to compound capital in a tax efficient manner, we readily acknowledge the often-turbulent markets do not always fit neatly into this framework and know some trading activity is sure to follow as a result. In the short book, we seek to generate absolute profits in a few stocks where we have uncovered a company entering financial duress or an excessively optimistic valuation where we feel their earnings outlook is likely to worsen materially. We will also use industry or market specific ETFs to mitigate market risk and will look to employ options and other opportunistic hedges when conditions appear favorable.

ALIGNMENT – We believe appropriate alignment of interests is the bedrock upon which all successful partnerships are built. Our primary means of ensuring proper incentive alignment is through significant co-investment of our personal wealth alongside our limited partners. Secondarily, we offer an investor friendly fee structure. We charge a modest management fee to support investment operations and charge an annual incentive fee on new profits only. Finally, commensurate with our fee structure which is intentionally structured such that the majority of fund earnings will be earned only if we generate compelling investment results, we commit to operating the fund as a boutique shop with a limited asset size. As many of our best investments often come from small stocks, we believe it is important to preserve our ability to take concentrated positions in our best ideas. Our size and structure ensure we are incentivized to generate compelling returns, not gather assets.

Think of it this way. *On the one hand, we are incentivized to generate the best investment results possible. On the other hand, we are unwilling to invest in a way we feel is likely to result in a meaningful loss of our own investment capital. What more could one want from an investment manager?*