Greystone Capital Management
Concentrated Value Investing

Q2 / June 2021

Dear Clients and Friends,

During the second quarter of 2021, returns for separate accounts managed by Greystone Capital ranged from -2.8% to +14.8%. The median account return was +3.1%, net of fees. Year to date, the median account return was +49.8%, net of fees. I look forward to publishing more in-depth performance data at the end of the 2021 fiscal year, reflecting a composite return number, net of fees, that will capture a portfolio built since inception of the firm. Please continue to check your individual account statements and feel free to reach out with any questions or concerns.

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 resulting in different position weightings for each of our holdings. This would change if/once I transition to a fund structure, but for the time being I will remain utilizing SMAs. I will be sharing some thoughts in the future surrounding how portfolios are managed for a client since inception versus one onboarded last month but given the dynamic nature of my portfolio management process (as opposed to static) I don't believe there is a perfect statistical formula for allocating new capital.

Second quarter results compare unfavorably to the S&P 500 and Russell 2000 returns of +8.4% and +4.2% for the quarter, and favorably to year to date returns of +15.1% and +17.4% for the indices. 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. Furthermore, one quarter's results, no matter how favorable or unfavorable, provide more noise than signal as to whether my strategy is being implemented effectively. During the quarter, the market seemed to be oscillating between two speeds, optimistic and pessimistic, while liquidity needs, equity outflows and disdain for small companies have caused some of our positions to fluctuate wildly. I view this as par for the course on our way to generating what I hope to be favorable returns moving forward.

Returns for the quarter were driven by additional increases in our top five position in RCI Hospitality, with additional top-five holdings in At Home Group (discussed below) and APi Group both appreciating incrementally as well. Other positive contributors included the appreciation of one new position purchased late in the quarter. Cash levels acted as a small drag on performance, as certain client accounts at quarter end were holding cash positions in the range of 10-20%. My intent is to reduce those levels moving forward, and I believe I've found a number of suitable ideas that I've been either researching or actively buying.

I made a number of what I believe to be positive changes to client portfolios this quarter, so I will spend the rest of this letter discussing the thought processes behind some of those decisions. I look forward to disclosing more next quarter and in future letters.

Portfolio Commentary

Highlighted below are quality companies that generate decent amounts of cash, have debt-free balance sheets and are being run by groups of people who are more than aligned with shareholders in terms of wanting to see a positive financial outcome. While these businesses operate in different industries and product lines, they share one commonality; nobody cares about them! Shares languish *both* below peers and at cheap absolute valuations of high single to low double-digit multiples of EBITDA, with plenty of optionality attached outside of what we paid for the core businesses, setting the stage for potential positive returns moving forward.

Part of my love for investing in the microcap space consists of the embedded discounts existing due to the size of these businesses and a lack of analyst coverage that can provide opportunities for informational advantages. For new holdings, add in non-traditional routes to IPO, low float and illiquidity, and you've got a recipe for economics being overlooked leading to good businesses trading at discounts to what they could potentially be worth. With most market participants focused elsewhere, I took full advantage of the many fish swimming in this pond, as the current investing environment has provided a number of underfollowed, ignored, high quality small-cap and microcap companies available for purchase at cheap valuations. I'm busier than ever sifting through this 'target rich' opportunity set.

Buying assets like these and attempting to hold them for long periods of time is an entirely different (and more favorable) strategy than trying to figure out where interest rates are headed, which cryptocurrency will gain mass adoption, or trying to buy into a first day pop in the next hot IPO (Krispy Kreme, anyone??). While I understand why microcaps can oftentimes trade at cheap prices, I can't help but scratch my head at the inefficiencies that reveal themselves through in-depth research. Continuing to focus on uncovering mispricings in this space (as opposed to paying attention to anything else) will be the core focus of my process. Having said that, operating results and subsequent share price action won't be linear, so if you see that I'm looking dumb before we experience a positive outcome, just know we are hopefully headed in the right direction.

Sold Positions

APi Group (APG)

For remaining clients who owned shares in The APi Group, I fully sold out of the position this quarter following a 70% plus price appreciation in order to allocate to potentially higher IRR opportunities that present better risk/rewards. I remain a fan of the business as well as Martin Franklin and team, and believe the future is bright. There is a chance we will again be owners of APG at some point in the future.

Hill International (HIL)

I also exited client positions in Hill International, largely for the same reasons outlined above, as opportunity cost can be a good driver of sell decisions depending on the current opportunity set. Our investment in HIL over the multiple years we owned the business returned anywhere from breakeven to +40%. With a large infrastructure bill on the horizon, improvement within their Middle East operations and the resumption of COVID-related project delays and deferments, I believe 2021 should be a positive year for HIL. It's possible that the business will be sold at some point in the future at a price higher than what we paid, but the turnaround has been a bit more muted than I originally anticipated and I feel as though I have better places to invest your capital.

New Positions

At Home Group (HOME)

During the end of Q1 and through Q2, I entered into a core position in At Home Group, a leading home décor retailer with 225 stores across the US. At Home sports a differentiated low-cost model that produces tremendous store-level unit economics allowing them to earn high returns on capital and better margins compared to peers. The high-level thesis behind the investment consists of the following: as HOME scales and continues to build out stores, unit economics would improve as a result of continued cost advantages, resulting in further margin improvements and growth in operating income.

At Home has an incredibly effective real estate strategy consisting of cost effectively entering defunct 'big box' stores in favorable markets and growing brand awareness by conducting grand opening events, offering coupons and incentivizing customers to join their loyalty program. That last point is an important one as HOME nearly 4x'd their marketing spend within the past five years, helping to drive traffic and engagement, including the above-mentioned loyalty program which now has over 9 million members.

Business improvements and the growth in brand awareness for HOME coincide with a continued difficult operating environment in retail which set the stage for the elimination of plenty of HOME's competition, including Pier 1, J.C. Penney and Tuesday Morning, all of whom recently filed for bankruptcy with plans to close a combined 1,000+ stores. As the market demonstrates that 'value' is winning in retail, the above dynamics should lead to huge market share gains for HOME as well as potential explosive top line growth. This was illustrated by the company's most recent quarterly results, where revenues and comparable store sales both increased nearly 200%, while SG&A margins *decreased* by 15%!

HOME was able to navigate the pandemic brilliantly (albeit with some serious damage to the share price) and emerged stronger than ever with an improved balance sheet and streamlined cost structure set to benefit from any and all stay at home trends as well as the current housing boom. Management set forth a target of 10% store growth per year, aiming to attack their estimated 600 store capacity across the US within the next decade. HOME was well on its way to achieving these goals, and during the time we owned our shares, HOME reported two of the best quarters in the company's history. While the market appeared to be overly focused on things like short-term margin guidance (following the Q4 / FY21 results, the company *lost* 16% of its market value in one day), I believed the valuation to be far off from what the normalized operating environment could look like, providing us with the opportunity to purchase shares at very favorable prices.

At a conservative multiple of 12x my earnings estimates a few years out (assuming I was directionally correct), shares would be worth over 2x the price we paid, while mature peers in the retail / home décor space with lower growth rates and thinner margins are valued north of 20x earnings. My original research can be found here.

At Home Group Update

In early May, At Home entered into an agreement to be acquired by private equity firm Hellman & Friedman for $36.00/share in cash (since revised to a tender offer of $37.00/share). Shares jumped around 16% on the day of the news, which some may have viewed as a positive. It wasn't.

In my view, the deal price materially undervalues the business even in the most conservative scenario and represents a private equity firm swooping in out of left field to rob us of what I believe would have been material positive returns moving forward. When I originally came across this business, it quickly became clear that they had a differentiated retail model with low costs that had just survived a global pandemic, and as mentioned above had a strategic plan in place that if executed, materially undervalued the business at its current price. I estimated shares to be worth anywhere from $50-75/share within the next few years on the back of continued execution and new store openings.

What I didn't factor into my valuation as a source of additional significant upside was the current housing boom taking place across the country due to a combination of low available supply and heavy demand which may persist for some time. As trends continue to shift including families migrating out of urban areas and as millennials begin to purchase their first homes, it wouldn't be difficult to imagine a scenario where demand for At Home's products – low cost home decor - would skyrocket as they build new locations and increase their brand awareness. With a tailwind like that, and if management's strategic goals were to be taken seriously, we could have potentially been looking at a business worth around $100/share.

The company's largest shareholder CAS Investment Partners voiced their displeasure with the deal and has been active in rallying shareholders to vote against the tender. In addition, an activist investment firm called Honest Capital (imagine that!) wrote a letter to At Home's Board of Directors outlining their displeasure with the transaction and inadequate valuation, among other things. Their letter can be found here. I agree with all of the points made in each letter and share their views regarding the final deal price. My tender would have been 'no' on behalf of all of us. Maybe there will come a time when Greystone Capital will be big enough to oppose a transaction like this where I feel that both my clients and the true owners of the business (the shareholders) have been unfairly compensated. But unfortunately that time is not today.

As of now, HOME has completed their 'go-shop' period where they were able to accept additional higher offers should they materialize. No such offer was made. At this stage, I don't see a path to the deal being rejected and following another large shareholder (North Peak Capital at 6%) reducing their stake to zero, I sold our position in order to deploy the cash into more favorable investment opportunities. Positive returns in a short period of time aren't the worst case scenario for an investment outcome, but since I run a concentrated portfolio with a limited number of investments, when I find what I believe to be a good one, I can assure you we aren't playing for 20-30%.

Charlie Munger is famous in investing circles for touting the power of incentives and saying if you show him the incentives, he will show you the outcome. In a recent podcast interview, comedian Dave Chappelle expanded on this concept by saying, 'by paying attention to how someone is incentivized, you can usually figure out what that person wants, which is the easy part. *How they get there* is where the surprises happen.' Unfortunately, in the case of HOME, there was a large change of control premium to be paid to certain members of the management team following exactly that, a change of control, which would include a sale scenario like the one taking place. This one incentive - which I did not view to be a material risk to our investment - is what likely drove CEO Lee Bird to accept such a low offer for the business and is where our surprise happened. If there is a better example of how shareholder/management alignment is of utmost importance in a concentrated portfolio, I can't think of one. During my research, I didn't deem it to be as important as I should have. I was wrong. While I don't believe the decision to invest was a bad one, I'm lucky that the misalignment didn't backfire.

Thunderbird Entertainment (TRBD.V / THBRF)

During the quarter, I entered into a core position in Thunderbird Entertainment, a microcap production and entertainment studio that creates scripted, unscripted and animated programming for global digital platforms, as well as Canadian and international broadcasters. I believe that Thunderbird is at an inflection point in their business and is set to benefit favorably from the secular tailwinds of increased content spend and the continued rise in streaming video on demand services.

While the initial version of Thunderbird studios has roots dating back twenty years, the current version of the company starts around 2011. Since then, Thunderbird has grown significantly, evolving from a 150-person studio primarily doing service work for content platforms to a 700-plus employee studio with three locations in Vancouver, Los Angeles, and Ottawa. In addition to continued high quality service work, Thunderbird now has a focus on developing in-house intellectual property (IP) consisting of launching kids and animated content among other shows. The company has produced such hits as Blade Runner 2049, Last Kids on Earth, Hello Ninja, and Kim's Convenience, yet the business remains under the radar due to its Canadian microcap status, limited analyst coverage, and somewhat obscure financials unlikely to show up on quantitative screens as they don't paint the full picture of the business. In other words, perfect for Greystone Capital.

Typically, the movie studio business is a bad business. With production requiring cash outlays upfront for the high cost of talent and overhead, and the final product being subject to consumer demand, studios are dependent on 'home-run' blockbuster hits to drive ticket sales and licensing/distribution revenues across the world. This dynamic is somewhat like a typical venture capital investment portfolio, where 1-2 investment hits drive the majority of portfolio level returns, while the remaining investments usually wind up as money-losing duds. In fact, I'd argue that Hollywood has all but given up on trying to 'hit singles', as sequels or re-makes drive all of the views (and licensing revenues) in theaters or on-demand. For confirmation, feel free to check out **F9** this weekend, or the ***ninth*** iteration of the Fast and Furious franchise.

Publicly traded Lionsgate Studios is a good example of a movie studio that succeeded despite the difficulty of the business model, but the list of now defunct studios reflects the low odds of success. Even Lionsgate suffered years of loss-making and dilution as it grew revenues and focused on producing high quality, low-budget content, before striking gold with hits such as American Psycho (first big piece of IP) and Fahrenheit 9/11.

Thunderbird's strategy and business model insulate them from the unattractiveness of the movie business, as the company is primarily focused on hitting singles, while leaving the potential for a huge IP hit to materialize on its own. As a Vancouver based company, Thunderbird benefits from favorable working capital dynamics in the form of Canadian tax credits, which typically fund around 75% of production costs prior to staffing a show leading to minimal capital outlays upfront. Furthermore, Thunderbird pre-sells every single one of their projects, removing the risk of a 'flop' by locking in a guaranteed sale before production begins.

The above is significant for two reasons as it de-risks the production side of things and also allows Thunderbird to take on projects not economically viable for US counterparts. While content creation itself has limited barriers to entry, replicating Thunderbird's competitive positioning would require years of investments in talent, creativity and time, not to mention the reputation that Thunderbird has built as a reliable, high-quality producer of in-demand content. Industry insiders have repeatedly emphasized that reputation within the industry and ability to execute on time are paramount. The pandemic provided a good example of this as Thunderbird was able to transition their entire staff to remote work while still meeting production deadlines and reinforcing quality standards. In fact, during COVID, with many in-person shows and developments being cancelled or delayed, Thunderbird's focus on animated content allowed their backlog of production work and IP creation to *grow* year over year. These factors have led to strong relationships with nearly all of the major streaming and content platforms in the media landscape, including HBO Max, Disney, Netflix, and Hulu, among others. These platforms would be hesitant to outsource an important piece of work to upstarts or new studios just to save a few bucks.

Today, Thunderbird's revenue split is made up of recurring service work and IP creation. While owned IP accrues to the balance sheet and should be valued higher than a service-related studio, the strategy of performing service work makes sense as this segment of the business is margin driven and provides steady cash flows and long tail duration while translating well all over the world. This allows Thunderbird to plough cash flows back into the business by hiring creative talent and developing new in-house IP. Service work also helps smooth the longer delivery and creation times for IP, as results from this category can be lumpy year to year based on the project pipeline and deliveries.

Thunderbird's current development pipeline is robust and growing, indicating the demand for content should provide favorable tailwinds into the foreseeable future. Industry reports estimate global content spend among the major streaming and media platforms to be in excess of $50 billion during 2021 with OTT subscriptions continuing to grow as well. While the growth in service-related work and IP licensing revenues are enough to generate favorable returns moving forward, Thunderbird has been focused on building an in-house consumer products and licensing division so that quality content can be followed up with consumer products leading to more licensing revenue. These investments in talent and sales should begin to bear fruit in 2023 and beyond.

According to management and industry participants, Thunderbird is constantly being approached by some of the top industry talent, validating this tiny studio's reputation and opening the doors for the creation of even higher quality content. This is important because as Thunderbird scales, they will drive more creators to the company, leading to better content, leading to more distribution, leading to further talent and so on. The value chain from a high caliber piece of content lends itself to many winners, and this non-zero sumness has led to win-win relationships for Thunderbird and the creators, distributors, actors and end customers. Moving forward, I would have a hard time imagining that Thunderbird will not end up playing a pivotal role in the future of content creation given the secular tailwinds, their competitive positioning, low risk business model and quality content production. Not factored into my valuation includes the not-far-fetched option of an IP 'tent-pole' being developed.

The previous mention of Lionsgate Studios is fitting as Thunderbird's efforts are being chaired by Lionsgate founder Frank Giustra, who grew the studio from a few hundred thousand in revenues to the world's largest independent film studio within a 20-year timeframe. Giustra is the company's largest shareholder, owning 14% of the business, and while his day-to-day involvement appears to be limited, his experience and relationships have led to key contacts and projects for the business. I view management as smart, experienced and highly aligned given their unwillingness to take on debt or grow for growths sake, and their willingness to take short term hits to the top line for the benefit of the business (as evidenced by their cancellation of Amazon's *Man in the High Castle* which led to a 50% decline in revenue from 2018-19, but nearly doubled their EBITDA margins). CEO Jen McCarron has been with the business since 2015 following Thunderbird's acquisition of Atomic Cartoons, where she oversaw the growth of Atomic from a few employees to over 600 before being acquired by Thunderbird.

Although Thunderbird can drive value as a standalone business, the company has been exploring accretive M&A opportunities which would contribute meaningfully to the bottom line, creative talent pool and IP catalog. Outside of that, I could imagine a scenario in which Thunderbird themselves become a strategic acquisition target given their relationships with major streamers, built in creative talent, cost effective operations, and huge project pipeline. In addition, two of the company's largest shareholders have been involved for over a decade, and large shareholders in a low float, thinly traded microcap would need an avenue for exit which the public markets may not provide. Moving forward, increased IR efforts and continued execution should drive more eyes to the business and its attractiveness.

While results will be anything but linear, our purchase price of around 10x EBITDA feels undemanding. I believe it's entirely possible for this business to generate around $40mm in EBITDA within a few years, making today's price, not accounting for the cash on the balance sheet, look like a bargain. I'm happy to let management execute on our behalf as they continue to grow and create high quality content, the value of which should help the business grow multiples above the price we paid.

Undisclosed Positions

I also purchased two new positions during the quarter (and one early in Q3) consisting of a European based online travel agency ('OTA') with a differentiated business model catering to the leisure traveler, an e-commerce focused auto parts retailer with a strong competitive position and long runway for growth, and an interesting special situation (on which I emailed you an update) involving an e-commerce appliance retailer that acquired their largest competitor while massively changing their capital structure. These businesses reflect the attractive opportunity set described above and I look forward to discussing these holdings more in depth in future letters.

Broad Market Commentary

As financial conditions remain loose, monetary policy remains beneficial, and consumers, flush with money and pent-up angst to spend, start unleashing their wallets, it wouldn't be hard to imagine the markets moving higher from here. However, inflation and its potential effect on the market was the topic of the quarter given the re-opening of the economy which could lead to a rise in interest rates on the back of increased consumer spending. In that scenario, certain risk assets would look less attractive which could have an adverse effect on the broader market. Because the timing and severity of this is unpredictable, my one warning would be to stay away from the financial news media for valid opinions surrounding the above, as you'd be presented with only two types of takes: wrong or irrelevant.

While my outlook on inflation and interest rates would be speculative at best, I gain comfort in the fact that we currently own good businesses that are growing, can operate successfully through all economic environments, and who run cost effective operations, some of which have pricing power. I also believe our portfolio companies remain cheap in terms of their valuations. This is the best 'defense' I know against inflation and/or rising interest rates, where I won't have to re-underwrite any crazy assumptions about long duration cash flows, nor take the associated 'multiple hit' from owning businesses valued at huge multiples of their revenues, for example. In any scenario, my investment process will remain the same and I will continue to pay attention to supply chain woes, rising input costs and labor shortages as they affect our companies and do my best to act aggressively when necessary.

Across the market, there are pockets of what looks like significant over-valuation and pockets of significant under-valuation, with any fears of inflation or rising rates contributing further to the latter. Because price volatility in the small and microcap space can register as extreme, it remains important to focus on the actual business results of our holdings as well as what our management teams have to say about their competitive environments. It's not likely that the value of a business is being accurately reflected in the price when said price is gaining or losing tens or hundreds of millions in market value over short periods of time. As long as the competitive positions of our businesses aren't deteriorating, volatility will give us a chance to deploy available cash by purchasing more of what's working at favorable prices.

Recent Developments

Greystone added four new clients this quarter, with additional clients currently being onboarded, all of whom 'self-selected' into the firm and all of whom I believe will make great long-term partners. Other than my presence on Twitter and publicly sharing my investment letters, I have done little to no marketing to date as my focus has been to generate good investment returns. In fact, not one client has joined the firm as a result of some outbound marketing or sales process. I'm incredibly proud of this fact, as I am first and foremost optimizing for the right partners. While we remain very small and scaling this way will take an incredible amount of time and effort, I feel confident that our current group of clients are the perfect fit for Greystone, which should set us up for continued success. My potentially naïve view is that, should we continue to do well, the right capital will follow.

With that said, if existing clients or readers of this letter know of any long-term investors who might be interested in putting capital to work, referrals are always welcome. As of now, our AUM levels remain far below what I believe to be the capacity of the strategy, and the current investing environment has provided me with more good ideas than available capital. To the 120+ non-clients currently on the Greystone Capital distribution list, I'm looking at you.

Also during the quarter, I had the pleasure of serving as a guest on the **Yet Another Value Podcast** hosted by Andrew Walker. The interview can be found here or anywhere you listen to podcast episodes. We discuss Liberated Syndication including the business, history and competitive positioning. Give it a listen if you've got an hour to kill. In addition to running a fund with his business partner, Andrew authors the phenomenal investing blog Yet Another Value Blog. YAV has long been a favorite read of mine and a consistent source of good ideas.

Thank you for the allowing me to serve as the manager of your hard-earned savings. I am incredibly grateful and have made it my goal to reward your trust and patience. As always, please feel free to reach out anytime. Thank you for reading.

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