Adestella
Investment Management

October 25, 2017

Dear Fellow Investors,

The Fund gained 21.0% in the third quarter, pushing our year-to-date performance to 43.4%. Our long book did most of the heavy lifting by gaining 18.7%, while our short positions broke even with a 0.2% return. Currency fluctuations accounted for the remaining 2.1%. In contrast to the last few quarters, it was our domestic holdings that drove performance this time, comprising about 80% of our overall gains.

During the third quarter, key economic (inflation and unemployment) and financial (interest rate and volatility) indicators remained low. This stable environment mixed with continued earnings growth was sufficient to deliver the seventh straight quarter of positive returns for the US market. We managed to outperform our benchmarks for the period, which gained between 3-6%. I am pleased with the results, though unfortunately the returns generated in the last few months are unlikely to be replicated on a regular basis in future quarters. That said, if we continue with our strategy of holding a concentrated portfolio filled with attractive risk-reward propositions, I am confident we will generate a satisfactory result over time.

An updated performance summary is as follows:

	3Q 2017	YTD 2017	Since Inception[1]
S&P 500	4.41%	15.68%	37.46%
Vanguard Total World Stock ETF	5.25%	19.89%	22.52%
Russell 2000	5.87%	11.84%	31.65%
HFRI Equity-Hedge (Total) Index	3.52%	9.63%	15.60%
Adestella Investment Management[2]	**20.99%**	**43.40%**	**70.92%**

**all index returns include reinvestment of dividends*

[1] Adestella began operations in the third quarter of 2014
[2] Time weighted returns on a gross basis

The Cost of Returns

One of my favorite financial writers, Morgan Housel, recently came out with an insightful piece on the key determinants of investing success. While all of the points were astute, my favorite was the third – the ability to be comfortable being miserable.[3] In explaining this, Housel wrote: *"*Returns do not come for free. They demand a price, and they accept payment in uncertainty, confusion, short-term loss, surprise, nonsense, stretches of boredom, regret, anxiety, and fear. Most markets are efficient enough to not offer any coupons. You have to pay the bill." This resonated with me because it's been my experience as well – nearly all of my best investments have gone through periods in which they made at least a few of those "payments" before eventually turning out well.

Indeed, while quarters like the one we just completed are satisfying, we paid the bill for it. Some days, our holdings exhibited nonsensical price action. Other days, we were greeted in the morning with some surprising bit of news on one of them. And on numerous occasions this year, we've incurred short-term losses in order to better our prospects at long-term gains. We will continue to do that as opportunities present themselves; knowing Mr. Market's history, this is a matter of when, not if. However, the timing of these opportunities cannot be predicted, and as a consequence, the timing of returns generated won't always match up neatly with the quarterly cutoffs or the calendar year. In this particular quarter, the timing worked to our advantage, but it's likely there will also be quarters in the future where it doesn't.

That's why I believe having a long-term investment orientation is critical – if we had been focused on maximizing gains on a quarterly basis, we may not have held or added to the short-term losers in the first half of the year that played a large role in driving the third quarter return. By prepaying our '"bill", we achieved a better net result than we would have if we'd tried to avoid paying altogether. I believe this demonstrates yet again the great advantage of having investors that do not equate volatility with risk and that judge performance over a multi-year period, and I'm grateful to each of you for it.

Winning the Mind Game, Part II

In my second quarter letter, I discussed how investors are often their own worst enemies, succumbing to emotions and cognitive biases that impact their judgment and adversely affect their investment results. I also stated my belief that this dynamic presents an opportunity for active managers to add value above a passively managed fund. If one is aware of and capable of taking control of his instinctive preferences, he can make the sometimes uncomfortable decisions required to outperform the market over time. However, the fact that so few investors, amateur and professional alike, manage to do this makes it clear that it's much easier said than done.

This brings me to the other key portion that stood out in the aforementioned Housel article – a ranking of the most and least lucrative psychological states for investment returns. At the top was "miserable but confident in its eventual rewards"; at the bottom was "comfortable and oblivious of what's to come."

[3] See http://www.collaborativefund.com/blog/the-four-fundamental-skills-of-all-investing/ if interested

While I'd guess many people are well aware of the positive correlation between understanding a company and generating a positive return on its stock, I'd bet far fewer are cognizant that comfort not only fails to predict investment success, but actively works against it. Seen in this light, it becomes clear why most people underperform the market – they prefer not feeling miserable!

The security that comes from comfort is a basic human need, and it's generally beneficial to us in the sense that creates paths of least resistance that facilitate easier living. People are innately drawn toward ideas and solutions that minimize cognitive dissonance. But while that may work well in most areas of life, it's problematic in the investing world. Because they're hardwired otherwise, many will not or cannot stand making unpopular decisions that increase their discomfort and instead seek choices that provide safety in numbers. And by doing about the same thing as everyone else, they generally end up getting about the same thing as everyone else – average returns.

However, some are able to maintain a level of conviction about their judgments and beliefs that leave them willing to endure short-term discomfort for the prospect of long-term rewards. This generally entails not only an awareness of the aspects of human nature working against you, but also a willingness to think independently, a thorough understanding of each investment target, and long-term orientation. Using these tools, we strive to be among this minority. Though the discipline required can certainly be painful at times, I remain convinced that this is the only way to sustainably outperform market indices.

As it happens, our portfolio includes a stock that is currently testing our resolve on this principle. I hope (and expect) it will eventually be a good case study of the merits of bearing short-term misery for long-term benefits. The company, Bluelinx Holdings (BXC), is the subject of this quarter's appendix.

Outlook

US indices have continued to grind slowly higher in recent months. While many point to the length of the current bull market as justification for an imminent correction, my outlook is more sanguine. Stock market performance is ultimately driven by macroeconomic performance, and all indications suggest the domestic economy continues to slowly improve. Bull markets don't die of old age – there is generally some large exogenous shock that catalyzes their conclusion. While risks abound (as always), I don't see anything that portends a collapse on the horizon. In any case, my focus remains on the fundamentals of our underlying holdings. So long as we continue purchasing good companies at attractive prices, we'll be fine regardless of the macro environment.

Conclusion

There's an old baseball adage that says "You can't put runs on the scoreboard if you're watching the scoreboard." It implies one must focus on the game in order to win, instead of on whether he's currently ahead or behind. The same holds true in investing – one must focus on his investment process instead of on daily fluctuations in the brokerage account. While we scored a few "runs" this past quarter, our focus on finding cheap stocks with attractive risk-reward profiles remains the same. The Fund is still in its early innings, and doing so gives us the best opportunity to be able to say "we won" at the end of the game.

I look forward to writing to you again after the conclusion of the year.

"The greatest danger for most of us is not that we aim too high and miss it, but that we aim too low and reach it."

- Michelangelo

Best Regards,

Andrew Jakubowski

Appendix A: Bluelinx Holdings (BXC) Investment Thesis

One area that often presents interesting risk-reward investment propositions is highly-levered companies trading at cheap multiples and generating significant free cash flow. If this cash flow stream is sufficient to service interest payments and pay back principal, over time slowly but consistently value will be transferred from the debt holders to the equity holders. As an added kicker, as leverage metrics decline the market will often award the stock with a higher multiple. These situations can be likened to a "public LBO," as the use of debt financing and focus on cash flows is very similar to the strategies employed by many private equity firms. Another area where I've often discovered attractive opportunities is in stocks that have become temporarily depressed due to forced/non-economic selling, only to quickly bounce back once the overhang ends and investors refocus on business fundamentals.

One opportunity that checks both these boxes is Bluelinx Holdings (NYSE:BXC), a North American building product distributor. While BXC has been a holding of mine for a while, recent developments have temporarily depressed the price, creating a highly attractive entry point and leading me to significantly increase my position.

Founding and Background

BXC started in 1954 as the distribution division of Georgia Pacific (GP). At the time, it had 13 distribution centers mainly for the storage and distribution of GP's plywood products. Over time, it built up a large network of these centers throughout the country (while also expanding product lines), and over the next 50 years, it developed the largest platform of distribution warehouses nationwide. As a subsidiary of GP, many of these facilities were built with an eye toward storing excess lumber instead of just distribution, giving the facilities a larger real estate footprint – something that has become important to the investment case today.

In 2004, GP sold its distribution assets to private equity firm Cerberus Capital Management, who took BXC public in December of that year. In mid-2006, Cerberus amended an existing BXC mortgage backed by the company's distribution centers into a larger mortgage carrying a 10-year term with a $1 M/month prepayment penalty. The timing couldn't have been worse: shortly after, the bottom fell out of the housing market. Even after green shoots in the economy showed up a few years later, BXC stock lagged as a result of self-inflicted wounds, including instability in the management ranks and a foolish attempt at speculation via "innovative" inventory management methods. From mid-2013 to early-2016, the company continued to struggle as a result of a sluggish housing recovery and its large interest burden, while the cash sweep and prepayment penalty features on its mortgage disincentivized real estate sales.

Current Situation

However, the company's fortunes began to turn around in 2016, as they refinanced their loan after the conclusion of the repayment fee period, and shortly after announced a deleveraging initiative. This initiative has been (and should continue to be) highly accretive to the company for two reasons. First, in the company's registration statement, it claimed it could nearly double capacity with minimal further investment, implying its asset base is far larger than needed for its current operations. This makes sense, because its creation as an arm of Georgia Pacific meant BXC facilities were initially run not for maximum space efficiency but also with storage concerns in mind. Second, around the time of its refinancing, BXC had its real estate portfolio appraised (at market rates) at a value of $332-352 M. The upshot is that BXC has real estate that is both valuable and unutilized, allowing it to bring in significant sums of money in a sale without any material change in operations.

Following a string of solid results, things seemed to be progressing as planned – up until earlier this month. A few weeks ago, shortly after filing a shelf registration statement, BXC announced a secondary offering to allow longtime PE holder Cerberus to exit the majority of their position. The size of the offering, coupled with the stock's lack of liquidity, caused a sharp selloff in which BXC shares lost around a quarter of their value. The offering ultimately priced at $7, over 20% below the pre-announcement price.

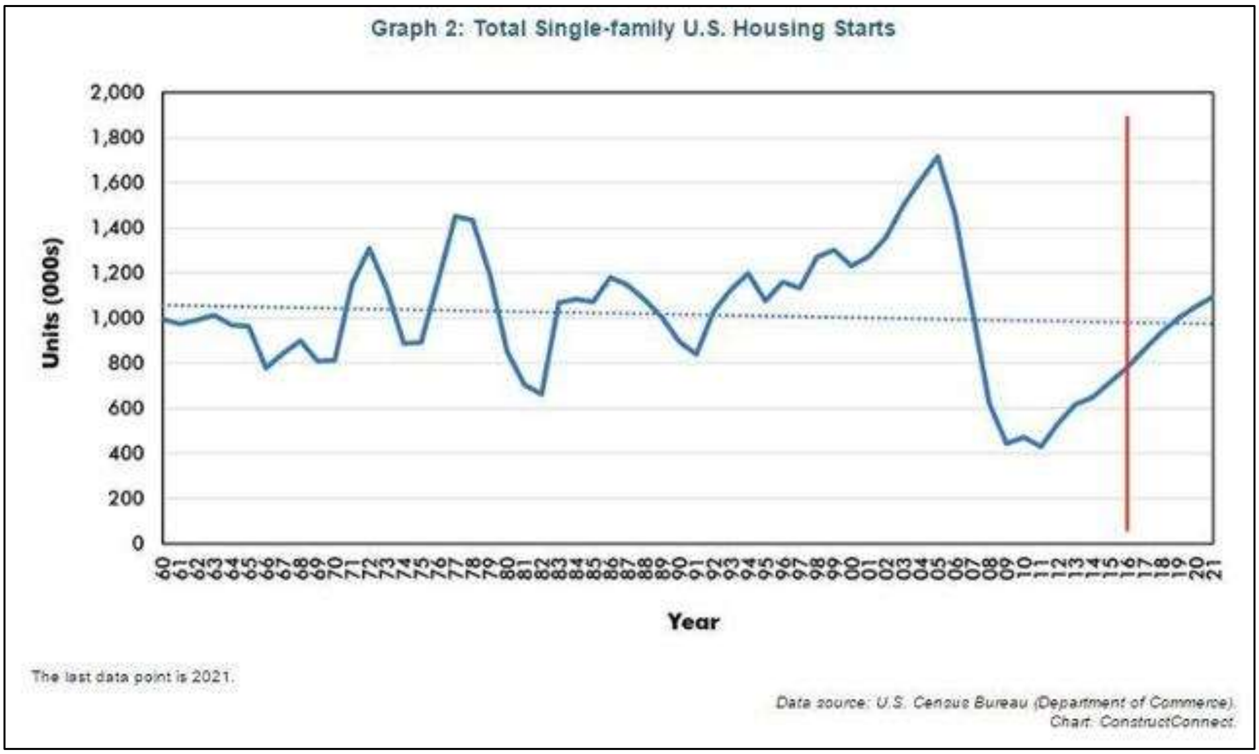
We can only speculate as to why Cerberus decided to exit at the time and in the manner they did. However, the specifics of the situation leave me confident that the decision was largely a non-economic one. First, pre-offering Cerberus owned 4.7 M shares, which are worth $37.7 M at the current price. For a firm managing around $30 B, this is equal to 0.13% of their portfolio – literally a rounding error. Thus, it's perhaps not surprising that the sell-down wasn't done in stages to minimize the price impact, as it wouldn't be able to move the needle either way. Second, the firm's original BXC investment was made over a decade ago; given the average PE investment holding period is around five years, this implies Cerberus's divesture was long overdue.

Key Thesis Points

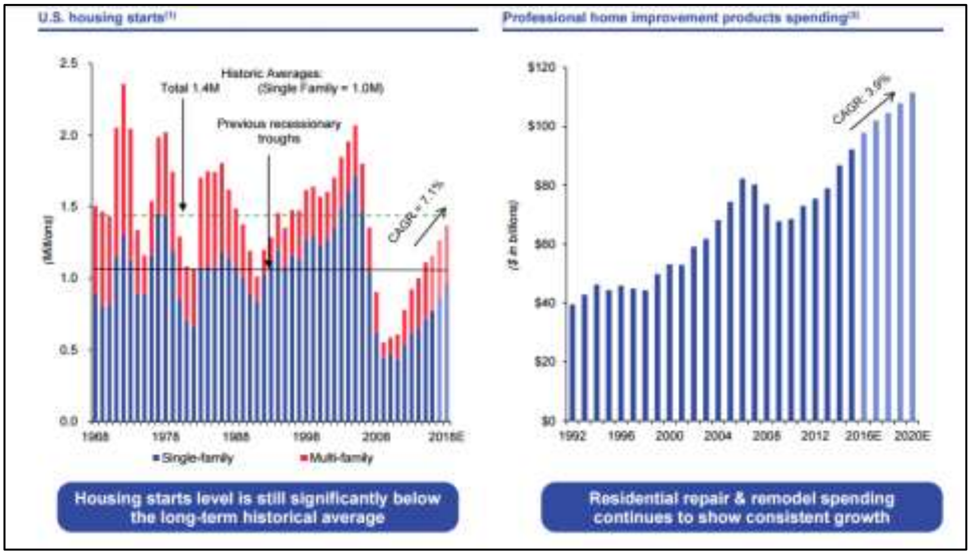
So what we have here is a stock that has been hammered in recent weeks, largely due to the announcement of a large and price-insensitive seller. While certainly painful in the short-term for existing holders, I think anyone with a longer-term orientation has a terrific opportunity to ultimately benefit from this temporary dislocation. Now that I've explained how BXC got to its present situation, it's time for the more important part – looking at the fundamentals of the business on a forward basis – since that's what will drive the stock performance from here. The key tenets of my thesis are as follows.

1.) **Single-family housing market strengthening.** In the past year we've seen a continuation of the trend of gradual housing market improvement, with YTD starts 6% ahead of last year. While there's been a short-term hiccup stemming from the natural disasters in Texas and Florida, this will quickly turn into a further tailwind as rebuilding progresses in these markets.

I believe this trend is highly likely to continue. For one thing, one of the biggest problems cited now is a lack of supply. Shrinking inventories drive up prices, which incentivizes homebuilders to build more houses, which in turn means greater demand for the parts and supplies that distributors like BXC provide. Secondly, even after the recent improvements, we're still well below a mid-cycle level. It will likely take another two years of further growth (i.e. another 20-25% increase in starts) to reach that figure.



Other forecasts suggest the pace could be even quicker than that. While predicting the exact numbers is impossible, the general trend is clear – and this is certainly a case in which it's better to be approximately right even if precisely wrong.



2.) **Continued real estate sales accelerate debt repayment and provide catalyst for the shares.** The company's progress on this initiative to date has been terrific, with a steady stream of sales across geographies. To date, BXC has sold properties for a total of around $52.5 M since announcing its deleveraging plan 18 months ago. Given that the real estate is being carried on the company's books for far below what it'd fetch at market, each sale helps to unlock BXC's hidden asset value by reducing the discrepancy. However, undervalued real estate plays are relatively common (see Sears as just one example); over time, I've found that for this type of value to be realized by the market, it's crucial for a company to actually be making these sales. Changing the value from a theoretical figure to an actual one often can serve as a strong catalyst for rerating, and I believe that will be the case here as well.

3.) **Potential for margin upside from decentralized corporate structure and better working capital management.** CEO Mitch Lewis took the reins in early 2014 and has brought some much needed stability to the BXC management ranks. One of his key initiatives has been to move the company from a centralized structure (likely an artifact of its days as a GP subsidiary) into a more agile firm where salespeople are closer to their customers and inventory is more tailored to local markets. Given that distribution companies add value through wide range/selection, quick turns, and dependable service, I view this shift as both positive for performance and necessary given the fragmented, competitive landscape of the industry.

While BXC's margin profile is still a work in progress, cost control and a focus on reducing working capital requirements (WC turnover increased consistently through 2016) should help create economies of scale that push them closer to (and eventually into) the 3-6% EBITDA range of peer companies.

4.) **Company's valuation discount to peers should close as leverage metrics decline and profitability improves.** The company trades below wholesale industrial distribution peers on nearly all key valuation metrics, probably due to fears over its debt levels and substandard profitability. As leverage falls thanks to OCF generation and further RE sales while margins improve from the company's operational efficiency initiatives, I expect BXC's multiples to trend more in line with the rest of the group. In the second, smaller set of building product focused peers, there's a similar discount.

Note that while BXC has not yet officially reported its Q3 results, I've used the midpoints of the preliminary estimates contained in the final secondary prospectus when calculating the firm's LTM and NTM multiples.

Comp Set #1: US-based wholesale industrial distributors

Company Symbol	Company Name	MV (USD)	EV (USD)	LTM P/E	NTM P/E	LTM EV/ EBITDA	NTM EV/ EBITDA	LTM P/CF	LTM P/FCF	EV/ uFCF	EBITDA Margin	Net Debt / EBITDA	ROIC
BLDR	Builders FirstSource, Inc.	2,016.3	3,910.1	14.2	12.9	11.2	7.9	8.6	10.8	12.4	5.5%	5.14	6.9%
FAST	Fastenal Company	13,906.6	14,213.4	28.0	23.1	15.8	13.1	19.9	41.9	34.0	22.7%	.31	22.6%
HDS	HD Supply Holdings, Inc.	6,859.2	10,844.2	36.8	14.2	12.0	14.4	10.8	20.0	27.2	12.1%	4.15	4.2%
HBP	Huttig Building Products, Inc.	180.8	284.2	10.8	NA	10.7	NA	13.4	12.6	20.3	3.7%	2.08	11.4%
LAWS	Lawson Products, Inc.	230.7	225.8	NA	31.4	34.2	13.3	22.1	39.1	61.9	2.4%	-.28	-2.4%
MRC	MRC Global Inc.	1,676.0	2,404.0	NA	32.3	35.4	10.4	26.1	9.0	-99.1	2.2%	4.49	-5.0%
MSM	MSC Industrial Direct Co., Inc. Class A	4,533.4	5,021.0	20.8	17.9	11.2	10.3	13.9	14.5	23.0	15.6%	1.24	15.4%
RUSHA	Rush Enterprises, Inc. Class A	1,933.9	3,164.8	48.1	23.1	12.9	16.3	8.1	4.0	289.6	5.8%	5.10	2.9%
SITE	SiteOne Landscape Supply, Inc.	2,484.9	2,955.6	NA	35.7	27.8	15.9	40.2	16.4	40.4	6.4%	3.49	6.0%
UNVR	Univar, Inc.	4,116.2	6,808.5	NA	20.6	14.5	10.3	14.5	10.9	36.6	5.8%	5.62	-1.8%
VRTV	Veritiv Corp	515.4	1,456.0	25.3	8.2	8.5	7.4	6.7	8.8	27.7	2.1%	5.11	1.4%
GWW	W.W. Grainger, Inc.	11,841.6	14,117.6	21.1	18.9	9.7	10.1	13.5	19.7	23.2	14.3%	1.36	16.5%
WSO	Watsco, Inc.	5,723.5	6,315.6	31.6	25.5	17.2	15.2	18.3	20.6	43.0	8.7%	.49	13.7%
WCC	WESCO International, Inc.	2,916.8	4,215.1	30.1	14.8	10.6	10.2	11.8	11.4	21.1	5.4%	3.27	3.1%
WEYS	Weyco Group, Inc.	288.6	272.7	18.1	NA	10.0	NA	15.0	8.1	18.4	9.2%	-.52	8.2%
INT	World Fuel Services Corporation	2,458.8	2,918.0	19.7	13.3	12.0	8.1	15.0	161.0	14.5	.9%	1.76	4.4%
	Average	**3,855.2**	**4,945.4**	**25.4**	**20.9**	**15.9**	**11.6**	**16.1**	**25.5**	**37.1**	**7.7%**	**2.67**	**6.7%**
	Median	**2,471.9**	**3,537.4**	**23.2**	**19.8**	**12.0**	**10.4**	**14.2**	**13.5**	**25.2**	**5.8%**	**2.67**	**5.2%**
	BXC	*73.4*	*395.4*	*9.7*	*4.9*	*9.7*	*8.6*	*4.3*	*4.5*	*12.8*	*2.3%*	*7.88*	*1.9%*

Comp Set #2: US-based building product focused distributors

Company Symbol	Company Name	MV (USD)	EV (USD)	LTM P/E	NTM P/E	LTM EV/ EBITDA	NTM EV/ EBITDA	LTM P/CF	LTM P/FCF	EV/ uFCF	EBITDA Margin	Net Debt / EBITDA	ROIC
BLDR	Builders FirstSource, Inc.	2,016.3	3,910.1	14.2	12.9	11.2	7.9	8.5	10.8	12.4	5.5%	5.14	6.9%
HDS	HD Supply Holdings, Inc.	6,859.2	10,844.2	36.8	14.2	12.0	14.4	10.8	20.0	27.2	12.1%	4.15	4.2%
HBP	Huttig Building Products, Inc.	180.8	284.2	10.8	NA	10.7	NA	13.4	12.6	20.3	3.7%	2.08	11.4%
MSM	MSC Industrial Direct Co., Inc. Class A	4,533.4	5,021.0	20.8	17.9	11.2	10.3	13.9	14.5	23.0	15.6%	1.24	15.4%
WSO	Watsco, Inc.	5,723.5	6,315.6	31.6	25.5	17.2	15.2	18.3	20.6	43.0	8.7%	.49	13.7%
WCC	WESCO International, Inc.	2,916.8	4,215.1	30.1	14.8	10.6	10.2	11.8	11.4	21.1	5.4%	3.27	3.1%
	Average	**3,705.0**	**5,098.4**	**24.1**	**17.1**	**12.2**	**11.6**	**12.8**	**15.0**	**24.5**	**8.5%**	**2.73**	**9.1%**
	Median	**3,725.1**	**4,618.0**	**25.5**	**14.8**	**11.2**	**10.3**	**12.6**	**13.5**	**22.1**	**7.1%**	**2.67**	**9.1%**
	BXC	*73.4*	*395.4*	*9.7*	*4.9*	*9.7*	*8.6*	*4.3*	*4.5*	*12.8*	*2.3%*	*7.88*	*1.9%*

Valuation Analysis

Even assuming just modest improvement in profitability and valuation multiples would spur large upside here. Assuming 5% sales growth (fairly low given starts are growing above 7%), flat gross margins (conservative to reflect uncertainty in commodity price inputs), and a very modest amount of operating leverage as profits rise faster than expenses, I believe BXC can generate at least $47 M in EBITDA and $25.6 M in levered FCF in 2018. At a 5.5x FCF multiple (well below all peers to reflect higher leverage profile), the stock would be worth $15-16 a share, producing 85-95% upside. A summary of my model is below:

figures reflect impact of divestments (presented on same-center basis)

Shares	9.39
x Price	8.23
MC	75.6
+ Debt	326.8
- Cash	4.8
EV	397.6
2017 PT	9.82
IRR	*42.5%*
2018 PT	15.39
IRR	*51.8%*
NTM PT	12.61
IRR	*53.2%*

	2015	2016	2017	2018			
Sales	1,644	1,752	1,804	1,859	3%	CAGR	
x Gross Margin	11.8%	12.5%	12.7%	12.5%			
Gross Profit	194.1	219.8	229.2	232.3	2017	2018	
- Operating Expense	186.6	196.9	194.9	195.1	10.8%	10.5%	of sales
EBIT	7.6	22.9	34.3	37.2			
- Interest	27.3	24.9	21.9	18.9	6.7%	WA IR	
- Tax	0.2	1.1	1.2	1.5	<-- AMT due to NOLs		
NI	(29.9)	(3.1)	11.2	16.7			
/ Shares Out	8.8	9.0	9.2	9.4	2.0%	annual dilution	
EPS	(2.28)	(0.34)	1.22	1.78			
x Multiple	9.0	9.0	9.0	9.0	9	P/E	
Value	(20.51)	(3.08)	10.96	16.06			
Upside	*n/a*	*n/a*	*33.2%*	*95.2%*			
IRR	*n/a*	*n/a*	*77.3%*	*56.2%*			
Debt Balance	384.4	300.3	326.8	282.7			
Avg. Net Debt	363.8	311.9	273.1	228.6			
Avg. Net Debt/EBITDA	21.0	9.7	6.2	4.9			
EBITDA Margin	*1.1%*	*1.8%*	*2.4%*	*2.5%*			

	2015	2016	2017	2018		
FCF	(11.8)	5.6	19.7	25.6	251%	CAGR
x Multiple	5.5	5.5	5.5	5.5	5.5	P/FCF
MC	(64.7)	30.9	108.6	140.8		
/ Shares Out	8.8	9.0	9.2	9.4		
Value	(7.40)	3.42	11.81	15.02		
Upside	*n/a*	*-58.4%*	*43.5%*	*82.5%*		
IRR	*n/a*	*-58.4%*	*106.1%*	*49.3%*		

	2015	2016	2017	2018		
EBIT	7.6	22.9	34.3	37.2		
+ D&A	9.7	9.3	9.5	9.8		
EBITDA	17.3	32.3	43.7	47.0	39.0%	CAGR
x Multiple	8.5	8.5	8.5	8.5	8.5	EV/EBITDA
EV	147.0	274.3	371.8	399.3		
- ND	379.6	294.7	302.3	256.7		
MC	(232.6)	(20.4)	69.5	142.6		
/ Shares Out	8.8	9.0	9.2	9.4		
Value	(26.58)	(2.26)	7.56	15.21		
Upside	*n/a*	*n/a*	*-8.1%*	*84.8%*		
IRR	*n/a*	*n/a*	*-15.6%*	*50.6%*		
Total FCF	(11.8)	5.6	19.7	25.6		
- Dividend Cost	-	-	-	-	$ -	annual dividend
+ Facility Sale Proceeds	-	28.1	24.3	20.0		
FCF for Debt Reduction	(11.8)	33.7	44.0	45.6		

	2015	2016	2017	2018		
FCF	(11.8)	5.6	19.7	25.6		
+ Capex	1.6	0.6	0.8	0.9		
CF	(10.2)	6.5	20.6	26.5	230.0%	CAGR
x Multiple	5.5	5.5	5.5	5.5	5.5	P/CF
MC	(56.1)	34.4	113.5	145.9		
/ Shares Out	8.8	9.0	9.2	9.4		
Value	(6.41)	3.81	12.35	15.57		
Upside	*n/a*	*-53.7%*	*50.1%*	*89.1%*		
IRR	*n/a*	*-53.7%*	*125.3%*	*52.9%*		

	2015	2016	2017	2018
Starting Debt Balance	402.9	334.0	300.3	256.2
- FCF for Debt Reduction	(69.0)	33.7	44.0	45.6
Ending Debt Balance	334.0	300.3	256.2	210.6

There are several potential sources of further upside as well. For example, applying peer multiples would make BXC nearly a triple from here. Further EBITDA margin improvement into the 3% range (still below comps) from rationalization of facilities and inventory assortments would also produce a 3x stock return (even at the discounted multiples used above); if both were to materialize, the stock would be a four-bagger.

Downside Protection

Despite the cheap valuation and clear housing tailwinds, I would probably pass on a company with this leverage profile if I weren't confident there was some sort of downside protection if the anticipated housing market improvement didn't materialize. Here, I think the real estate value provides strong downside protection and turns this from a binary bet on the housing market to an investment with a margin of safety. This is not just hypothetical either – as discussed above, they've already successfully sold properties and received prices in line with the valuation estimates. BXC had its properties appraised in late 2015 at $342 M; adjusting for disclosures from recent sales, the land and buildings on the company's books are worth just around $285 M, almost three times the carrying value on the balance sheet. Even after applying haircuts to its other assets, BXC's salvage value is far above the current market price in a liquidation scenario.

	June 2017			
	Current	Haircut	Adj. Value	
Cash	4.8	100%	4.8	
Receivables	167.6	90%	150.8	
Inventories	220.7	80%	176.5	
Other Current	20.2	50%	10.1	
Land	285.0	100%	285.0	<-- *adj. for sales through 2Q17*
Buildings				
Machinery & Equip.	75.0	33%	24.8	
WIP	0.4	0%	-	
Other Non-current Assets	12.1	50%	6.0	
Total Assets	785.7	83.7%	658.1	
- Total Liabilites	537.7	100%	537.7	
+ Current Deficit	(25.4)	100%	(25.4)	
		Adj. BV	95.0	
	Salvage Value/Share		10.33	
		Upside	*25.6%*	

Why Does This Opportunity Exist?

There are several clear reasons for the opportunity in Bluelinx stock today:

- As discussed earlier, a stampede of shareholders trying to get out ahead of the Cerberus sale (despite the lack of information content in the sale)
- Limited liquidity has historically prevented larger institutions from getting involved (although the completion of the secondary should ameliorate this) and exacerbated the recent selloff
- While the bullish housing thesis is fairly well-known, the same can't be said about all of the companies it affects. Here, we have a small cap company ($`73 M MC) with a very limited

following (no analyst coverage and only 918 Seeking Alpha followers), which has allowed it to fly under the radar despite generally positive industry coverage

- BXC screens messily on many historical metrics – one must take a forward-looking view in order to appreciate the value here. This is especially true given that the company's hidden real estate value is not something that can be captured via stock screener.

Catalysts

I see a variety of potential catalysts here, including:

Closing of the secondary offering. I believe the stock will quickly return to its pre-announcement price, thanks in large part to its improved liquidity. However, given the size of the offering relative to the float, it may take a few weeks for the selling pressure to subside.

Release of third quarter earnings. In the final secondary prospectus BXC provided preliminary numbers for the period that were very solid, but I believe few investors are aware of them as of yet. The official release of results next week will change that.

Continued single-family housing start strength. A rising tide lifts all boats, and so long as the housing market continues trending in the right direction, building distribution stocks should perform well. Continued positive homebuilder sentiment could also help here too.

News on additional real estate sales. As the company monetizes its unneeded properties to further reduce net debt, valuation multiples should start to shift closer to peers. Of course, it will be important to see that the company continues to command prices in a similar range to its previous sales.

Risks

There will always be risks associated with buying a highly-levered company in a cyclical industry. That said, investing is all about weighing a risk-reward profile in the context of the probabilities of the various outcomes. I believe the housing market recovery will continue to remain robust, and that even if it doesn't, BXC's real estate assets provide downside protection in a liquidation scenario. Of course, neither of these things are guaranteed, and the range of potential outcomes is relatively wide, so the position should be sized accordingly.

Further margin and real estate sales, which will likely be needed for multiple expansion, will depend on management execution. To date, I have been impressed with the leadership of CEO Mitch Lewis and think the company has taken the correct steps in rightsizing its operations and prioritizing profitability over growth at any cost.

Conclusion

When evaluating investment opportunities, incentives (or lack thereof) matter. I believe this is a situation where a lack of economic incentive from a large seller has temporarily depressed a company that is otherwise performing well and on the cusp of a significant profitability inflection. Once the overhang is removed, I expect the stock to once again trade on the basis of its strong and improving business performance.

Leverage is a double-edged sword, but with careful analysis you can find “public LBO” situations where you can use it to your advantage. I believe BXC is one such situation, as a favorable industry environment and its ongoing balance sheet monetization should produce a large value transfer across the capital structure from debt holders to equity holders. The situation is not without risks – but that’s true of any stock offering potential multi-bagger returns. As the company continues to execute on its real estate sales and improve operating performance, I believe investors will take notice, driving upside above $15/share and possibly much higher than that.

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