March 2024

Dear Fellow Investors,

Adestella gained 3.2% in the last quarter of the year to finish 2023 with an 18% gain. Long positions gained 6.8% but were offset by 3.4% losses in a short book that swam against the tide during the period. Our domestic holdings, which contained nearly all the short exposure, gained 0.2% while international stocks gained 3.2%. Currency movements were a net 0.2% headwind as the US dollar declined slightly.

Markets were sharply higher over the period as the Federal Reserve signaled it was done hiking rates and could potentially pivot in 2024, and were once again led by mega-cap tech as the Magnificent Seven closed out a banner year. As a reminder, while the indices are important reference points, the Fund does not make any effort to track them quarter to quarter. Our main goal is long-term market outperformance, and such outperformance cannot be achieved unless one is willing and able to deviate from the benchmarks. Of course, deviation cuts in both directions, as demonstrated this quarter — our underweight positioning in financials and technology, along with our sub-90% net exposure, led us to lag behind the benchmarks in the final portion of the year.

Alpha and Anisoptera

When people think of the most fearsome hunters in the animal kingdom, a few species often come to mind. Perhaps lions? Cheetahs? Sharks? And since these animals enjoy hunting success rates of anywhere from 30% to 50%, their reputations come with good reason. However, one other prolific hunter tends to fly below the radar (literally): the dragonfly. It's a common insect found all over the world, and it's not physically imposing or majestic like the larger animals that immediately spring to mind. But with an impressive array of adaptations leading to a 95-97% hunting success rate, it's the very last thing you would want targeting you if you fell beneath it in the food chain.

There are often lessons to be drawn in applying findings from one branch of science to another, and in this case, biology and finance aren't too far away. Indeed, the traits that dragonflies rely upon have several notable parallels to those of astute investors. Both groups often utilize the following to achieve consistent success:

- *Ability to see things from multiple angles.* The best investors put together several views to make a holistic assessment when evaluating a company, considering not only financial metrics but also things like managerial quality, competitive positioning, and industry dynamics to get a more complete picture of the overall business. They consider not only blue-sky return scenarios but also downside ones when things don't go according to plan.

- *Agile maneuvering.* Good investors know the value of being able to access harder-to-reach areas of the market. Smaller and less liquid stocks are often inefficiently priced because there are fewer eyes on them and less competition. While size and liquidity constraints make it implausible for some, it is generally beneficial to expected returns when your capital base is small enough to pursue such opportunities.

- *Speed to target...* Related to the above, once an investment decision is made, it is beneficial to be able to act quickly on it — truly exceptional ideas usually don't just sit there indefinitely. Rather than having to put it to a committee vote, find a large block available for purchase, or address any number of other potential roadblocks, many of the top investors are willing and able to act fast when they identify an opportunity. Again, this becomes more difficult with size, but most investors would agree that having the optionality to decide on and transact in a stock quickly is a definite advantage.

- *... but capacity to slow things down when needed.* The amount of information available to an investor today can often make one feel as though he's drinking from a fire hose, particularly when that information updates every day. Good investors can step back and filter out the day-to-day noise, instead keeping their focus on the key drivers for a stock or market's ultimate return. They keep daily moves in perspective and don't allow fear or greed to dictate their decisions.

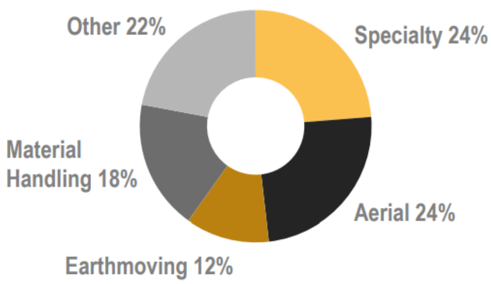
- *Context-specific techniques and knowing when to use them.* Sum-of-the-parts valuations make sense in some circumstances but not others. Ditto for sales and dividend-based valuations. There is no one-size-fits-all technique for making an accurate estimate of intrinsic value, and the best practitioners know when each is appropriate to the situation.

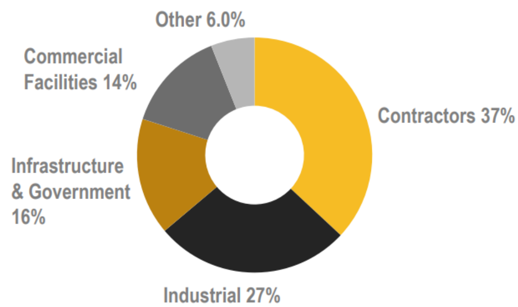
- *Versatile diet.* Many top investors explore a wide range of industries and geographies and are willing to go wherever the opportunities present themselves. Turning over more rocks tends to unearth more gems, with a correspondent improvement in expected portfolio returns. By keeping their universe sufficiently broad, they're able to avoid the "man with a hammer" syndrome.

Like a dragonfly, our Fund will not intimidate with its size. And we will never manage to reach a 95% success rate on our investments. But by using some of the same tactics while hunting for opportunities, we can hopefully continue to improve our process and leverage the advantages we have in our current small, agile state.

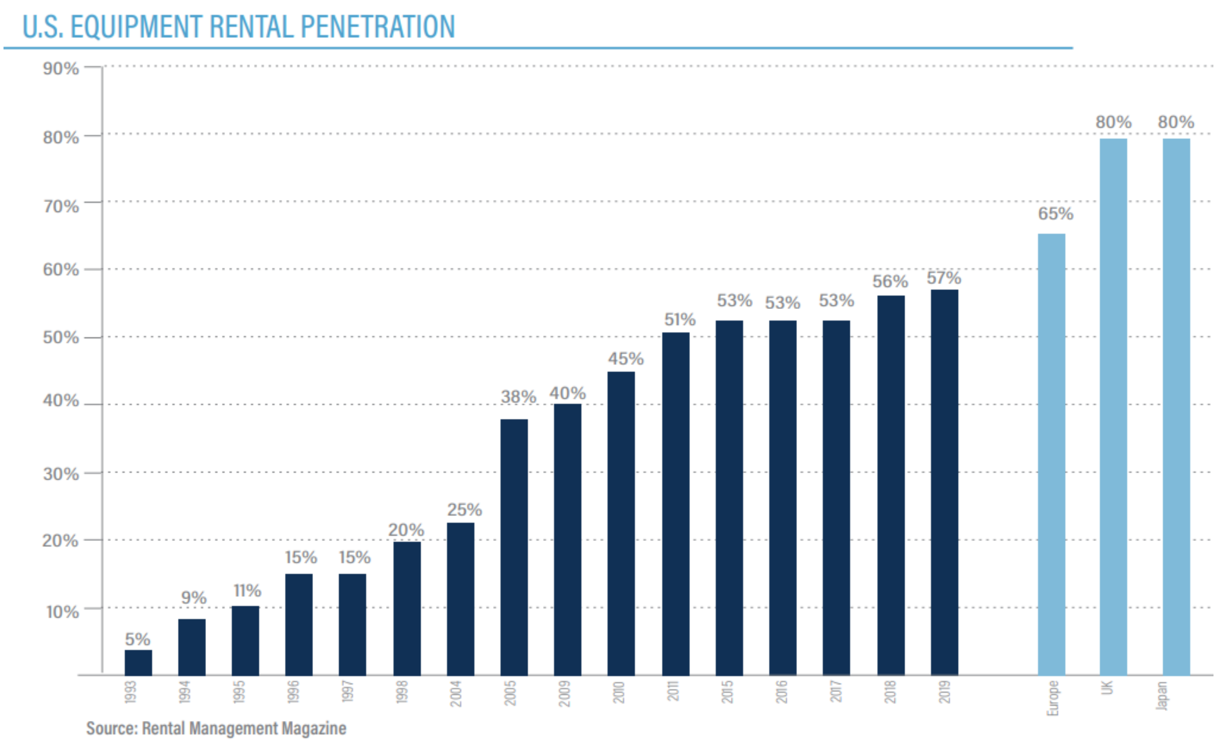
Portfolio Update: Say HRI to a New Position

Herc Holdings (HRI): Herc Holdings is a heavy equipment rental company. It was opened as a division of rental car giant Hertz in 1965 and continued operating as a subsidiary until it was finally spun off by the parent in 2016. Today, HRI has about 400 branches and manages a $6.3 B fleet of machines that is well-balanced across both across equipment type and customer group ([see charts](#) below).

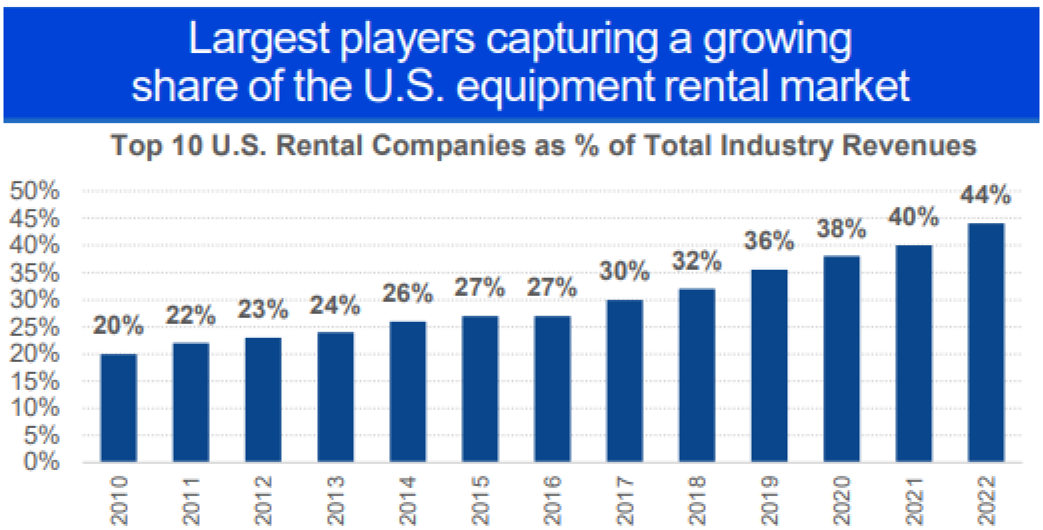




Heavy machinery industrials are an obvious beneficiary of a few large long-term tailwinds, such as increased infrastructure investment and housing shortfalls. Rental equipment providers in particular stand to gain from continued share gains in rental penetration, which has increased consistently in recent decades, but at 55-60% is still far below the 80%+ levels seen in other developed countries such as the UK and Japan.



Scale players such as HRI also have the opportunity for accretive bolt-on acquisitions in what is a relatively fragmented industry; rolling up smaller operators at 3.5-4.5x synergized EBITDA multiples creates value when your stock trades above 10x. These acquisitions allow them to either quickly enter greenfield territories or add density (and thus operating efficiency) to the existing network. As a result, rental companies have consistently gained share of the US equipment rental market (see chart below). The pipeline remains strong throughout the industry, and HRI sees an opportunity for around $500 M a year in strategic acquisitions (versus a $430 M total M&A investment last year), so I would expect this share to continue to expand in the years ahead.



Management seems up to the task of executing on this opportunity. The current CEO, Larry Silber, has been at the helm for nearly a decade, over which time HRI has handily outperformed the indices. He has a background in both industrial operations and private equity, a useful combination in a business where efficiency and thoughtful M&A are important pieces of the puzzle. Executive compensation targets are fairly standard; importantly, however, they include a "returns on revenue earning equipment" metric that deters value-destructive growth for its own sake.

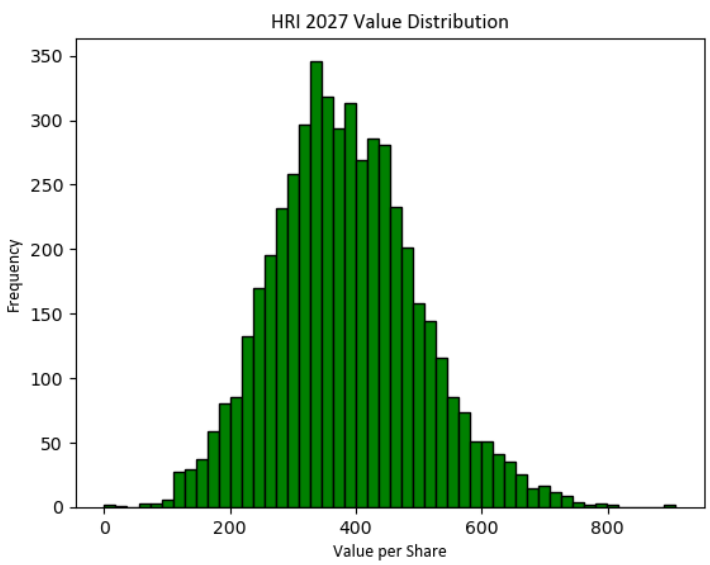
While HRI has done a good job closing the financial gap with competitors United Rentals (URI) and Ashtead (which owns Sunbelt Rentals) since becoming an independent company, we think there are still a few levers that can be pulled to reduce it even more. Beyond the typical scale benefits, additional acquisitions to increase branch density (HRI made 12 in 2023 alone) should allow for overhead leverage and enhanced fleet efficiency. Prioritization of its higher-margin specialty fleet, which is currently less than a quarter of the total, will bear fruit over time as it slowly gains share of the total OEC. HRI's dollar utilization in FY23 was 45%; for comparison, URI finished last year at 57%. Of course, there are some differences in terms of fleet and customer compositions, but these companies rent very similar equipment to very similar end markets. URI has a head start, but there's no reason HRI, under the current team, can't continue to climb toward its levels.

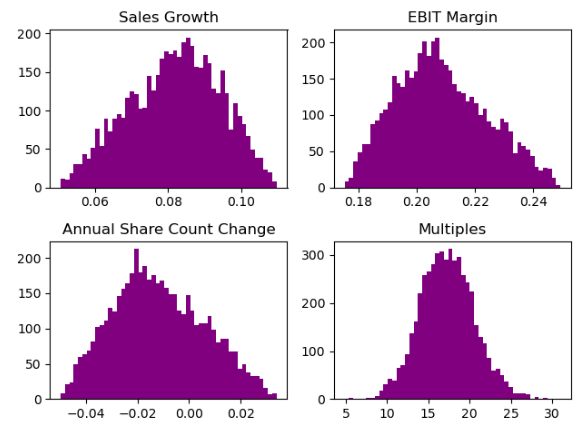
Herc's 2023 results were solid, with 20% revenue growth and 11% EPS growth on a 10% return on capital. This was achieved despite a material drag from its Cinelease business, which offers lighting and grip equipment to motion picture studios. As the industry has moved toward having these items included as part of studio ownership, rather than rented, results in this unit have deteriorated. Rather than moving outside its circle of competence and purchasing studio real estate, HRI has made the prudent decision to instead divest these assets. A sale process is underway, and upon completion, it will immediately boost headline earnings and sales growth figures. HRI has also demonstrated intelligent capital allocation via its shareholder return programs; in 2023, they completed a material buyback (4% of shares) at discount prices while also raising the dividend. We expect the same for 2024 as well following the completion of the Cinelease divestiture should the stock remain range-bound. Net leverage is 2.5x currently, within both historical ranges and HRI's targeted 2-3x band.

Pro forma for the divestiture of Cinelease, the stock seems undervalued on the basis of the remaining operations, which posted 24% sales and 18% earnings growth last year. Indeed, while the broader market sets new records, HRI remains below its all-time high reached in fall 2021 despite having increased EPS by 64% in the two years since then. Trading multiples remain below long term pre- and post-pandemic averages, both on a trailing and forward basis. There will likely be some rental sales deceleration this year as they lap these outsized figures, but the myriad of tailwinds to the industry remain intact, and at 12x 2024 earnings we aren't paying a premium for it.

So what is the business worth? Over time, I have put less emphasis on exhaustively modeling every line item across multiple financial statements, instead trying to prioritize being approximately correct rather than precisely wrong. It seems in general my time is better spent trying to find situations where there are reasonably few key input drivers, making a directionally correct estimate of what those will probably look like in a few years, and then purchasing the ones that offer a discount to intrinsic value/margin of safety and that fit in the portfolio within the makeup of our current holdings. The bottom line is that it seems like HRI should be able to generate both sales growth and operating leverage to produce outsized earnings growth; combining that with the potential for multiple expansion and share count reductions, the equity should have all three value creation engines firing in the years ahead.

To put some numbers around it, if HRI can grow rental revenue at 7-10% a year while continuing to make progress on their efficiency initiatives, we should see earnings of around $500 M by 2027, depending on the ultimate M&A cadence. On 26 M shares (2% reduction annually), this works out to just under $19 in EPS. On a 18x trailing earnings multiple (below both the market and HRI's long-term averages), we arrive at a $350 share price, good for a 30% IRR from here. A scenario analysis, which flexes a few of these key input drivers, suggests this is a reasonable (41st percentile) target.





Thus, much like our UFPT and MYRG ideas, this isn't a particularly complex thesis. Herc is a good company operating in an attractive industry trading at a discount to peers and its own multiples, and there are credible reasons to think that future years will be even better than the current. With a sub-$5 B market capitalization, it's a bit under the radar, but it's likely more investors will take notice as the core business continues to grow and the drag from its money-losing segment is removed. The balance sheet is in good shape, so interim cash flow generation gives management some flexibility around capital allocation, and their track record on that front is strong.

Outlook & Conclusion

While the most famous indices are at new all-time highs, smaller ones remain subdued; like Herc, the Russell 2000 index remains stubbornly below its 2021 highs. This has been difficult at times, as median market cap of our current holdings is far closer to that of the Russell's $950 M than the

S&P's $30 B, but in the longer term, the weighing machine always wins out. The good news is that our companies have executed well in general, and we are finally starting to see some signs of life from the less famous companies we often target. This bodes well for the year ahead, and rate cuts later this year—if they materialize—have generally been a net positive in the months following as well. In the meantime, we will be looking in every direction (though perhaps not all of them at once like dragonflies) for ways to further improve our portfolio's expected return.

I hope everyone's 2024 is off to a good start, and I look forward to writing you again in the summer.

Per Ardua Ad Stella,

Andrew Jakubowski

"In any contest between power and patience, bet on patience."

- W.B. Prescott

Performance Summary:

	4Q 2023	2023	Since Inception
S&P 500	11.6%	26.2%	189.3%
Vanguard Total World Stock ETF	11.3%	22.0%	104.5%
Russell 2000	14.0%	16.8%	89.7%
HFRI Equity-Hedge (Total) Index	6.4%	11.4%	65.8%
Adestella Investment Management	**3.2%**	**17.6%**	**263.7%**