Greystone Capital Management
Concentrated Value Investing

Q2 / July 2023

Dear Clients and Friends,

During the second quarter of 2023, returns for separate accounts managed by Greystone Capital ranged from -0.7% to +8.0%. The median account return was +2.6%. Year-to-date, the median account return was +6.4%, net of fees. Second quarter and year-to-date results compare unfavorably to the S&P 500 and Russell 2000 returns of +8.7% and +5.2% during the quarter and +16.9% and +8.1% 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.

As always, I would caution against reading too deeply into any three or six-month period, good or bad. Our short-term underperformance comes on the heels of solid results from our businesses, which is a situation I can live with. I also have no excuses as the way I've positioned client portfolios means we will sometimes be out of sync with the market, something that bears repeating often (the last sentence from the first paragraph is copied and pasted into each letter).

I'm also not surprised. The market seems dead set on not rewarding the types of businesses we own, both in client portfolios, and broadly speaking, even in the face of strong execution. Index returns are being driven by a select few of the largest businesses in the world, which is a dynamic unlikely to continue into perpetuity. We do not participate in the returns generated by these businesses, nor did we benefit from a rising market because of them. However, history has shown that this storyline can't last forever, which should re-introduce tailwinds for us over time.

Thankfully, as of now, there exists many growing, well managed, cash generating businesses trading at single digit multiples of earnings or cash flow, underfollowed or ignored due to the current market structure. They won't be ignored forever. As part of the hangover effect from 2022, fear surrounding investing in small companies, and strategies dedicated to such, has remained palpable year to date. This is evidenced by small cap to large cap valuation spreads, the low number of small cap active managers who remain in business, and the persistent focus on some of the largest businesses in the world. It also wasn't that long ago that plenty of market participants were predicting a severe recession, the odds of which are still not zero. When you combine these factors, it creates a large cavity where quality small companies are not being priced correctly. Greystone was created to take advantage of this gap, and the number of opportunities to deploy capital at favorable valuations is growing every day.

If this letter had a theme, it would be to not ignore the obvious. That's the advice I was given by a veteran scout years ago while working in the NBA, the effectiveness of which I didn't realize until years later. His shining example included many of his peers claiming that Steph Curry was too small for the NBA. The scout attended a pre-draft workout featuring Curry, and told me succinctly, 'he was 6'3"'. In other words, it was obvious he wasn't too small, and just by looking, it became impossible to ignore. I've been making the following point ad nauseum for 18 months, but eventually, growing, well managed, cash generating businesses trading at single digit multiples of earnings or cash flow will become obvious and thus impossible to ignore, regardless of economic uncertainty.

As such, building a carefully selected portfolio of small, high-quality businesses that are not priced that way is how we will continue to operate. There will undoubtedly be bumps in the road on our way to positive long-term performance. There are pockets of uncertainty within the economy. There are plenty of people calling for a recession. But the current opportunity set is incredibly attractive, and I believe market conditions are providing me with the opportunity to execute my strategy effectively. Historically, there have been a few periods for small companies like the current one, where returns coming out of these periods should be very strong. If history is on our side, we should be compensated. I say we, because as always, my family and I are invested alongside each of you. Our interests remain aligned.

Portfolio Commentary

This quarter was a busy one, with a full travel schedule and a large number of management meetings. Under the surface of the S&P 500, there are plenty of growing, profitable, and cheap companies being overlooked, the types of which we've typically had the most success owning. We exited the quarter having made two new investments, one of which is discussed below, with a large pipeline of opportunities that I'm evaluating for portfolio inclusion moving forward.

I remain very excited about what we currently own along with what our businesses can accomplish during the next few years. When I look across client portfolios, I'm still not seeing what I believe to be accurate valuations for the majority of our holdings. In fact, we remain far from what I'd call appropriate. I believe this gap will close over time. For the remainder of this section, I will provide updates on our top five positions, as well as discuss our newest investment in **Limbach Holdings.**

Top Five Positions

RCI Hospitality (RICK)

RCI Hospitality, a top five holding since inception, continues to chug along, integrating recent acquisitions, evaluating M&A deals, and advancing new projects, all of which should have the effect of boosting revenues and free cash flow moving forward. When compared to similar businesses and peers in the restaurant space, RICK's unit economics are tough to match. Their food/beverage mix skews significantly towards higher margin alcohol, nightclubs boast 40% operating margins, they own the real estate for all their clubs and restaurants, they earn 20-33% cash on cash returns through M&A deals, and Bombshells unit volumes remain attractive (while same store sales numbers have likely reached a trough).

Early in Q3, RICK disclosed their sales figures for both Nightclubs and Bombshells, which were admittedly weaker than I expected and represented the first same stores sales decline following nine straight quarters of positive figures. Up until this point, RICK's operating results have been largely insulated from both the economy and broader restaurant sector, but a continuation of this trend of same store sales declines would not bode well for the stock. Projected results through 2023 may prove to be unfavorable, but I believe there are levers to pull in order to offset any softness in near term results. Short-term bumps in the road will ultimately pave the way for RICK to continue strengthening the business and setting themselves up to grow earnings power over time.

During periods of share price weakness, shareholders have been rewarded with strong capital allocation in the form of large share buybacks, and M&A deals, which typically accelerate across the industry during periods of economic weakness. As a reminder, RICK completed their largest deal to date (the 11-club

Lowrie acquisition) in mid-2021, following the rough year and a half period when many operators were forced to shut down or exit the business. As another reminder, RICK is aiming to deploy $200mm per year during the next few years to continue consolidating the industry with the goal of doubling the company's EBITDA profile from $100mm to over $200mm. These levers being pulled will serve to grow the company's earnings power now and into the future, at which point the current valuation will look even more favorable.

We also remain invested alongside a smart owner-operator with plenty of skin in the game and capital allocation prowess. I believe there are multiple ways our downside is protected, and I continue to have a clear eye toward what the company can accomplish during the next few years.

Basic-Fit (BSFFF)

Basic-Fit is our gym business and the largest fitness operator in Europe, that, similar to RICK, sports outstanding unit economics on its mature club base, along with very strong barriers to scale and elements of low-cost leadership that have positioned them well moving forward. One frustrating part of this investment has been wading through the perception surrounding the business including how the company is covered by various analysts (typically causing the share price to react strongly to new neutral, hold, or sell recommendations based on non-essential information). For example, the draconian scenarios the market braced for during 2022 regarding European energy costs and the need for increased liquidity for the business have abated, the company has demonstrated their ability to raise prices (and laid out the pricing math), and they've surpassed most expectations regarding membership growth in difficult to penetrate geographies, yet many analysts refuse to update their cash flow models or upgrade their price targets. There are also analysts covering the business who have not previously analyzed the equity side of a company, leading to uninformed opinions based on an inapplicable skill set.

But woe is not us. BFIT stock is up around 30% YTD, and this is what makes a market. Typically, our estimates and projections will differ widely from what's priced into the long-term business valuation. Management is also non-promotional, and giving quarterly updates for this business is not always conducive to strong stock performance. The company is attempting to grow significantly faster than both the industry and competitors, for which there will certainly be bumps in the road. We have seen plenty during our ownership period alone. With that said, Basic-Fit's growth strategy remains largely intact, and I've been very pleased with management's treatment of shareholder capital.

There are concerns about short-term results, as analysts fight over the *exact* NTM EBITDA figure to use, the exact NTM club openings number, and the exact membership yield number, down to the tenth of a cent. We are looking further down the road. I've written about Basic-Fit's cost structure being the wildcard moving forward. There is now clarity there. I've written about a worst-case scenario in energy costs. Those have abated. Memberships are growing, new clubs are being built, competitors are struggling, and BFIT is *raising* prices. All in all, there is execution risk...for competitors!

I've laid out my math for Basic Fit in past communications, but put simply, investors can purchase shares in this business for a single digit multiple of EBITDA on *the mature club base alone*. From a growth perspective, BFIT is opening 200 clubs per year with likely *better* unit economics. BFIT trades at cheap absolute and relative valuations, is growing significantly faster than both the industry and competitors and shows no signs of slowing down its expansion plans. As the membership base grows, premium pricing uptake increases, and new clubs are built, the strength of the business will shine through and the market

should value it more appropriately on an absolute basis. Last quarter I outlined the reasons behind adding to our position in Q1. Those comments stand, and I continue to look forward to what the remainder of this year as well as 2024 will bring.

Currency Exchange International (CURN)

Currency Exchange is our provider of foreign currency exchange services. The company generates revenue by sourcing foreign currency for both individuals and financial institutions through their Banknotes segment, as well as facilitating international payments for financial institutions via their Payments segment. CURN also has a retail business via partnership agreements located inside of high traffic airports, as well as an online delivery service for foreign currencies in 40 states. We are currently in the midst of the all-important travel season for the business, where data is skewing positive, and I'd expect the company to report strong quarterly results in September.

We are interested in the longer-term picture, however, and not included in my last letter was my attendance at the company's annual meeting in March with a lot of positive takeaways. Management and the Board seem to grasp the opportunity set in front of them and are doing their part to execute with vigor. Banknotes and Payments are chugging along and should provide enough growth and operating leverage to power strong earnings growth moving forward.

Outside of Payments, The Exchange Bank of Canada (within Banknotes) where Currency Exchange is one of only three banks able to source US dollars from the Federal Reserve, may become CURN's crown jewel asset over time. There are significant competitive shifts taking place throughout the industry among CURN's larger competitors that favor the company, and I believe the opportunity set both internationally and within Banknotes is not being appreciated by the market. Almost as a footnote, and something I'm pushing the company to communicate, was management's comment at the annual meeting regarding the size of the opportunity for Exchange Bank of Canada being in the neighborhood of $400mm annually. Management thinks they can capture 20% of this market over time, which would result in incremental revenues that would eclipse the current run rate for the entire business. With similar operating leverage that we've seen in Banknotes, (staffing and compliance costs would be behind them at this point), the operating income numbers would start to look silly.

CURN is in the process of making investments to continue building out these capabilities, and I'm excited to see them bear fruit beginning in 2024. I think it's only a matter of time before the market recognizes the company's strong competitive position as well as earnings potential. The road will not be a smooth one, but CURN remains on track to double earnings within the next few years and as such the business remains firmly among our top five positions.

APi Group (APG)

APG is the largest business we own, by far. The company has over ten analysts and is included in various indices. A large value shop, along with Vanguard and Blackrock own 30% of shares outstanding. Not quite off the beaten path. Yet I believe there are a number of dynamics including the management team, various business segments and APG's route to going public that have served as an overhang to the business quality, where aspects of the company's competitive strengths and growth runway remain unappreciated.

I would call APG our fire safety business, which has been around for a long time. In fact, there are not many 75-year-old businesses. There are not many businesses whose services are considered a requirement (statutorily mandated) for their end customers. There are not many businesses whose leadership, during a transition period, hand-picked the buying party in order to preserve the company's culture and employee base. There are not many businesses whose Chairman has a positive decades long track record of capital allocation and operating expertise. If you find a business that contains the above elements, it usually can't be purchased for a fair price.

APG fits the above description (surprise) and I believe there remains significant upside as the market comes to better understand the strength of the business, the company continues to integrate a large – and very accretive – acquisition from 2021, and as they continue to pay down debt. APG will also perform well during any adverse economic periods as they have in the past, and since the business is mistakenly viewed as levered to new construction, I think strong performance over time will shine through.

APG went public via SPAC, has few pure public comps, and has some non-believers when it comes to management. Separating the company's Specialty Services business from Safety Services (Fire Safety) would go a long way toward simplifying the story (although in my view it's quite simple). Outside of that, with continued execution, the market will start to recognize both the strength and attractiveness of APG's business, as well as the potential for increased cash flow generation moving forward. If management is to be taken seriously about their cash flow guidance, APG is trading for less than 10x EBITDA looking out a few years. I like our chances to do well owning this business over time.

Sylogist (SYZLF)

The investment case for Sylogist can be found in last quarter's letter, and not much has changed since then, aside from the company hosting their first ever Investor Day which I attended in Toronto during the month of June. The event was very well done and gave the company a chance to highlight their competitive strengths, growth runway, and recap how far they've come since the current management team was brought on board. Investors got to hear from key members of the management team, each of whom outlined their respective roles and strategic visions, revealing a company that has become much more streamlined, data driven and incentivized to drive shareholder value.

In both my and management's view, this is a completely different company relative to pre-2020, and there is a tremendous opportunity to grow the earnings power of the business moving forward. The market has been slow to appreciate this. I'm excited to be invested alongside a very high-quality management team that has executed the playbook of organic growth + M&A at previous roles. This is not a group that thinks, acts, or operates like a sub-$150mm business. Furthermore, I believe management remains conservative in terms of their financial outlook, as organic growth could accelerate if additional verticals start to contribute, margins could expand more than expected over time, and if they get the M&A engine revving, they will grow FCF per share at a considerable rate. These are all free options as the current IRR in terms of the FCF yield + growth is attractive on its own. But as an example of the embedded optionality, the opportunity set in the Education vertical alone could come to represent a revenue run rate that exceeds the entire revenue profile of the business today.

There was an exciting buzz among investors in attendance regarding this business and the market's lack of appreciation for the current state of affairs. Management agrees as the company is buying back stock as we speak. I believe our shares remain significantly undervalued, and of all the businesses we own, I

think I'm most excited about the opportunity set in front of the company, as well as our potential upside. I added to our position during the quarter.

New Position

Limbach Holdings (LMB)

My career experience in professional sports opened my eyes to how a strong culture can positively impact an organization. A strong culture is hard to find, quantify, and grow, but you know a good one when you see it, and you know a bad one when you see it. To get a sense of the strength of a business's culture, I prefer to visit the company, meet with management and employees face to face, conduct channel checks with former employees and measure those things against competitors. It's far from a perfect science, but businesses are a collection of people (which is the type of insight you're here for), and how those people are treated, rewarded, and managed matters. A lot. Assessing the culture of a 100+ year old business isn't something that can be done following a few weeks or months of due diligence (and in fact, I often get to know our businesses much better *during* our ownership), but one can put the pieces together by doing some of what I described above.

During the quarter we entered into a new position in Limbach Holdings, a microcap construction and engineering services business that is successfully shifting their business mix to stickier, more resilient, higher margin segments that over time will have the effect of contributing organic revenue growth, boosting margins and increasing cash flow generation. In the case of Limbach, and a number of our other businesses, I believe there are cultural reasons why the business has been around so long, and why they've succeeded in driving positive recent results.

Limbach considers themselves a building systems solutions business, that takes part in the design, installation, management, and maintenance of building systems such as plumbing, HVAC, mechanical and electrical components. The company has a decent presence throughout the US, with a focus on helping their end customers address mission critical systems. With a large recurring revenue profile, and with a presence in favorable and growing end markets, Limbach is well positioned to grow even in the face of economic pressures.

Limbach went public via SPAC during the initial part of the SPAC craze in 2016 and spent the next several years struggling to adjust as a public company while undergoing some operational missteps as they executed their strategy. I've followed the business since that time but remained on the sidelines due to concerns about the industry as well as the former CEO, a talented operator who for good reasons struggled to earn the market's trust. He resigned earlier this year, clearing the way for current CEO Mike McCann, who I believe is the right leader to move this business forward.

Limbach has two business segments, General Contractor or 'GCR' and Owner Direct or 'ODR'. The GCR segment, responsible for around 50% of revenues, manages new construction or renovation projects that involve some of the previously mentioned building systems. The GCR segment is a longer duration, lower margin business with significant competition, and is an area where historically Limbach has experienced some setbacks. GCR projects are typically commodity-based offerings with little ability to differentiate between vendors, and since projects are awarded by general contractors or construction managers, Limbach will typically have to accept the lowest bid given the level of competition. This is reflected in low gross margins for the segment as well as the lack of pricing power. Prior management put a large emphasis

on GCR related projects, which aside from the negatives listed above, continuously ran into construction delays and cost overruns.

The ODR segment, responsible for the other 50% of revenues, earns revenues by providing owner direct construction projects and maintenance services. An example of this would be Limbach integrating themselves into the maintenance of a particular building's systems, such as their HVAC or plumbing operations, developing a relationship with the building owner, and delivering reliable, high-quality work. I mentioned mission-critical above as the types of projects ODR seeks out involve maintaining systems that for various reasons can't afford to fail. Think of the air conditioning system inside of a hospital. These services are assigned by building owners themselves, allowing Limbach to develop more of a recurring, relationship-based offering that is shorter in duration (thus better cash flowing) than GCR projects. Importantly, ODR work also sports higher margins and more opportunities for organic growth, with management targeting low teens revenue growth moving forward. As mentioned, as the portion of ODR revenues continues to grow, it will result in more recurring revenue, higher margins and increased cash flow generation, while leading Limbach to become an indispensable partner to their building owners.

A look at the income statement would reveal a shrinking set of GCR revenues, which is intentional as Limbach is now prioritizing the ODR segment as well as attempting to maximize margins within GCR. The revenue mix should reach 50/50 between GCR and ODR during 2023 with a 75/25 target between ODR and GCR over time. Management has mentioned being in the first inning of their growth strategy where they will be able to grow ODR revenues at a double-digit pace from here.

On top of the company's strong organic growth prospects, there are significant opportunities for M&A, as Limbach operates in a very fragmented industry and value can be added by purchasing mom and pop operations that complement Limbach's offerings. The company has successfully demonstrated the impact of accretive M&A using their net cash balance sheet, and this should only serve to bolster free cash flow per share moving forward.

As mentioned, Limbach is led by CEO Mike McCann, who has been an employee of 13 years and was hand-selected by the board to succeed the former CEO. Mike was chomping at the bit (his words) to take the helm at Limbach and in getting to know him over the past few months he reminds me of many of my former Spurs colleagues, as he is unassuming, laser focused on the task in front of him, and patient enough to be taking a very long-term view. I feel very good about Mike's leadership as well as his adherence to the Limbach culture, which got its start over 100 years ago. Like a lot of our businesses, many employees have long tenures with the company, indicating that there may be something in the water at Limbach.

Despite the strength of the business, strong fundamentals, growth runway and balance sheet, we were able to purchase our shares around 5.0x EBITDA, a cheap price on both an absolute and relative basis. Past missteps with the prior management team along with the oft-hated engineering and construction industry in which Limbach operates means that shares are being valued like a cyclical, non-recurring construction company with most of their business tied to new construction projects. The reality is that this is a much stronger, more durable, and faster growing business today than it was just a few years ago, which means over time the market should come to recognize the strength of ODR as well as the potential to grow free cash flow per share, especially if Limbach gets the M&A engine revving.

There are many parallels between our investment in Sylogist and our investment in Limbach, namely a business with a checkered past, a favorable management change, a strategy shift, and the opportunity for

organic growth, M&A, and strong capital allocation. Despite the strong share performance year to date, I believe there remains significant upside as we are in the initial stages of the company's execution. I look forward to discussing Limbach in future letters.

Broad Market Commentary

During the past few decades, there have been three specific instances where small company valuations became severely dislocated from larger businesses. These periods were the 1974 Nifty-Fifty era, the Dot-com bubble, and 2020, during the pandemic. [The fourth one is happening right now.]

As a result, we are currently being provided countless buying opportunities across the small company universe, as many stocks have been unfairly punished despite continuing to deliver strong fundamental results. This is not because [each of] these companies are lower quality than their larger peers. It's not because they are less able to withstand economic shocks, and it's not because they can't outpace inflation or access capital markets. It's because economic uncertainty combined with a changing market structure has caused them to be ignored. When all companies are being priced as if they will behave equally in any environment, there are opportunities.

I don't have a crystal ball, and maybe things will get worse in the near term, but active managers have historically benefitted coming out of low return periods for small companies, and the past few years have certainly been a low return period. It's true that lower quality companies tend to perform worse during a recession. But what happens if we own businesses with much higher quality fundamentals and at cheaper prices than the broad market? What happens if we own businesses that are conservatively financed and don't need to access capital markets to fund their business plans? What happens if we can stretch our time horizon from the next three months to the next three years?

I am confident that rather than attempting to confront many of the perceived macro issues head on, we are invested in businesses and alongside management teams whose experience and understanding will help guide our businesses through any uncertainty or adverse macroeconomic periods. Regardless of what the rest of the year brings, our best course of action is to stick to the approach of owning growing, durable business models when they are trading at reasonable valuations and hold them for the long run. Cyclical headwinds could pressure economic results in 2023, but I believe that the growth and earnings power that our businesses can generate over time remains very attractive.

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. 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.

During the quarter, the San Antonio Spurs were awarded the #1 draft choice in the NBA Draft Lottery. This marks the second time the team has secured the #1 pick, with the first being in 1997, when they drafted Tim Duncan. The same owner, head coach and President remain in place since that time period. That kind of continuity is extremely rare in any organizational setting, let alone professional sports. The Spurs are the living embodiment of pounding the rock, as decades of effort, consistency and small incremental efforts built up over time has led the organization to where it is today.

Their story was also not without bumps in the road. I talk a lot about the various bumps that we may incur over time, and if we are to have any success doing what I think we can do, it will be on the back of your ability to withstand those bumps along with me. Thus far, your trust and patience have allowed us to do so. These are things I do not take for granted.

Head Coach Gregg Popovich conducted a press conference on the night of the draft and I would highly suggest listening to the first 8-10 minutes of the interview. There are an incredible amount of important life and investing lessons regarding patience, letting things develop and giving yourself the freedom and flexibility to iterate with the receipt of new information. Pop was hired in 1994 to run the team, later moving to the head coaching position in 1996. That's twenty-seven years of pounding the rock. I hope to gain similar tenure with Greystone, and 27 years from now, I'll consider myself lucky to be in this exact same spot, managing your capital. Thank you for the opportunity.

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

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