MERION ROAD

April 2021

	MRCM Long Short Small Cap	IWM (Russell 2000)	Barclay Hedge Fund Index
Annualized Since Inception	**25.4%**	**16.0%**	**7.4%**
Q1 2021	**23.8%**	**12.9%**	**4.9%**
2021	**23.8%**	**12.9%**	**4.9%**
2020	29.4%	20.0%	10.9%
2019	17.9%	25.4%	10.7%
2018	15.7%	(11.1%)	(5.2%)
2017	34.8%	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	**20.4%**	**14.4%**
Q1 2021	**2.5%**	**6.3%**
2021	**2.5%**	**6.3%**
2020	53.1%	18.3%
2019	25.0%	31.2%
2018	(5.6%)	(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.

The long only portfolio was up 2.5% net of fees in the quarter. During the period I added to our position in Fidelity National Financial ("FNF"). FNF is the nation's largest title insurer with 33% market share. It was built over the last 30 years by Bill Foley, who revolutionized the industry with his emphasis on eliminating bureaucracy, utilizing technology to streamline operations, and maximizing customer service. He is well-regarded as a savvy investor and consummate deal-maker having acquired and divested multiple entities both in title and ancillary fields. He continues to serve as the chairman of FNF with a personal stake in the company worth hundreds of millions.

While title insurance is technically insurance, it is a bit of a unique animal. Being that the insurer writes a policy based on past events, not unknowns in the future, losses are relatively small and predictable. The more data an insurer can analyze, the less likely they are to experience a claim; and the more efficiently they can analyze the data and process the application, the lower their costs will be. FNF has invested in automating its work stream through their ownership of NextAce (automated search), SoftPro (document production and closing), and multiple other cloud-based platforms. Due to these investments, FNF boasts industry leading margins and is able to attract more third party agents who can leverage their service offering.

Last year FNF acquired the outstanding interest in FGL Holdings ("F&G"), a fixed indexed and fixed rate annuity provider. Though this appears to be a financial rather than strategic acquisition, there should be some opportunities to grow the combined business. Notably, the acquisition afforded F&G an improved credit profile which has led to ratings upgrades. These upgrades allow F&G to address new distribution lines, such as in the bank market where FNF has strong relationships through their title and escrow business. The company announced that since launching in July 1st it had already achieved $500mm of sales in this channel (vs. full year sales of ~$4bn).

FNF is likely over-earning right now based on the recent spike in mortgage activity. Looking out to 2022 I estimate that earnings should step down to something a little shy of $5.00/sh. At current prices we are collecting a double digit earnings yield for a business with strong market positioning and a superb capital allocator. Last year they repurchased a bunch of stock in Q1 at depressed prices and have announced their intent to acquire another $500mm over the next 12 months.

The long short portfolio had its best quarter since inception, up almost 24% net of fees. While this is a positive outlier, it was achieved without deviating from our target risk parameters and portfolio construction. Notably, our beta adjusted net exposure, my primary measure of our market risk, was in-line with prior periods at 43%. Returns were broad-based with the top three winners contributing 31%, 13%, and 11% of the positive performance.

Rocky Brands ("RCKY") was our largest position heading into the year and was also the top gainer for the quarter. I have followed and invested in the company since 2017 when new management stepped in to address some blocking and tackling missteps from the prior team (I discussed RCKY in that year's annual letter). Today the company is a well-run boot manufacturer and distributor predominately in the work, western, and military markets. RCKY has historically traded at a discounted valuation despite two meaningful strengths. Unlike other retail, their products serve function over form which leads to stable product demand and low inventory obsolescence. Secondly, the company has successfully built a high growth B2B operation. Within this division they create specialized websites for their customers (i.e. United Airlines, Pepsi) that serve as a portal for employees to buy their work boots, be it a RCKY brand or one of their competitors. Customers prefer this as it streamlines the purchasing decision and ensures safety compliance. It's good business for RCKY too, as they move closer to the end user and can capture a slice of the pie from competitor sales.

With the improvement of the company's financials over the past several years, RCKY had swung from a net debt to a fairly sizeable net cash position. Management has been smart with deploying capital, be it internally (B2B operations, direct to consumer initiatives) or through share repurchases. In January they announced that they would acquire Honeywell's outdoor boot brands, effectively doubling the size of the company. These brands appear to fit well with RCKY's utilitarian focus and will add to their existing outdoor product lines. On their Q4 earnings call management gave the first glimpse into their rationale for the transaction. While the acquired brands have been well-run, it appears there are many opportunities for RCKY to leverage their infrastructure and operating experience. These include cross-selling, fulfillment consolidation, and growing the new brands' direct to consumer sales. Importantly management has demonstrated their ability to be successful in these endeavors, as they mirror many of the tasks they took on a few years ago.

It is also worth revisiting Tuesday Morning ("TUEM"), which I discussed in my Q3 2020 letter. In January the company reemerged from bankruptcy. As part of the plan, they raised equity and offered existing shareholders the right to purchase shares at $1.10. With the stock trading well north of that figure, I exercised our rights while tactically selling shares to maintain our target exposure, thus capturing the spread. From day one I purposely kept TUEM a small position given its risk profile, but it has worked out wonderfully as we made multiples of our investment.

Sincerely,

Aaron Sallen

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