Dear Clients and Friends,

During the first quarter of 2023, returns for separate accounts managed by Greystone Capital ranged from -1.5% to +10.1%. The median account return was +4.7%, net of fees. As the firm grows and new capital onboards, it is my expectation that our returns will continue to be sporadic across client accounts given the timing and inflow of new capital. Please continue to check your individual account statements and feel free to reach out with any questions or concerns.

First quarter results compare unfavorably and favorably to the S&P 500 and Russell 2000 returns of +7.5% and +2.7% during the quarter. Because client portfolios are invested in a concentrated way consisting of small companies mostly outside of the major indices, our returns should typically vary from the returns generated from those indices.

Although we entered the year with a favorable setup for value stocks, the quarter ended amidst a rough macroeconomic backdrop whereby the failures of Silicon Valley Bank and First Republic Bank were added to the growing list of investor concerns. Surprisingly, the market deftly absorbed these blows and finished in positive territory as the bank failures seemed to be constrained to specific financial institutions and the government stepped in quickly to avoid a full-blown crisis. I’ll spare you my take on the situation, but I’d imagine the ripple effects of such events have not yet revealed themselves. This, plus continued evidence that the economy is slowing caused investors to flee to safety among large cap technology businesses as near-term recession risks came more into focus.

Despite positive returns during the quarter, small companies, especially consumer facing, were adversely harmed, with the Russell 2000 and the iShares Microcap ETF up +11% and +13% at one point during the quarter, only to finish well below those figures. There are significant structural forces as to why small caps remain cheap, as well as misperceptions about these types of businesses being riskier, which I believe is creating opportunities to purchase quality businesses at bargain prices. We bought shares of one such business during the quarter, outlined below, and I’ve got my eyes on several others for potential portfolio inclusion.

Given the level of uncertainty remains high, navigating this market in the near term may prove difficult as investor sentiment seems to ebb and flow along with the daily news cycle. Unfortunately, the news cycle, and how investors react to it is out of my control. Within my control is the ability to remain disciplined and focus my attention squarely on your portfolios and on identifying high quality investments that fit our criteria and align with our risk management framework.

Moving forward, we should be positioned well, owning many businesses that fit the more traditional value investment bucket, priced at large discounts to my estimate of their fair values. I expect strong results from each of our companies during 2023 and although the road ahead will not be perfectly smooth, our collection of businesses have bright prospects, regardless of the macro environment.

**Portfolio Commentary**

This quarter was relatively muted in terms of portfolio activity as I remain very optimistic about what we own. Clients hold portfolios of small, differentiated, off the beaten path investments that possess attractive characteristics consisting of strong customer value propositions, attractive unit economics, long runways for growth, operating leverage, net cash balance sheets and cheap valuations. These things help drive what matters
most over time, which is growth in earnings power. We also remain invested alongside management teams who are actively taking steps to close the price to value gaps outside of internal reinvestment opportunities with specific actions or capital return programs which should have the effect of positively contributing to returns over time. Broadly speaking, apart from a few companies with attractive reinvestment opportunities, our businesses trade at single digit multiples of cash flow, which will continue to grow at decent rates over time. While some of these investments will require patience to bear fruit, the earnings growth outlook for 2023 and beyond appears favorable, and our businesses’ current market prices appear to be a fraction of their long-term fundamental values.

Below you’ll find some brief updates on select positions along with commentary surrounding our newest investment in Sylogist Ltd.

**Griffon Corp. (GFF)**

Griffon Corp. was one of the positions in client portfolios undergoing a strategic review whereby significant value could be realized through the sale of one of the business segments or the outright sale of the entire company. As the macro-economic environment continued to worsen, putting pressure on housing related activity, increasing costs of capital, and raising questions in my mind about receiving a fair valuation for the business, I reduced our position, moving it outside of our top five.

In late April, Griffon announced the conclusion of the strategic review with no deal, explaining that the best path forward would be the ongoing execution of the business strategy. In conjunction with that announcement, Griffon also announced they would be returning a significant amount of capital to shareholders in the form of a $2.00/share special dividend and a $260mm buyback authorization, enabling them, at current prices, to repurchase around 15% of shares outstanding. With a refreshed Board, better capital allocation policies will be put in place and the company can now resume investor communication to help outline the strategic plan from here. As anticipated during our initial purchases, the dividend and our shares may serve as sources of cash for other investments over time.

**Basic-Fit (BSFFF)**

I added to our position in Basic-Fit during the quarter as the business continues to execute in line with management’s strategy and has recovered nicely since the pandemic forced them to close their doors for an extended period during 2020 and 2021. Basic Fit remains one of the most well-positioned businesses in our portfolio from a competitive standpoint and has been able to raise prices during a period when the majority of their competitors are struggling, closing locations and ceasing expansion plans. As a reminder, Basic-Fit’s scale and expertise enable them to construct gyms for a lower cost compared to competitors, allowing them to enter and expand into markets with a lower pricing strategy given the lower breakeven membership numbers that competitors can’t match. This means that even the deepest of deep pockets crazy enough to enter one of BFIT’s markets would have to endure years of operating losses before seeing a positive impact to revenues and ARPU, saying nothing about the efforts and resources that would be required to build a brand. I look forward to what 2023 and 2024 will bring.

**Polished.com (POL)**

As discussed, Polished remains in the midst of their sales process whereby I’d expect to hear some progress updates by the end of Q2 if not before, along with the company’s long-awaited financials that should be released around the same time. A sale of the business is not a foregone conclusion, but noteworthy steps have been taken to right-size the company on the continued path toward profitable growth. I believe there are interested...
parties (as was the case pre-internal investigation) that may emerge as serious bidders as management and Jefferies continue to work together to find an acquirer at an appropriate price.

In late April, the company put out a press release with sales estimates for the completed FY22, Q1’23 and management’s outlook for FY23. Despite the recent events, the press release and outlook were largely positive and provided for the first time since early 2022 a glimpse into how the business is faring. Despite the tough macro environment, pressure on the consumer, housing related declines and notably pulled forward appliance purchase activity during the past few years, the low end of the company’s FY23 outlook would represent just a -7% sales decline, with EBITDA margins holding up well and the company remaining cash flow positive. This is about half the decline of the broader industry from Q4’22 through Q1’23. There is concern that the company falls short of this outlook given it implies a significant pick up in the second half of 2023, but I’d imagine that their commentary was heavily lawyered and heavily scrutinized, given that after all this time, putting out a set of expectations, unprompted, that they fail to deliver on, would fall squarely outside the realm of sanity.

Furthermore, the company remains in good standing with their lender, Bank of America, and although the company’s net debt position has not been disclosed, reading between the lines, I believe prior management, in addition to their other missteps, were granted a large credit facility and used it to boost marketing spend and lever up inventory at exactly the wrong time, typical of a CEO who operated on ‘gut feel’ as opposed to using data, detailed operating procedures or supply chain management processes. As management reduces inventory levels more in line with current demand, I suspect they will continue to pay down debt moving forward. I will continue to provide updates as they occur while I remain patient in anticipation of a positive outcome.

**New Position**

**Sylogist Ltd. (SYZLF)**

During the quarter we purchased shares of Sylogist Ltd. and setting the stage (or table, if you will) for this investment are the many cooking shows in my rotation, where I love watching chefs prepare and talk about food. These shows offer many parallels to investing and portfolio management, one of which is that the greatest chefs understand that the best recipes are all about the ingredients. I believe Sylogist is following the recipe for success, with the ingredients consisting of a high-quality business, strong growth prospects, a net cash balance sheet, good management, and free cash flow generation at a bargain price. Sylogist is a public sector software-as-a-service (SaaS) business whose stock has been orphaned due to its history of poor corporate governance along with a recently implemented strategy shift and dividend cut that caught investors off guard but was executed with the sole focus of driving shareholder value. This, along with the massive selloff in small companies and software related businesses during 2022 has caused the stock to be left for dead, despite possessing some characteristics that point to an intrinsic value much higher than where the shares trade today. Over time, and with proper execution, I believe our shares could be worth multiples of what we paid.

Sylogist is a Canadian listed SaaS business that provides mission-critical software solutions to nearly 2,000 customers worldwide in three public sector verticals of Non-profits/NGOs through their SylogistMission segment, Government through their SylogistGov segment, and Education through their SylogistEd segment. Within these verticals, software solutions consist of ERP, CRM, fundraising, education administration, and payments products. These products carry high value propositions and sticky customer relationships as they serve a critical need for organizations of all sizes. The areas within the niche that Sylogist occupies have less competition than enterprise level software businesses, who typically avoid these end markets and are not well adapted to offer the customized solutions that Sylogist can. One example would be a growing non-profit that requires more advanced fund accounting and donor management software that integrates with the rest of the organizations applications, thereby eliminating sometimes manual processes for data input and storage. The organization could use Sylogist’s ERP product to address those needs. Historically, despite underinvestment in
customer relationships under the previous management team, customer retention has been in the high 90% range as there is reluctance to switch providers given the integration into their workflows and systems.

Sylogist has three primary revenue segments made up of Cloud Subscriptions (40% of revenues), Maintenance and Support (25%) and Professional Services (29%). Approximately 65-70% of revenues are recurring between Cloud Subscriptions and Maintenance and Support, providing both visibility and resiliency into future revenues, with software gross margins in excess of 75% and cash flow conversion in the 70-80% range. Several of Sylogist’s products are built using the Microsoft Dynamics platform, where Sylogist can not only customize products for specific verticals but can also benefit from the reputation and track record of Microsoft during customer acquisition and when cross-selling adjacent products and services. Moving forward, management’s strategy is to grow both organically and via M&A, while focusing on the organic growth of software subscription revenues.

Software businesses, and among those, Sylogist’s peers, can be great businesses, especially when tied to critical parts of an organization’s operations. They share characteristics such as strong organic growth, high revenue retention, high margins, and strong cash flow conversion, while providing remarkable durability through all economic cycles. Publicly traded peers Tyler Technologies, Blackbaud and Sage have long histories of growth and profitability, while each grew revenues through the financial crisis with no decline in operating margins. Strong fundamentals and durability means that most of Sylogist’s peers trade at valuations of 20x EBITDA or more, compared to <9.0x NTM EBITDA for Sylogist.

For the reasons behind the valuation disparity, I’d point you toward the company’s history. The early version of Sylogist consisted of a low margin, no growth, reseller of software until prior management made some acquisitions in the early 2000’s to capture more of the customer relationship and to focus on building a public market software business. Unfortunately, prior management made it a point to focus on tuck-in M&A, manage acquisitions for cash flow, neglect organic growth, and milk the company for compensation. Poor corporate governance, a company with no business being public, and a management team with no desire to drive shareholder value was going nowhere and would never garner a proper public company multiple. Prior to the former CEO’s retirement in late 2020, Sylogist ran a strategic review (an attempt to sell the business) and emerged with the Board determining that the best path forward would be to pursue the near-term market opportunities for growth in order to drive shareholder value. They also went on a search for a new CEO who would be given an organic growth mandate.

Enter current CEO Bill Wood, an industry veteran who was a founding member of Blackbaud, one of Sylogist’s direct competitors, also previously serving as President and CEO of two software businesses during a 17-year span that culminated in both businesses being acquired, one by Constellation Software and the other by a private equity firm. Shortly into his tenure, Bill cut the dividend (a 9% yield), freeing up nearly $12mm in annual cash flow, and formally announced the company’s strategic shift toward growing organically and via M&A. As part of the strategy shift, EBITDA margins would be taken down from the low-mid 50% range to 30%, while maintaining a Rule of 40 posture, with the excess cash flow being reinvested into product development, sales and marketing, and M&A. The company’s credit facility was also increased by 65% to $125mm, providing additional firepower for acquisitions, while a share buyback program was put in place that would allow the company to repurchase up to 10% of shares outstanding. The market, along with yield focused investors, did not like this news. I, however, am thrilled with these decisions, as I tend to seek out management teams willing to endure short-term discomfort in exchange for potential long-term value.

The strategy is working, and investors have been slow to recognize the shift, despite what I believe to be an important inflection point. In just three short years, Sylogist has made tremendous progress toward building a software platform by strengthening the management team, launching and acquiring in-demand products, repairing customer relationships, improving the NPS score, and returning the business to organic revenue growth. To date, efforts to accelerate sales, marketing and product development have been and should continue...
to prove successful as the sticky products that Sylogist offers, and the collegial nature of their end markets means that a continued organic growth profile shouldn’t be too difficult a hurdle to overcome. In fact, Sylogist is firing on all cylinders, growing bookings, revenues and cash flows effectively, and as of the most recent quarter, reported positive sequential growth in organic software subscription revenue. During the most recent earnings call, management highlighted an attractive sales pipeline and new bookings matriculating at a higher rate than at any point since the current management team was brought on. This, along with the hiring of an experienced Chief Revenue Officer and the continued flexing of marketing muscle bodes well for future organic growth. A recent upgrade to the CFO position should also come with improved communication and disclosures, helping investors better understand the story and strong fundamentals.

Sylogist’s strategy shift will be bolstered by significant tailwinds including the large addressable market among their customer base, low digital penetration among the same customer base, the acceleration of software tools post-COVID, and a fragmented market for products and services that Sylogist can tap into for M&A. Since their hiring, management has completed four acquisitions, all largely accretive and providing both the opportunity for continued organic revenue growth and the opportunity to add valuable products and services to their platform. According to management, the deal pipeline remains incredibly full, with hundreds of potential targets on their list. As private market valuations continue to come down, we should see additional transactions take place that help grow the top and bottom lines over time. Sylogist could also find themselves on the receiving end of an acquisition offer, as the government software space is incredibly lucrative due to the fragmented nature of these businesses, value to both strategic and financial acquirers, and durability of the business models. In a macro environment where two of the biggest worries are inflation and a recession, the combination of non-discretionary recurring revenue and pricing power makes for an attractive setup. Even share-losing Blackbaud, who has consistently underinvested in the business to the point of declining revenues and margins, finds itself in the midst of a take-private offer from a PE firm.

Sylogist remains a ‘show me’ story but I believe the right ingredients are in place. The company is small. Publicly traded float is minimal. Shares trade over the counter in the US and have zero US analyst coverage. Management is non-promotional and IR efforts could improve. The potential for mispricing here is significant and I believe shares could be worth multiples of what we paid looking out a few years. I like the setup and look forward to discussing Sylogist in future letters.

**Broad Market Commentary**

Small-cap stocks remain in an ongoing bear market at the end of this quarter, declining -25% from their most recent peak at the end of 2021. Many individual stocks suffered even greater losses during that time. The average stock in the Russell 2000 was down -35% from its 52-week high as of the end of March. The good news is there is ample evidence that negative return periods for small caps have usually been followed by above average performance. In fact, the Russell 2000 enjoyed positive annualized five-year returns 100% of the time, that is, in every single one of the 81 five-year periods following negative performance. Furthermore, the average returns following periods with annualized returns of 5% or less was 14.9%. Periods like the last 12-18 months have sorely tested every investor’s mettle. But decades of data on historical returns would reveal that these are often the most rewarding times to be invested with a long-term view in quality small cap stocks regardless of where the economy and equity markets go from here.

With that said, a recession would be a negative for the market and your portfolios, but we remain invested in businesses that can thrive during adverse economic periods by strengthening their operations, acquiring things at cheaper valuations, taking market share, and continuing to grow their earnings power. It is this increase in earnings power that over time, can provide some comfort that should stocks fall, they will eventually catch up to business fundamentals. To protect and grow your capital, I continue to seek out compelling long-term
investment opportunities in companies that have defensible businesses and trade at a discount to our estimate of intrinsic value.

Recent Developments

Greystone added one new client during the quarter with the goal of continuing to add like-minded and patient investors to the firm. Our distribution list continues to grow, and I enjoy responding to inquiries from thoughtful high net worth, family office and institutional investors. Referrals are always welcome and if you know anyone that might be a good fit for the firm, please feel free to pass along my information. Non-client readers are more than welcome to reach out anytime.

On a more personal note, in late April, my wife and I welcomed into the world our second child, Gino Anthony Wilk, a baby boy who now makes us a family of four. We are incredibly excited, mostly because I can now put to rest any concerns I had about Greystone Capital’s succession plan. I’m happy to share that both my wife and son are doing great, while our 20-month-old daughter is coping with her new reality of sharing our attention with her brother. Who knew there was integration risk outside of investing?

Thank you as always for the opportunity to manage your hard-earned savings. I’m grateful to be invested alongside each of you. Please feel free to reach out anytime. Thank you for reading.

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