February 1, 2023

Investment Commentary

Do You Want a New Smart Water Meter? Get In Line.

With this Investment Commentary, we have begun a revolution at our firm. Pursuant to the CEO's (Fredric E. Russell) directive, we will try to keep our commentaries to a maximum of three pages. Our analysis shows that most letters have contained ten pages, sometimes more. With our now abbreviated commentaries, clients will not need strong coffee from Starbucks (NASDAQ: SBUX) to thoroughly read our letters.

A Review of Our Investment Strategy

Our investment strategy, method of operation, or most plainly, the way that we, as fiduciaries for your money, has been simple: invest in companies with outstanding competitive advantages.

Badger Meter, Inc. (NYSE: BMI) is one of these companies.

"…The Company's water quality monitoring solutions include optical sensing and electrochemical instruments that provide real-time, on-demand data parameters. The Company's product lines fall into two categories: sales of water meters, radios, software and related technologies, and water quality monitoring solutions to water utilities (utility water) and sales of meters and other sensing instruments, valves, software and other solutions for industrial applications in water, wastewater, and other industries (flow instrumentation). The Company estimates that over ninety percent of its products are used in water related applications." *Form 10-K for the Fiscal Year ending Dec. 2021; Badger Meter, Inc., February 23, 2022; page 3*

Brian Valencia, our Vice President of Investments, spoke on December 22, 2022, with Karen Bauer, Vice President of Investor Relations, Corporate Strategy, and Treasury at Badger Meter. In the box below is a conversation that Brian had with Karen Bauer.

Brian Valencia: "I was wondering approximately what percentage of smart meters account for the automated metering network in the United States?"

Karen Bauer: "Approximately seventy percent of water meters currently in use are smart meters. This includes Advanced Meter Reading (AMR) or Advanced Meter Infrastructure (AMI)."

Brian Valencia: "Considering that number, how would you describe the transition to smart metering, and how does that reflect growth year over year?"

Karen Bauer: "In terms of growth, our growth is characterized by very attractive consistency, risk-averse, and single-digit percentage growth. You won't see any gluts (sic) of growth or decline. This box continues on page two.

The transition has been a slow implementation for municipalities, but our rapid and easy deployment relieves any need for new infrastructure to be developed. For a long time, up until 1990, all water meters were manually read. Then Badger Meter developed Advanced Meter Reading (AMR)."

Brian Valencia: "Perfect. Could you explain the differences between Advanced Meter Reading (AMR) and Advanced Meter Infrastructure (AMI)?"

Karen Bauer: "Advanced Meter Reading (AMR), made meter reading a lot more efficient. Meters would be equipped with a radio transmission device so that a truck could roll by at low speeds, typically lower than twenty miles per hour, and could pick up a signal and transmit the information from the meter to the truck. This would eliminate the need to exit the vehicle, open the meter cover, and mark down the reading on the mechanical meter. With Advanced Meter Infrastructure (AMI), we have water meters that can communicate with utility departments using a fixed network to send the data, eliminating most of the old processes used for a water meter reading."

Brian Valencia: "Wow. So, if a municipality were to reach out to Badger Meter today, wanting to set up Advanced Meter Infrastructure (AMI), how long would you say it would take for it to roll out? Also, how much would you say the new Advanced Metering Infrastructure (AMI) saves a municipality in terms of cost?"

Karen Bauer: "We are able to deploy our equipment in a few days, typically around five to seven days, just depending on the municipalities' existing infrastructure. Since we are able to use what is available, it is almost free for our deployment of services. We'll send out devices that can attach to existing cell phone towers and use them as a beacon to send encrypted data to the recipient, the water company in the area. I can't tell you how much a municipality saves in costs from making the transition. There is much to be saved regarding labor, fuel costs, and vehicle upkeep. Labor is one of the more difficult things to obtain. With Advanced Metering Infrastructure (AMI), it eliminates a large amount of those necessities and results in a lot of savings."

Brian Valencia: "Last question, which acknowledges growing issues with water infrastructure, such as the water problem in Flint, Michigan. Does Badger Meter produce a meter capable of measuring water quality as it passes through a meter?"

Karen Bauer: "Great question. We have recently acquired two companies, S::can and Analytical Technology, Inc. (ATi), companies that measure water quality. Currently, there is no water meter capable of calculating water quality as it passes by. These two companies implement probes that allow testing at different points of the transfer to the tap."

This marks the end of Brian Valencia's interview with Karen Bauer.

Xylem Inc. (NYSE: XYL), Roper Technologies (NYSE: ROP), and Badger account for eighty-five percent of the U.S. water meter market.

Badger is unique in how its services can be accessed remotely and easily. Furthermore, the company can offer service contracts that are convenient and flexible.

We studied Badger's 10-Ks for the last three fiscal years, 2019, 2020, and 2021 ending on December 31st. The following paragraph from Badger's 10-K for the year ending December 31, 2021, was very interesting.

"A number of the Company's competitors in certain markets have greater financial resources than the Company. The Company, however, believes it currently provides the leading technologies in water meters and water-dedicated radio solutions and analytics. As a result of significant research and development activities, the Company enjoys favorable patent positions and trade secret protections for several of its technologies, products, and processes." *Form 10-K for the Fiscal Year ending Dec. 2021; Badger Meter, Inc., February 23, 2022; page 5*

After Brian's phone call with Badger Meter, Brian and I sat down to review Badger's prospects. We noted Karen Bauer said that Advanced Metering Infrastructure (AMI) eliminates a large amount of labor, fuel costs, and vehicle upkeep for utilities. This meant that revenue and cash flow should rise, as most capital expenditures have been made. With utilities being more profitable, Badger Meter should be able to push through aggressive price hikes in the next ten years.

When Brian Valencia joined the firm, I have had the ability to work with someone very interested in making money. Equally important, Brian is someone who I greatly enjoy working with and who will challenge my ideas and vice versa. I am very appreciative of this dynamic. At the same time, our work would not be possible without the great support from Ms. Cathy Karney, Chief Operating Officer; Mr. Lee Young, Head of Accounting and Auditing; and Ms. Alaina Hall, Administrative Assistant. We have a harmonious and productive environment that ought to lead to better investment performance.

Sincerely,

Fredric E. Russell

Brian Valencia