VOSS
CAPITAL

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Dear Partners,

In Q1 2018 the Voss Value Fund returned +3.99% to investors net of fees and expenses, compared to a -0.08% total return for the Russell 2000 and a -0.76% total return for the S&P 500. The Fund's total gross exposure stands at 131.6% and the beta-adjusted net long exposure is 45.0%. Our top 10 longs have a 71.5% weighting and our top 10 shorts have a gross weight of -15.5%.

Voss Value Fund, LP

ESTIMATED NET MONTHLY PERFORMANCE | 2018				
PERIOD	VVF (Net)	VVF (Gross)	Russell 2000 TR	S&P 500 TR
JANUARY	0.61%	0.85%	2.61%	5.73%
FEBRUARY	1.49%	1.94%	-3.87%	-3.69%
MARCH	1.84%	2.37%	1.29%	-2.54%
1st QUARTER	**3.99%**	**5.25%**	**-0.08%**	**-0.76%**
APRIL				
MAY				
JUNE				
2nd QUARTER	**0.00%**	**0.00%**	**0.00%**	**0.00%**
JULY				
AUGUST				
SEPTEMBER				
3rd QUARTER	**0.00%**	**0.00%**	**0.00%**	**0.00%**
OCTOBER				
NOVEMBER				
DECEMBER				
4th QUARTER	**0.00%**	**0.00%**	**0.00%**	**0.00%**
YEAR TO DATE	**3.99%**	**5.25%**	**-0.08%**	**-0.76%**

The table below shows the Voss Value Fund's Net Returns compared to some of the relevant indices over various time frames:

Net Return Comparison as of March 31st, 2018					CAGR		
	1 Month	3 Month	YTD	1-Year	3-Year	5-Year	ITD
Voss Value Fund, LP	**1.8%**	**4.0%**	**4.0%**	**6.2%**	**13.0%**	**16.0%**	**17.1%**
S&P 500	-2.5%	-0.8%	-0.8%	14.0%	10.8%	13.3%	16.4%
Russell 2000	1.3%	-0.1%	-0.1%	11.8%	8.4%	11.5%	15.8%
Russell 2000 Growth	1.3%	2.3%	2.3%	18.6%	8.8%	12.9%	16.7%
Russell 2000 Value	1.2%	-2.6%	-2.6%	5.1%	7.9%	10.0%	14.8%
HFRI Equity Hedge Index	-0.7%	0.8%	0.8%	10.0%	5.4%	5.8%	6.6%

CAGR is defined as Compound Annual Growth Rate. All performance figures are unaudited, estimated, and may be subject to subsequent adjustment. A limited partner's actual returns may vary from published fund returns based on the timing of capital and fee arrangements. This statement represents information based on the policies of the fund's managers and general partner. Please contact Kelli Walter, Chief Operating Office of Voss Capital, LLC, with any inquiries.

Just when The Great Humiliator's gyrations seemed pitifully limited, February offered a brief glimpse of its tempestuous nature and the instability lurking beneath the gentle guise. Q1 witnessed peak-to-trough declines in the S&P 500 of -10.2% and -9.2% for the Russell 2000 (on an end of day/closing basis). Investor focus seemingly shifted myopically from one worry to the next, such as a variety of import tariffs and the 3% yield threshold on 10-year US Treasuries. The anxiety from these events and topics are far outrunning their true market impact potential, in our opinion.

Retail investor fund flows (Mutual Funds + ETFs) have been negative for three months in a row. The Conference Board's gauge of US investor sentiment in April showed that just 33% of respondents believe stocks will rise over the next 12 months. It's amazing what a little volatility can do to the psyche. The mild correction finally sapped sentiment a smidge, surely setting a lower hurdle for reality to clear as the year progresses.

Through the end of April, the Russell 2000 Index had a total return of 0.79%, with a continued divergence between growth and value, as evidenced by the Russell 2000 Growth index being up 2.38 % YTD and the Russell 2000 Value Index being down -0.92%. The Value Line Composite Index, an equally weighted index of ~1,700 stocks, is down 2.32% YTD (this index gives a better sense of the "average stock").

As of April 27th, of S&P 500 constituents that have reported Q1 2018 earnings (about 66% of them), year-over-year earnings growth clocked in at a blistering average of +27%, which is well above the +18% that was estimated just a month ago. The earnings growth is certainly not all from tax law changes either, as Q1 revenue growth has been a solid +8.4% y/y, with 74% of companies beating top-line estimates (5-year average beat rate is 57%).[1]

With this pace of earnings growth and mild price declines, the P/E ratio has substantially compressed in each of the last four months. The forward P/E for the Russell 2000 sits at 16.9x, down 3-turns since November 2017. This forward multiple is about 10% above the average since 1985 and is in the 74th percentile. On a median basis, however, the forward P/E is 19.6x, which is still a 20% premium relative to the historical average of 16.4x.[2] The S&P 500's forward P/E is now actually below its trailing 5-year average.

In sum, skepticism has swelled and sentiment has soured while stocks' fundamentals have improved the last few months. We are generally finding more bargain-priced companies where positive developments are being scorned and ignored and this makes us more optimistic on the long book's return prospects than we've been in some time. On the flip side, there remains many pockets of bubbles within the market that offer generational shorting opportunities.

We previously laid out the case for shorting consumer goods companies, particularly a basket of the packaged food companies, and consumer staples as a sector has been the worst performing YTD at -11.1% through the end of April. Staples as a group are still valued at forward P/E ratios ~50% above their long term median. We are sticking with the shorts and are looking for other companies whose top line and margins will be hampered by a secular shift towards more private label goods and lower barriers to entry for CPG start-ups.

Trio of New Healthcare Shorts

One area of persistent froth in the market is certain pockets of healthcare. While growing steadily, several med-device and healthcare services firms remain above 10x or even 25x sales (which is not normal historically). We have recently shorted three new healthcare stocks.

First, Healthcare Services Group (HCSG). HCSG provides outsourced housekeeping, laundry, and dining services to 3,700+ senior living facilities and hospital locations. Customers serviced include acute care hospitals, psychiatric hospitals, surgery centers, skilled nursing facilities, assisted living and continuing care retirement centers. HCSG occupies a decent niche with >90% annual customer retention (no long-term contracts), is growing, and consistently has low cap-ex needs. The company has raised the dividend 58 consecutive quarters, so optically things look quite good. The Voss Variant View on the stock is that it's a highly valued (24x LTM EBITDA at time short initiated) mediocre business (14% gross margins) with major accounting issues and poor quality of earnings that could lead to multiple compression and >50% downside.

HCSG masked weakening organic growth with what appears to be an acquisition that was spun to investors as a large contract win. This large contract win was offering Dietary Services to Genesis Healthcare, a public company (GEN) that is currently distressed (over 11x Net Debt/EBITDA). Since the acquisition, DSOs have spiked, rising from the low 50s to over 70. Additionally, the company shifts questionable accounts receivables into interest-only Promissory Notes, which now make up 9.3% of total A/R. Skyrocketing receivables has severely crimped free cash flow, with last twelve months FCF now negative compared to Adjusted EBITDA coming in at over $100 million. In the first quarter of 2018, the company wrote down $35 million in receivables and shifted more receivables into Notes Payable as they commented that both Genesis Healthcare and another large customer had corporate restructurings.

In addition to receivables issues, we believe EBIT growth has been overstated by additional aggressive accounting, whereby the company reversed an insurance reserve in Q4 2017. We estimate that had they not done this, EBT would have been *down* 18% y/y vs. the 7% reported growth (and flat for the year). In order for the company to hit their current EBIT estimates, they would have to grow 35% in 2018 off what we believe was the more normalized EBIT base (ex-insurance reversal). Thus, the company has to hit heroic assumptions to come close to matching the sell side's expectations, leaving room for further downside disappointments. Additionally, an ongoing segment mix-shift to more Dietary segment revenues could materially compress gross margins (Dietary ~450 bps lower than Housekeeping's ~9.7%). HCSG's 10-year median forward EBITDA multiple is 17x. At 17x 2018 consensus, the stock still has about 15% downside. However, given the numerous issues plaguing both the company and the industry it serves, we believe the stock should go materially below its median EBITDA multiple. If the shares were to dip to 10x our bear case EBITDA (normalizing for insurance reserve reversal along with a spike in bad debt expense), there is still 67% downside.

Next up, Inogen, Inc. (INGN). INGN manufactures and sells portable oxygen concentrators (POCs) for long term oxygen therapy to people suffering from chronic respiratory conditions (COPD). POCs are small ~5 pound devices that can be carried over the patient's shoulder and have breathing tubes coming out. INGN's latest model retails for about $2,500. The stock has spiked to a new all-time high, mostly on the back of multiple expansion, even as growth has slowed and margins have compressed. INGN has limited recurring revenue but is still trading at an EV/Sales multiple of 12.4x as if it were a SaaS business model. The bull case on the stock is that INGN has a better mouse trap with a lighter weight, more easily transportable oxygen concentrator (as opposed to bulkier steel oxygen tanks that require refills) and they dominate the POC niche, which is increasing its penetration in a growing long term oxygen therapy market. ResMed, the 800 pound gorilla in the sleep treatment equipment market, is also just now entering INGN's niche and will throw a lot of marketing spend and an established distribution network behind their new POC product.

Like HCSG, INGN's receivables are elevated and have become concentrated into just two customers, one of which is their private label partner. It is possible that they have used good financing terms to entice distributors to load up on excess inventory, increasing the chances of a slowdown as the inventory is worked off. INGN has quickly been shifting away from the rental market, which is almost entirely Medicare business, and instead is focusing efforts on a direct-to-consumer sales approach. INGN has shown an impressive growth rate in units shipped. And despite a positive mix shift towards DTC Sales, INGN has experienced 13 consecutive quarters of Average Selling Price declines on their units sold, with those ASP declines accelerating downward, particularly in the last two quarters.

Like most high fliers in this market that are rewarded purely for sales growth, INGN is spending more and more on sales and marketing as a percentage of sales, eroding profitability. A difference between INGN engaging in this tactic versus a software company is that INGN has no recurring revenue component, thus it makes less sense to spend upfront to land the customer whose lifetime value is quite low compared to a high margin, low-churn SaaS company.

INGN aggressively bid for Medicare rental business over the last few years, which could come back to bite them. Almost all of the Medicare reimbursement for POCs comes in the first 36 months of a 60-month cycle. However, the supplier, in this case INGN, must provide maintenance, support, and any related supplies over the full five-year term for no additional charge. Their POCs usually have a 3-year warranty as, like any piece of electronic equipment, they can be dropped, start to wear out and have problems, etc. If INGN has underestimated their warranty cost on the rented units, there will be a long tail of continuous pressure on gross margins on units sold many years ago. Additionally, INGN offers a lifetime warranty on all DTC sales. The company estimates that ~20% of patients die each year and most will die within five years, thus they will not have a lot of warranty expenses. On the contrary, research shows that the median expected life expectancy for even the most severe COPD patients (Stage 3/4) that still smoke is >8 years. For those that are Stage 3 or 4 but have never smoked, the median life expectancy is >16 years.[3] Typically the patients with the most severe COPD will not be able to use POCs, so they are not even in INGN's target market. They are going after the less severe patients, thus the life expectancy is even longer. It is possible INGN has systematically under-reserved for warranty expenses for the next few years.

The sell side has been drastically overestimating INGN's gross margins and are forecasting expansion going forward. It is possible they continue to disappoint with ongoing ASP declines and increasing provisions for warranties, which are included in the company's cost of goods sold.

INGN's NTM EBITDA multiple has ranged from 19x to a current high of 79.8x, with an average since its 2014 IPO of 31x. If the stock reverts back to this average on forward EBITDA estimates as EBITDA margins have compressed and growth has materially slowed down, the stock has 48% downside.

Lastly, we are short Senseonics, Inc. (SENS). SENS is a medical device company focused on continuous glucose monitors (CGM) for diabetics. SENS is making an implantable CGM (iCGM) that lasts for 90-180 days, where the patient has a pill-sized fluorescent sensor inserted into the back of the upper arm with a procedure at an endocrinologist doctor's office. They do this once every 90-180 days versus alternative of swapping out a patch-CGM every few days/weeks. After Q2 2016 approval and launch of their only product in the EU and using a large and experienced third party as a distributor (Roche), SENS's Eversense iCGM has failed to gain market traction with cumulative revenue to date of only $6.7 million (since June 2016), which compares to inflated expectations for >$60mm within first 18 months of their US launch.

The stock is up over 100% in the last year and up 20% YTD after positive FDA review of safety and efficacy by the FDA Clinical Toxicology Devices Panel and has priced in an overly optimistic sales scenario over the next five years and is priced at >5x 2020 consensus sales estimates. Consensus sell side expectations will be revised down meaningfully over the coming quarters/years. Consensus 2019 Sales estimates have come down from >$100mm in mid-2016 to $70mm currently, but market cap is up 100% over that time.

The company's trailing twelve month cash burn is $56.1 million which will accelerate meaningfully this year (to >$75mm estimated this year, and remain elevated for the next several years) as they ramp up commercialization, build out a marketing sales force and elevate other fixed costs due to opting to go to market with self-distribution in the US.

Given the insertion/removal of the Eversense requires a doctor's visit and an additional external sensor still needs to be worn above the implanted device, the Eversense is equally as cumbersome and is *not* hassle-free. The procedure itself requires special training for the doctor, conducted by Eversense staff, further limiting speed of any potential ramp up due to the resources and personnel required for training and the fact that doctors are unlikely to have fast uptake as it requires a habit change on their part and is something entirely new. Additionally, implant retrieval required general anesthesia in many cases in the company's PRECISE II trial, which signifies it is often more than just a "simple procedure." In fact, 23% of patients in the EU dropped after the first insertion. Another 10% dropped after the second insertion. Patient "churn" will likely be very high and proves the benefits are possibly overstated and the lifetime value of a customer is not great.

Competition within the CGM space is intensifying greatly in 2H 2018/1H 2019 with several large players bringing no-finger-stick CGM systems to market, including Abbott in 2H 2018 and Dexcom by 1H 2019. Medtronic has proprietary CGMs that pair with their insulin pumps, but they are also entering the standalone CGM market this year with their Guardian Connect system. Both Dexcom and Medtronic stopped pursuing development of implantable CGMs because the tech on external CGMs has gotten so much better. Another major source of competition that could leapfrog every established player is Google's Verily, which is working on a miniaturized CGM in conjunction with Dexcom, as well as a contact lens that senses glucose and still works as a contact. Many diabetics who are insulin dependent are moving to a pump/CGM combo, or hybrid closed loop system, a/k/a "Artificial Pancreas"—a set-up that requires no intervention or action by the patient. Given Dexcom's interoperability and market leadership, the leading insulin pump players will either integrate with Dexcom CG6 (e.g. Tandem Diabetes TNDM), or go it alone, like Medtronic.

Short interest is also low at only 8% of the float, lowering the potential for a short squeeze which can happen in these smaller low revenue med-device stocks. This is only a small short for us for now, with the potential to be upsized should the stock pop upon news of final regulatory approval that is expected in June or July.

The famous Gilbert & Sullivan comedic opera from 1878, HMS Pinafore (aka The Lass That Loved a Sailor), pokes fun at the rise of unqualified people to positions of authority (a satire that could be more timely than ever now). In it there is an interesting exchange between Captain Corcoran and his crew[4]:

Captain: Bad language or abuse,
I never, never use
Whatever the emergency;
Though "bother it" I may
Occasionally say,
I never use a big, big D-
Chorus: What, never?
Captain: No, never!

Chorus:	What, never?
Captain:	Hardly ever!

We had a large short get bought out in April at an 80% premium, badly dinging the month's returns. I am still scratching my head over what the acquirer saw. While we do not believe INGN, SENS, or HCSG would make attractive takeout candidates at their present valuations, that possibility is always a 'what-if', forever undermining our conviction and limiting our position sizes. The markets are merely an extension of human nature, so wondrously and befuddlingly complex that almost anything possible can happen. At Voss, we never say never, well….at least hardly ever.

Thank you for your continued trust and support and for the privilege of managing a portion of your capital.

To Continued Alpha,

Voss Team

Sources:

1: Factset, 4/27/2018

2: Bank of America Merrill Lynch US Equity & Quant Strategy report, 5/3/2018

3: International Journal of COPD, 2009: Life expectancy and years of life lost in chronic obstructive pulmonary disease: Findings from the NHANES III Follow-up Study

4: Source: http://www.gsarchive.net/pinafore/web_opera/pin04.html

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