**October 2023**

| | Merion Road Small Cap Fund | IWM (Russell 2000) | Barclay Hedge Fund Index |
|---|---|---|---|
| **Annualized Since Inception** | **15.5%** | **7.5%** | **4.9%** |
| **Q3 2023** | **(3.1%)** | **(5.2%)** | **(0.4%)** |
| **2023 YTD** | **0.3%** | **2.5%** | **3.9%** |
| 2022 | (16.9%) | (20.4%) | (8.5%) |
| 2021 | 42.5% | 14.5% | 10.0% |
| 2020 | 29.5% | 20.0% | 11.0% |
| 2019 | 17.9% | 25.4% | 10.6% |
| 2018 | 15.7% | (11.1%) | (5.2%) |
| 2017 | 35.7% | 14.6% | 10.3% |
| 2016 (Jul-Dec) | 1.3% | 18.7% | 5.4% |

| | MRCM Long Only Large Cap | SPY (S&P 500) |
|---|---|---|
| **Annualized Since Inception** | **10.6%** | **10.1%** |
| **Q3 2023** | **(2.6%)** | **(3.2%)** |
| **2023 YTD** | **25.9%** | **13.0%** |
| 2022 | (34.9%) | (18.2%) |
| 2021 | 20.4% | 28.7% |
| 2020 | 54.3% | 18.3% |
| 2019 | 25.2% | 31.2% |
| 2018 | (6.0%) | (4.6%) |
| Dec 18 - Dec 31 | 0.1% | (0.5%) |

Note: All returns are net of management and performance fees. Past performance is not indicative of future results.
Returns for the Merion Road Small Cap Fund for the period prior to fund launch (01/13/22) reflect a basket of SMAs.

The Long Only portfolio fell 2.6% in Q3. I continued to peel a little off of our tech names like GOOG, AMZN, and NOW. These still remain significant holdings for us, but have become relatively less attractive as their valuation has recovered, rates have increased, and other stocks have lagged.

During the quarter I established a new position in Summit Materials ("SUM"). SUM is a construction materials provider with about 40% of their revenue from aggregates and cement, 30% from ready-mix concrete, and the remaining from asphalt and paving. I have followed the aggregates and cement industry for many years and have always been attracted to it. What's not to like given the lack of substitutes, limited competition due to permitting and transportation costs, and long-term demand growth. With the majority of product serving public construction needs, the industry should benefit from the recently passed infrastructure bills that have yet to truly hit the market.

In early September the company announced that they would acquire the U.S. operations of Cementos Argos, a Colombian cement company. The market did not like the transaction as SUM subsequently traded down over 20%. While this move was not entirely unwarranted, I thought it was excessive and used the sell-off to establish a position. To be fair, SUM paid up for the assets (10x EBITDA) and I wouldn't be surprised if Argos had underinvested in them / they require additional capital. On the flip side, this acquisition will shift SUM's business mix to the more stable and higher valued business lines of aggregates/cement. Furthermore, it increases the company's exposure to growth states like Florida, the Carolina's, and Georgia. Add in the potential of operational synergies and high-return capital investments, and this deal might not be so bad after all.

The Small Cap Fund was down 3.1% in Q3. I did some repositioning in this portfolio as well. Notably I fully exited our position in Westwood Holdings ("WHG"). I miscalculated on management here and ultimately realized that any value in the business will continue to get siphoned away to employees.

As you may recall I wrote up Distribution Solutions Groups ("DSGR") in my last letter. In late September they had an investor day during which they did a deep dive into their business lines and highlighted the various ways to drive revenue, profitability, and stability of earnings. While management had a lot to say on these issues, what stood out to me was their focus on driving value added services which in turn leads to higher profitability and customer retention. DSGR is making the upfront investment today in both people, to serve complex needs of customer, and physical assets. As the company gains scale, these costs get spread out over a larger base and drive further profitability. Management put out a 5-year goal of $5+ in earnings power per share which would be highly welcomed given that shares are currently trading for a bit over $30. While the stock price has understandably appreciated with the increased disclosure and long-term targets, it remains attractive even if they just get in the ballpark of their goals.

Since the quarter ended I have built a small- to mid-sized position in WK Kellogg ("KLG"). KLG is the North American business spun-out from the business formerly known as Kellogg. There is a ton of pessimism around this company. Two weeks before the spin the Wall Street Journal put out a scathing article on the cereal industry titled "It's the Breakfast of Champions No More: Cereal Is in Long-Term Decline." Unrelated, Ozempic and other GLP-1s have been a topic dejour and deemed to be a massive headwind to any unhealthy food product. Industry issues aside, KLG has recently performed worst amongst the big three (Post and General Mills being the other). In 2021 their production was stymied by a fire at their plant in Memphis and a strike by 1,400 people; production lagged and KLG generally lost share. Add in the fact that the spin accounted for only ~5% of the value of the parent company and it makes sense why most legacy shareholder receiving the stock would prefer to dump it into the market.

KLG owns highly recognizable and established brands like Frosted Flakes, Raisin Bran, Special K, Fruit Loops, and even Kashi for the health-conscious consumer. They have historically generated about $2.8bn in revenue but EBITDA margins were only in the mid- to high-single digits. Part of this can be explained by being a small part of a much larger company. Some brands were run separately from others, geographies were split, and the sales force was responsible for selling not just cereal but the whole arsenal of Kellogg product. By eliminating silos and having a dedicated sales force management hopes to drive margin improvement and regain lost share. More importantly, however, they plan to invest several hundred million into their outdated manufacturing facilities. Management is targeting a 5% margin improvement over the next couple years which would still leave them below Post, which operates in the 15%-20% range. If margins don't move up much from here earnings are probably in the $0.75 range putting the stock at 13x. Assuming operating margins improve 3% off LTM figures (to account for any incremental depreciation expense) we would get to $1.50 in earnings or less than 7x. This all compares favorably to Post and General Mills multiples in the mid-teens. While there is a lot to dislike about KLG, the risk return seems attractive.

Sincerely,

Aaron Sallen

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