HEADWATERS CAPITAL

www.headwaterscapmgmt.com

**July 10, 2025**

Dear Investors,

The Headwaters Capital Management, LLC (“Headwaters Capital,” “Headwaters,” or the “Firm”) portfolio gained +7.5% (+7.3% net) during Q2 2025 compared to a +8.5% gain for the Russell Mid Cap Index over the same period. A brief discussion of the performance and trading activity during the quarter is presented below.

**Headwaters Capital Performance:**

| | Q1 25 | Q2 25 | YTD 2025 | 2021 | 2022 | 2023 | 2024 | Cumulative Since Inception (1/4/2021) |
|---|---|---|---|---|---|---|---|---|
| Headwaters Capital (Gross) | -9.0% | 7.5% | -2.2% | 17.9% | -22.7% | 34.8% | 14.0% | 36.8% |
| Headwaters Capital (Net) | -9.2% | 7.3% | -2.6% | 17.1% | -23.4% | 33.0% | 13.1% | 31.4% |
| Russell Mid Cap Index | -3.4% | 8.5% | 4.8% | 22.6% | -17.3% | 17.2% | 15.3% | 43.6% |

**Performance for the Headwaters Capital portfolio has been calculated by Liccar Fund Services from 1/4/2021-12/31/2023.*

***Performance for the Headwaters Capital portfolio has been calculated by Longs Peak Advisory Services from 1/1/2024-6/30/2025.*

****Performance presented is that of a representative account invested in the strategy. Individual SMA performance may differ from the results presented above.* [1]

<u>*Q2 25 Performance Discussion*</u>

The Headwaters portfolio bounced back from the Q1 uncertainty and, along with the rest of the market, had a strong rebound from the tariff induced sell-off at the beginning of the quarter. Performance for the overall market was highlighted by the same themes that have been prevalent in the market over the last nine months: AI enthusiasm driving large cap outperformance v. small cap and speculative/lower quality stocks leading within small & mid caps (see appendix for more detail). Market breadth (number of stocks outperforming the index) continues to be extremely narrow by almost every measure and remains concentrated in large cap AI beneficiaries and high momentum/low quality stocks. While there is a growing narrative that the market rally is broadening,, I don’t see evidence that this is occurring (large continues to lead small, cap weighted S&P leading equal weighted S&P). If anything, broadening market leadership has just been a rally of the lowest quality and most speculative names in the market, which is just an extension of the risk-on trade that is partially fueling AI stocks. This dynamic can be seen in the outperformance of the lower quality Russell Mid Cap and Small Cap indices both of which have outperformed the higher quality S&P Mid and Small Cap Indices, which only include profitable companies.


[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. For further information about the total portfolio’s performance, please contact Headwaters at the email address listed.

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Unpacking the returns of the Russell Mid Cap Index for Q2 and YTD provides even more evidence of the narrow market breadth that is concentrated in some of the most speculative companies in the market. The Russell Mid Cap Index is composed of 810 stocks, but four companies accounted for 22% of the index's returns during Q2 and 31% of the index's return YTD. I now understand the frustration that large cap managers have felt over the last decade in trying to outperform a concentrated S&P 500, but at least I understand the fundamentals of those businesses. In the case of the four companies leading the mid cap index, three of the market leaders are crypto companies (Coinbase +41% YTD, Robinhood + 151% YTD, Microstrategy/Strategy + 40% YTD) and one (Palantir + 80% YTD) has become a cult retail stock whose valuation increasingly pushes the boundaries of reason (76x revenue at the end of Q2). As more evidence of the speculation occurring within the market during Q2, Bloomberg reported that Bitcoin-linked firms rallied 78%, while quantum computing shares climbed 69% and meme stocks advanced 44%. Trading in these stocks is emblematic of today's elevated risk appetite and is reminiscent of the meme stock/SPAC market of 2021. If these are the companies leading the market higher, I'm comfortable lagging behind the index as history has taught us that performance from these types of companies is rarely sustained.

*Stretched Rubber Band: 1999 Redux?*

Which brings us to the state of the overall market today. The narrow market leadership combined with the nature of these market leaders increasingly resembles 1999. Market participants are so focused on momentum trades in AI and speculative assets that the rest of the market has been completely ignored. This historically narrow market has caused valuation spreads to widen to record extremes not seen since 1999. If history is a guide, the AI trade fueling momentum in large cap stocks will eventually falter, which would likely have a domino effect on other speculative trades. **As a result, the current market environment appears to be one of the more attractive investment opportunities for quality small cap businesses since 1999. While readers may be sick of hearing the "small caps are cheap" story, the reality is the market has reached a point where the extreme divergence in valuations and fundamentals are unsustainable. You can only stretch a rubber band so far.** A full presentation discussing the current market environment and investment opportunity in small caps can be found **HERE**, but a quick summary is outlined below.

1. AI is real and is likely to have lasting benefits, but excitement around the technology in terms of investment and valuations are reaching extremes. History suggests that the AI cycle will resemble nearly every other technological revolution and will eventually reach a point of over-investment/excess capacity.
2. AI hype is leading to narrow breadth in the equity market as investors chase AI and AI-related beneficiaries at the expense of the rest of the market. Broader risk appetite is fueling additional investor interest in speculative themes such as crypto, quantum computing, and meme stocks, all of which are driving a disproportionate share of equity market returns. Stocks in these momentum strategies have outperformed by the widest margin on record outside of 1999/2000.
3. The current market backdrop has created a wide discrepancy in valuations for the winners (AI beneficiaries, speculative stocks) and everything else. This can be seen in absolute and relative valuations for these baskets of stocks.
4. History can be useful in navigating periods like this and has shown that investors can still generate strong future returns by investing in quality businesses that have been ignored by the market.
5. While timing this rotation is nearly impossible, there are early signs that we are in the later innings of this trade. A robust fundraising environment for AI, significant capital investment in AI infrastructure and IPO activity related to AI/speculative themes are all signs of later cycle behavior.

Market returns YTD and really since the beginning of 2023 have been concentrated in AI related companies. This extends beyond the most obvious AI beneficiaries such as Nvidia and mega cap tech companies, but also to downstream beneficiaries such as utilities, data centers and industrial companies serving the AI ecosystem. Investors have correctly chased the earnings momentum behind AI and the associated infrastructure build, but the duration of this momentum is the key question for investors today. While I am a believer in the value of AI and its widespread adoption, the elevated levels of investment (both capital markets and infrastructure), concentration of market returns and current valuation spreads are all reminiscent of 1999. If we are in the later innings of this trade, investors are ignoring history which has taught us that transformational technology shifts such as AI are prone to excessive hype and overinvestment, eventually leading to poor investment returns. While the cash flow profiles of the AI companies are significantly better than the internet companies of 1999, which likely insulates these companies from any sort of crash like 2000, the market still appears to be pricing these companies for perfection when much of this spend may prove to be more cyclical than the market appreciates.

Why is this important? This narrow market breadth is reaching historical extremes by almost every measure. When the market is fixated on the results of just a handful of companies, it leads to excessive optimism and inflated valuations for these businesses. It also means investors are ignoring many other companies while they chase this momentum trade. This vacuum has left other businesses trading at historically attractive valuations. For investors considering an equity allocation today, the key question is where are the best opportunities for future returns? **Similar to 1999, quality small caps offer an attractive risk/reward both on an absolute basis and relative to large cap peers. As shown in the full presentation, small caps went on to outperform large caps over the next twelve years and current valuation spreads are nearly identical to valuation spreads in 1999. While the timing and catalyst for a rotation are unknown, small caps do stand to benefit from Trump's OBBB and interest rate cuts have historically been positive for small caps. Additionally, given current valuations, any disappointment from AI beneficiaries could also serve as a catalyst for the rotation. For investors seeking to capitalize on this opportunity or merely looking for diversification within what are likely concentrated investment portfolios, I encourage you to reach out to me directly to discuss investment options.**

*Q2 25 Portfolio Review*

**Top Contributor:** Transmedics (TMDX) +98%. The top contributor for Q2 '25 was also the top detractor in Q4 '24. How quickly narratives can change despite actual results largely remaining the same. Concerns around TMDX approaching a market share ceiling were dismissed with Q1 '25 results. Market share gains for its OCS heart product resumed once a competitor's clinical trial reached completion, OCS liver continued to steadily gain share and seasonality in the transplant industry flipped from a headwind to a tailwind. Nonetheless, competitive dynamics are likely to change later in 2025 and into 2026, which led to the decision to sell TMDX following the strong share price performance (see details below).

**Top Detractor:** Globus Medical (GMED) -19%. The Globus decline was discussed in detail as part of the May edition of Navigating the Currents. Q1 results were disappointing, although I believe they will prove transitory once the Nuvasive integration is completed later this year.

*Trading Activity*

**Buy: Bio-Techne (TECH)**: See below. A new position was added early in July and will be detailed in the Q3 letter.

**Sell: Transmedics (TMDX)**: TMDX was sold following a strong Q1 report that saw the shares nearly double in value. Despite incredible volatility in this name, it was a successful investment for the Headwaters strategy. For the representative account, TMDX returned +85% in less than two years, generating a +56% IRR (for those that prefer to look at things with a private equity lens). While I prefer to hold investments longer than two years, industry dynamics have changed since the initial investment. Compared to initial research, the Company's Organ Care System has proven much more controversial than expected. Specifically, many transplant surgeons question whether the value of the system justifies its high cost. Additionally, competition will be increasing later in 2025 as OrganOx raised $160mm earlier in 2025 and XVIVO is starting a liver clinical trial that will likely pressure market share for TMDX. I was also disappointed with the way management handled controversy around the stock late in 2024. Ultimately, with shares trading at a high valuation and risk from competition increasing, I exited the position given numerous other attractive opportunities in the market.

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**Bio-Techne: Coveted Life Sciences Asset On Sale Due to Academic Pressures**

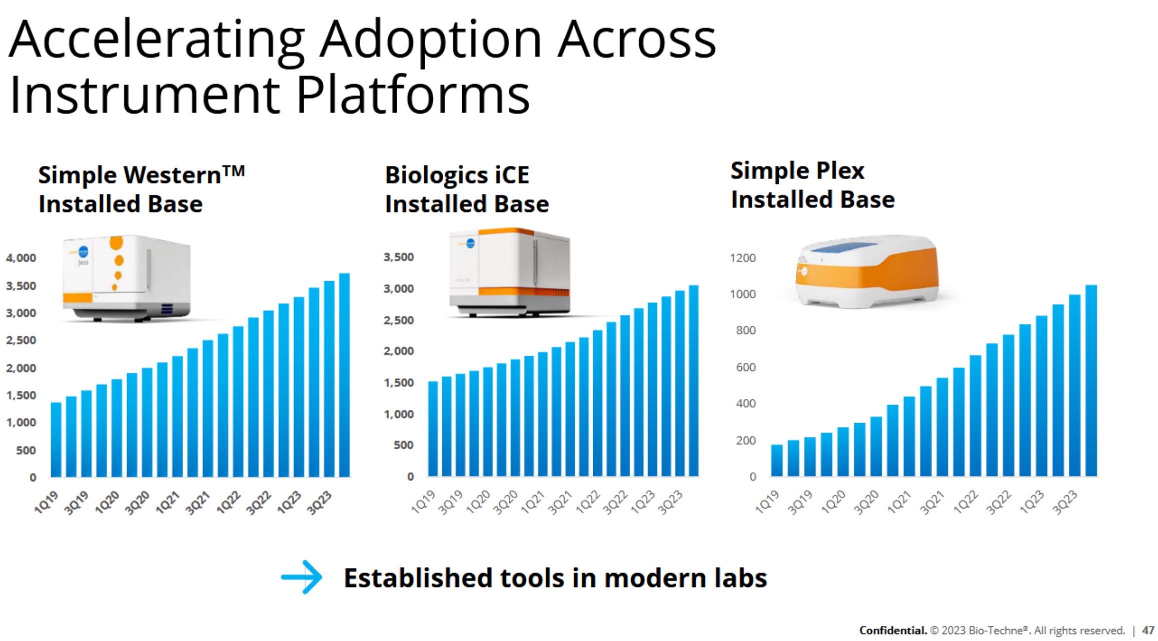
*Summary Thesis:*

1) Market leading life sciences reagents and instrument company. Recurring consumable revenue, strong profit margins, healthy free cash flow and a net cash position.
2) Concern around US academic funding is weighing on shares of TECH, pressuring the stock to its lowest valuation since 2017.
3) Revenue growth rate inflecting higher in FY ’27 (6/30 FYE) as Company laps one-time NIH budget reset and growth assets propel consolidated revenue.
4) Coveted asset as evidenced by recent M&A transactions, which supports a significantly higher valuation than implied by current share price.

Bio-Techne (“TECH”) develops, manufactures and sells life science reagents, instruments and services for the research, pharmaceutical, diagnostics and bioprocessing markets worldwide. Founded in 1976 as Research and Diagnostic Systems, the company IPO’d in 1985 when it merged with Techne Corporation. TECH has been a leader in manufacturing high-quality antibodies and proteins used in life sciences research. The Company also manufactures instruments that utilize these reagents, creating a razor/razor blade model. In 2013, the Company embarked on a strategy to accelerate revenue growth by utilizing cash flow from its Protein Sciences business to acquire higher growth products leveraged to its existing customer base. Today, 80% of the company’s revenues are consummables, driving highly recurring revenue for the company. Customer concentration is minimal given TECH’s broad product and customer base. Today, the Company operates in two segments: Protein Sciences and Diagnostics & Genomics.

Protein Sciences – TECH's Crown Jewel

Protein Sciences represents the original TECH business that sells reagents and instruments into research and diagnostics markets. Key customers in this segment include research institutions, biopharma, pharma and diagnostics companies. TECH's proteins and antibodies are widely used in academic research, which in addition to patent and trademark protection, provides important validation for the quality of the products. Academic citations also serve as a strong marketing tool for TECH's products and help to drive future sales. On the equipment side, TECH's growing installed base of instruments provides visibility into ongoing utilization of TECH's products.



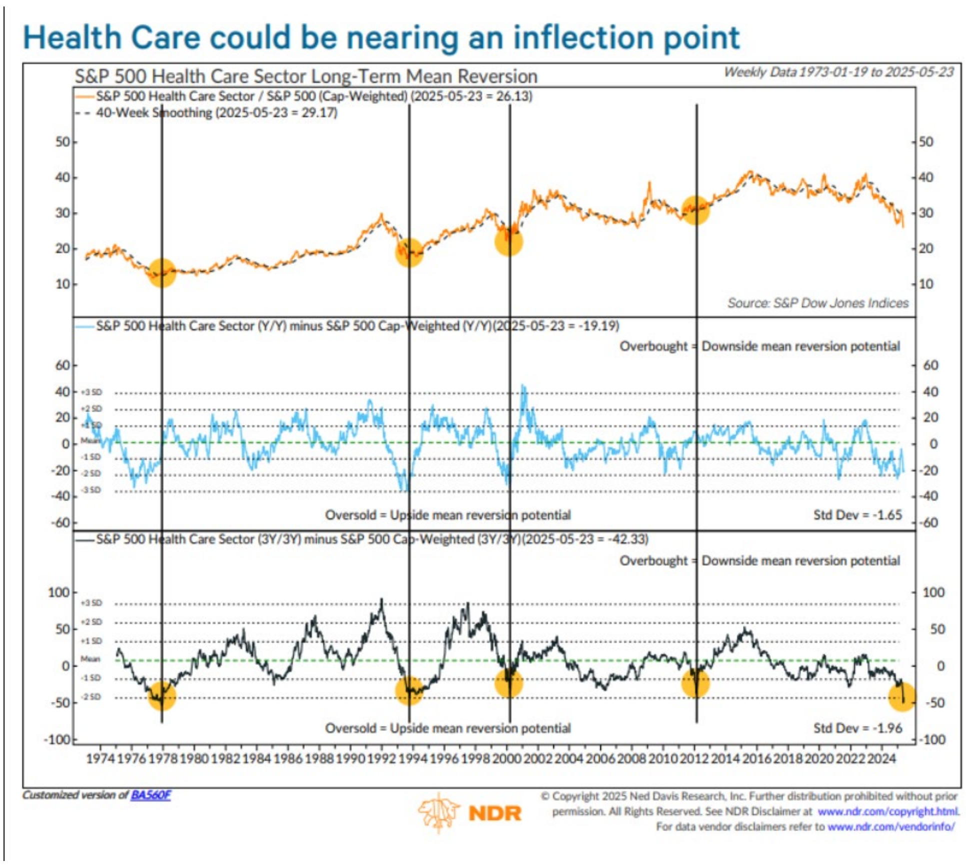

More recently, TECH has broadened its customer base and now sells GMP grade proteins that are utilized in the production of cell and gene therapies ("C&GT"), both in clinical trials and FDA approved commercial products. The C&GT business represents a growth opportunity for the segment as clinical trial customers (85 today) ultimately convert to commercial customers (4 today). The core reagents and instruments business has historically grown at mid to high single digit rate as ongoing innovation in drug discovery and development has fueled strong demand for TECH's products. While comprising only ~11% of Protein Sciences revenue today, TECH's emerging C&GT business is projected to sustain its +20% growth rate over the next few years, supporting ongoing growth for this segment. Gross margins for the Protein Sciences segment are ~75% and the business generates an impressive 45% operating margin. The Protein Sciences segment accounts for ~70% of TECH's revenue and 95% of consolidated operating income. This is the crown jewel of Bio-Techne.

*Diagnostics and Genomics – TECH's Venture Capital Portfolio*

TECH's Diagnostics and Genomics business represents a collection of assets that have been acquired since the 2013 strategy shift. Many of these businesses are small and each one specializes in niche diagnostic and research markets. Key areas of focus include spatial biology, liquid biopsy, molecular diagnostics and diagnostic reagents. Understanding each of these businesses in detail is very difficult as the science is beyond my comprehension. Instead, I think of this segment as the venture capital portfolio of TECH. Each of these businesses represents a call option for a potentially significant business. Given the small size of each company in this segment, it is difficult to underwrite significant value from any individual asset today. Given that many of the businesses in this segment are emerging and require significant marketing and R&D, operating margins for this segment are depressed at ~7%. While not a meaningful source of earnings today, there is significant potential from this portfolio via operating leverage and a focus by management on margin improvement. I trust that TECH is appropriately sizing its bets in these markets and that the portfolio will ultimately deliver shareholder value.

*Investment Opportunity – Customer Budget Concerns*

TECH's stock has been hit hard by concerns around cuts to NIH/NSF funding, which will have a direct impact on the 12% of TECH's revs that are generated from US academic customers. As proposed today, the 2026 fiscal budget would cut the NIH budget by 40%. TECH's revenues should be less exposed to the full 40% cut for a myriad of reasons (less indirect cost exposure, consummables focus, priority funding areas, etc), but this figure is a good baseline to run sensitivity analysis around NIH exposure. TECH also has risks related to China revenue (8% of revs) and general uncertainty around pharma and biopharma spending. No matter how you slice it, it's hard to envision TECH generating significant revenue growth in FY '26 (6/30/26 YE). This uncertainty has weighed on not only TECH's stock, but also the broader healthcare sector and life sciences tools industry. While the chart below illustrates Healthcare's underperformance for large caps, the same dynamic is occurring in small caps.




As a result of the pressure on the healthcare sector broadly as well as specific risks to TECH's revenues, the Company's shares traded down to a multiple not seen since 2017. While the absolute multiple by itself is likely at or near a floor, it was interesting that TECH's multiple also approached that of Thermo Fisher ("TMO"). TMO has always been considered a natural acquirer given that TECH already has a commercial distribution agreement with Thermo in its Protein Sciences segment. Additionally, TECH's CEO, CFO and President of Protein Sciences all held previous roles at TMO. As can be seen below, TECH's shares have historically traded at a premium to TMO given faster revenue growth rates and an embedded take-out premium (from TMO or any other larger cap player). This provides some comfort that shares of TECH are likely at or near a trough valuation.


*Financial Outlook and Valuation*

It's reasonable to assume that TECH's revenue in FY '26 will probably be flat with FY'25 as pressure on US academic revenue is offset by growth in C&GT and other smaller growth assets. Margins can likely be maintained in '26 as margin compression in Protein Sciences is offset by improvement in Diagnostics. More importantly, FY '26 is likely to represent trough earnings for TECH. Once the Company digests the one-time reset of the NIH budget cuts, growth assets should support consolidated revenue growth in 2027. Additionally, TECH will continue to generate strong free cash flow during FY '26 and, absent M&A, will operate in a net cash position within the next year. TECH is unquestionably one of the highest quality assets in the life sciences space and it appears that we are buying this A+ asset at a trough multiple on trough earnings. Investors may need to wait 12 months for the market to recognize that earnings are inflecting in 2027, but this is exactly the type of market inefficiency that the Headwaters Capital portfolio seeks to exploit via a patient and elongated investment time horizon. Management believes the business will return to long-term double-digit revenue growth after next year and margin expansion should support mid-teens earnings growth. Given the scarcity of this asset and strong growth and margin profile, TECH will likely trade at a 20-25x EBITDA multiple once growth resumes. Using a 20x multiple on my 2027 EBITDA forecast yields a price target of $64, or +27% upside from the $50 average purchase price. 25x yields a $78 price target or +57% upside.

*M&A Value*

Readers may notice that TECH's Protein Sciences segment is similar to a previous Headwaters Capital investment, Abcam, which was ultimately acquired by Danaher. I was initially attracted to Abcam through research I had done on TECH years ago. I always admired TECH's protein sciences business, but I could never get comfortable with Bio-Techne's valuation which seemed to assign excessive value for its portfolio of smaller growth businesses. At today's multiple, investors don't need to ascribe any value to these growth businesses as the Protein Sciences segment itself is trading at a discount to recent transactions. Using comparable transactions in the antibody and protein space, we can see that there has been substantial M&A interest in peers over the last few years. A 30x EBITDA multiple on trough 2026 earnings would yield a price target of $82, or +64% upside. I sincerely hope that TECH would not sell the Company based on 2026 earnings, but it's a useful sanity check on the true value of the Company.

**TECH Comparable M&A Transactions**

| Date | Acquirer | Target | Forward Revenue ($ MM's) | Forward EBITDA ($ MM's) | EBITDA Margins | Rev Growth Rate | Purchase Price ($ MM's) | EBITDA Multiple |
|---|---|---|---|---|---|---|---|---|
| 8/28/2023 | Danaher | Abcam | 550 | 180 | 33% | HSD | $ 5,700 | 31.7x |
| 10/31/2022 | TMO | The Binding Site Group (1)(2) | 250 | 88 | 35% | 10% | $ 2,600 | 29.7x |
| 12/30/2021 | TMO | PeproTech (3) | 102 | 41 | 40% | | $ 1,860 | 45.6x |
| 7/27/2021 | PKI | BioLegend (4) | 380 | 190 | 50% | 15% | $ 5,250 | 27.6x |

(1) Headwaters Capital estimate for EBITDA and EBITDA margin. TMO disclosed Binding Site Operating Margins "above corporate average" on 11/19/22 Conference Call. TMO adjusted operating margin was 24.5% in 2022, adjusted EBITDA margin was 27%.
(2) TMO disclosed Binding Site Revenue Growth Rate on 11/19/22 Conference Call
(3) EBITDA and EBITDA margins are a forecast based on TMO's disclosure for 2022 revenue and EPS accretion
(4) PerkinElmer BioLegend Infographic and ex. 99.4 of 8-K (11-4-21)

As always, if you have any questions about the portfolio or the market, please do not hesitate to contact me.

Christopher Godfrey

*Appendix*

## Russell Midcap

**Exhibit 32: Russell Midcap Performance Attribution Analysis**
1m, 3m and YTD performance attribution (as of 6/30/2025)

| | June | | Last Three Months | | Year to date | | |
|---|---|---|---|---|---|---|---|
| | Return | Contrib. | Return | Contrib. | Return | Contrib. | Weight |
| **Core Index** | 3.7 | — | 8.5 | — | 4.8 | — | |
| **Market Cap Size Quintile** | | | | | | | |
| Q1 (Largest) | 4.1 | 2.1 | 11.4 | 5.7 | 8.9 | 4.6 | 51.5 |
| Q2 | 3.6 | 0.8 | 6.6 | 1.5 | 3.3 | 0.8 | 22.5 |
| Q3 | 3.4 | 0.5 | 6.1 | 0.8 | -0.2 | 0.0 | 13.2 |
| Q4 | 3.4 | 0.3 | 4.3 | 0.4 | 0.3 | 0.0 | 8.6 |
| Q5 (Smallest) | 4.8 | 0.2 | 5.4 | 0.2 | -3.6 | -0.2 | 4.1 |
| **P/E Quintile** | | | | | | | |
| Q1 (Lowest) | 4.6 | 0.5 | 3.3 | 0.4 | 0.9 | 0.1 | 11.9 |
| Q2 | 3.0 | 0.5 | 6.2 | 1.1 | 2.7 | 0.6 | 17.9 |
| Q3 | 3.9 | 0.8 | 6.1 | 1.2 | 6.1 | 1.1 | 19.5 |
| Q4 | 2.6 | 0.5 | 5.7 | 1.3 | 1.5 | 0.4 | 20.8 |
| Q5 (Highest) | 4.4 | 1.2 | 17.1 | 3.9 | 8.6 | 2.3 | 26.2 |
| Nonearnings Stories | 9.0 | 0.3 | 22.5 | 0.8 | 21.3 | 0.8 | 3.7 |

*Source: Bank of America*

The chart above is a good illustration of how large has outperformed small and low quality (non-earnings) has outperformed value (low P/E).

Important Disclosure
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Investing in small- and mid-size companies can involve risks such as less publicly available information than larger companies, volatility, and less liquidity. Investing in a more limited number of issuers and sectors can be subject to greater market fluctuation. Portfolios that concentrate investments in a certain sector may be subject to greater risk than portfolios that invest more broadly, as companies in that sector may share common characteristics and may react similarly to market developments or other factors affecting their values.

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