Dear Fellow Partners:

The partnership officially launched on June 4, so the results discussed below consist of less than one month of trading activity. A shorter than one-month period is inconsequential in the grand scheme of things and deserves little attention in this letter. But in summary, the partnership increased by 1.3% in June, net of fees, which compared favorably to the S&P 500 total return of .6%. Please check your statements as returns will vary slightly by class. The biggest contributor in the month was Eagle Pharmaceuticals (EGRX) while the biggest detractor was Anika Therapeutics (ANIK). At the end of June, the portfolio consisted of nine long positions and one short position well within our investment parameters of up to fifteen longs and five shorts. The top five positions represented 61% of the portfolio and our cash position was 9% at the end of the quarter. We view our cash position offensively and will deploy cash as market opportunities permit.

The best performer in the period was our lone short position, which declined by 16% (resulting in a 16% gain). Our plan is to scale into this position over time, and as a result, it was not the top contributor in the period. The reason we have chosen to scale into this position is because the catalyst for the short -- a new product launch that we expect will disappoint versus consensus -- is not scheduled to occur until the back half of the year. As a reminder, our goal with shorting is to generate positive absolute returns over time. We will only discuss short positions once they are closed out.

One common narrative across the portfolio is the presence of multiple founder-led or family-controlled companies. To be precise, five of our nine long holdings fit into this category. What is attractive about these situations? For starters, we bought them at favorable valuations that afford us a margin of safety. But, we like investing alongside founders and families as they tend to be maniacal about their businesses and very shareholder friendly. We won't always hold this many founder-led or family-controlled companies, but we are excited about those we currently own and expect them to do quite well over time.

At the end of the second quarter, my family was the largest investor in the partnership. Our commitment to the partnership represents the majority of our liquid net worth, and I believe a large ownership stake with real "skin in the game" creates strong alignment with limited partners.

Stock in the Spotlight

The largest position in the portfolio at the end of the second quarter was Anika Therapeutics (ANIK). The stock was also the largest detractor in the June period. As a rule of thumb, I believe it is more instructive to write about failures (losers) than successes (winners) as counterintuitive as that may be. Hopefully, LPs will gain a better understanding of our stock selection process and ongoing decision-making process because of this discussion.

Anika Therapeutics develops products derived from hyaluronic acid (HA) for the treatment of joint pain related to osteoarthritis of the knee. HA drugs are typically used as a replacement for synovial fluid in the joint if a patient fails to benefit from short-acting steroid injections, which are generally cheap and effective. Steroids can provide short-term pain relief (four to six weeks), while HA therapy can provide a longer duration of action (up to six months). Anika's lead products are ORTHOVISC (multi-injection) and MONOVISC (single-injection), but the market is moving quickly to the single injection option which is more patient and doctor friendly. Anika's products are sold by Johnson & Johnson's (JNJ) orthopedic business unit in the United States and by other partners around the world. The global hyaluronic acid market generated sales approaching $8 billion in 2017 and the market is expected to grow at a high single digit rate through 2025.

I have followed Anika for over a decade, but I have never been an owner of the stock. Anika recently popped up on my radar after selling off from a high of $68 to the low $40s. In the low $40s, the company had 27% of its market cap in cash and no debt and an underlying operating business that had averaged free cash flow of $27 million per year over the past five years. In 2017, the company generated $32 million of free cash flow after spending almost $19 million on R&D (+75% y/y), a record high. The company has produced operating margins in the 40-50% range over the same five-year period. Additionally, ROIC has averaged 25% per year over the past five years and ROE has averaged 15% per year in the same period. In short, this was a fantastic business that we were buying with an attractive free cash flow yield (7%) and earnings multiple (15x) on trailing numbers with significant pipeline optionality from the company's lead phase 3 asset, Cingal.

Cingal is a third generation HA-based product for the treatment of pain related to osteoarthritis of the knee. Cingal combines HA and a short-acting steroid (triamcinolone) into one convenient injection to provide both short-term and long-term pain relief. The drug has been approved in Europe and Canada and is launching well in both markets. In the U.S., the drug is in a large-scale phase 3 clinical trial. Unfortunately, in June it was announced that the drug failed to meet its primary endpoint of pain reduction at six months versus steroid alone due to a higher-than-expected placebo effect in the active comparator arm. This was an unexpected result, but I didn't believe we were paying much for this program when we entered the position in the low $40s. Cingal would have participated in a very large market, which could have doubled the company's sales in a short period of time (two to three years) with very high incremental margins. In the low $40s, I believed our margin of safety to be a 20% loss, but the stock sold off by roughly 30% from our average cost on the news – a clear error of judgement on my part. In hindsight, the other error that I committed was making the position too big in front of the data readout.

We aggressively added to Anika on weakness almost doubling our position in total. At prices ranging from $29-$31 per share, we were buying stock with almost 40% of the market cap in cash (again, no debt) and a wonderful underlying operating business. Cingal will have one additional clinical readout on a nine-month pain score endpoint, which the company could file on if the result is positive. We should know the outcome in September or October. I believe that we paid virtually nothing for this optionality when the stock was in the $29-31 range. Anika recently announced that the company is buying back 5% of its shares outstanding this year, and I have encouraged the CEO to take a bolder stance on capital deployment at the current price.

How do we win from here? If Cingal can deliver a statistically significant result versus the active comparator arm on the nine-month clinical endpoint, the company could potentially file the drug and gain FDA approval. In this scenario, the stock has >100% upside. In both a clinical success or failure scenario, Anika could become a takeout candidate at some point in the future with JNJ being the logical acquiror. If Cingal is a complete failure in the U.S., I believe short-term downside could be a re-test of the recent lows, but management would most likely become more aggressive with capital deployment at that level. In short, I believe the risk-reward picture is highly favorable in the mid-$30s where the stock trades today.

Clients are More Than Investors

An investment firm is only as good as its clients; in this case our limited partners. Attracting limited partners with a long-term focus and value orientation is crucial to our success. Of our initial "founder" partners, I am pleased to report that almost 70% have chosen the five-year lock-up option demonstrating a strong commitment to the partnership's strategy. In total, these five-year partners represent over 90% of the initial capital in the partnership. Along with our three-year partners, I am thankful to have found such valuable, long-term oriented partners and view them as a material strategic advantage. In a world that is obsessed with short-term thinking and performance evaluation, having a three and five-year runway is hugely beneficial to my ability to hold stocks for the long term.

Our current investor base includes public company CEOs, portfolio managers, board members, investment bankers and other industry professionals. They provide a network of talented individuals to use as a sounding board and to assist when performing due diligence on ideas. I feel very fortunate to have such high-quality and long-term focused partners invested in the partnership.

The Path Forward

We will remain focused on finding value in our small circle of competence. If we can't identify attractive investments, we will hold cash until our patience pays off. The areas of the market where we are looking most closely for opportunities include in founder-led companies, corporate spin-offs and carve-outs, and orphaned companies. Along these lines, we are evaluating one opportunity in particular which looks very compelling. We are performing due diligence now, and if we decide to invest, I will write about the company in a future quarterly letter.

We are in the process of registering with the state of Colorado as an investment advisor, and my expectation is that we will be approved in the next thirty to forty-five days. Being a Colorado-registered investment advisor will allow the partnership to accept IRA money. I will inform you when this important step has been accomplished, and my family will be making another meaningful contribution to the partnership at that time.

Macro Musings

I don't spend much time considering the macro environment, so I will keep these remarks brief. As rhetoric out of Washington continues to heat up, I worry about the risk of trade wars and the law of unintended consequences especially with equity markets near all-time highs. Also, the yield curve continues to tighten which we will monitor closely going forward. Historically, a negative yield curve has been a reliable predictor of an economic recession on the horizon. Today, the spread between the 10-year treasury note and the 2-year treasury note is a mere 28 basis points. With stocks at historically elevated multiples, investors do not seem to be pricing in the risk of a recession in the near term, which leads us to have a cautious outlook.

Within the health care sector, it is a story of the "haves" and "have-nots." Stocks such as Align Technologies (ALGN), Abiomed (ABMD), Intuitive Surgical (ISRG), among many small cap biotech companies, have had remarkable runs, but we see no value at their current prices. The price momentum in these stocks is truly a thing of beauty. Meanwhile, value stocks within the sector are largely being ignored by investors in favor of the market darlings. In fact, many of the beaten down value stocks in the sector (and in our portfolio) are trading near multi-year lows. When will this dynamic change? I have no idea, but patience is the best recipe in times like these.

A Partnership is Born

Summers Value Partners LLC was founded on the idea that a disciplined investment process focused on small and micro-cap stocks within a narrow circle of competence can generate attractive risk-adjusted returns over the long term. Compounding our partner's capital at an attractive rate of return over the long term is paramount to our existence. The Summers Value Fund LP was officially launched in June with this clear mission in mind.

It was twenty years ago to the month that I graduated from the University of Wisconsin as an aspiring equity analyst and began my investment career at INVESCO Funds Group in Denver, CO. Since my grandfather bought me my first stock as a young child, my passion for investing has burned bright. I feel very lucky to have this job, and I come to the office every morning excited to learn more about investing and to research new investment opportunities for the partnership. The first twenty years of my investment career have been an incredible journey. However, I am even more excited about the next twenty years given the flexibility of our mandate and our ability to focus on the long term.

I am not predicting a smooth ride. In fact, I vastly prefer a bumpy ride with higher annualized returns to a smooth ride with lower annualized returns. Our portfolio is concentrated in our best ideas, but the market will not always agree with my assessment of value, which could lead to long periods of underperformance. The portfolio will be uncorrelated to the broader market and will be far more volatile. Our long-term lock-ups are intended to give us time for our investments to pay off and to ride out short-term volatility.

I would encourage current and future partners to peruse the partner handbook that has been posted on our website at www.summersvalue.com. The handbook describes the core values of the firm and the strategy that we will employ as we attempt to generate attractive risk-adjusted returns for our limited partners over the long term.

In Closing

I would like to extend a warm welcome to the new limited partners who joined the partnership on July 1. Our strategy has ample capacity and we seek like-minded individuals to join the partnership. A referral from an existing limited partner is our preferred method of growth and is always appreciated. Interested parties can reach out to me directly at andy@summersvalue.com.

Sincerely,

Andrew Summers, CFA
Managing Partner

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This report includes candid statements and observations regarding investment strategies, individual securities, and economic and market conditions; however, there is no guarantee that these statements, opinions or forecasts will prove to be correct. These comments may also include the expression of opinions that are speculative in nature and should not be relied on as statements of fact.

Summers Value Partners LLC is committed to communicating with our investment partners as candidly as possible because we believe our investors benefit from understanding our investment philosophy, investment process, stock selection methodology and investor temperament. Our views and opinions include "forward-looking statements" which may or may not be accurate over the long term. You should not place undue reliance on forward-looking statements, which are current as of the date of this report. We disclaim any obligation to update or alter any forward-looking statements, whether as a result of new information, future events or otherwise. While we believe we have a reasonable basis for our appraisals and we have confidence in our opinions, actual results may differ materially from those we anticipate.

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