Greystone Capital Management
Concentrated Value Investing

Q2 / July 2024

Clients and Friends,

During the second quarter of 2024, returns for separate accounts managed by Greystone Capital ranged from +4.3 to +7.1%. The median account return was +6.0%. Year-to-date, the median account return was +6.3%, net of fees. Second quarter and year-to-date results compare both unfavorably and favorably to the S&P 500 and Russell 2000 returns of +4.3% and -3.3% during the quarter and +15.2% and +1.7% year-to-date. 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.

Though I'm not displeased with year-to-date results. They could have been better. Punitive Canadian capital gains tax rules (significantly increasing the tax rate) taking effect this year caused a small sell-off toward the end of the quarter among two of our top five positions, as investors locked in cheaper profits. In addition, I failed to act aggressively enough in certain situations when intra-quarter volatility presented itself. In a short period, some of our positions went from cheap to absurdly cheap. Instead of biting a big chunk, I nibbled. This cost us. When Steph Curry has a wide open three pointer, he doesn't second guess. I will strive to get better at this moving forward.

As you've heard me say often, one six-month period is not something to focus too deeply on, considering the longer-term mission at hand. What we should be focusing on is the operating results of our businesses, which so far this year have been very strong, and are anticipated to remain that way through the back half of the year. Unexpected things will undoubtedly happen, but I am optimistic about what our companies can achieve moving forward, and **trust them** to carry out their strategies, a topic which I discuss below.

Keeping in mind our long-term focus, performance during the past three quarters has been a welcome relief to what seemed like ever-widening discounts between the operating performance and valuations of our businesses. One theme of my letters during the past few years has been, despite uncertainty about the timing, eventually, our strategy will be in favor again, which should lead to outsized returns over time.

If you have eyes and ears, you are likely aware that the performance of the market is being driven by just a handful of businesses, which now make up over 1/3rd of the S&P 500. We do not own any of these businesses and have looked bad comparably as a result. This dynamic has been exacerbated by the current structure of the market made up of largely passive investors and quantitative based strategies, something I've discussed previously, where forced buying and momentum based factors are disproportionately rewarding large caps. Furthermore, the emergence of Artificial Intelligence related investment themes has been another catalyst underpinning the strength of these large businesses. A.I. related stocks have performed very well this year, something we have also not participated in.

There is a lot to say about these topics, but not by me. Since these letters are meant to be discussions about what we own and not what we don't own, I will spare you my take on both large company valuations and A.I., as my ill-informed opinion would be a waste of space in this letter.

Despite small cap underperformance persisting for some time, periods like this are not without precedent. There have been multiple stretches during the past few decades where small company valuations deviated notably from large companies to both the upside and downside.

There have also been multiple stretches where some of the world's best investors experienced periods of underperformance while their strategies lacked acceptance. Our small company focused strategy is enduring one of those periods. The businesses we own do not in any way reflect the businesses that are driving the market's recent returns. If these trends continue, our approach could remain out of favor.

The reality of this, or my acknowledgment of it, doesn't make it any easier to swallow when it's happening. But as Charlie Munger so astutely put it:

*"The big money is not in the buying and the selling, **but in the waiting**."*

We are attempting to find value in the smaller and sometimes more obscure areas of the market, among businesses that are improving their earnings power, some of which are not patently obvious *today*, and require fundamental research to uncover, which is a lonely practice right now.

But the bets we are making – on management and on improving fundamentals, and based on the prices we paid, are patently obvious to me, which means that if I'm correct in my assumptions we will be rewarded over time with both improved earnings power and multiple expansion. Furthermore, if decades of history are on our side, we may be gifted with a rising small cap market, which makes my job one of ***waiting*** until we are granted a changing tide.

It's worth repeating that there are things to invest in outside of both the Magnificent 7 and major indices, making now an ideal time to allocate to a strategy like ours. I am finding outstanding opportunities among businesses that don't start with 'N' and end with 'vidia'. I added one such position to your portfolios this quarter which has my sought after combination of excellent business, great management and a dirt-cheap valuation. I will refrain from discussing here as I'm still adding to the position.

Allan Mecham, an investor I admire greatly, has said about portfolio construction: 'let's build a house we want to live in'. Ours will be built the way it always has, with the types of businesses that provide a strong foundation for outperformance over time. Unpopularity and all. Whatever the future holds, our interests remain aligned.

Portfolio Commentary

Thoughts on Trustworthiness

Prior to making any investment, I make it a point to get to know the people behind the business to determine how they are likely to treat our capital once it's in their hands. I am very thoughtful about the types of people we invest alongside, which stems from the many mistakes I've made over the years. When it comes to small companies, people matter, and the right people have played a large role in whatever positive results we've had up to this point.

Even though I adopt the mentality of a business owner buying for keeps, our ownership stakes represent minority interests in our businesses. That means we're always faced with two difficult aspects of being non-insiders:

1. We have no operational or financial control
2. Despite my best efforts, we don't always know exactly what's taking place inside of a company

Therefore, developing trust in both the business and the management team is paramount. I've both underestimated and overestimated trustworthiness in the past, and it has cost me dearly. For that reason, emphasis on management, incentives and operating with an owner's mindset sits at the forefront of investment attributes I seek. In fact, if I had to choose *one* attribute behind which to invest, it would be trustworthiness. I need to trust that management will treat our capital like an owner, consistent with being thoughtful about capital allocation decisions and risk taking. Often, I want management to actually *be* owners, so we have alignment surrounding potential outcomes.

I spent the early part of my career evaluating people and talent in an environment outside of investing, and learned very quickly how difficult it can be. I've made my fair share of mistakes when assessing a person's character or motivations. This is because certain characteristics can be faked such as sincerity, kindness and even motivation.

However, with much time spent learning about people and behavior, I've concluded that genuine trustworthiness can't be faked. That's because the formula for trust is crafted over a long period of time, where each element must be sustained, which only happens if it is a person or companies' *way of being*. In other words, one doesn't strive to *be* trustworthy. Trustworthiness is not a feature or amenity, like heated seats in a car. It's a defining characteristic.

If trustworthiness could be broken down into a formula (it can't), it would be:

Trustworthiness = <u>competence</u> + <u>continuously meeting expectations</u>

Although not perfect science, some good ways to ascertain trustworthiness include examining track records, paying attention to accountability, and studying a business's relationships with its customers and shareholders. These are things that can't be faked. Warren Buffett is perhaps the best example of what it looks like to take accountability (publicly) and treat his shareholders

well. He gives you reasons to trust him because that is *how he is* as a manager. The good news is, like Buffett, companies and management teams will give you reasons *to* trust them, or *not to* trust them. You just need to pay attention. In other words, they will be who you thought they were.

Trustworthy businesses are rare. They are hard to identify. Even when you think you've found one, you can be misled. But there are patterns among them. I've found that the best, most trustworthy businesses contain some combination of the following:

- Conservatively financed or even overcapitalized
- Lack empire building or unwillingness to make bad deals
- Non-dilutive (because it is likely their capital as well)
- Fair compensation policies relative to employees and total profits
- Long-term focus (willing to forego short-term profits for long term value creation)
- Open communication with the owners of the business
- Culture of accountability and leadership (decentralized, everyone takes out the trash)
- Typically get stronger during a downturn or weak economic period

Trust takes time to ascertain. I have sometimes followed a business for years before making an investment or deciding not to. Despite my upfront due diligence, I often get to know our businesses and management teams better *after* becoming a shareholder. Some of Berkshire Hathaway's most successful investments took years to become large positions as Buffett got to know the management teams and let them build a track record to evaluate. When talking about long-term holdings, he has said:

"The primary difference between permanent holdings and non-permanent holdings is one of personal relationships."

This requires a monitoring period and establishing a relationship with the people behind the business, something I do often. When you combine a trustworthy relationship with attractive economics, you typically have the hallmarks of a great investment.

Trustworthiness does not show up on the P&L. It cannot be screened for. It's even difficult to decipher it when it's being built. But it leads to everything great about a business and a company's long term return profile. Companies that can be trusted have more built-in downside protection, attract the best shareholders, and ~~receive~~ deserve higher multiples.

While I'm always on the lookout for evidence to the contrary, our companies are trustworthy and possess a great combination of the characteristics discussed above. Each has earned their place in your portfolios based on their business quality, management strength and forward return potential. In addition to discussing operational and financial details below, I will talk a bit about how our businesses have earned our trust over time.

Top Five Positions

As of the end of Q2, our top five holdings consisted of **Sylogist**, **Bel Fuse**, **APi Group**, **Medical Facilities Corp**, and **Limbach Holdings**. Currency Exchange International sits right outside of

the top five, with our top seven positions representing nearly 80% of client assets. I will make adjustments as necessary, but regardless of where the economy and public equity markets go from here, I remain optimistic about business results through the remainder of the year and moving forward.

Sylogist (SYZLF)

It's been years since our first purchase of Sylogist shares, and I continue to admire the intrinsic qualities of the business. Sylogist possesses many of the investment attributes I crave which include a leading position in their industry, durable and counter-cyclical characteristics, strong growth prospects, and an impressive managerial record of operating and capital allocation. I remain confident that Sylogist's attractive economics and long runway for growth will produce improved earnings power and shareholder value over time.

The core business for Sylogist, which consists of selling non-profit, government and education related software, continues to fire on all cylinders. Customer relationships are strengthening, SaaS revenue is growing, and Bill Wood and team are focused on strengthening the company's competitive advantage within their end markets.

Sylogist began to earn our trust years ago, taking short-term actions (viewed as negatives) to make the business more durable and strengthen customer relationships over the long term. A hefty dividend was cut, and margins were temporarily lowered to make value-accretive growth investments, which are paying off today. Even amid aggressive investment spending, Sylogist's business remains highly cash generative.

As SaaS revenues continue to grow, especially with the help of channel partners, the Professional Services segment of the business will naturally atrophy, while margins and cash flow will increase over time. I estimate that within 12-18 months, we should see a significant inflection in SaaS revenue growth along with the potential margin benefits stemming from the positive mix shift, at which point we will be the owners of a recurring revenue, high margin, cash generative SaaS business with a durable competitive position, counter cyclical aspects, and a cheap relative and absolute valuation.

With further contributions yet to materialize via the Gov and Ed segments (which are wide open for the taking), revenues could accelerate even further than what I anticipate. It won't happen overnight, but Sylogist is on its way to CAD $100mm in revenues and likely 30% EBITDA margins, measured against an EV of less than CAD $250mm. We will continue to benefit from increases in intrinsic value over time, assuming the business isn't acquired beforehand.

Bel Fuse (BELFB)

Shares of Bel Fuse, our electronics component manufacturer, are up slightly for the year, despite industry de-stocking issues expected to impact the company's top line during FY24. Despite these well-documented issues along with the company's Magnetics segment still limping along, profitability improvements will remain sticky moving forward, resulting in continued ample cash generation.

In terms of uses for that cash, Bel is entering into new product and market segments, gaining exposure in attractive end markets such as space and data centers, while M&A remains an option to accelerate top line growth. Most importantly, for the first time in the company's history, Bel Fuse established a share buyback program to the tune of $25mm, which should be exhausted by the end of this year. Given the current valuation, buying back stock with a double-digit cash flow yield is a great investment, and I welcome further reductions in the share count moving forward.

Bel Fuse has earned our trust by communicating openly, changing capital allocation policies to benefit shareholders, and facing bumps in the road with humility. There is a continued path to strong returns here through a return to normalized operating conditions, further cost optimization, new business wins, and working capital improvements. I remain optimistic about what Bel Fuse can accomplish during the next few years.

APi Group (APG)

APi Group has been in and out of client portfolios since inception (mostly in) and has earned our trust by carrying over the founding culture of the business on its route to becoming public, while increasing their focus on growing the more durable and higher margin fire safety services segment.

The start of 2024 has been a busy one for APG with the recent retirement of their Series B Preferred stock, along with the acquisition of Elevated Facility Services Group, a leading provider of contractually based maintenance and repair services for elevator and escalator brands. I was thrilled to see this deal announcement given the revenue and EBITDA contributions, but also because management likely sees similar opportunities to grow non-discretionary recurring revenue by winning incremental service work.

As a reminder, Safety Services, which represent 70% of APGs business, are statutorily mandated services that represent sticky, higher margin revenue and are largely recession resistant. APG's disciplined selection of shorter duration, smaller project sizes create a differentiated cost structure (read: lower) versus competitors, providing APG with the opportunity to raise prices over time, creating what should be operating leverage with further scale.

I estimate that by 2027, APG will approach 15% EBITDA margins (200bps above management's 2025 targets) on close to $9 billion in revenues (6% consolidated growth). By then, 80% of EBITDA should convert to free cash flow, which means at today's price, APG would be valued at less than 13x FCF.

Organic efforts continue to be complemented by M&A, as APG has made 25 acquisitions since going public, with 300 identified businesses remaining in the pipeline, most of which are sourced via proprietary channels. The combination of organic growth, M&A, pricing and de-levering means there are many ways to win here, which makes my job one of holding on and getting out of the way. With continued execution and strong capital allocation, shares should climb higher from here.

Limbach Holdings (LMB)

Limbach, our construction and engineering services business, has earned our trust by maintaining a long-term focus along with consistently exceeding expectations during our ownership. Companies that intentionally shrink a piece of their business that is not adding value, at the expense of top line growth (often a death knell for public market businesses) give credence to the idea that management matters, a lot.

There are plenty of elements of Limbach's culture that I love and don't have the space in this letter to share, but I believe these cultural elements are leading to advantages which allow Limbach to displace competitors. Few businesses in Limbach's competitive universe take a relationship-based approach (as opposed to transactional) to servicing customers, which is now largely responsible for LMB's improving recurring revenue profile.

Currently there are investments being made that will bear fruit by 2026 and beyond, at which point Limbach's brand will be strengthened, and they can likely take some price on ODR projects. Demand is high and ODR revenue as a percentage of consolidated revenue still has plenty of room to grow. Healthcare and data centers are two growing areas where Limbach can shine moving forward. Importantly, this will continue to remove the cyclicality associated with many of Limbach's construction focused peers.

With continued execution, I estimate consolidated gross margins can exceed 30% over time, likely driving EBITDA margins toward 12%. If Limbach complements organic efforts with disciplined M&A, free cash flow per share could really accelerate, and would be worth a higher multiple over time.

Medical Facilities Corp. (MFCSF)

With shares up +40% year-to-date, Medical Facilities Corp. has moved firmly within our top five positions and shall remain there as long as they continue to execute the very simple strategy of running hospitals profitably and returning excess cash flow to shareholders via dividends and buybacks. Management has earned our trust by executing very well and doing what they say they will do, with the most recent quarterly results showing increases in revenues, decreases in costs, and strong cash flow conversion numbers.

When I first came across MFC, it fit the mold of a turnaround by virtue of some very poor decision making by prior management. After getting familiar with the assets and earnings power, and with new management in place prior to our investment, I realized it was less of a turnaround but rather more a return to common sense. Management quickly simplified the entire cost structure, stopped doing value destroying M&A, and began returning all capital to its rightful owners, us. Given that MFC owns durable streams of cash flows in the form of hospitals that collect service revenue on the back of medical procedures, these capital returns should continue.

I estimate MFC could generate greater than $30mm in distributable cash flow during FY24, against an enterprise value of around $270mm. These cash flows can be reinvested by MFC at mid-teens rates of return simply by repurchasing stock, which they've done by reducing the

share count by nearly 25% during the past two years, letting shareholders know that long term value per share is the guidepost by which management is operating.

Our position in Medical Facilities Corp. is a good reminder that we don't have to chase trends in A.I. or predict the future to generate strong returns. Investing in durable businesses with strong cash flows, smart capital allocation policies and cheap valuations works just fine. Significant potential upside also exists should the company decide to monetize its portfolio of hospitals via asset sales.

Broad Market Commentary

Please refer to the first section of this letter for my market commentary, included in my initial thoughts.

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. The first half of the year also involved plenty of travel, some of which included productive conversations with thoughtful high net worth, family office and institutional investors. Referrals continue to be welcome and if you know anyone that might be a good fit for the firm, please feel free to pass along my information. Thank you as always for allowing me to manage your hard-earned savings. I am incredibly appreciative and look forward to touching base again in October.

Please feel free to reach out anytime. Thank you for reading.

Adam Wilk
Greystone Capital Management
www.greystonevalue.com
Email. adam@greystonevalue.com
Direct. 302.593.4483

Disclaimer: *Past performance is no guarantee of future results. Investing involves risks which clients should be prepared to bear, including but not limited to partial or complete loss of principal originally invested. Investing in small and microcap companies can result in additional volatility and higher risk due to comparatively low market capitalization, more sensitivity to economic and market conditions, and more limited managerial and financial resources. In addition, small companies typically trade in lower volume, making them more difficult to purchase or sell at the desired time and price or in the desired amount. Please refer to Form ADV Part 2 brochure for more information about Greystone Capital Management and its personnel.*