April 18, 2022

Dear Investors,

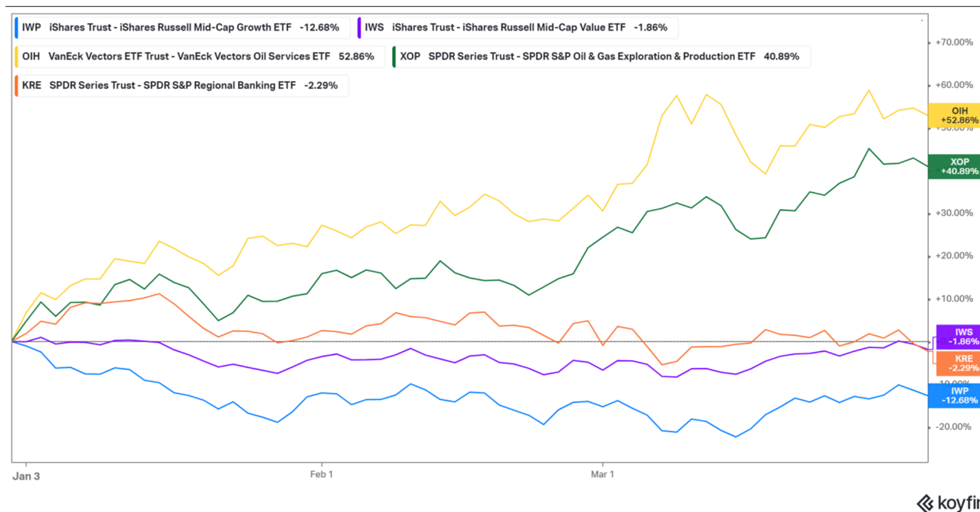
The Headwaters Capital portfolio declined -10.9% compared to a -5.7% decline for the Russell Mid Cap index in Q1 2022. A brief discussion of the stocks that impacted performance is included below, along with an overview of the trading activity during the quarter.

	Q1 '22	YTD '22	Since Inception (1/4/2021)
Headwaters Capital (Gross)	-10.9%	-10.9%	5.0%
Headwaters Capital (Net)	-11.1%	-11.1%	4.0%
Russell Mid Cap Index	-5.7%	-5.7%	15.6%

**Performance for the Headwaters Capital portfolio has been calculated by Liccar Fund Services for the period presented above.*
***Individual SMA performance may differ from the results* [1]

Q1 '22 Performance Review

It was hard to not cut and paste the write-up from the first quarter of 2021, but Q1 '22 was impacted by many of the same trends that played out last year. The quarter can best be summarized as a highly correlated macro trade where commodity and inflation beneficiaries performed well given higher commodity prices and interest rates benefit earnings for these companies, whereas most other companies underperformed given that those same factors serve as headwinds to both earnings and multiples. As with Q1 '21, it was the magnitude of the increase in both commodities and interest rates over such a short duration that created the correlation in performance across sectors. Graphs once again help to show the stark divergence in performance underneath the index, where the Russell Mid Cap Value declined by -1.9% during the quarter whereas the Russell Mid Cap Growth declined by -12.7%. Oil and gas, which carries a bigger weight in the value index, once again led the market higher during the quarter as Russia's invasion of Ukraine led to a +43% rise in oil prices during the quarter and + 62% rise in natural gas prices.



[1] The composite performance ("portfolio" or "strategy") is calculated using the return of a representative portfolio invested in accordance with Headwaters Capital's fully discretionary accounts under management opened and funded prior to January 1, 2021. The performance data was calculated on a total return basis, including reinvestments of dividends and interest, accrued income, and realized and unrealized gains or losses. The returns also reflect a deduction of advisory fees, commissions charged on transactions, and fees for related services.

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To provide some context around the graph above, energy was a 3.6% weight in the Russell Mid Cap Index at the beginning of the quarter. Assuming the energy sector posted a +45% gain during the quarter, this implies that the average return for all other companies was an approximately -7.5% decline during the quarter. As further evidence of the correlation between factors during the quarter, 92% of the members in the Russell 2000 saw a decline of at least 10% during the quarter and the average peak to trough decline for these small cap stocks was -28% (Source: Charles Schwab). The only place for investors to hide this quarter was in commodity related businesses.

Following the underperformance of growth names during the quarter, many of the names in the HCM portfolio are now trading at attractive multiples relative to their long-term growth prospects. As evidence that management teams believe their own stocks are trading at attractive values, 10 of the 23 companies in the HCM portfolio implemented/increased a share repurchase program during the quarter or had insiders buying company stock in the open market. Similar to last year, I will continue to focus on finding businesses with sustainable competitive advantages that can consistently grow revenue and earnings regardless of the broader economic environment. This approach served the portfolio well last year as it outperformed the broader index once the highly correlated macro trade in Q1 '21 subsided and, more importantly, will serve the portfolio well over a much longer investment period that will be subject to numerous unknown cycles.

Q1 '22 Portfolio Review:

Top Contributor: Inspire Medical ("INSP") +12%. Inspire Medical sells an implantable neurostimulation device to treat sleep apnea (detailed discussion in Q4 '20 letter). Inspire outperformed during the quarter as the company continues to add new implant centers at a faster pace than management initially expected. Additionally, given that Inspire's devices are an alternative to CPAP treatment, the company is expected to benefit from a recall of Phillips Respironics' CPAP devices, which is driving increased interest in the Inspire device.

Top Detractor: Floor & Decor ("FND") -38%. The sell-off in Floor and Décor was driven by general concerns around slowing consumer discretionary spending as stimulus benefits wane and consumers shift their spend toward services. More specifically, there is also concern that slowing home sales due to higher mortgage rates will negatively impact home remodel spending. I believe a lot of this remodel concern is misplaced given that the US housing stock continues to age and consumers are sitting on record levels of home equity due to recent home price appreciation, which should support continued strong remodel activity. As of FND's analyst day on March 14th, management had not yet seen signs of slowing consumer spending given that the company reiterated guidance for same store sales growth of at least 10% for 2022. FND is currently trading at a 20% discount to its pre-COVID multiple, which represents an attractive valuation for a competitively advantaged specialty retailer with a long runway for new store growth.

Trading Activity

Sells: Cerence ("CRNC"). Cerence was sold during the quarter despite purchasing shares in the company last quarter. Following purchase of a full position in the company in Q4 '21, the company saw a departure of its CEO, CFO, and General Counsel. Additionally, 2024 financial guidance that was issued in August of last year was removed as the previous management team had clearly set unrealistic growth targets. More clarity around why these targets were unachievable was provided during the Q1 earnings call, when management explained that prior revenue growth had a higher level of non-recurring revenue than had previously been disclosed and growth from new end markets was largely unproven. Given wholesale management turnover

and an inability to trust any of the previous financial disclosures, the thesis was clearly broken, which forced a sale of the shares.

Teleflex ("TFX"): The Teleflex position was exited in Q1 largely due to outperformance of the shares relative to the market and more compelling investment opportunities elsewhere. Additionally, sales of the company's Urolift product are trending below my original forecast, which could lead to slower growth for the company going forward.

Q1 '22 was a period of heightened uncertainty and elevated volatility, which presented an opportunity to concentrate capital into the highest conviction ideas in the portfolio where visibility into outcomes and valuation were most certain. The intimate familiarity with these companies and their end markets provided the conviction to add capital while the broader market was declining. While the portfolio seeks to minimize portfolio turnover, broad market sell-offs such as that experienced in Q1 tend to create unique buying and selling opportunities where company specific fundamentals are largely overshadowed by bigger macro trends. As a result, clients likely noticed some trimming and adding to positions that were not discussed above.

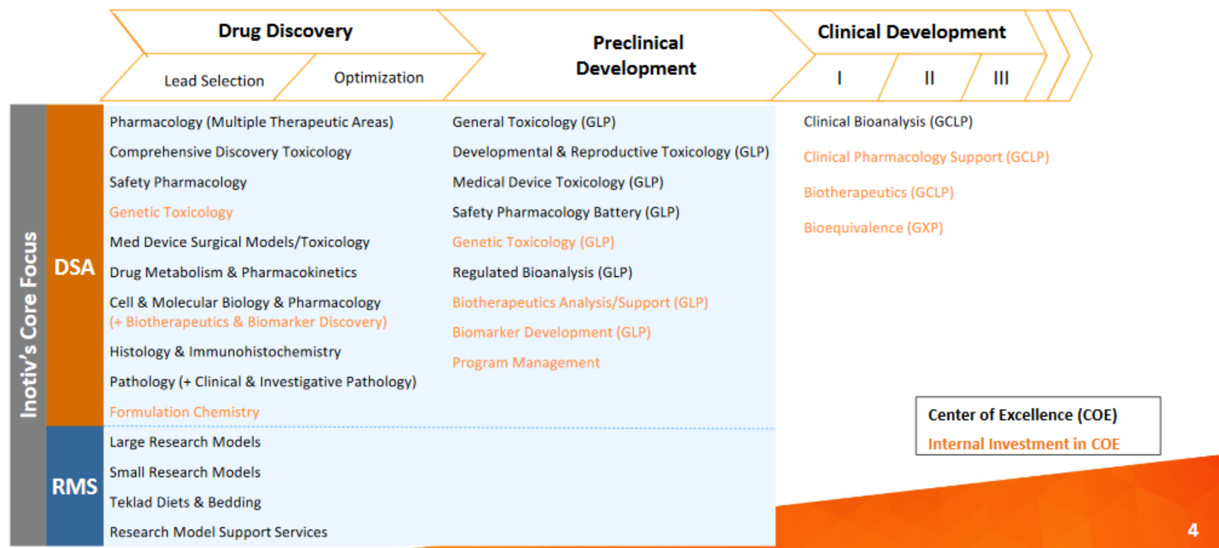
Buys: Inotiv ("NOTV") – See below

<u>Inotiv ("NOTV") – Transformation into a Critical Full-Service Contract Research Organization</u>

Summary Thesis

1) Vertically integrated, full-service provider of non-clinical contract research services to biotech and pharma positions the company well to gain market share in a fragmented industry of single service providers.
2) Dual secular revenue tailwinds from:
    a. Increased role of biotech companies in the drug discovery pipeline.
    b. Increased outsourcing of pre-clinical and clinical CRO services by both biotech and large pharma.
3) Margin expansion from increased scale and improved operational performance at acquired assets.
4) Fragmented industry of smaller competitors operating at low utilization levels provides ample opportunities for highly accretive M&A.
5) Discounted valuation relative to larger peers will narrow as the company demonstrates that it has evolved into a more critical partner for both biotech and pharma clients.

Company History
Inotiv was founded in 1974 and is headquartered in Lafayette, IN. Originally named Bioanalytical Systems ("BASi") the company has been a non-clinical (not running clinical trials) contract research organization ("CRO") serving the biotech and pharmaceutical industries. The company has largely focused on pre-clinical services, which includes discovery and safety work that typically involves toxicology, pathology and other scientific work that is performed prior to the initiation of any clinical trials in humans. An overview of the process and services provided by Inotiv is shown below.



Prior to 2017, BASi was a subscale provider of pre-clinical services and had excessive customer concentration to a few large pharma customers that created highly variable revenue year to year. From a competitive standpoint, BASi was poorly positioned as their pharma customers increasingly consolidated their pre-clinical and clinical work with larger CRO's who could serve as one-stop providers for all of their outsourced needs. As a result, NOTV's revenue declined by 38% from 2011-2016 and EBITDA turned negative in 2016. This revenue decline combined with an excessive debt burden placed the company in deep financial trouble in 2016.

In 2016, as a result of the financial and strategic difficulties facing the company, BASi's lenders engaged Bob Leasure as a financial consultant to the Company to ensure that the Company's debt was repaid. Mr. Leasure's background as a turnaround expert paid off for the company as revenue grew by 20% in 2017 and has grown every year since. After unsuccessfully attempting to sell the Company following the revenue stabilization, Mr. Leasure was named full-time CEO in early 2019. The unsuccessful sale process was informative to Mr. Leasure as he realized that there were few buyers of small, single service CRO providers in the pre-clinical space. Mr. Leasure saw a unique opportunity to both consolidate these assets at attractive multiples and build a full service pre-clinical CRO that would better serve clients. Since 2019, Bioanalytical Systems has completed 10 acquisitions with the most transformative deal being the Envigo deal announced in September 2021 (discussed below). As a symbol of the amazing transformation the company has undergone over the last 4 years, BASi changed its name to Inotiv in March of 2021 and rebranded all of its acquisitions under this new name.

Mr. Leasure's strategy behind the acquisitions was simple: a scaled CRO can serve as a comprehensive primary service provider to drug developers, resulting in a steadier revenue stream that can support higher utilization rates and higher margins. Mr. Leasure realized that many of these smaller assets were underutilized because they only offered limited services to their customers. As a result, these smaller companies were typically overflow providers for their customers, meaning they were only utilized when their primary CRO couldn't handle the work (tight capacity or no expertise in that area). These smaller companies suffered from all of the same problems that BASi experienced from 2011-2016: customer concentration,

revenue variability, limited value to the end customer. As part of a broader service portfolio, the utilization of these assets could be managed more strategically, resulting in sustainably higher margins than were achievable at the individual company level. As evidence of the success of this strategy, revenue has grown significantly from $20mm in FY '16 to a projected $460mm in FY'22 ($180mm excluding Envigo) and EBITDA margins have improved from negative in 2016, to a forecast of 18-22% in the medium term. With the turnaround complete, NOTV is well positioned to capitalize on the industry trends described below.

Envigo Acquisition
While the company has completed a number of smaller acquisitions, in September of 2021 it announced a transformative acquisition of Envigo that cements NOTV's competitive positioning in the pre-clinical CRO space. Envigo is a provider of high-quality research models (research animals) that are utilized as part of the pre-clinical testing process for new drugs and medical devices. This market is highly regulated, consolidated, and generates recurring revenue as customers tend to utilize the same supplier for research models to ensure consistency in their research/testing (99% revenue retention rate, 17 of top 20 customers have been with Envigo for at least a decade). Envigo specializes in large research animals, specifically non-human primates (NHPs).

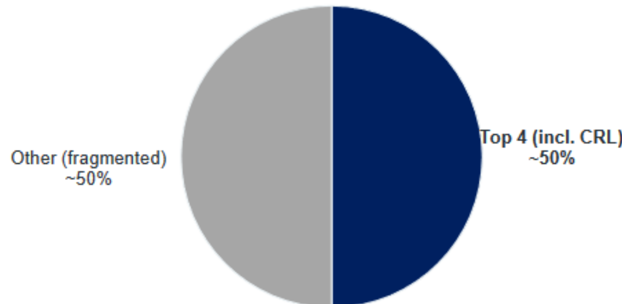
China is currently the largest supplier of NHPs, but suspended all exports of NHPs during COVID. As a result, there is currently a shortage of NHPs, leading to significant price increases for these models. In 2021, NOTV's customers began expressing concerns that NOTV may not have access to a reliable supply of research models to perform pre-clinical work. By vertically integrating this piece of the pre-clinical workflow, NOTV improved its positioning as a critical service provider for their customers. Furthermore, the acquisition brings in a number of new customers, which opens up significant cross-selling opportunities for both NOTV and legacy Envigo.

From a financial perspective, the steady and recurring nature of research model revenue helps to diversify NOTV's revenue from the more cyclical aspects of the pre-clinical CRO work, which is heavily dependent on biotech funding cycles.

CRO Industry
The CRO industry has seen strong and steady revenue growth over the last 10 years as pharma and biotech companies look to outsource more of the drug development and clinical trial work. As drug development has grown increasingly complex and the success rate of drug development has declined, large pharmaceutical companies increasingly view their core competency as drug commercialization and distribution. As a result, drug discovery and development is increasingly performed by smaller biotech companies with large pharma stepping in to acquire these companies once the path to commercialization is more visible. This trend in drug development is important for the CRO industry given that these smaller biotechs often lack internal resources and expertise to conduct much of the pre-clinical and clinical trial work. This has led to more R&D work being outsourced to CRO's, which have the expertise and experience to help these biotech companies reach drug approval faster and more reliably.

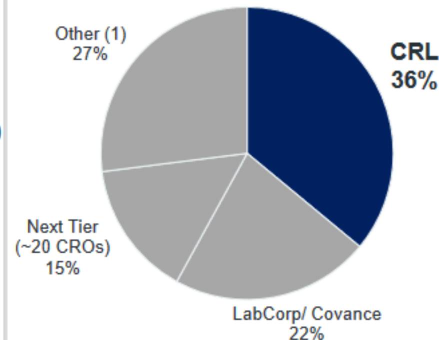
Within the CRO industry, the market is largely bifurcated between the large CRO's who can best serve larger pharma with their outsourcing needs and a fragmented industry of smaller players who serve the biotech market.

Outsourced Global Discovery Services Market Sector



~$5-6B Outsourced Market Sector
Low-Double-Digit Growth
~25% Outsourcing Penetration

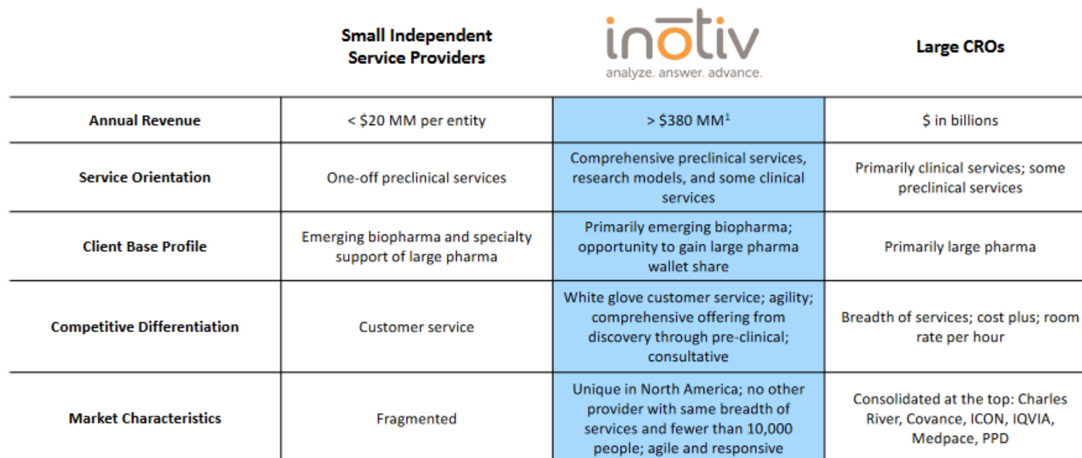
Outsourced Safety Assessment Market Sector



~$5B Outsourced Market Sector
Mid- to High-Single-Digit Growth
60%+ Outsourcing Penetration

NOTV's consolidation of the smaller pre-clinical providers has created a new full-service provider for the biotech market. Charles River Labs is the only other full-service non-clinical provider in the biotech market and both NOTV and CRL are well positioned to take market share from smaller players. Larger CRO's tend to focus more on clinical trial work given the larger revenue streams associated with this work.

Inotiv's Competitive Positioning—Filling a Gap



	Small Independent Service Providers	inotiv analyze. answer. advance.	Large CROs
Annual Revenue	< $20 MM per entity	> $380 MM[1]	$ in billions
Service Orientation	One-off preclinical services	Comprehensive preclinical services, research models, and some clinical services	Primarily clinical services; some preclinical services
Client Base Profile	Emerging biopharma and specialty support of large pharma	Primarily emerging biopharma; opportunity to gain large pharma wallet share	Primarily large pharma
Competitive Differentiation	Customer service	White glove customer service; agility; comprehensive offering from discovery through pre-clinical; consultative	Breadth of services; cost plus; room rate per hour
Market Characteristics	Fragmented	Unique in North America; no other provider with same breadth of services and fewer than 10,000 people; agile and responsive	Consolidated at the top: Charles River, Covance, ICON, IQVIA, Medpace, PPD

[1] annual revenue run rate, including HistoTox, Bolder BioPath and Envigo acquisitions (9 months ending 6/30/2021 annualized)

While there is currently investor concern about overall biotech funding activity, NOTV should be able to weather any downturn in overall industry work through market share gains given its improved competitive positioning.

Management

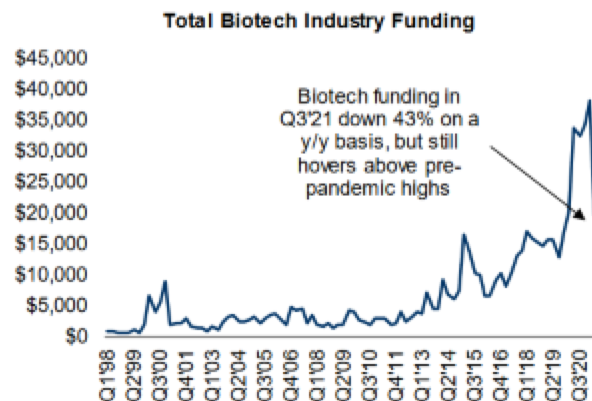
While Mr. Leasure had limited healthcare experience prior to joining NOTV, he has a proven track record of operating expertise through numerous company turnarounds. This should prove valuable as the company looks to improve both the operating and financial performance of recently acquired companies. Mr. Leasure has also surrounded himself with a strong management team that has extensive healthcare and CRO experience. NOTV's COO for the services segment joined the company in early 2021 after spending more than 20 years at CRL. The COO for the research models segment had over 20 years of experience at Covance and the entire Envigo team helps to build out a strong bench of talent. NOTV's chief strategy officer, Dr. John Sagartz, has over 20 years of experience in the pre-clinical toxicology space via the founding of Seventh Wave Laboratories, which was sold to NOTV in 2018. Notably, Dr. Sagartz chose to remain with the company following the acquisition and continues to own 2.6% of the company.

Mr. Leasure's ownership stake in the business and alignment with shareholders meaningfully improved following approval of the 2022 compensation plan. Mr. Leasure was awarded 415,000 RSUs (~$11mm grant date value, $23mm value at the company's 52-week high share price) that will vest over the next 3-5 years. In total, Mr. Leasure now owns 744,000 shares, or 2.7% of the company.

During the first quarter of 2022, 9 different insiders made open market purchases of NOTV stock with prices ranging from $19.65 to $23.97 compared to the current stock price of $23. This is a strong vote of confidence by the management team in the future of the company and the current valuation.

Financials

The growth outlook for NOTV is underpinned by the secular trend toward increased biotech drug development, which supports increased pre-clinical outsourcing as these smaller companies do not have the internal expertise to perform this work. Capital raising by biotechs over the last 2 years has occurred at a record pace, which has created healthy cash balances to support multiple years of pre-clinical CRO growth.



Source: BioCentury and William Blair

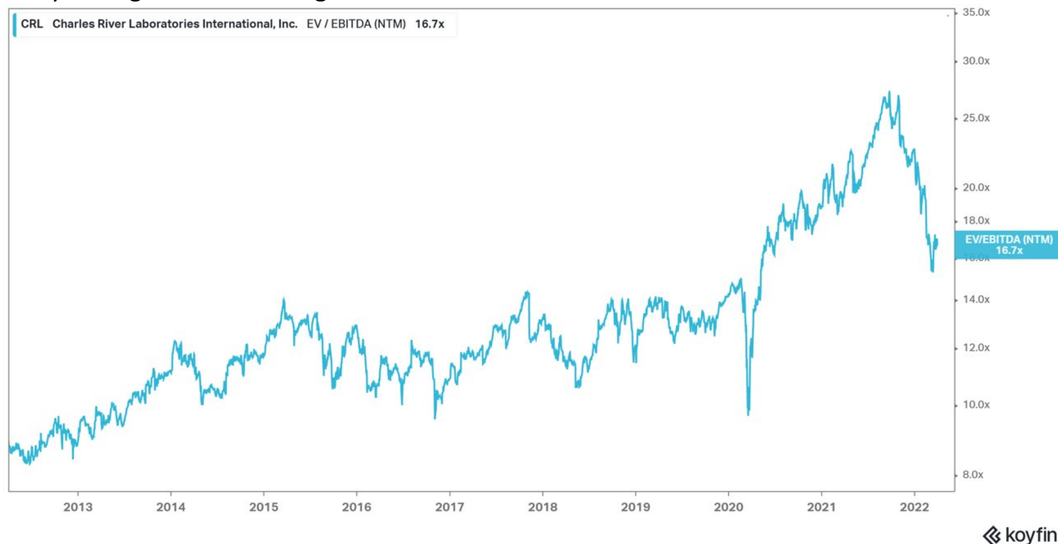
Frost and Sullivan projects that the nonclinical CRO market will grow at an ~6% CAGR through 2026. Given a comprehensive service offering at NOTV and access to critical research models, the company should be well positioned to outgrow the fragmented market of smaller pre-clinical service providers. NOTV's low double digit revenue growth target for its preclinical services is in-line with a similar growth forecast from industry leader CRL.

For its research models business, growth is likely to be more modest in the mid to high single digits, but will also be less cyclical than the preclinical services business. The consolidated organic revenue growth of ~10% will be supplemented by M&A as the company continues to roll up smaller service providers.

EBITDA margins are projected to expand from 12% currently to 18-22% as the company leverages recent corporate investments, improves operations at recently acquired sites, and in-sources more work that has historically been outsourced.

Valuation

NOTV has essentially transformed itself into a smaller Charles River Labs ("CRL"). CRL has a similar corporate history in the sense that they built a full service, pre-clinical CRO largely through M&A. CRL has long been the industry leader in research models, but recognized that while this business had strong recurring revenue characteristics, the growth rate for the market overall was relatively slow. CRL understood that they could play a bigger role in the pre-clinical space by offering more services to their current biotech customers, who were largely overlooked by the bigger CRO's who were focused on large pharma and clinical work. Furthermore, the service work is a higher growth business than the research model segment, which led to accelerating top-line growth for the company. CRL utilized the cash flow generated by the research models business to acquire a broad offering of complementary pre-clinical service offerings. Consequently, CRL's valuation expanded to ~15x EBITDA prior to COVID. The robust biotech funding environment seen over the last 2 years has led to multiple expansion well beyond historic levels, but was somewhat supported by the exceptionally strong biotech funding environment.



CRL's transformation over the last decade provides a good comp for NOTV once the company has integrated its recent acquisitions. Longer term, I expect NOTV can trade at 14-16x EBITDA given the strong organic growth profile of the business, improved margins and the opportunity for M&A to provide additional growth.

NOTV could also be an attractive M&A candidate for any of the larger CRO's who are looking to increase their exposure to both biotech customers as well as preclinical services. The industry has a history of consolidation given that mergers often combine complementary services, enhancing the value proposition of the combined company for customers. The preclinical work can serve as an attractive pipeline for future clinical work for other CRO's that are looking to engage with customers earlier in the drug lifecycle. Transaction multiples for public CRO's have ranged from 18x-25x EBITDA over the past few years.

Given the pace of recent acquisition activity, limited analyst coverage and small market cap of the company, I believe NOTV is flying under the radar of many investors or is viewed as an overly complex investment. As a result, the company currently trades at a discount to peers. As the company slows its acquisition activity over the next year and the run-rate EBITDA of the business is more visible, investors will begin to recognize the transformation that has occurred at Inotiv. Using a conservative 14x EBITDA multiple on my 2025 EBITDA forecast of $140mm, yields a price target of $60. This represents ~140% upside from the current price of $23, or a 25% annualized rate of return over the next 4 years. Notably this forecast does not include the benefit from any additional acquisitions that the company may undertake.

Summary Thesis
NOTV has completed a significant transformation from a tier-2 non-clinical CRO to a comprehensive provider of both services and research models that can meet the majority of the pre-clinical service needs of the biotech industry. While the CRO industry as a whole should see secular revenue tailwinds due to increased outsourcing of non-clinical work, NOTV's more robust service portfolio positions it well to take market share from smaller service providers. Additionally, the company has an opportunity to improve margins at existing assets and Mr. Leasure's turnaround expertise is well suited to execute on this improvement. As investors gain more visibility into both the run-rate revenue and earnings potential of NOTV, the stock should benefit from multiple expansion in-line with other CRO peers.

As always, if you have any questions, please do not hesitate to contact me.

Christopher Godfrey

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