

Q1 2026 Quarterly Commentary

By Nathan Fredrick, CFA

Strategy Overview / Performance Summary

The Riverwater Partners Micro Opportunities strategy slightly underperformed its benchmark in the first quarter of 2026.

The first quarter of 2026 marked a notable shift in both market leadership and investor sentiment, largely driven by escalating geopolitical tensions in the Middle East and a reassessment of previously favored growth areas. The emergence of conflict involving Iran introduced a meaningful external shock, most clearly reflected in rising energy prices and heightened market volatility. While such disruptions have historically been transitory, we believe the current environment may signal a more durable repricing of supply risk, with broader implications for inflation, corporate profitability, and consumer spending. Concurrently, equity markets began to reevaluate segments that had led performance in recent periods—particularly software and AI-related businesses—amid growing concerns around long-term monetization, competitive dynamics, and the sustainability of elevated earnings expectations.

At the same time, stress has begun to surface in select areas of the private credit market, driven primarily by tightening liquidity rather than a deterioration in underlying credit quality. As capital availability has become more constrained, borrowers dependent on continuous access to private financing have faced increasing pressure. We view this dynamic as contained and more comparable to the liquidity-driven disruptions seen during the 2023 regional banking episode, rather than indicative of a broader systemic issue. While these conditions may weigh on certain companies, they are also fostering a more disciplined pricing of risk across capital markets.

In this environment, we are focused on capitalizing on opportunities created by indiscriminate selling, particularly in areas impacted by heightened concerns around AI disruption. In many cases, valuations have declined meaningfully despite limited changes in fundamental performance, creating attractive entry points into high-quality businesses with durable competitive advantages. Historically, periods characterized by uncertainty and liquidity-driven volatility have provided compelling opportunities for long-term investors, and we believe the current backdrop is beginning to offer a similar set-up.

Sector Highlights

Health Care and Consumer: From an attribution standpoint, the portfolio's positioning in Health Care and Consumer Staples provided the largest positive contributions to relative performance during the quarter. Our Health Care holdings outperformed the sector benchmark, driven by strong stock selection, while the overweight to Consumer Staples—an area where our companies continue to execute well operationally—added further relative value.

IT and Materials: Conversely, results were hampered by our allocations within Information Technology and Materials. Relative performance in IT suffered from an underweight position as the wider sector proved more resilient than our specific, concentrated holdings, which were caught in the broader software downturn. Within the Materials sector, we saw significant quarterly weakness primarily due to American Vanguard (AVD). The company faced headwinds from the geopolitical conflict in the Middle East and concerns that rising input expenses might outpace their ability to implement product price hikes.

Looking ahead, we intend to expand our exposure to the **Energy and Materials** sectors, moving toward overweight positions. Our conviction is based on the structural shifts occurring in the Middle East, which we believe will provide a competitive advantage to specific North American firms in these industries. Conversely, we remain cautious and will continue to avoid the Consumer Discretionary and Financials (specifically banks) sectors. While we held a bullish outlook on these areas at the beginning of the year, we now believe the significantly altered macroeconomic landscape will present a persistent headwind for the foreseeable future.

Top Contributors & Detractors

Top Contributors

NPK International (NPKI) was the strategy's leading contributor during the quarter. NPKI outperformed the market in the first quarter of 2026, driven by increasing investor recognition of its role as a "picks and shovels" beneficiary of the ongoing energy and infrastructure buildout, including power demand tied to AI-driven data center expansion. The company's composite matting solutions are critical for supporting grid expansion,

pipeline development, and broader infrastructure projects, positioning it well in a capital spending environment that remains resilient despite macro uncertainty. Investors have also responded positively to the company's long runway for growth, as NPKI continues to expand its rental fleet, providing a clear path to incremental revenue and margin expansion. Importantly, the composite mat industry is growing faster than traditional wood-based alternatives, driven by superior durability, environmental benefits, and lower total cost of ownership. This combination of structural growth, capacity expansion, and exposure to durable infrastructure themes has supported both earnings visibility and multiple expansion during the quarter.

Douglas Dynamics (PLOW) was another standout and a company we highlighted in the deep dive section of the fourth quarter of 2025 letter. PLOW is a leading North American manufacturer of commercial snow and ice control equipment and work truck solutions, serving municipal, commercial, and contractor end markets. The bottom line is that this winter's snow season was considerably more robust than last year's and exceeded the strength of most typical winters. This favorable weather significantly improved the financial results and fundamental outlook for Douglas Dynamics.

Top Detractors

Red Violet (RDVT), a provider of data analytics and identity intelligence solutions used across government, law enforcement, and enterprise markets, underperformed in the first quarter of 2026 primarily due to broad-based weakness across the software sector. Much of the sell-off was driven by investor concerns around AI disruption, which has led to indiscriminate multiple compression across data and analytics companies. Despite this pressure, we believe RDVT's competitive positioning remains intact, supported by its proprietary data assets and highly specialized identity intelligence capabilities. These datasets, which have been built over time and are difficult to replicate, create a meaningful barrier to entry and underpin the company's value proposition. In our view, the recent underperformance reflects sentiment rather than fundamentals, and the company remains well positioned to benefit from continued demand for high-quality data and analytics solutions.

Coastal Financial (CCB) was our second largest detractor. CCB experienced a more volatile first quarter, with stock performance shaped by evolving investor perceptions around risks tied to its fintech partner

ecosystem and broader private credit dynamics. While underlying fundamentals remained relatively stable—supported by its Banking-as-a-Service model and continued growth in partner-driven deposits and fee income—investors grew more focused on the durability of its fintech relationships amid increasing AI-driven disruption and tightened credit conditions. We reduced our position during the quarter but continue to hold CCB at a lower weighting, as we believe the core business model remains intact.

Strategy Additions & Sales

New Positions

We initiated positions in several companies during the quarter that align with our focus on quality businesses trading at attractive valuations.

Ranger Energy Services (RNGR) is a leading provider of high-spec well service rigs and ancillary services to U.S. onshore oil and gas operators, with a focus on completion, production, and maintenance activity across key basins such as the Permian. The investment case is centered on its leverage to sustained and potentially increasing North American oil and gas production, particularly in an environment where global supply uncertainty—driven in part by geopolitical tensions—supports higher commodity prices and incentivizes domestic output. Unlike exploration and production companies, RNGR offers a more stable, service-oriented exposure to the energy cycle, benefiting from ongoing well maintenance and workover activity that is less volatile than drilling. As producers seek to maximize existing asset productivity and extend well life, demand for high-quality service rigs remains robust, positioning RNGR to drive utilization and pricing improvements. Combined with disciplined capital allocation and a focus on operational efficiency, the company is well positioned to generate strong free cash flow and deliver attractive returns through the cycle.

We initiated a position in **Talkspace (TALK)**, a digital mental health platform with improving unit economics. TALK was taken out shortly after we made the purchase, providing an immediate return. The acquisition was bittersweet: while the takeout delivered strong performance on the day, we believed the company's improving fundamentals offered more upside over a longer horizon.

We added **LSB Industries (LXU)** in the first quarter and go into depth on the holding in the deep dive section below.

We added to existing positions in **Climb Global Solutions (CLMB)**, **Allot Ltd. (ALLT)**, **Natural Gas Services Group (NGS)**, and **American Vanguard (AVD)**, taking advantage of price dislocations from the AI disruption thesis or to build positions that we believe will benefit from the new macro environment.

On the sell side, we trimmed **IRadimed (IRMD)**, **Douglas Dynamics (PLOW)**, **Coastal Financial (CCB)**, **Delcath Systems (DCTH)**, **First Business Financial (FBIZ)**, and **Avidia Bancorp (AVBC)**. The trims to IRMD and PLOW were primarily valuation-driven following strong performance. We trimmed our bank positions based on the possibility of less rate hikes and the worries about private credit hitting the entire Financials sector.

Company Deep Dive: LSB Industries (LXU)

LSB Industries (LXU) is a U.S.-based pure-play nitrogen chemical producer operating three manufacturing facilities in Alabama, Arkansas, and Oklahoma, along with a nitric acid facility in Baytown, Texas operated on behalf of Covestro. The company produces ammonia, urea ammonium nitrate (UAN), and both high-density ammonium nitrate (HDAN) for mining explosives and low-density ammonium nitrate (LDAN) for agricultural fertilizer. LXU is a micro-cap “baby CF Industries”—a concentrated, higher-beta way to play the nitrogen market compared to diversified giants like CF Industries or Nutrien.

The stock has been weighed down by cyclical concerns around nitrogen pricing normalization and broader commodity market volatility. However, the market appears to be overlooking a powerful structural shift: the Strait of Hormuz blockade and Russian ammonium nitrate export suspensions have removed approximately 27% of global ammonia supply and 35% of global urea flows from the market, creating the tightest nitrogen inventory in years and driving North American benchmark prices for ammonia higher. For a company of LXU's size, this supply dislocation has an outsized impact on margins and cash flow.

A Natural Moat Built on Geography, Chemistry, and Scale

LXU's competitive moat, while less visible than that of a technology franchise, is deeply rooted in the physical

realities of its business. First, ammonia manufacturing is a capital-intensive, hazardous process that achieves meaningful economies of scale only at high production volumes—creating substantial barriers to new entrants. Building a greenfield nitrogen plant requires hundreds of millions of dollars in capital and years of permitting and construction. Second, LXU benefits from a critical feedstock advantage: its U.S.-based plants use domestically sourced natural gas priced well below the international LNG benchmarks that European and Asian competitors must pay. As global LNG markets tighten due to the Hormuz disruption and the force majeure at QatarEnergy's Ras Laffan facility, LXU's cost-of-production advantage widens dramatically—the company's input costs remain stable while global selling prices are being set by the highest-cost marginal producer. Third, the distribution of HDAN (the mining-grade explosive) creates a regional moat: ammonium nitrate is heavy, hazardous to transport, and subject to strict regulatory oversight, which means domestic producers like LXU enjoy near-total pricing power within their geographic footprint. With U.S. copper and gold mining at peak production levels, demand for HDAN remains robust and largely insulated from import competition.

An Oligopolistic Industry With Limited New Supply

The North American nitrogen industry is highly consolidated, with CF Industries, Nutrien, and LSB Industries accounting for the vast majority of domestic ammonia, UAN, and ammonium nitrate production. This oligopolistic structure is reinforced by the immense capital requirements and long lead times needed to bring new capacity online—no material greenfield nitrogen capacity has been added in the U.S. in decades. Globally, the supply landscape has become even more constrained: Middle Eastern producers, historically the world's lowest-cost exporters, are now physically blocked from reaching key markets due to the Hormuz chokepoint, while Russian export suspensions have further tightened trade flows.

The result is a supply–demand dynamic that structurally favors incumbent North American producers. Unlike many commodity industries where new entrants can quickly erode pricing power, the nitrogen market's combination of regulatory hurdles, capital intensity, and geopolitical supply disruptions creates a prolonged window of elevated profitability for domestic players. Additionally, the threat of substitution is low—nitrogen fertilizer is essential to global food production, and while synthetic urea research continues, no commercially

viable alternative has emerged. This consolidated market structure gives LXU meaningful pricing leverage that is unlikely to erode in the near to medium term.

Valuation, Catalysts, and the Free Cash Flow Story

At current levels, LXU trades at an undemanding multiple on forward EBITDA, which we view as attractive given the company's meaningful upside leverage to improving nitrogen pricing. Management has outlined a path to higher earnings power and \$200 million in EBITDA under more normalized commodity assumptions, and the current pricing environment—supported by supply disruptions tied to geopolitical developments—suggests the potential to exceed those targets. This would imply a roughly mid single digit EV/EBITDA multiple. Importantly, nitrogen fertilizer pricing remains the primary driver of both EBITDA and free cash flow for the business, with higher realized prices flowing through with significant operating leverage given a largely fixed-cost structure. As benchmark prices for ammonia and UAN have moved higher, LXU is positioned to capture meaningful incremental profitability, particularly if pricing strength persists through the key spring application season.

Sustainability

Beyond the near-term nitrogen cycle, LXU has a call option in clean energy: its partnership with Lapis Energy to produce blue ammonia—capturing 450,000 metric tons of CO₂ and qualifying for annual 45Q tax credits—is on track for a late 2026 startup. The combination of a favorable commodity backdrop, structural supply constraints, a clean energy transition option, and a tax-shielded balance sheet with net operating losses for the next four to five years, makes LXU a compelling small-cap opportunity for investors willing to underwrite the cyclical risk inherent in nitrogen markets.

Outlook

Entering 2026, we held a constructive view on microcap equities, supported by improving monetary conditions, compelling relative valuations to large caps, and the expectation of a rotation back toward higher-quality businesses. We believed that easing financial conditions and an acceleration in earnings growth would provide a favorable backdrop for more cyclical areas of the market, particularly companies positioned for inflection in fundamentals. However, the recent escalation of geopolitical tensions in the Middle East, specifically the onset of conflict involving Iran, has materially shifted the

near-term outlook and introduced a higher degree of macro uncertainty.

The most immediate impact has been a sharp rise in oil and broader energy prices, which we expect will act as a headwind to the consumer and weigh on discretionary spending. Although tax refunds are trending higher than last year and would typically support consumption, much of that benefit is likely to be offset by increased gasoline and energy costs. Combined with the persistence of tariffs and a growing risk that inflation reaccelerates, the likelihood and pace of further rate cuts have become less certain. As a result, sectors we previously expected to inflect—particularly consumer-oriented businesses and financials—may see a more delayed recovery, even as their longer-term fundamentals remain intact.

In response, we have begun repositioning the portfolio toward areas better aligned with the evolving environment. We are finding increasing opportunities in energy and materials, which stand to benefit from supply disruptions and sustained pricing strength, while also selectively adding to more defensive sectors such as utilities and real estate, where earnings visibility is higher. This repositioning reflects a tactical adjustment rather than a change in philosophy, as we remain focused on owning high-quality businesses with durable competitive advantages and strong long-term return potential.

Despite the elevated uncertainty, it is important to recognize that markets tend to respond to incremental changes rather than absolute outcomes. As seen in prior periods of disruption—including the pandemic, the 2022 rate shock, and the regional banking stress in 2023—conditions do not need to fully normalize for equities to recover. Stabilization and gradual improvement are often sufficient to support a re-rating in risk assets. We are closely monitoring developments in the Middle East and remain prepared to take advantage of dislocations, selectively adding to high-quality businesses where valuations have become more attractive, with the goal of compounding capital over the long term.

Closing Remarks

Our dedication to a meticulous, bottom-up investment strategy within the micro-cap space remains steadfast, as we prioritize businesses characterized by robust balance sheets, strengthening fundamentals, and management teams focused on prudent capital allocation. The first quarter of 2026 was marked by a varied return landscape, yet our portfolio activity,

characterized by initiating positions at attractive entry points and reducing exposure to those with increased headwinds from the change in the macro environment, demonstrates our active and value-oriented approach in practice. We value the trust you have placed in us and look forward to sharing further updates on the strategy's evolution.



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(Disclosures and strategy largest contributors and detractors on next page).

**Micro Opportunities Strategy
 Largest Contributors and Detractors — Q1 2026**

5 Best - Absolute Contribution

Ticker	Company	Avg. Weight	Contribution
NPKI	NPK International Inc.	5.82%	1.09%
PLOW	Douglas Dynamics, Inc.	3.88%	1.03%
LMAT	LeMaitre Vascular, Inc.	3.48%	0.96%
MAMA	Mama's Creations, Inc.	5.93%	0.62%
AVBC	Avidia Bancorp, Inc.	4.08%	0.58%

5 Worst - Absolute Contribution

Ticker	Company	Avg. Weight	Contribution
RDVT	Red Violet, Inc.	2.79%	-1.39%
CCB	Coastal Financial Corporation	3.17%	-1.15%
AVD	American Vanguard Corporation	2.49%	-1.11%
ALLT	Allot Ltd.	2.27%	-0.68%
QNST	QuinStreet, Inc.	2.09%	-0.33%

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