MERION ROAD

April 2024

	Merion Road Small Cap Fund	IWM (Russell 2000)	Barclay Hedge Fund Index
Annualized Since Inception	**16.7%**	**9.5%**	**5.9%**
Q1 2024	**4.9%**	**5.0%**	**4.4%**
2024 YTD	**4.9%**	**5.0%**	**4.4%**
2023	11.5%	16.4%	9.3%
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	**13.6%**	**13.0%**
Q1 2024	**12.9%**	**10.4%**
2024 YTD	**12.9%**	**10.4%**
2023	38.7%	25.7%
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 increased 12.9% during the quarter. While performance was broad based, our added exposure to cement via Summit Materials (previously discussed) and CRH proved fruitful. Both companies reported strong Q4 earnings and gave an equally bullish outlook for the year ahead. Cement PPI is up 3% through March and volumes should pick up as well given the increase in housing activity and infrastructure spend.

During the quarter I uncharacteristically built a position from nothing into our top holding. Clean Harbors ("CLH") is the largest US hazardous waste management company. Before digging into CLH I would like to diverge with a bit of personal history. In my early 20's I worked at Macquarie Bank where our team was responsible for acquiring investments on behalf of our managed infrastructure funds and the bank's balance sheets. One of my first assignments was the acquisition of a publicly traded municipal solid waste (MSW) management company (Waste Industries). While not technically infrastructure per-se, MSW has similar characteristics like being an essential service, operating regional monopolies, and controlling scarce assets. In any case we paid something like 8-9x EBITDA which was a premium to the then trading multiple. Waste Industries is now a small part of GFL Environmental which trades at 12x EBITDA. And GFL is actually at a notable discount to its peers of Waste Management, Republic Services, and Waste Connections that are at 15x. While hindsight is 20/20, buying into this asset class 15 years ago would have been a home-run given their strong cashflow and multiple expansion.

While hazardous waste is not entirely comparable to their MSW brethren, CLH has many attractive attributes. They own and operate scarce assets including nine incinerators and eight landfills where new supply is limited by a complex permitting process and significant construction cost. They maintain vertically integrated operations that allow it to control waste from collection through transportation and disposal; this activity similarly requires specialized permits for which the company maintains over 500. As the largest player in the space, CLH has a proven history of managing waste properly – a key consideration amongst customers given environmental ramifications. They also have scale benefits that include route-based efficiencies, capacity utilization, and the deepest breadth of service offering.

I view their business in broadly two segments, Environmental Services and Safety-Kleen Oil. Environmental Services provides waste remediation and cleaning services for various industries with particular concentration in chemical, manufacturing, refining, and auto service. Though many of these end-markets are individually cyclical, the diversification of their product offering and customer base will somewhat offset this. Additionally, these sectors should benefit from the ongoing shift to reshoring and increased regulatory / environmental scrutiny. Safety-Kleen Oil provides used motor oil collection and recycling; it is the most volatile part of CLH as profitability is largely determined by commodity prices. This business is currently depressed and accounts for just 13% of their consolidated EBITDA. CLH is taking steps to structurally improve these operations. For instance, by separating their feedstock during collections they can offer Group III base oils that receive a meaningful premium to Group II.

CLH has historically operated the Environmental Services business at a low to mid-20's EBITDA margin. This is noticeably lower than the 30% range that most MSW operate in; this differential is even more jarring on an EBIT basis as CLH is less capital intensive than MSW. In early 2022 Republic Services acquired hazardous waste competitor US Ecology. A key part of their thesis was that they viewed the hazardous waste sector equivalent to the MSW sector 20 years go. Republic has said that they see 10 percentage points of margin expansion, to be achieved through further consolidation and a more rational approach to pricing. Since the acquisition, Republic has taken two double digit pricing increases and witnessed expanding margins. This approach is benefiting the industry as a whole, with CLH margins up 1.6% in 2023 to reach 24.5%.

CLH is currently trading at 10.6x consensus EBITDA for 2025, a meaningful discount to their MSW peers. Assuming the base oil business is worth just 3.0x EBITDA, the remaining business is trading at 10.8x. This is entirely too low given their market positioning, essential service offering, and meaningful barriers to entry. Furthermore, this discounted multiple gives no optionality to further margin improvement. If margins were to increase another 500bps (obviously over the long-term), consolidated EBITDA would be 20% above consensus and the multiple would fall to <9x. Keep in mind that Republic acquired US Ecology at almost 14x trailing EBITDA.

The Small Cap Fund increased 4.9% during the quarter. One timely position to discuss is Bassett Furniture ("BSET"). BSET is a 120-year-old manufacturer, wholesaler, and retailer of upper-middle / upper-end furniture. This is an asset heavy company. On the back-end they own and operate 2 wood manufacturing facilities in Virginia, 2 upholstery facilities in North Carolina and Alabama, and 3 warehouses. They own and operate 8 retail locations that cover more than 200k sq feet of retail space; and they operate another 49 owned stores that are leased. Additional distribution comes from 31 Bassett branded retail stores operated by 3rd parties, as well as wholesale sales into other retailers. Up until 2022 BSET had an internal distribution (trucking) company; this was sold to J.B. Hunt for $87mm with part of the proceeds used for a special dividend.

BSET has historically generated a 4-5% EBIT margin across its wholesale and retail business. Right now they are slightly loss making as the industry works through a glut in supply. LTM revenue is at $390mm which is right around where the company used to run pre-covid. Of course sales could dip further as retailers de-stock and demand lags given higher interest rates and slower home sales. But long-term I think it is fair to assume that this company could generate something like $20mm of EBIT.

The current situation is not lost on management. In their most recent quarterly press release, BSET discussed plans the impetus to return to profitability and specifically noted a plan to reduce warehouse and delivery costs by 2% points. This will be accomplished through the consolidation of retail distribution facilities and improved capacity utilization. For each 1% increase to margins, the company would generate an incremental $4mm of EBIT. They also have a plan in place to improve their wholesale sales by showcasing their best products (custom upholstered furniture) with a slimmed down version of their store-in-store presence.

The risk-reward here seems compelling. From a downside protection perspective, BSET is currently trading at a price of $13.50 but has tangible book value of over $19. Cash accounts for a large part of their book ($70mm or $8/share) and their real estate is not properly marked. For instance, the reported value of their 8 owned retail stores is just $24mm or $119/sq foot. My review of listings near these storefronts shows that most are offered at over $300/sqft. Assuming this low-end price, their retail properties are worth $36mm more than they are recorded at on the books (+4.19/share). Should BSET achieve $25mm of EBIT, a 5x multiple would put their enterprise value at $125mm and market value at $195mm or over $22/share (66% upside). This stock truly flies under the radar as it has just $120mm market capitalization and does not host conference calls.

Sincerely,

Aaron Sallen

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