

River Oaks Capital H1 2025 Report

Investing with an owner, long-term mindset in a select number of small, underfollowed public companies.

www.riveroaks-capital.com

River Oaks Capital Performance (%) since inception January 1, 2020- June 30, 2025

Benchmarks	YTD	1 Year	3 Year	5 Year	Since Inception	Annualized
Russell 2000 TR*	-1.8%	7.7%	33.1%	61.31%	40.4%	6.4%
Russell Microcap TR	-1.1%	13.4%	28.2%	56.0%	38.5%	6.1%
River Oaks Capital**	0.9%	18.4%	35.4%	127.3%	77.0%	11.0%

*TR = Total Return (dividends reinvested)

**Before Management fees
(~10% annualized after fees)

S&P 500 TR	6.2%	15.2%	71.6%	115.9%	109.2%	14.4%
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Our Companies

Name	Market Cap*	Strategy
Citizens Bank (CZBS)	\$80m	Excessive Discount
Truxton Trust (TRUX)	\$230m	Wonderful Business
Boston Omaha (BOC)	\$440m	Wonderful Business
America's Car Mart (CRMT)	\$460m	Wonderful Business
BuildDirect (BILD.V)^	\$45m	Wonderful Business
Innovative Food Holdings (IVFH)	\$70m	Wonderful Business
Undisclosed	\$50m	Wonderful Business
BankFirst (BFCC)	\$220m	Excessive Discount
Medical Facilities (DR.TO)	\$210m	Wonderful Business
Fitlife (FTLF)	\$120m	Wonderful Business
BCP Investment Corp (BCIC)	\$160m	Excessive Discount
Greenfirst Forest Products (GFP)	\$55m	Excessive Discount
Old Market Capital (OMCC)	\$40m	Excessive Discount
Haypp Group (HAYPP)	\$450m	Wonderful Business
R&R REIT (RRR.UN)	\$175m	Excessive Discount
SR Bancorp (SRBK)	\$125m	Excessive Discount

*As of 6/30/2025

^ Invested on 7/15/2025

H1 2025 Letter

The H1 2025 letter was delayed this year due to River Oaks Capital participating in a [Private Placement](#) equity raise for BuildDirect (BILD.V) in July – mentioned further in the following section.

Here is the link to River Oaks Capital's previous letters: [Past Letters](#)

River Oaks Capital is open for new investors, if you or anyone you know is interested in learning more about our fund, please visit [our website](#) or e-mail me at whuguley@riveroaks-capital.com

Thank you to all who have expressed your interest in River Oak Capital's letters. They tend to be long and in-depth, much like the research River Oaks does on a company

before we buy ownership. To that end, I have started a table of contents, to make the letter more navigable.

- I. Investment Philosophy & Thoughts
 - II. Companies added in the Past Year
 - III. Updates from H2 2024 Letter
 - IV. Mistakes
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I. Investment Philosophy & Overview

"Investors should remember that their scorecard is not computed using Olympic-diving methods: Degree-of-difficulty doesn't count" – Warren Buffett

As I sat down to write this letter, I became curious over the similar characteristics amongst the small, public companies River Oaks Capital owns – or has owned – that have given us wonderful returns for the past five and half years.

The only four common themes I could find were:

1. An "A+" management team – I am sure you are sick of me using this term by now!
2. A wonderful small, niche business
3. A valuation that provides a margin of safety
4. Attentive to their share price – where being a 'suggestivist investor' comes into play

The absolute top tier investments we have made have been when all four of these variables are combined (more on this at the end of the section).

1. A+ Management team

To use a quote from the last letter "The importance of the management team is inversely proportional to the size of the company."

A vast majority of the success of small, public companies relies on the capability of the management team – most specifically the CEO.

Running a small business is hard.

The management team often deals with suboptimal technology and supporting staff.

Without an A+ CEO carrying a heavy load of the work and astutely allocating capital, the business will generate mediocre returns at best.

The question I get most frequently when being interviewed on podcasts or when talking to other investors is how do you identify and find an A+ CEO in small, public companies?

The short answer is that it takes a tremendous amount of investigative work.

Imagine if you are a partial owner of a small, fast food restaurant chain with a few locations in

your hometown.

You go each month to talk to the manager of the restaurant chain and all they tell you is how wonderful the restaurants are performing and there are no improvements needed.

In fact, they say that this small restaurant chain is so wonderful that it has real potential to be the next McDonalds!

You would probably leave the meeting feeling you were being told only half the story – knowing that any business (especially small businesses) has a host of problems – as well as feeling the conversation was more of a sales pitch than an actual discussion about the capabilities and needs of the company.

You would be shocked at the number of conversations I have with small, public company CEO's who make the exact same claims.

Pronouncing our business is perfect and we are on track for our stock to increase 1000% and eventually become the next Apple – often throwing in whatever buzzword is popular at the time (AI, cryptocurrency, etc.).

I have used this example continuously since beginning River Oaks Capital, but Dayton Judd – A+ CEO of Fitlife – did the exact opposite.

When I flew out to visit him in Fort Worth, Texas years ago, he spoke to me business owner to business owner (knowing the company's numbers inside and out), telling me what areas Fitlife excelled in and what areas needed improvement.

Dayton's capital allocation abilities are second to none, but he certainly did not pitch to me that Fitlife's stock would go up 1000% or one day they would be in the S&P 500.

It was a purely business focused conversation.

Dayton has always under promised and over delivered. He has been my north star whenever I talk to other CEOs. I always see how they stack up against Dayton.

It's worth again putting in Jim Collins definition of a "level 5 leader" from the book ['Good to Great'](#):

"A leadership style that is characterized by a powerful combination of personal humility and professional will."

"Which means that they are highly ambitious for the organization's success but with a modest and self-effacing attitude, prioritizing the needs of the company over their own personal gain."

This not only describes Dayton better than I ever could but gives a prototype for the types of A+ CEO's we are looking to invest in.

For me personally, I can only diagnose if a CEO is A+ by visiting them in person – which is still not fool proof.

But time and again, it has proven to be imperative to fly and meet them in person.

In a typical year, we may only find one to three new A+ management teams in small, public companies – three would be a very good year – to invest alongside which has both good news

and bad news.

The good news is that A+ CEOs in small, public companies and small businesses in general are extremely few and far between.

This means that once you find an A+ CEO they are almost certainly dominating their industry as they are competing against sub-par CEO's.

Compared to their competitors, they will be able to adapt to changing times much faster and steadily navigate any choppy water that arises in their industry.

Simultaneously, they are gaining market share on their competition and delivering positive surprises to investors who are conditioned to expect nothing but negative announcements from small, public companies.

Perhaps, most importantly, they are looking at their CEO role not as a 9-5 job but rather, they are building the foundation and capital allocation plan for a business that can flourish for decades to come.

To go back to the restaurant analogy, they will comp the meal of a reliable customer knowing it will decrease quarterly earnings but create a loyal patron for life – focusing on duration of earnings over short-term gains.

The bad news is trying to find an A+ CEO in a small, public company takes very hard detective work!

They are often non-promotional and intentionally remain difficult to find as they are 100% focused on business execution.

It requires tireless effort and traveling the country far and wide but the excitement on the plane ride home after you have found an A+ CEO to invest alongside is worth all the effort.

2. A wonderful, small, niche business

Regardless of the size of the company, investors are always looking for a business with a distinct competitive advantage or 'economic moat' before they buy ownership.

When looking at small, public companies, they almost never have an 'economic moat' like Coca-Cola or Apple.

If a company the size of Coca-Cola or Apple wanted to become the market leader in a sector that a small, public company was currently dominating, they could easily do so.

They have so much cash and resources that they could run an unprofitable, money-losing operation until the small, public company could no longer compete with them.

This is why it rarely makes sense for a small, public company to attack a large, well-known market.

The companies River Oaks Capital buys ownership in are in small, niche industries.

Often, I did not even know the industry existed before I spoke to or visited the business.

Although these companies will rarely ever have a true 'economic moat', the way I think about it is they are a 'remote island' so far away that it is too time-consuming for any major player to

conquer.

A multi-billion-dollar corporation will either:

1. Leave this 'remote island' business alone as even if they gained significant market share in the 'remote island's' small, niche industry it would insignificantly increase their revenue.
2. Pay a significant premium to buy the 'remote island' business rather than trying to conquer it.

This allows the dominant wonderful business in this 'remote island' small, niche industry to often generate above average returns for decades as any large, worthy competitors just simply stay away.

The ability of these wonderful companies to generate a long duration – multiple decades – of above average returns is what typical investors tend to miss as they instead search for small, public companies making massive returns in large markets that will soon be squandered as major competitors approach.

3. A valuation that provides an adequate margin of safety

As mentioned in the River Oaks Capital ['Owner's Manual'](#) and previous letters, even when buying a wonderful company, a margin of safety is imperative – especially when dealing with small, public companies.

In any business mistakes are made but in small businesses they seem to be made at an even higher frequency.

Even after due diligence is done on the company and I visit the management team in person multiple times, I could still be wrong in diagnosing the company to be a wonderful business – or we could just simply run into bad luck.

This is where purchasing ownership in the company at a margin of safety is a necessity because in small, public companies you can't just immediately sell all your shares when you realize a mistake or bad luck has occurred.

Remaining disciplined in our purchase price – fortunately even most wonderful small, public companies are dramatically undervalued – has allowed us to exit our mistakes and still receive a large percentage of our full purchase price.

4. Attentive to their share price – where we have been 'suggestivist investors'

Over the past five and a half years of running River Oaks Capital all of the small, public companies we have owned have been or remain inefficiently priced – trading well below fair value.

The ongoing narrative has always been that if the management team just keeps their head down and executes eventually the market will realize the company's undervaluation.

I am now changing my mind on this thesis, as almost no one is paying attention to these markets anymore.

Thus, it is imperative for the management team to be prepared to buy back shares to not only

take advantage of their inefficiently priced stock – instead of getting upset about it – but also to make sure their stock price eventually closes in on fair value if they ever foresee needing to use their shares as currency – such as in an acquisition, growth capital needs or emergency situation.

This is why over the past few years I have taken a ‘suggestivist’ approach by flying around the country to visit companies River Oaks Capital already owns pitching them to implement a share buyback program.

This gives investors’ confidence that if the company’s share price drops to an illogical valuation the management will step in and buy a large amount – creating a ‘floor’ for the share price.

Over the years, I have watched management teams not implement a share buyback program and pay zero attention to their share price which has come back to really hurt them.

For example, bad luck occurs and they have to do an emergency dilutive equity raise, they want to sell their company but the buyer is only willing to pay a premium based on the significantly undervalued share price or they want to do an acquisition but can’t use their shares as currency.

In short, having your share price consistently remain at an egregious low valuation and the management team taking no action presents a lot of danger in small, public markets.

Combining points #1, #2, #3 and #4

When you plug in an A+ management team into a wonderful, small niche business, the above average returns for owners start to transform into incredible or even astronomical returns.

Once the A+ management team steps in the door, they almost immediately unlock the often-dormant potential of this wonderful business – that was previously being run by a marginal CEO.

The A+ CEO identifies the core competency of the wonderful, niche business and then use their brilliant capital allocation skills and drive to exploit the company’s advantage over their limited competition – while buying back shares if the market doesn’t fairly value their company.

Then once their marginal competition starts to suffer more and more, the wonderful business starts to gain market share either organically or by acquiring the now distressed companies in their industry.

Moreover, the A+ management team often then starts to find additional niches within their niche market and the growth of the incredible returns continues to increase.

Furthermore, as long as River Oaks Capital buys ownership in these companies at a margin of safety valuation, even if we are wrong in our analysis or bad luck occurs, we can still recover most or all of our purchase price and redeploy it right back into the next wonderful business we find.

The over simplified formula = A+ capital allocator in a wonderful, small, niche business with a valuation that provides a margin of safety

River Oaks Capital puts in the necessary ‘time requirement’ to find the few undiscovered gems in a forest left for dead.

Part of that ‘time requirement’ over this past year included traveling to:



- Omaha, NE
- Bentonville, AR
- Raleigh, NC
- Charlotte, NC
- Spokane, WA
- Chicago, IL
- Omaha, NE (2x)
- Las Vegas, NV
- New York City (4x)
- Atlanta, GA
- Boston, MA
- Tinley Park, IL
- Luckey, OH
- Baltimore, MD
- Indianapolis, IN
- Greenwich, CT
- Dayton, OH
- Cincinnati, OH
- Somerset, NJ
- Rogers, AR
- Columbus, OH
- Durham, NC
- New Orleans, LA Conference

Quick Recap

As outlined in the River Oaks Capital ['Owner's Manual'](#), our ultimate goal is to have our fund invested in 10-15 small, underfollowed wonderful businesses that check all these six bullet points:

- Sells a wonderful product that will generate substantial cash for years to come
- Treats their customers, employees, and community admirably
- Is run by honest and able people that also have ownership in the business
- Does not take excessive risk
- Has a long-term plan for the business
- Is selling ownership at a significant discount to fair value

However, small, underfollowed wonderful businesses are not always selling at a significant discount to fair value, so along the way we will also buy 'excessive discount' companies which are so deeply undervalued – \$0.50 or less on the dollar – that almost none of the first five bullet points are needed as virtually any long-term outcome coupled with proper capital allocation will generate an acceptable return.

II. Companies added in the Past Year

BuildDirect (BILD.V)

BuildDirect is a physical and online professional flooring company with locations mainly in the U.S and one in Canada. It is the fifth largest position in our fund and has a \$45m market cap. *(number are expressed in USD)*

BuildDirect emerged in 1999 when founders Jeff Booth and Robert Banks began the business with the goal of using the internet to simplify the home improvement industry by connecting buyers (everyday consumers and contractors) directly with suppliers – specifically focusing on heavyweight building material (primarily flooring).

In 2002, the company launched their e-commerce site – Builddirect.com – where you could buy flooring online alongside a few other home improvement items.

Their goal was to become the Amazon for flooring and home improvement.

Builddirect.com experienced significant growth and a strong customer base until the 2008-2009 financial crisis.

Coming out of the financial crisis, the company experienced significant difficulties for well over a decade.

They made the common mistake of diversifying into other markets. At the same time, the logistics of warehousing and shipping heavy online orders from across the country became increasingly more expensive.

Making matters worse, administrative costs for running the company were far too high and ever expanding.

For a company with under \$100m in revenue, this made achieving profitability a near impossibility.

The combination of all these errors eventually led to the resignation of their remaining founder and their bankruptcy in 2017.

With the help of their largest investors, BuildDirect came out of bankruptcy in 2018 but continued on their rocky road until September 2022 when the company brought in Shawn Wilson as their new CEO.

Prior to becoming CEO of BuildDirect, Shawn had over two decades of experience in the flooring and home improvement industry working for big box retailers (Home Depot), the world's largest flooring manufacturer (Mohawk Industries), a few start-up companies in various areas of the flooring and home improvement supply chain and the largest independently owned flooring retailer in the U.S (Empire Today).

In getting to know Shawn well, I can attest that he knows all segments of the flooring industry like the back of his hand.

The flooring industry is a very small community, and Shawn is a respected household name.

What I have admired most about Shawn is his intense dedication to prudent and conservative capital allocation – after our meetings in person and our talks over the phone I can assure you this isn't something he is just saying aloud.

This intense focus on proper capital allocation is exactly what BuildDirect needed as they had ignored the damage being done by their unprofitable e-commerce and bloated administrative costs.

However, their core business – seven brick and mortar professional flooring stores at the time alongside an e-commerce business that was fully capable of being highly profitable – had tremendous potential if in the hands of the right CEO.

These scenarios turn into our best investment opportunities – when River Oaks Capital finds a small, niche company with a solid core business that just needs a top-notch CEO and management team to be plugged in to unleash their hidden underlying potential.

Using his deep expertise in the flooring industry and his brilliant capital allocation skills, Shawn has laid the foundation to do just that.

He recently told me he was very pleasantly surprised at how well the underlying business was running – especially the strength of their brand and their ability to efficiently procure flooring.

This is strong statement coming from someone that worked at Home Depot.

Before we dive into the specifics of how Shawn has revamped the company, it might be best to further understand how the flooring industry works.

The North American Flooring market is a \$90 billion+ industry that has both professional buyers (contractors, builders, commercial developers, etc.) and retail buyers (the average consumer or interior designer buying flooring for a bathroom).

The retail side of the industry is very consolidated and dominated by a few well-known major players – Home Depot, Lowe’s, Floor & Décor, etc.

They each target slightly different markets but their main customer is the retail buyer.

The professional buyer side is much different.

This side of industry is very fragmented and localized – mostly due to big box retailers not wanting to adjust and risk jeopardizing their dominate retail position.

It is common for there to be a local mom and pop professional flooring center – a 20,000-30,000 square foot warehouse next to a small storefront run by an expert staff with flooring samples – in each populated area.



Note: BuildDirect locations are unique in that they offer e-commerce orders as well

The professional buyer isn't looking to buy flooring for a bathroom or even a small house.

They need to buy flooring for a major project such as a new restaurant or office space.

They need a location where they can:

- Back up their truck to load large amounts of flooring
- Get real-time expert help on solving installation problems

- Buy an extraordinary amount of inventory in specific, easy to install flooring products
- Get large deliveries to their work site if necessary

The professional buyer is looking for a one-stop shop which none of the major big box retailers offer.

This means professional buyers still rely on their local mom and pop professional flooring centers.

There have been attempts to consolidate the mom-and-pop professional flooring industry but with little success as someone with deep expertise of the industry is needed to analyze the true earnings potential and inventory valuation of each mom-and-pop professional flooring center.

Furthermore, none of these consolidation attempts had what BuildDirect has – a heavily trafficked e-commerce site alongside best-in-class flooring procurement.

For years while working in various sectors of the flooring industry, Shawn observed these local mom and pop professional flooring centers and thought it was a dying segment not worth paying attention to.

Slowly, Shawn began to realize how important these local mom and pop professional flooring centers were to the professional floorer who had no place else to go.

In fact, it is one of the few growing areas of the flooring industry today.

Once Shawn was recruited to be CEO of BuildDirect, he felt confident he and his team could be the ones to dominate this fragmented industry.

Shawn felt BuildDirect could dominate the professional flooring industry by:

- Right sizing their e-commerce business
- Expanding their professional flooring center footprint

Right sizing their e-commerce business

When Shawn stepped in as CEO, Builddirect.com was losing money, even though they had an established website and an impressive customer base.

Shawn immediately hired Jay Allen to come in and revamp the website.

Jay's job was to keep what was already good about their e-commerce platform – the high amount of organic traffic, the domain name, etc. – and then taking out the parts that were drastically bloating costs.

The most needed fixes were: no longer fulfill their orders using a third-party and instead use their own warehouses, start marketing solely to professional floorers and updating the outdated technology stack running the website.

Even though they had to scale down the e-commerce business from \$30-\$40m revenue per year to ~\$15m per year to implement some of these changes, it is now a profitable segment of the business.

For example, by using their own warehouses to fulfill orders instead of a third-party, they

lowered their fulfillment costs by 95%.

Now that the e-commerce side has been fixed, Shawn, Jay and the rest of the BuildDirect team are working on ramping the revenue back up to \$30-\$40m+ with operating margins in the 15-20% range being a very achievable goal.

Expanding their professional flooring center footprint

When Shawn first arrived as CEO, BuildDirect had seven professional flooring centers throughout North America – one in the Vancouver area and six in Michigan.

The previous management team had done a nice job of acquiring high quality professional flooring centers that were profitable and thus disguising the unprofitability of the e-commerce business.

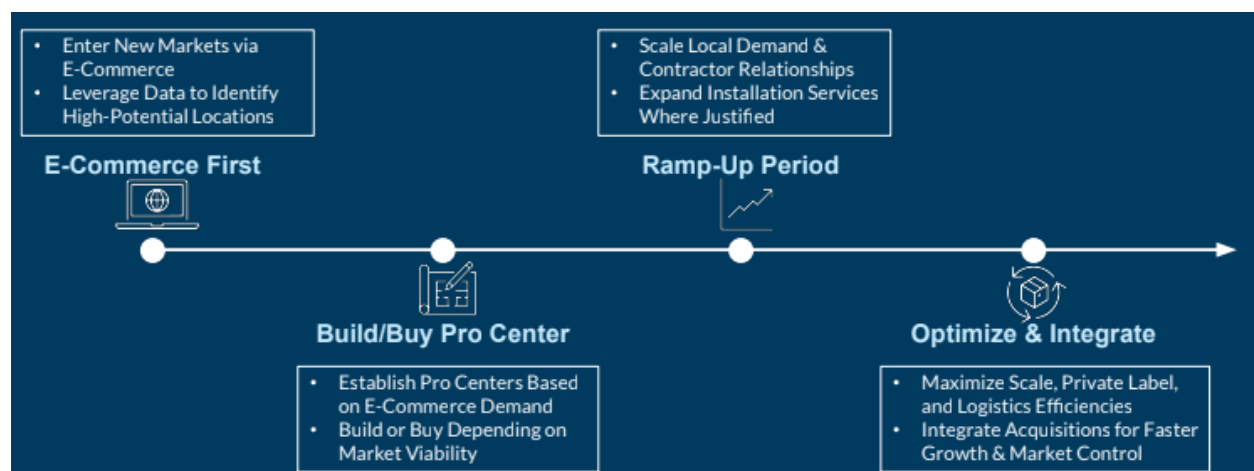
Shawn and his team realized continuing to expand their professional flooring center footprint was a 'no-brainer' capital allocation decision.

Not only do the professional flooring centers on their own generate wonderful returns for shareholders but they can also be utilized for fulfillment of the e-commerce business – creating a synergistic relationship.

Furthermore, if their e-commerce information shows high demand for their flooring products in a certain city or region, then it becomes an indicator to Shawn and his team that it is time to build or acquire a professional flooring center in that area.

This enables BuildDirect to reduce the costs of e-commerce fulfillment – as they can store inventory in their new warehouse – while the local professionals buyers now have a top-of-the-line professional flooring center to use for all their business needs.

This process is best illustrated in the chart below:



Shawn and his team feel having 75 professional flooring centers over the next decade is a very achievable goal given their current pipeline of mom-and-pop professional flooring centers throughout the U.S.

Building versus Buying a professional flooring center

The decision to expand to 75 professional flooring centers then comes down to whether to build or buy the 75 centers.

The first decision Shawn and his team make is whether it makes economic sense to put a professional flooring center in a certain location – mainly using the data collected via their e-commerce site.

Then they decide whether to build or go acquire a mom-and-pop professional flooring center already doing business in that area.

To build a professional flooring center requires initial up-front costs often around \$500k-\$750k* which is required to build up inventory and design the store front – as they lease the building.

However, these costs don't include customer acquisitions costs, all the necessary expenses of growing BuildDirect's presence in that area and finding the right management team.

If Shawn and his team are able to find the right local mom and pop store for sale, the initial upfront costs may be more expensive – ~\$1.5m* – but you are acquiring a seasoned professional flooring center management team with a solid local reputation and a large customer list.

**Of note, whether building or buying, they are leasing the 20,000 to 30,000 square foot warehouse so that isn't factored in the upfront costs (which is a risk I will monitor).*

Shawn and his team already have the best-in-class technology and brand recognition so their sole focus when acquiring a business – aside from the right price – is if the team fits their culture and if their customer base will remain.

At the beginning of 2025, they began their growth strategy by building a professional flooring center in the [Los Angeles area](#) and acquiring one in [Orlando area](#).

The valuations Shawn and his team are seeing for acquiring these mom-and-pop professional flooring centers are extremely favorable.

They bought the Orlando business for essentially the value of their inventory and they are seeing similar valuations elsewhere as well.

Most of the equity owners of these mom-and-pop professional flooring centers are willing to part ways at such low valuations because they already sold the business's warehouse they owned for decades to a real estate investor for an astronomical gain and are just looking to shed the operating company.

Additionally, the valuations are so low because the companies BuildDirect acquires are "fixer uppers" – nearing breakeven with outdated technology.

Once Shawn and his team come in and set up the BuildDirect top of class [ERP system](#), move the accounting to their corporate office, implement their own flooring procurement system, and use their various other technologies to energize the newly acquired business, they can start to generate 15+% operating margins – meaning an acquisition price of less than 2-3x free cash flow to equity.

Another major development that BuildDirect's CFO Kerry Biggs organized was a strong relationship with [RBC Bank](#) who is willing to finance ~60% of their build or buy capital needs at

very reasonable interest rates – prime plus 1.0%-1.5%.

Shawn and his team recently raised \$7m CAD of growth equity – to build or acquire professional flooring centers – for a discounted \$1.15 CAD per share through a private placement River Oaks Capital participated in.

After the \$7m growth equity raise, depending on the pace of the 75 professional flooring center build out, the rest could be funded by the free cash flow of the business – an estimated \$100-\$150m+ of total cash need (debt plus equity).

Now let's look at this from a valuation perspective

We invested in BuildDirect at a discounted \$35m market cap valuation – which has [increased considerably](#) since.

From a downside protection standpoint, if Shawn and his team were to never grow the business and remain a ~\$60m revenue company, they would be able to generate \$4-\$5m of free cash flow to equity per year in 1-2 years just from the existing assets alone – an 11-14% free cash flow yield (7-9 P/E ratio).

The \$4-\$5m of free cash flow to equity will come to fruition over the next 1-2 years as the result of the first initiatives Shawn and his team implemented: bringing the e-commerce division back to profitability, lowering fulfillment costs and reducing administrative costs.

A no growth scenario at this point is purely hypothetical as they have already added two professional flooring centers in 2025 and fully plan on bringing the e-commerce business back to the historical \$30-\$40m of revenue run rate.

Using conservative estimates, BuildDirect should be able to get to \$90-\$100m in revenue over the next 1-2 years even if they do not acquire any more professional flooring centers.

At this revenue, the company can generate \$6-\$7m of free cash flow to equity – a 17-20% free cash flow to equity yield (5-6 P/E ratio).

If Shawn and his team execute on their plan of 6-8 professional flooring centers per year for a decade at very low upfront investment costs, the upside potential we have here is hard to even quantify.

There are ~\$3.5-\$4.0m of fixed costs in the business that won't go up much as the company grows – meaning revenue will progressively convert more to free cash flow as growth continues (creating a steady state free cash flow to equity margin of ~10%+).

That would translate to \$35m-\$40m+ of free cash flow to equity in year 10 if they execute the plan laid out.

Although thinking about the upside isn't how I look at investing, it is a wonderful risk/reward opportunity for us.

The final item worth mentioning is that over 80% of the company is owned by insiders, family offices and other long-term-minded investors who also have additional capital. The shareholder base as a whole is fully aligned with Shawn and his plan and will give him the patience needed to execute on his long-term growth strategy.

Innovative Food Holdings (IVFH)

Innovative Food Holdings ('Innovative Foods') is a nationwide specialty food distributor to the food service industry. It is our sixth largest position and has a market cap of \$70m.

A detailed analysis of the food distribution industry was given in the [previous letter](#).

Similar to BuildDirect, Innovative Foods is a small, niche company with a solid core business that just needed an A+ CEO and management team to be plugged in to unleash their hidden underlying potential.

As I have gotten to know Bill Bennett – CEO of Innovative Foods – and his team even better over the past six months, I can further reaffirm he is the perfect fit to unlock the decades long dormant capability at Innovative Foods.

Recall from the previous letter that Bill became CEO of Innovative Foods in early 2023 and rapidly started the process of turning around the company.

Bill began the turnaround by outlining the exact two core competencies of their business:

1. A specialty food distribution marketplace to all national food sales channels using '[drop shipping](#)' to connect small food vendors to national broadline food distributors – their competitors mainly only distribute locally
2. Their ability to find and train new small food vendors – such as '[Ham Sweet Farm](#)' mentioned in the previous letter

Bill and his team then laid out a three-phase plan that revolved around these core competencies.

Phase 1: Stabilize

This entails fixing pricing and margins (which astonishingly hadn't been adjusted for the past few years of inflation), divesting non-core assets (specifically the e-commerce businesses and unused buildings), cutting costs by reviewing every check that goes out the door and reducing headcount.

Phase 2: Build a Foundation for Growth

This means adding new broadline food distributors, adding new specialty food vendors and executing small, inexpensive tuck-in acquisitions.

Phase 3: Grow and Scale

Once they have built a solid foundation and proven their ability to grow both organically and through acquisitions on a smaller scale, then begin to significantly grow their revenue and free cash flow – leveraging the asset light nature of their core business and consolidating their market share in a fragmented industry through more acquisitions.

The first half of this year marked a continued growth in phase 2 of their strategic plan – *Build a Foundation for Growth*.

This was evident as they continued to integrate their two most recent acquisitions – [Golden](#)

[Organics](#) and [LoCo Food Distribution](#) – into their national catalog.

They also saw meaningful growth in their new national broadline distribution partner (Sysco), continued to expand their airline catering business, and realized a triple-digit growth in their new Amazon sales channel.

As with any turnaround there will be risks and changes made that do not unfold as planned.

This recently occurred as Bill and his team decided to end their business venture with Sam's Club as the sole gourmet cheese provider after less than a year of trying to make the numbers pencil out.

From a capital allocation standpoint, it made perfect sense for Bill and his team to try to make use of their underutilized Pennsylvania warehouse to potentially develop an ever-growing long-term relationship with one of the largest retailers in the world.

However, it made equally as much capital allocation sense for Bill and his team to admit the project wasn't generating the returns they required, and it was taking too much time and money to get the business to scale.

They quickly pulled out of the business and immediately [sold their Pennsylvania warehouse](#) to become a net debt-free company.

Of note, their sale of primarily gourmet cheese to the airline industry – mainly through Gate Gourmet and LSG Sky Chefs – will continue and be fulfilled through their Chicago warehouse.

Overall, I view the ending of the Sam's Club initiative as a positive development because:

1. It shows that Bill is willing to quickly pull the plug on a venture that isn't making adequate returns – he is focused on profitability over revenue growth.
2. Now, Bill and his team can solely focus on their true core competence of 'drop shipping' – plenty of companies can provide Sam's Club with gourmet cheese, only Innovative Foods can connect mom and pop vendors to national sales channels.
3. When thinking of capital allocation, Bill and his team also think of 'human capital allocation' and the time and personnel resources needed to develop the Sam's Club venture didn't align with their overarching business model.

Recall from the last letter, 'drop shipping' is a very asset light business model that involves essential no working capital or inventory for Innovative Foods – meaning as their drop shipping business grows, no invested capital is needed to dramatically increase profitability.

Simply put, it has become even more apparent to Bill and his team that 'drop shipping' needs to be their sole focus – it's crystal clear this is where they make their excess returns for shareholders.

The next obstacle Bill and his team are tackling is how to grow the 'drop shipping' business.

For the past decade now, the items in their national catalog have remained flat at around 5,000.

Prior to Bill and his team taking over, it took 6-12 months to fully on-board a specialty food

vendor – such as Ham Sweet Farm.

This made it very hard to recruit new vendors because of the tremendous amount of upfront paperwork and preparation needed to get connected into Innovative Foods' national catalog – often having to use outdated technology such as manually plugging numbers into Microsoft Excel.

This process was very disruptive to the specialty food vendors day-to-day business and thus often made them hesitant to sign on with Innovative Foods.

In turn, prior to Bill and his team arriving, Innovative Foods didn't focus much on sourcing new vendors because they simply couldn't manage adding any meaningful number of items to the catalog.

However, Bill and his team through using AI-driven technology, adding employees and addressing bottlenecks have decreased this onboarding time down to 6-8 weeks and this should further decrease as the AI-platform is enhanced – while also simplifying the onboarding process for the specialty food vendor as well.

With these changes, Innovative Foods is adding 100 items per week to their catalog versus 13 per week in the past – Bill has said he will be much happier when they are in the 300-400 items per week range.

As a result, this has allowed Innovative Foods to start hiring more people and focusing more resources on finding new specialty food vendors.

Additionally, Innovative Foods already had up to 3,000 items in their specialty food vendor backlog that needed to be worked through and onboarded – with many more vendors sure to be interested in Innovative Foods now that the onboarding process isn't treacherous work.

As Bill recently re-iterated, with an asset-light, non-capital-intensive business the goal needs to be to grow their national catalog as fast as possible as it can create astronomical returns on capital.

Furthermore, the bigger their national catalog becomes, the more their relationships with the major broadline distributors (Sysco, U.S Foods and PFG) are entrenched.

Also, worth further diving into is how they are currently integrating their two acquisitions of specialty food distributors – Golden Organics and Loco Foods.

This gives us a view on the pace and success at which Bill and his team will integrate future acquisitions.

After the purchase of Loco Foods, they combined it with Golden Organics – both located near Denver – while bringing on new team members to help run the combined entity.

One of the main takeaways from these acquisitions is that small businesses are often run by the 'gut instinct' of the founder – meaning there is no process in place once Innovative Foods acquires these small specialty food distributors.

Therefore, Bill and his team developed a "playbook" making future acquisitions more "plug and play" and quickly scalable.

The ultimate goal is to make each acquisition going forward more turnkey.

Getting these two most recent acquisitions up to Innovative Foods' standards has taken serious dedication from Bill and his team, reinforcing Bill's focus on 'human capital allocation'.

Remember, the real goal of phase 2 is to do a few acquisitions at inexpensive multiples – 3-5x earnings – to prove to investors that they can do this on a larger scale.

Over the next six months, once Golden Organics and Loco Foods are fully integrated and the synergies are realized, Bill and his team will decide going forward how many acquisitions and at what pace makes sense.

This again boils down to 'human capital allocation' and how much work it will take Bill and his team to integrate a newly acquired company versus how much return the acquired company provides.

The discipline of Bill and his team of slowly making acquisitions versus rapidly acquiring 10 specialty food distributors all at once has paid off.

The especially good news is the acquisitions were done at such a low price – the value of their inventory and property – that there's really no negative outcome scenario.

The main key to any acquisition of a specialty food distributor going forward is whether or not it will complement their core competency – the 'drop-ship' business.

As we think about valuation, at a steady state of a ~5,000 item national catalog company, Innovative Foods' is a \$70m+ revenue company that should generate ~\$4m+ of free cash flow to equity – 6-7% free cash flow yield (~15 P/E ratio).

However, Bill and his team have made it clear there is a straightforward path to significantly growing their 5,000-item catalog both through their recent acquisitions and newly implemented onboarding technology.

If their catalog growth trend stays on pace, the \$100m revenue business goal in the near term still seems achievable, which (given the asset light nature of the 'drop-ship' business) would generate \$6-\$7m+ of free cash flow to equity – 10-12% free cash flow yield (~8-10 P/E ratio)

In order to start generating \$10m+ of free cash flow, Innovative Foods needs to enter Phase 3 of their plan where they rapidly scale their 'drop shipping' business and national catalog growth alongside complementary acquisitions.

The two items most investors seem to be missing are how it requires virtually no invested capital to achieve significant growth and the downside protection we are given by a best-in-class management team and board of directors.

Chairman of the board James Pappas and the rest of the board/insiders own 50+% of the company and have a deep expertise in capital allocation and the food industry – they will do what makes most sense for us shareholders over the long-term.

The last thing that that is important to remember here is that Bill and his team plus the board want to build something incredible over the next 10-15 years.

They are not thinking quarter to quarter – as has been shown by their decision to exit the

gourmet cheese business and delay their NASDAQ uplisting.

This company is only for those investors with a long-term mindset who favor a long duration of above normal returns on capital versus chasing extreme returns on capital that often phase out quickly.

III. Updates from H2 2024 Letter

Click on each company name below for update

Note: The updates just focus on the last six months of developments in each company so for further details reference previous River Oaks Capital letters [here](#).

Citizens Bank (CZBS)

Truxton Trust (TRUX)

Boston Omaha (BOC)

America's Car Mart (CRMT)

Bankfirst (BFCC)

Medical Facilities (DR.TO)

Fitlife (FTLF)

BCP Investment Corp (BCIC)

Greenfirst (GFP)

Old Market Capital (OMCC)

All Companies below 3% of our fund

We own three companies that are below 3% of the fund: **HAYPP Group (HAYPP), R&R REIT**

(RRR.UN) and SR Bancorp (SRBK). As usual, if our ownership of these companies grows, I will provide a detailed write-up. If you are interested in learning more about these companies now, please feel free to give me a call or I can e-mail you a write-up.

IV. Mistakes

In the opening section of this letter, I outlined the over simplified formula for our successful investments = **A+ capital allocator in a wonderful, small, niche business with a valuation that provides a margin of safety.**

In the past, I did not put enough value into how much 'key-man risk' can be involved here.

If the A+ capital allocator leaves because they are offered a significantly larger salary and various other perks by an often-larger corporation, this could drastically affect our investment outcome.

Fortunately, this has only happened to us once.

However, going forward I will pay much more attention to how we can mitigate this risk.

Most of the time, the A+ CEO and their key team members have come to a small, public company because they enjoy the entrepreneurial environment and the performance based ('eat what you kill') pay out – if they are able to significantly increase shareholder returns.

A small, public company can rarely pay as high of a base salary as a major corporation so using stock compensation and other upside pay outs is imperative.

The A+ CEO and their key team members' salaries should be designed so they can make comparable compensation to a major corporation's management team if they achieve wonderful returns for us shareholders.

If this is not the case, I will make sure to reach out to each and every board member.

This means their compensation package will often be many multiples of their small, public company competitors' management teams but it is more than worth it.

**Best,
Whit Huguley, CFA**



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