Idea Brunch with Adam Wilk of Greystone Capital Management

Adam Wilk on concentrated small cap investing and his top two ideas

Welcome to Sunday's Idea Brunch, your weekly interview series with underfollowed investors and emerging managers. We are very excited to interview Adam Wilk!

Adam is the portfolio manager for Greystone Capital Management, a West Chester-based long-only RIA he launched in late 2019. Greystone is a concentrated value-based RIA and typically holds 9-12 positions in client portfolios, with a focus on small-cap and micro-cap companies. Since its inception in Q4 2019, Greystone has returned a cumulative 97%, net of fees, compared to roughly 50% for the S&P 500.

Adam, thanks for doing Sunday's Idea Brunch! Can you please tell readers a little more about your background and why you decided to launch Greystone Capital Management?

You're very welcome, thanks for the invite!

We could spend a good amount of time on my background given the non-traditional aspect but put simply, I started my career in the sports world working for two separate NBA teams, the San Antonio Spurs and the Houston Rockets as a basketball analyst, scout, and operations coordinator. My early intended career path was very different from anything finance-related, but without me having any knowledge of it at the time, I gained exposure to a number of investing-related themes, and the founding principles of Greystone Capital were actually formed during my time in San Antonio. For those not familiar, the Spurs organization is one of the most successful in all of professional sports, and the culture they developed over three decades is one of curiosity, the constant pursuit of incremental improvement and what they refer to as 'pounding the rock'. Pounding the rock comes from a quote titled 'The Stonecutter's Credo' by photographer Jacob Riis. I won't recite it here but I shamelessly stole pounding the rock (now

the title of my blog and in some of my letters) as well as the Jacob Riis quote which is in my pitchbook.

My boss in San Antonio, the President and GM at the time, is probably the smartest person I've ever met and was the embodiment of a 'lifelong learner' well before I heard the same term from Charlie Munger. I learned an unbelievable amount from him on both a personal and professional level, and I'm forever grateful for the internal exposure he allowed me to have while working there. He also taught me a number of incredibly rich lessons that I still use to this day and helped hone my talent evaluation, analytical, and risk management skills.

To reiterate, I had no idea how the dots would connect later on in life through investing, but there are an incredible amount of parallels between the two disciplines of investing and running an NBA team. I bring this up because something clicked for me in a major way as soon as I discovered finance and investing where the lessons being taught by some of the investing greats resonated with me immediately. My introduction to value investing took place about a decade ago where I was able to translate many of those former talent evaluation skills and my analytical ability into evaluating real estate and then businesses (through a 9-5 job) which led to me a few of the classic books as well as the writings of Warren Buffett. After being 'bitten by the bug', I spent the next 4-5 years acting like a sponge, absorbing everything I could get my hands on related to investing and spending my lunch hours, nights, and weekends reading books, teaching myself accounting, studying business models, reading writeups and perusing SEC filings. This led down a path that ended in a career pivot, where I developed the confidence to start sharing research and writeups online (in addition to talking about stocks 24/7 with friends and family) leading to the start of managing friends and family money for a number of years via separately managed accounts. The returns for my early investors during those beginning years were actually pretty good! Mostly because I was too scared to do anything stupid.

Following the distribution of letters and investment research, I experienced significant interest from outside investors which led to the formation of Greystone

Capital as it is today. This was a shortcut I took to launching my own investment firm, as I was always under the impression that I should gain some formal experience first. I reached out to hundreds of firms for analyst jobs and to telegraph my interest and even made it to some final interview rounds with some very generous and forward-thinking funds (who were willing to give me a pass on my background/lack of experience). But I always knew the path forward was to end up on my own and working for myself given that I am not meant for a 9-5 job. The only reason it worked in sports is because there wasn't one day that ever felt like work.

When you launched Greystone you wrote, "Most active managers do not – and cannot – beat the market due to high levels of fees, inability to be patient, misaligned incentives, and myths regarding diversification." What do you do differently that has allowed you to beat the market?

Given the length of time since inception, I would say I've benefitted from luck and good timing, but the word *structural* comes to mind when thinking about some of the elements of Greystone that are different from other firms/funds. During my analyst job search, I came to learn a lot about the industry and had some very interesting conversations with wealth managers, financial advisors, fund managers, and investors. Years of meeting people this way and collecting information allowed me to separate the firms/funds I thought were managing money in a way that would set them up for continued long-term success, vs. those who weren't. There can be a lot to dislike about this industry, especially the misaligned incentives between investors, investment managers, and companies, so I basically set out to replicate the structures I thought would a) suit my personality and style best, and b) set myself up for long term success. This meant that Greystone had to be differentiated, and I believe we are in many ways. The firm is set up to place compounding client's capital as the highest priority, with a willingness to buck conventional diversification wisdom, concentrate on my best ideas only, remain a small pool of capital as to preserve the elements of my strategy and keep nearly the entirety of my net worth invested into the firm. When people stumble upon the firm, it should be clear that I am not catering to the

masses, I am not trying to develop a marketable investment product, and I am not interested in collecting assets for the sake of assets. I am partial to people who understand completely who they are, and I try to make it very clear who and what I am and what Greystone is about / trying to accomplish. As a result, Greystone will not be right for everyone but will be perfect for the right people. That last point is key, as I am optimizing first and foremost for the right people and partners, which will drive all of the success that Greystone realizes moving forward. Those with a long time horizon, ability to withstand some volatility, and patient capital are a great fit for us and are the types of people I hope to attract.

To answer your question about beating the market, I would view beating the market over time as an output of following a solid investment process, so the best way to look at this would be to understand what the inputs are that could lead to continued outperformance. I spend most of my days managing client portfolios and our current positions as well as conducting investment research. These are the highest value add activities in investing and given that I have limited meetings during the week, I keep phone calls to a minimum and I am an investment committee of one, I get to spend most of my time studying businesses, industries, getting to know management teams and reading as much as I can.

As a result of this, I can invest anywhere, and move quickly and with conviction, which helps a lot from a portfolio management standpoint. This is important and results in client portfolios typically not looking anything like what's contained in various indices, leading to what should be differentiated investment results over time. We are not designed to track or look like the market and as a result end up investing in off-the-beaten-path companies, or specific opportunities that larger funds or firms can't own given their size or mandates. I view this not only as a competitive differentiator but also as a way to generate outperformance, as I can invest in a sub-$100mm market cap company that is executing tremendously well and potentially at an inflection point within their business but for a number of reasons isn't covered by analysts or the management team hasn't gotten out and told the story yet despite the attractiveness of the business. I'm not claiming to be the only person sifting through these investments, but I'd view the odds as tilted in my favor when investing small and off the beaten path.

You have a pretty diverse portfolio – ranging from a $60 million auto parts eCommerce busted SPAC deal to a $3 billion textbook company. How are you able to come up with off-the-beaten-path ideas in an industry with so much groupthink?

I doubt my answer will surprise you or anybody in your audience, but I read a lot…

In all seriousness, I get asked this question often and I'm not sure I've come up with a satisfactory answer. I've found that rather than being a highly systematic or rigid process, idea generation is more along the lines of haphazard. There is an element of idea generation that is almost accidental, despite working really hard to turn over a lot of rocks. If something is presented to me in a particular way, sparks some small curiosity or connection to something else, that may lead me down a rabbit hole which then leads to a potential investment. Most of the time I am just curious to know more and more about a particular business or industry, and as I learn more, I never lose that curiosity or interest. In fact, I get more and more interested. Given that I aim to find 1-2 new ideas per quarter, I try to keep an open mind about where ideas may come from and let new information spark some interesting or unconsidered connections.

Given that I don't use quantitative screens or filter through businesses based on backward-looking financial metrics, I'm usually looking for things that don't screen well or where value creation is not apparent on the surface. These days, the majority of market participants consist of passive investors and quantitative-based strategies, so I like to look for things that wouldn't be, or can't be screened or picked up by those participants. Things like management or a specific company culture, a business line that hasn't yet been broken out, primary research revealing some insight, or just general qualitative dynamics. A few common sources of investment ideas for me include talking to other smart investors, reading a lot of research and writeups, spending time on sites like MicroCapClub, Value Investors Club, and Seeking Alpha, and working to build a knowledge base of companies and industries where experience and pattern recognition can often take hold to let the stars align surrounding a new idea. This usually leads to interesting things to research. I've developed a watch list of businesses over the years made

up of companies I like, strong management teams, formerly owned businesses, and companies representing themes I find attractive. This list is constantly being updated and monitored but outside of this, ideas can pop up anywhere. During times like these, the watchlist grows and certain candidates look better and better every day.

I also place a tremendous amount of weight on management teams, as strong leadership and a favorable company culture are things I emphasize when looking at new investments, carried over from my time in professional sports. Owner-operator-led businesses are given preference over almost all others. Although it can work against you in some situations, I like investing alongside managers with no fear of job security and the ability to adopt a long-term mindset in the pursuit of their own wealth creation. Given that I am a secondary investor and have no operational control, management has to be 'A+' for core positions, with boxes to check consisting of large equity ownership relative to their salary, industry experience, a strong history of capital allocation, skills as an operator, forward-thinking mentality, and shareholder-friendly with open lines of communication. Management is a good place to start and stop when researching new investments, and in addition to certain industries I avoid, I will steer very clear of unproven operators, entrenched thinkers, misaligned managers, and outrageous compensation packages.

What are two ideas on your radar now?

I am very bullish on 1847 **Goedeker Inc** (NYSE: GOED — $168 million), an e-commerce appliance retailer that operates across the US, the current version of which has existed as a public company for a very short period of time following an odd but beneficial set of transactions involving two competitors merging into a larger, more scaled, more profitable business from its legacy version. Given fears surrounding inflation, a looming recession, and consumer-related weakness, Goedeker's share price has been hammered over the past few months despite phenomenal business execution during 2021 with an even more meaningful opportunity in front of them.

Goedeker is an e-commerce appliance retailer that sells standard and luxury appliances, furniture, and home goods throughout the US. Goedeker was founded in the 1950s as a brick-and-mortar appliance retailer and today they carry over 140,000 SKUs with 95% of sales occurring online. Customers can speak with sales and service reps 24/7 as part of the shopping experience which can be a crucial part of selling appliances, and Goedeker has worked to build out their logistics infrastructure which now covers the entire US. The business model utilizes drop shipping whereby inventory is purchased following a sale, and only 65% of appliances flow through the company's warehouse. This stands in contrast to larger brick and mortar stores such as Lowe's or Home Depot which use a large portion of the store as a showroom and cater to the shopper who prefers to purchase appliances in person. Today around 85% of Goedeker's orders are retail-based, while the remaining percentage is made up of government and developer/builder customers.

GOED is currently being led by CEO Albert Fouerti, the founder (along with his brother) of Appliances Connection, the business that was purchased by Goedeker in late 2020. I (and others) have spilled a lot of ink about the transaction details which I won't re-hash here, but at a high level, for a fair purchase price, Appliances Connection brings their scaled operations, logistics expertise, efficient marketing spend and distribution capabilities to the table, while Albert's focus is on scaling the combined entity by improving customer conversion, reducing delivery times and continuing to stock a wide variety of products. He also as recently as two months ago expressed his view regarding the current share price by purchasing $1.0mm in stock in the open market. This is the second time he's made a purchase of this size since he was appointed CEO. Today, Goedeker primarily competes with brick and mortar and online mom and pop appliances retailers who are badly understaffed, under-scaled, and can't access the growth capital to compete with larger e-commerce businesses. This is a large reason why GOED has been able to significantly exceed industry growth rates by large amounts (growing 32% YoY as of Q4) as they are focused on taking a share of the appliance market that is shifting to e-commerce transactions. There remains a large runway for profitable growth as the percentage of appliances purchased online in the US sits somewhere around 15% today, set to grow to 40% by 2026.

I’m somewhat puzzled by the fact that a fast-growing, cash generative e-commerce business with real products, a decent moat around their business, and the ability to take share moving forward is left for dead at sub-4x next year’s EBITDA.

Appliance retailing isn’t the sexiest business in the world, but GOED is currently being valued as a sub-scale, slow growth appliance manufacturer as opposed to similar e-commerce peers or even building products businesses in the bulk items category such as Wayfair, Overstock, and even Lowe’s and Home Depot. With fears surrounding inflation, continued supply chain woes, a slowing economy and a potential recession, a consumer products company selling goods at higher price points may not seem like the ideal positioning right now, but through my work I uncovered that appliances are a strange consumer goods category that actually holds up quite well in recessionary environments and seem to have a decent amount of price elasticity. I’m comforted somewhat by the fact that Goedeker is most likely seeing a large chunk of their mom-and-pop competitors with limited operations and no web presence struggle to keep up with demand during this period.

The way I’m looking at valuation can be broken down into three scenarios between a bull case, base case, and bear case. In all of those scenarios I make assumptions about order growth and fill rates, revenue growth, gross and operating margins and EBITDA or free cash flow generation. My base case estimates call for revenue growth below the company’s recent execution, as well as assumptions for lower gross margins, higher than expected SG&A and EBITDA margins that slightly decline, to be conservative. If the company continues down its current path, I don’t believe there is a case to be made for conservatism as all of those fundamentals should improve moving forward as GOED makes improvements in logistics, distribution, conversion rates and marketing spend. Furthermore, I’m assuming that the company’s ‘fill rate’ (or percentage of orders that aren’t canceled during the year) barely normalizes to its 80-85% historical average, from around 65% today. I also view this as unlikely as we continue to move past COVID-related supply chain issues that are currently putting a strain on the industry. There is significant potential for explosive top-

line growth on the back of increased demand, additional marketing spend and a normalization of fill rates.

The important thing to note is that looking a few years out, using conservative business assumptions, I can reasonably see shares trading for a price at or above the current valuation even in a bear case scenario, making this a ‘heads I win, tails I don’t lose much’ type of investment. In what I would view to be wildly pessimistic scenarios for fill rates, revenue growth, and EBITDA margins, and using a multiple much lower than peers in the space, I still end up with a share price higher than today’s valuation. While the share price has been subject to significant volatility during the past few months, I continue to like the setup moving forward.

I’ve also been somewhat vocal about our investment in **IDT Corp (NYSE: IDT — $822 million)** and have written about it extensively elsewhere as I don’t believe IDT is being given credit for the attractive number of best-in-class and favorably positioned assets or subsidiaries within the consolidated business. Shares have declined around 40% over the past few months, while the business is executing tremendously well and, in my opinion, getting stronger. This is likely a good situation to step in front of as IDT has many levers to pull for value creation in line with its historical playbook of incubating new businesses and then executing tax-free spinoffs or special dividends to unlock value.

Furthermore, there is a very near-term catalyst consisting of the spinoff of IDT’s Unified Communications as a Service (UCaaS) business Net2phone, set to take place by the end of July. Net2phone’s business plan will be fully funded and set to grow profitably for many years into the future, while the ‘stub’ or what’s left within IDT will likely remain undervalued following the spin, where IDT will then focus its attention on the next potential spinoff of their point-of-sale business, National Retail Solutions or NRS over the next 18-24 months.

The entire business is available for around 7x just one segment’s EBITDA (Traditional Communications, IDT’s core telecom businesses), not taking into account the potential value of IDT’s three growth businesses as well as the optionality embedded within the new business lines and services IDT is

developing. I believe looking out a few years shares could be worth greater than 100% of today's price using conservative business assumptions.

Adam, what are some of the first things you do when researching a potential investment? What does that first hour of research look like for you? Do you do anything that few others do?

I think it varies with each investment depending on my current understanding of a particular business or industry. I spend most of my time focused on two distinct activities, managing our current portfolio and researching new ideas. While doing that, especially managing the current portfolio and staying on top of industry trends and competitive dynamics, new ideas and interesting research topics pop up all the time. Growing up, I remember certain teachers used to say 'use the test to take the test'. I like to use our investments to find new investments as I will have a lot of interesting things come across my desk when researching things around our current holdings including competitors, suppliers, and vendors among other things.

Given that I don't typically run quantitative screens or filter through businesses using backward looking financial metrics, if an idea becomes a research candidate, typically something will have flagged it as interesting measured against my investment criteria. Once I start to dig in, I'm basically trying to find a way to pass on the idea as soon as possible. That can happen quickly, within minutes, all the way up to a few days, and there are definitely ideas on my study list and watch list that have made it through a lot of filters but haven't become additions to the portfolio for specific reasons. The businesses I like best are very easy to understand and operate for the most part in industries in which I've already become familiar.

As mentioned, I place an incredible amount of weight on investing with quality management teams, usually made up of owner-operators, so most of the time I like to start my research in this area. To take a step back for a minute, if it's a business I'm unfamiliar with, I will have to thumb through or read fully the company's investor presentation and most recent annual report to get a feel for the business, and level of disclosure and how the company communicates. I then

like to read as much as I can about the management team and board, with a focus on the CEO and CFO. I'll read all of the company-provided information, and then spend a lot of time on Google looking at things like work experience, past companies operated or sold, competitors that they've worked for, interviews they've done, or just general personal information. I'll usually be able to highlight some potential references and channel checks for later in case my research takes me this far, but the goal here is to gain a decent sense of who we are investing alongside and how they might treat our capital.

Following that process, I like to 'spend a year' with the company by sort of circling through the past four quarters' results, press releases, and conference calls so that I can get a decent sense of how management communicates and understand what a typical year might look like for the business. If the company is deemed worthy of further research at this point, I'll usually read a few more publicly available documents, and then it's off to the races with digging into the unit economics, learning everything I can about the industry, and scouring the internet for articles about the company.

The initial research process just described provides me with enough information to get a sense of what might happen moving forward. The real work starts after this and involves determining 'reality' by speaking to everyone and anyone I can who has expertise about the business or industry. Depending on what's required, I will speak to former employees, former managers, competitors, suppliers, vendors, and investors in the space. At a high level, this allows me to do two things: one, determine if what I believe will happen is likely to happen, and two, figure out what I'm missing or how I could potentially lose money.

What would you like Greystone Capital to look like 10 years from now?

I've spent a lot of time thinking about the answer to this question which I'm sure I will tweak as time goes on and throughout the firm's development. Let's actually extend your time horizon another few decades. That's the type of view I am trying to take about building this business. In terms of practicing the craft of investing, I'd like to be able to do that as long as humanly possible and Greystone

is my vehicle through which to express myself. I believe I've found my life's pursuit and I am having so much fun operating Greystone that I can't ever picture doing anything else. I believe if things continue along our current trajectory that there is a significant opportunity for us (clients + myself) to outperform the market over long periods of timekeeping in line with my strategy elements. While I am far from my desired level of scale today, the plan is to eventually cap the firm's assets under management at a certain threshold, most likely between $100-200 million so that I can preserve the elements of my strategy including my preferred hunting grounds as best as possible. Although there are outliers, I'm aware of what the typical playbook looks like for emerging managers interested in scaling to $1 billion in assets or beyond, and I'm not sure I have any interest from a business or lifestyle perspective to go down that road. I love investing in small caps and micro caps and if you told me that my ability to invest in those opportunities in the pursuit of outperformance was going to be removed as a function of managing too much money, I would view that as a very effective way to poke holes in what I believe to be some of my greatest advantages as a small firm. It's not lip service when I talk about my aim to remain small, and I'm much more interested in building an enviable long-term track record as opposed to growing the firm to a certain size or building a large team, etc. You can certainly do both, but I don't believe that is the way forward for Greystone. This may mean returning capital at some stage, but I hope to be able to cross that bridge when we get there.

There's the old saying in investing that goes 'in order to be successful, you first have to survive', and that has been the aim since inception in terms of how I am thinking about the structure of the firm and what my day to day looks like. I am first and foremost optimizing for bringing in the right people, clients, and partners who understand what I am trying to accomplish and can provide the necessary capital and leeway to aid in that mission. I've been incredibly lucky to be working with our current client base, consisting of professionals from all walks of life who are generous, thoughtful and smart, and seem to be aligned with our goals in a very serious way. I would like much more of those types of partners.

Finally, I've been doing my best to reinvest as much capital as I can back into the firm's research process and infrastructure to provide stability and resources, and that will continue as we scale. I wouldn't be opposed to hiring a research analyst down the road if necessary, or an operations person also if necessary, but the most important parts of the investment and research processes as well as portfolio management will remain under my control. That's about as narrow as I'd slice it at this stage. Please ask me this same question again in 10 years:)

Adam, thank you for the great interview! What is the best way for readers to follow or connect with you?

There are a few places where you can find me. I have a fairly active Twitter presence under the handle @AKWilk with a separate @GreystoneCap handle for the firm. My blog www.poundtherockinvesting.wordpress.com is where I occasionally post research, writeups, and quarterly letters, and my website www.greystonevalue.com is where readers can find past letters to clients as well as sign up for my distribution list to receive all future communications from Greystone Capital. I love speaking with investors about ideas, books, or whatever else might be interesting so I would encourage anyone to reach out anytime.