Greystone Capital Management
Concentrated Value Investing

Q3 / November 2022

Dear Clients and Friends,

During the third quarter of 2022, returns for separate accounts managed by Greystone Capital ranged from -0.7% to -13.9%. The median account return was -9.7%. 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.

Third quarter results compare unfavorably to the S&P 500 and Russell 2000 returns of -4.9% and -2.2% 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. Contributing to poor results this quarter includes our investment in Polished.com (formerly 1847 Goedeker Inc.) which I discuss below.

Public market sentiment has improved very little from where we left off last quarter. Present day investor concerns are being accentuated, with many investors, executives and media personalities calling for significant economic deterioration from here, driving much of the negative sentiment and valuation compression we've seen recently. This is highlighted by the range of value that is currently to be found among small cap and microcap companies, including our current holdings. The focus on near-term uncertainty has been a headwind for us as we typically own investments with stronger multi-year outlooks than multi-month outlooks. These investments aren't immune from market drawdowns as sometimes their near-term issues can become exacerbated as the multi-year outlook moves further and further out of focus. Last quarter, I outlined why we would want to own the companies we own when faced with such dire worldly and economic circumstances. That view is unchanged. I believe now is an excellent time to be investing in the types of opportunities we seek, provided one can lengthen their investment horizon. While no one can accurately call the bottom for stocks or economic data, some classes of stocks, namely small caps, are being valued in line with periods like the Great Financial Crisis or the Dot-Com crash*, implying very strong returns from these levels moving forward.

Right now, however, it's easy for investors to solicit reasons for avoiding certain investments, and even reasons for exiting the market altogether. Among them are rates will continue to rise, the economy is headed for a nasty recession, the labor market will roll over, consumers are weakening, and small cap stocks, while cheap on forward earnings multiples, could see earnings revisions and declines. As a result, investments deemed less risky (and less volatile) than stocks have been the preferred uses of investor cash as time horizons shorten during periods of uncertainty. However, things can change very fast in public markets – to both the downside and upside – and inflation, recession fears and rising interest rates have already served as the risk-asset-bathwater being dumped out, taking many babies with it along the way. During times when the market's perceived outlook for every business is equally grim, despite the quality, there is opportunity to profit.

Furthermore, if history is to be repeated, things will eventually turn. Although the timeframe is unclear, what is clear is that the turn will not arrive because investor concerns have been alleviated. It will arrive *well before* the coast is clear. The market is eerily consistent in its ability to be forward looking, bottoming

---

*In terms of economic scariness, comparisons to the early 2000s or 2008-09 aren't very useful in today's market. However, the historical context we now have from those time-period points to at least similar if not worse amounts of pessimism throughout the investment world.

(and recovering) well before the economy does. As a result, any seemingly compelling arguments to avoid stocks today, eliminates an investor's ability to participate in the strong returns that tend to follow large market drawdowns. Please see **Appendix I** for an illustration of the turn during different historical periods.

What's more is that I am not sitting on my hands. Periods like this provide ample data and opportunities to assess what's working, learn about the types of businesses that will benefit in a potentially new investment environment, and upgrade the quality of your portfolios. I will continue to remain respectful and aware of the numerous well-flagged risks, but most importantly will continue to allocate your capital in a way that tilts the odds in our favor over time, so that we don't miss the turn, and can reap the benefits of sticking to our process, owning quality businesses, and being patient.

Portfolio Commentary

The massive gap between the business performances of our holdings and their share prices continues to widen. Clients currently own between 10-12 businesses. Nine of those businesses have used the phrase 'record results' at least once, if not more, during the last few quarterly earnings reports. Keep in mind, these are not high multiple growth stocks or COVID beneficiaries set to see their fundamentals start to deteriorate. In other words, earnings power is increasing considerably, yet many of their share prices have declined to levels I would have never forecasted when initially making the investments. I remain flexible and willing to change my mind, but as this dynamic persists, I will look to opportunistically add to our holdings. I continue to cling to the belief that stock prices will converge with business value over time.

Polished.com (POL)
(Formerly 1847 Goedeker Inc.)

This will be the third straight update I've provided on Polished.com, our largest detractor to performance this quarter. This has been one of the more frustrating investments I've ever made, and we continue to hold our shares despite a significant price decline following the company's announcement that their Q2 financials would not be filed on time. The announcement came in conjunction with the company disclosing that an internal investigation is being conducted to investigate claims regarding the business made by certain former employees. The most frustrating part of this situation has been the company's receipt of poor legal advice leading to the issuance of vague press releases surrounding the issue that have unfortunately raised more questions than they've answered.

With that said, I continue to believe that a positive outcome is possible. A declining share price does not mean the story has changed or that the investment thesis has been invalidated. I'm aware of the loss we are holding. But the important question to ask in this scenario is not how much does the stock have to go up for us to make money? but rather, what is the business worth? I am confident that less than 0.1x sales and below 1.5x EBITDA is not the right price. We are also in year one of a multi-year investment thesis. There will be setbacks along the way. This is a large one. The market is clearly pricing in something dire, including accounting issues, potential financial restatements, or fraudulent activity. Based on what I've gathered, I believe the company will emerge clean from their internal investigation and reveal that the root cause was not related to their financial statements, accounting practices or any impropriety within the business operations. There is of course a non-zero chance that I am wrong, and I reserve the right to change my mind with the receipt of new information. For the sake of brevity, I emailed you separately my thoughts on the situation that explain more in depth how I'm thinking about our position.

Sold Position

Rimini Street (RMNI)

During the quarter I sold out of our remaining position in one of our longest held companies, Rimini Street. Of the errors I made, the first consisted not in assessing the business quality, but rather understanding the macro backdrop for labor and accurately layering that into my growth projections. The second, and more fundamental error included completely whiffing on my analysis of the management team, particularly CEO Seth Ravin.

I don't claim to have all the answers when it comes to analyzing a company culture or management team. I may have a unique perspective at times given my experience with the San Antonio Spurs and evaluating coaching, management, and athletic talent, but it is far from a perfect science. I prefer to speak to a lot of people – particularly employees or former employees – to get an accurate picture of what leadership is actually like. In this case I failed to do so accurately or meaningfully as the company's competitive positioning and growth runway appeared to be too attractive to pass up. I believe I was also wrong about some aspects of the company's competitive position, especially during periods of economic stress, and with a large number of potentially better risk/reward or higher IRR opportunities, I re-allocated the cash from the sale to other current holdings and some new investments. Moving forward I aim to be more critical of our management teams and vow to change course more quickly when it becomes clear I am wrong about my assumptions.

New Positions

Small Cap Event Driven Situations

During Q3 and early in Q4, we entered into two small cap event driven situations that I believe provide the potential for material short-term upside while also providing significant downside protection. The first business is a family-controlled real estate investment company with a diverse group of assets that just completed the sale of a large swath of multi-family apartments for an amount nearly 5x the current market cap. I believe the company's true book value is understated by over 100%, and the incoming cash and property value from the sale is not yet reflected on the company's balance sheet. Although there are reasons why book value may not immediately re-rate following the Q3 and Q4 filings, I believe there are levers being pulled in favor of minority shareholders to unlock additional value within a favorable time frame.

The second business is a consumer products business that manufactures tools and home improvement products with a large professional products segment that builds residential and commercial garage doors for both dealers and retail chains. Years of mismanagement and the abuse of shareholder capital has led to an activist battle / proxy fight where I also believe levers are being pulled in favor of minority shareholders to unlock value either through the sale of the entire business or the separation of one of the business segments. The company is currently undergoing a strategic review where all signs point to a value-unlocking event occurring at the conclusion. Whatever the outcome of the review, we purchased our shares at prices that would imply one of the business segments being worth more than the entire enterprise value of the company. I look forward to disclosing both investments in more detail next quarter or in future letters.

Cannabis Related Investments

In 1975, Jeffrey Edmondson, a drug dealer based in Minneapolis, filed his taxes. He had a good year as a self-employed man in the illicit drug trade. He sold 1.1 million amphetamine pills, five ounces of cocaine, and 100 pounds of marijuana. Like any other tax-paying American business owner, he wanted to deduct standard business expenses. On his tax return, Edmondson recorded $105,300 in costs related to selling speed, cocaine and marijuana during the taxable year of 1974. Not surprisingly, the IRS denied all his deductions in an audit, but in 1981 Edmonson fought the decision in U.S. Tax Court and a judge sided with him. He recouped most of his expenses. However, in 1982 Congress took aim at drug dealers like Edmondson and enacted **US Federal Tax Code 280E**, a punitive and onerous tax code that prevents businesses that traffic Schedule I or Schedule II controlled substances, which includes cannabis and other drugs, from claiming standard business deductions.

Today, even though 39 states have legalized medical-use cannabis, and 19 other states permit recreational or adult-use marijuana in some form, cannabis retailers must pay taxes under 280E. This tax code essentially makes cannabis companies pay taxes on **gross revenue**; a huge financial burden that makes it difficult to turn a profit. These effective tax rates are anywhere between 60-100% of retailer profits, depending on the company structure. But that's not all. Cannabis retailers across the country do not currently have access to basic banking tools available to all businesses including the ability to accept credit cards, bank with large financial institutions, or borrow money at favorable interest rates. As a result, the entire capital base for cannabis businesses is either incredibly expensive or non-existent. Many, if not all cannabis businesses have been forced to issue expensive equity, borrow money at mid-to-high teens rates and suffer without growth capital despite the incredible demand for legal cannabis across the US.

The above story about Mr. Edmondson is funny, yet true, and among other things sets the stage for potential strong investment returns among publicly traded cannabis businesses. Although the timeline is unclear, I believe 280E is on the cusp of being eliminated via The SAFE Banking Act, which would result in a massive windfall to cannabis businesses (who would get to keep more of their profits) and remove the restrictions on new capital (including institutional capital) from entering the industry. SAFE banking would also allow cannabis businesses to access basic banking services, accept credit cards, borrow money at lower rates, and ease compliance and custody concerns from larger investors and banks.

As a nascent industry, cannabis already underwent a bubble-like explosion between 2018-2021 which was accompanied by massive capital spending, debt and equity fueled M&A, promises of favorable regulation and sky-high stock valuations. Fast forward to today, and the industry has sobered up completely, with M&A activity down nearly 80% from last year, capital raises down nearly 75% from 2021, and stock valuations at trough multiples with industry sentiment no better. As the anticipation of federal legalization and the passing of favorable banking laws dissipated, industry participants woke up to the fact that many cannabis companies are not great businesses. Even the largest players sell a commodity product, have low barriers to entry, significant competition (including from the illicit market), cash consuming tax profiles, high capex needs and less than stellar balance sheets. There is also a crazy arms race taking place in all markets leading to price wars and margin compression as operators fight for scale. While that doesn't sound attractive in terms of finding good cannabis *businesses*, I do believe that they could make for good *investments*, especially considering the dynamics surrounding liquidity, size, lack of analyst coverage and the inability of larger funds to own shares. I also believe I've found some that look very attractive fundamentally relative to the broader group. During the quarter, we purchased a bucket of small positions among a group of cannabis related microcaps.

Despite the headwinds I described, there are several businesses that trade at valuations implying severe mispricings, given their fundamentals, growth runways and potential legalization tailwinds. Although I've spoken about the tailwind that favorable regulation will provide, I don't believe regulation will be necessary to do well owning the specific businesses we own.

What we currently own consists of the smaller, lesser-known operators who are growing revenues, taking market share, generating cash, and have clean balance sheets. Although these businesses will look attractive on their own as they grow and scale, I believe that significant acquisition potential exists among smaller companies as larger multi-state operators or 'MSOs' look to extend their geographic reach and dominant market positions. Scaled smaller players in states like New Mexico, Illinois, Florida, Massachusetts, and Pennsylvania who have also developed some decent brands should become very attractive acquisition candidates in the coming years, especially if institutional and lower-cost capital is allowed to enter the space.

Our bucket of companies possesses the following attractive characteristics, rare among their peers:

- All operate in limited license or protected states
- Each have strong geographic presences in states with approved legal usage
- All are growing revenues and EBITDA at mid-teens rates or higher
- Each business is free cash flow positive
- All of our holdings have clean balance sheets with very minimal debt profiles
- Each are currently at significant inflection points in terms of realizing the benefit of prior investments in the form of revenue growth, EBITDA growth and margins

I believe we paid bargain basement prices for our shares in these businesses given the fact that both sentiment and valuations are severely depressed. Although political progress will be the biggest near-term driver of stock prices, I like the setup here and believe we should do well over time. Research on one of our holdings, Cansortium Inc. can be found here. I look forward to sharing more detail in future letters and in communications with each of you.

Broad Market Commentary

Continually weighing on the market are a large number of negative forces. There is also the possibility of further declines from here. My view that now is not the time to swing for the fences remains intact, although it's also not time to run away from the ballpark. This is an environment where there are bargains to be found as the cheap get cheaper. There are also strong economic data points to sift through, and there are reasons to believe that things are never as bad as they seem. I believe it's possible that the economy is evolving faster than is being captured in economic statistics, it's possible that inflation fears are overblown, and it's possible that corporations will perform much better than investors think, making comparisons to prior cycles irrelevant. Favorable data points that have provided some level of comfort include information surrounding the strength of our financial institutions, consumer loan data (non-performing loans and delinquency rates), and corporate data surrounding financial distress, leverage ratios and margin strength.

With that said, there is precedent that points to stocks trading at lower valuation multiples during periods of inflation or recessionary conditions. In prior scenarios, rates were much higher than current levels, but there is precedent. Currently, it is unclear where rates will ultimately settle. The uncertainty inherent in the collective assumptions has given rise to fear and confusion, creating the many headwinds we've been facing. That, combined with the view that it is no longer detrimental to hold cash has created less pushback for investors interested in reducing market exposure. Not many will question the decision to move cash to T-bills yielding above 4% with no added risk compared to the market's mid-single digit earnings yield. Having a perceived viable alternative to stocks is a dynamic that we have not seen in a very long time, where long term implications are also unclear. Some good news is that the market is forward looking, so I'd imagine a large percentage of the adjustment to this dynamic has already taken place, but as I mentioned, further valuation and stock declines could continue.

I take some comfort in the fact that my strategy is not based on needing to actualize overly optimistic assumptions. There is plenty of negative news priced into the valuations of our businesses, all at a time when their competitive positions are not deteriorating, and none have the need to raise capital in the short term. In other words, they are not priced for perfection, and I don't believe a lot has to go right for us to make money from here. Whichever direction inflation, rates, or the economy trends, our current holdings as well as quality businesses within our investment universe continue to be discarded or ignored. This will not go on forever. I continue to build client portfolios in a way that puts the odds in our favor over time, while remaining flexible and willing to change my mind as new information is uncovered. My strategy is designed to be long-term focused, and only works if we don't get scared away from the many ups and downs we will experience together. I say together because the majority of my and my family's capital remains invested in the firm. Our interests are aligned.

Recent Developments

Greystone added two new clients during the quarter. As a reminder, the firm remains far from our desired AUM capacity, and my hope is that we can continue to take positive steps forward in that regard. For non-client readers, please feel free to drop me a line anytime or distribute these letters to any like-minded investors.

During the quarter I also had the pleasure of serving as a guest at both the 2022 Microcap Leadership Summit and on Lunch at the Club via Avenel Financial's The CO/Investor (link emailed separately as it is a paid service). I was given the chance to talk about Greystone Capital and our investment process as well as pitch our holding in Cansortium Inc. Please feel free to watch or listen to both presentations. As always, feedback is welcome.

Your patience and ability to withstand times like these has not gone unnoticed. I believe it will ultimately be rewarded as the current state of affairs will not be a permanent one. I am incredibly grateful for the amazing group of clients behind the firm and continue to feel as enthusiastic and as optimistic as I've ever felt to go to work every day.

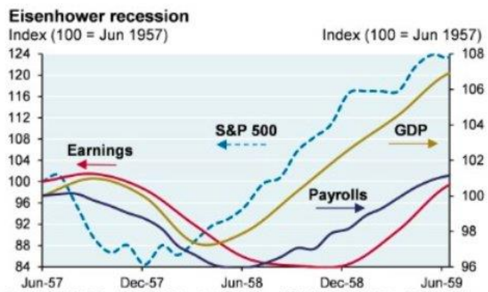
Please feel free to reach out anytime. Thank you for reading.

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.*

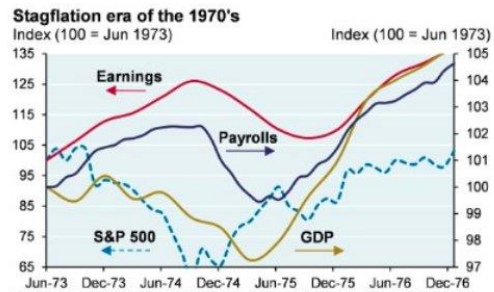
Appendix I

An illustration of 'the turn'. Notice the blue dotted line of the S&P500 sharply declining and recovering well before earnings, payrolls and GDP.



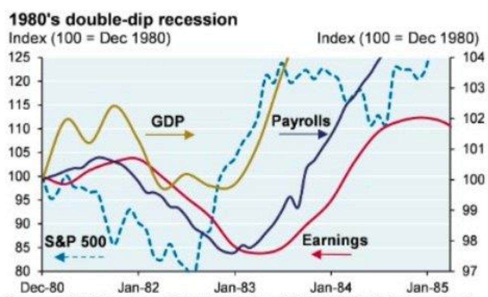
Source: BEA, Bloomberg, Robert J. Schiller, JPMAM. 2022. Note: Earnings is represented by S&P 500 EPS rolling 4Q avg.

View info



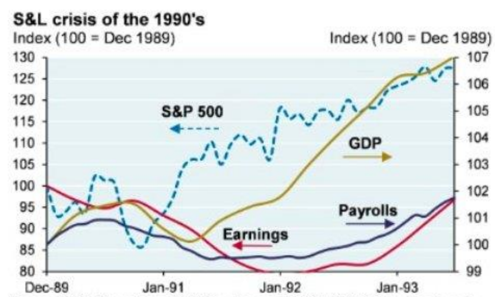
Source: BEA, Bloomberg, Robert J. Schiller, JPMAM. 2022. Note: Earnings is represented by S&P 500 EPS rolling 4Q avg.

View info



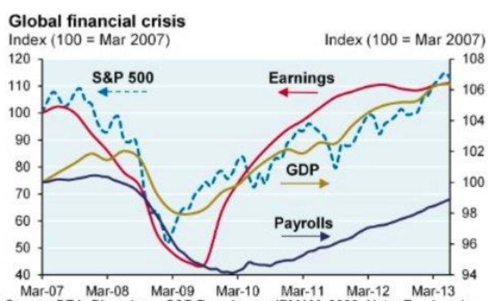
Source: BEA, Bloomberg, Robert J. Schiller, JPMAM. 2022. Note: Earnings is represented by S&P 500 EPS rolling 4Q avg.

View info

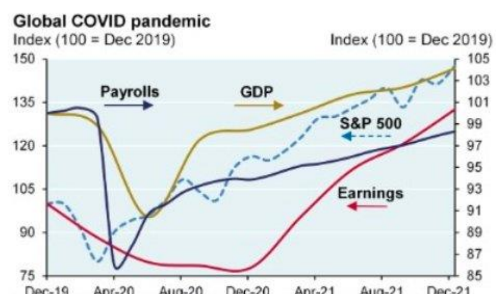


Source: BEA, Bloomberg, S&P Dow Jones, JPMAM. 2022. Note: Earnings is represented by S&P 500 EPS rolling 4Q avg.

View info



Source: BEA, Bloomberg, S&P Dow Jones, JPMAM. 2022. Note: Earnings is represented by S&P 500 EPS rolling 4Q avg.



Source: BEA, Bloomberg, S&P Dow Jones, JPMAM. 2022. Note: Earnings is represented by S&P 500 EPS rolling 4Q avg.