Kopion Asset Management

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Platform Value

Tuesday, July 18, 2023

Dear Kopion Clients,

During the first half of 2023, Kopion returned 21.6% before fees (21.0% after fees). This compared to the S&P 500 and the Russell 2000, which returned 16.9% and 8.1%, respectively.

The consequences of pandemic-era policies continue to ripple through the economy. The most notable of these are that inflation remains too high and central banks continue to increase interest rates in an attempt to slow economies and reduce inflation. Similar to last summer, many investors are still anticipating a recession, though some are beginning to have their doubts about that. Their pessimism has thus eased into a more moderate skepticism, mingled with a fear of missing out on a rally. These dynamics have lifted stock prices.

Our portfolio as a whole has risen steadily over the last six months, but the individual stocks themselves have been remarkably volatile. There have also been a number of peculiar developments—even for the stock market—and I've often found myself thinking, "Gee, I've never seen that before."

The most notable development is that five companies in our portfolio have attracted take-over interest simultaneously. Moreover, two of those take-over attempts have had surprising characteristics. The most extreme has involved Stratasys, which is now fighting off an unethical, hostile take-over, as it tries to complete its own merger with another company, while yet a different company has begun a bidding war with the first suitor. The details of this drama are beyond the scope of this letter, but for those of you who are interested, *Forbes* recently published a good overview of these events. We are closely monitoring this extraordinary situation and will follow-up if we conclude that any action is needed on your part.

Another example is NI (formerly National Instruments), which announced that it had entered into a formal agreement to be acquired for $60.00 per share. Most of the time when this happens, the acquiree's stock will rise to within 2-3% of the agreed upon acquisition price and hold very steady there until the deal is completed. NI's stock initially began that pattern, but has since eased back down modestly, even after its shareholders approved the deal. In fact, as of this writing, the stock offers an annualized return of about

8-13% if the merger is completed on schedule and even more if NI continues to pay its generous dividend until then. I've never received this kind of bargain for continuing to hold one of our companies that is getting acquired.

I believe that the recent breadth of take-over interest in our companies illustrates two things about our portfolio. The first is that many of our companies were demonstrably undervalued as we entered 2023. Stock market investors were nervous while corporate buyers were not, and some of the latter have attempted to exploit low valuations. But the second and more important point of this take-over interest is that Kopion truly focuses on unique companies. Many investors claim to do this, but only a minority are selective in practice. In fact, over the last 10 years, Kopion has had three times as many companies be acquired as we have sold out of voluntarily. We are highly selective in the businesses we choose to purchase.

One of the characteristics that makes many of our companies unique—and all of the five receiving take-over interest—is that they have developed product *platforms*. For example, NI sells test and measurement equipment, but that equipment is made up of ingenious combinations of building-block software and hardware products. Each new piece of hardware and incremental software capability has expanded the usefulness and value of the overall platform. Later on, their offering came to include an ecosystem of third party service companies and technology firms that worked with NI's products, further extending the value of the platform. This touches on a facet of capitalism that isn't discussed very often but has become increasingly important over the last 30 years: the role of time.

An analogy on this front might be helpful. Imagine a competition in which various expeditionary teams will race to the highest point in "Darkest Peru," a region covered by tall mountains and dense jungle.[1] In this race, the teams start out with a few weeks of food, after which point they have to forage or hunt to sustain themselves. They also begin with only the most basic supplies. Everyone has a vague understanding of the summit's location, but progress towards it will be slow. They have to learn how to provide for themselves along the way and discover viable routes forward. Lastly, a few of the teams will have meaningful head starts.

Time plays a central role in races, so the teams with head starts begin with a significant advantage. But the newcomers may end up with advantages of their own. They might hear word of what has and hasn't worked for the initial teams. They may discover routes that prove faster. And as everyone's speeds, route lengths, and obstacles emerge, the role of time will come into sharper focus. At this point, some teams will realize that they can make much better progress if they join forces. Perhaps one team has discovered a secret route that is very promising but includes a cliff that can only be scaled with the climbing and rope-making expertise of a different team. And this leads us back to the concept of platforms and time.

Capitalism has some race-like characteristics, and time plays a big role in success. Product platforms typically require many years, if not decades, to develop, which means

[1] Acknowledgement: Darkest Peru is the fictitious birthplace of Paddington Bear, but he is not part of this analogy.

that it is sometimes advantageous to simply acquire a useful platform from someone else instead of spending years developing it in-house, during which time the other teams will still be advancing. The attractiveness of buying such a platform can be even greater if it is required to meet a window of opportunity or a deadline. The platforms that many of our companies have developed as standalone businesses have proven desirable to outside companies willing to pay a premium for those assets. And this is a reason that some of our companies are occasionally acquired.

In summary, the secondary effects of pandemic-era policies led to some unusual dynamics in our portfolio during the first half of the year, including significant acquisition-related activity. While larger than normal, this illustrates one of the merits of how we invest on a regular basis.

Thank you for your continued trust and support.

Best regards,

Terry Ledbetter, Jr., CFA
Jonathan Lindstrom, CFA

PERFORMANCE DISCLOSURES

Period	Kopion, Gross	Kopion, Net $_{\text{Max Fee}}$	S&P 500	Russell 2000
1st Half of 2023	21.6%	20.9%	16.9%	8.1%
Annualized*				
1 Year	-17.1%	-18.2%	-18.1%	-20.4%
3 Years	5.2%	3.9%	7.7%	3.1%
5 Years	6.7%	5.4%	9.4%	4.1%
10 Years	7.8%	6.5%	12.6%	9.0%

*Ending 12-31-22

Past performance does not guarantee future results. Investments with Kopion may lose value.

Terry Ledbetter, Jr. began managing his first diversified investment account on 2-4-04 while employed by Friedberg Investment Management (FIM). Mr. Ledbetter left FIM on 7-31-09 and founded Kopion Asset Management, LLC (Kopion), which became a legal entity on 8-24-09. Importantly, when Mr. Ledbetter founded Kopion, he continued to manage the same accounts that he had been managing while employed by FIM. The accounts, investment strategy, and investment process all remained the same. The performance information cited throughout Kopion's marketing materials includes all of the diversified investment accounts managed directly by Mr. Ledbetter since 2-4-04, which is when he began managing his first diversified investment account. This information is provided for both Mr. Ledbetter's entire performance history as well as for the portion of Mr. Ledbetter's performance history that occurred after Kopion was founded and became a legal entity.

The performance information cited throughout Kopion's marketing materials has been thoroughly documented, and it has been calculated using normal industry protocols, which are described in more detail below. This information has not, however, been audited by an independent third party. Dividend and interest income in these accounts was reinvested. Returns for these accounts have been asset-weighted to calculate historical returns. Said another way, the accounts were aggregated into a single group and then performance was calculated for that single group. This group includes some sub-accounts and securities that were carved out of larger accounts in order to exclude assets like mutual funds that Mr. Ledbetter did not manage directly. Those mutual funds were managed by professionals at third party firms, and Mr. Ledbetter's involvement was limited to being a passive shareholder of those mutual funds. In addition, some of those mutual funds followed fixed income strategies, which were very different from the strategy used by Mr. Ledbetter when he was employed by FIM and later at Kopion. Performance information that includes assets like mutual funds that were not managed directly is available, and Kopion will provide it promptly upon request.

Kopion reports its Time Weighted Returns (TWRs). TWRs make adjustments for deposits and withdrawals so that those transactions do not influence performance results. Consequently, deposits do not increase the return, and withdrawals do not decrease the return. TWRs thus allow for performance comparisons between Kopion's (and Mr. Ledbetter's) history and market indices.

Kopion reports both "gross returns" (which are returns before Kopion's management fee) and "net returns" (which are returns after deducting Kopion's management fee). Kopion's management fee schedule is graduated, which means that the fee rate begins to decrease after an account's dollar value exceeds a certain threshold. The label "Net $_{\text{Max Fee}}$" indicates that the net returns being presented reflect Kopion's maximum fee rate for all periods presented. The words "net" or "after fees" without the words "Max Fee" in subscript lettering indicates that the net returns being discussed reflect actual fees.

Kopion has provided the returns of the S&P 500 and the Russell 2000 indices in order to provide the broader stock market context of Kopion's (and Mr. Ledbetter's) returns. The S&P 500 tracks the performance of relatively large publicly traded companies, and the Russell 2000 tracks the performance of relatively small ones. Kopion does not "benchmark" its portfolio against indices in the traditional sense of carefully managing the portfolio for comparison against a specific index. Instead, these two indices are used as broad indicators of the stock market's performance. Mr. Ledbetter has primarily focused on small and medium sized firms, but he has also invested in some large companies as well. This is why Kopion has provided the results of both the S&P 500 and Russell 2000. These indices cannot be invested in directly, but mutual funds and exchange-traded funds that track these indices ("index funds") are available in the market. Kopion's (and Mr. Ledbetter's) investment strategy carries more risk than investing in an index fund that tracks either the S&P 500 or the Russell 2000. This is primarily because Kopion's (and Mr. Ledbetter's) strategy involves investing in a relatively small number of stocks and those stocks are primarily for small to medium sized companies. This approach results in greater volatility and greater risk of capital loss than index funds tracking either the S&P 500 or the Russell 2000.

Indices' performance figures have been obtained from sources believed to be reliable.