MERION ROAD

April 2025

	Merion Road Small Cap Fund	IWM (Russell 2000)	Barclay Hedge Fund Index
Annualized Since Inception	**15.1%**	**7.9%**	**5.8%**
Q1 2025	**(7.8%)**	**(9.5%)**	**0.1%**
2025	**(7.8%)**	**(9.5%)**	**0.1%**
2024	17.4%	11.4%	9.4%
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	**12.8%**	**12.3%**
Q1 2025	**(8.2%)**	**(4.3%)**
2025	**(8.2%)**	**(4.3%)**
2024	32.4%	24.9%
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 fell slightly over 8% during the quarter, primarily attributable to our tech-oriented holdings (GOOG, AMZN) and economically sensitive industrials (CLH, FERG). Regarding the former, there continues to be a debate as to whether or not their investments in AI will produce adequate returns. The AI race publicly began back in 2023 when Microsoft CEO Satya Nadella threw the gauntlet down stating that he hopes GOOG would "come out and show that they can dance." In response, GOOG ramped their capex spend from $32bn in 2023 to almost $53bn last year, with a planned $75bn this year. So far, their pre-tax return on tangible capital has barely budged at 48% (though consensus has this falling next year). With a wide range of ubiquitous products, GOOG is as well positioned as anyone to win the war. For instance, the integration of AI overviews into search has produced strong metrics and the company is broadening its application to encompass novel query formats, including images and audio.

But will all of this investment generate an acceptable return? I don't know. And it will be many years before we have an answer. CEO Pichai's philosophy is that the cost of missing out on what could be a generational opportunity far outweighs the benefits of conserving its cash. This makes sense to me. Even if GOOG burns the majority of their free cash flow over the next couple years, that's a drop in the bucket. The value in the business comes from the long tail of earnings from things like Search, Youtube, Cloud, and hopefully some of their moonshots (I'm looking at you Waymo). If AI returns disappoint, I believe GOOG will scale back.

CLH and FERG sold off as fears of a recession increased. This brings me to a brief discussion on macro and fund positioning.

The macroeconomic environment has obviously been highly volatile. During the end of the first quarter and into the first, the US has assigned meaningful tariffs on its trading partners one day, just to lift them the next. This lack of clarity makes managing any business incredibly hard. How will a CEO feel confident investing in inventory, employees, or a new facility when they don't know if foreign products will be taxed at 10% or 50%? As an investment manager, it makes my job hard too. Realizing that uncertainty has risen and conviction has fallen, I decided to take a few chips off the table by selling our position in VCTR (whose earnings are exposed to how well the stock & bond markets do). We began the quarter at 9% cash (13% if you include our merger arb position in SUM) and ended at 19% - so an additional 6% buffer. I have continued selling into Q2 and our cash holdings currently stand at about 25%. I did purchase more CLH, already our largest position, as they will be a beneficiary of any additional onshoring.

The Merion Road Small Cap Fund also experienced a decline of roughly 8%, as small cap companies continue to underperform their larger counterparts.

For reasons mentioned above, I have opted to reduce the fund's net exposure. We began the year at 93% net long (47% net on a beta-adjusted basis) and ended the quarter at 66% net (32% beta-adjusted). I typically manage the fund based on our beta-adjusted net exposure. During substantial drawdowns, however, correlations tend to converge towards 1. As such, I must qualitatively balance my assessment of risk between our net exposure and beta-adjusted net exposure.

Monarch Cement ("MCEM") recently announced another special dividend after having previously paid one out in December. This will bring their total dividends paid to $7.75 over the past 4 quarters (~6% yield). The company recently moved from the Pink Sheets to OTCQX Best Market - hopefully this will enhance liquidity and valuation. Lastly, management provided attractive guidance for continued pricing strength and energy savings from their solar investment.

A company I haven't previously discussed is Butler National Corp ("BUKS"). BUKS owns a regional casino in Dodge City, KS and an aircraft modification business. While I have tracked the company for many years, I began buying in 2023 following the announcement that their former CEO would step down and sell his shares back to the company (~10% of the shares outstanding). This event removed a key overhang for me – the presence of an entrenched management team with multiple family members on the company payroll. BUKS further strengthened its corporate governance in early 2024 by bringing on two new independent directors, including its largest shareholder. At the annual meeting last year, the company passed a resolution to declassify the board, yet another step in the right direction. Summing up this activity, BUKS executed a large buyback at a fraction of current trading levels, reduced unnecessary overhead, has a highly incentivized board of directors, and is taking steps to improve shareholder friendliness.

While the stock has worked tremendously well, I believe there is still a lot of opportunity ahead. The casino generated about $13mm of EBITDA over the past four quarters. There will be a modest headwind as their gaming tax increases by 2%, but this should be somewhat offset by additional growth in revenue from their sportsbook via their contract with Draftkings. A 6x EBITDA multiple would value this business at almost $80m. A couple sanity checks on this. Firstly, the casino cost nearly $90mm to build in 2008-2009. Secondly, the operating entity purchased the real estate in 2020 at a cost of $41mm, financed via debt. The following year BUKS acquired the outstanding 40% equity interest in the operating entity for $16.4mm in 2021, implying a total value of $41mm. Adding these up we get to $81mm.

The aircraft modification business generated about $10mm of EBITDA over the past four quarters. Two thirds of the revenue come from Avcon, a subsidiary that modifies airplanes for specialized services like search and rescue, fire detection, and surveillance. The rest of the revenue largely relates to BNC Tempe, a subsidiary that makes gun control units for Northrop Grumman. Revenue should grow high single digits / low double digits over the next few years and is supported by increased global demand for defense applications. Backlog is currently at $35mm, up 16% from this time last year. Assuming EBITDA grows to $12mm, a 9x multiple would value the business at $106mm.

This sum of the parts results in a value per share of $2.60 (+66%). Alternatively, we can look at BUKS on a consolidated basis generating ~$18c per share next year in earnings, putting it at just 8x. This seems attractive given the qualitative factors previously discussed. The company is nearly net cash positive and I would not be surprised to see continued shareholder returns or potentially a strategic acquisition.

Sincerely,

Aaron Sallen

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