Historically we have written letters to our investors on a semi-annual basis. If you are an avid reader of these missives, you know they tend to be quite thorough and thus require a lot of our bandwidth to put together. Going forward, we will continue sharing these longer letters on a semi-annual basis and compliment them on a quarterly basis, with an abbreviated recap of key transactions and performance drivers.

PERFORMANCE REVIEW

We define top contributors and top detractors as companies having an impact of 100 basis points or more on the portfolio's return for the period. This quarter, we had one top contributor and one top detractor: Activision Blizzard, Inc. and Dollar General Corp.

Top Contributor

If you were not following the saga that was the acquisition of Activision Blizzard by Microsoft, we invite you to breeze through our play-by-play write-up of the merger here: ATVI: Anti-Trust Gone Wild. At the time of this write-up, the Federal Trade Commission (FTC) had just been denied its request for a preliminary injunction, or a request that Microsoft's acquisition of Activision be delayed until the FTC could finish its suit to block the deal. After the FTC's denial, the UK's Competition and Markets Authority (CMA), which previously vetoed the acquisition, announced its willingness to reconsider remedies offered by Microsoft. We will pick up there.

Following the loss, the FTC trudged on. It appealed Judge Corley's denial of the preliminary injunction and lost, then took the case back in-house to its administrative law judge. Why they would do this – we aren't sure. The FTC's administrative proceeding will eventually end up back in the district court where it was previously shot down. It's a losing game.

A month after the CMA showed willingness to reconsider the deal, Microsoft submitted a revised deal for review which included the transfer of cloud gaming rights to Ubisoft. The CMA accepted the revised deal and the deal closed at the originally agreed-upon price of $95 on October 13th.

Top Detractor

In September, publishers named Dollar General the Worst Retail Job in America. The headlines exposed "rat infestations, blocked fire exits, expired kids' food, machete-wielding and watermelon-throwing shoppers and other nightmares" and Dollar General was going to spend a mere $150 million to fix it. The market speculated: "If DG cannot handle its current store base, will it need to slow store growth?" and "Is $150 million really going to be enough?" The wrong answer to either question would be dire. Rather than join the cause to panic sell first and ask questions later, we re-underwrote the position and stress-tested our thesis.

When the pandemic forced us into our homes, many living in urban areas decided to try out the countryside, reversing a decade-long trend of urbanization. According to the US Census from 2021 to 2022, the largest US cities saw the greatest concentrations of residents moving out. For Dollar General, this means that there are now more rural areas to build new stores. So long as there are growing pockets of rural development, we do not see a need for Dollar General to slow store growth. But execution remains a crucial ingredient to DG's success.

In a back-of-the-envelope calculation, the $150 million labor investment equates to about $14 a day per store assuming the investment is split evenly between stores. This shorthand calculation was commonly cited alongside criticisms of DG's store conditions, but it fails to appreciate that not every single store needs a facelift. In June, management began piloting a new strategy called Smart Teams where district managers choose 2-4 of their district's best inventory stockers to clean up the worst stores in the district. After a successful pilot, the strategy was deployed across the store base over the last quarter. We expect the investment to reduce inventory shrink and improve same-store sales, metrics that have plagued the stock this year.

TRANSACTIONS

We exited two stocks in the previous quarter: Netflix and Dollar Tree. When we initiated a starter position in Netflix last fall, we expected the execution of its new initiatives (paid sharing and ad-supported streaming) to be bumpy. We were right in assuming paid sharing and ad-supported streaming would revive subscriber growth, but we were wrong on the timing - it took only four months for Netflix to reach our estimate of fair value and thus we exited the position.

We also exited our position in Dollar Tree in early July. With much of the upside of Dollar Tree's turnaround already reflected in the stock price, we sold the stock and reinvested the proceeds into Dollar General, which we believed was trading at a significantly cheaper valuation. Clearly, we were early, as the stock is much cheaper today.

BOTTOM LINE

We are grateful for your continued trust and partnership. We come into the office each day striving to earn it, and we realize just how fortunate we are to have such a wonderful group of like-minded, long-term investors who place their confidence in us. You enrich our network, strengthen our competitive advantage, and just make our work all the more enjoyable.

As always, please feel free to reach out at any time with questions. We enjoy hearing from you.

Sincerely,

ABOUT BROYHILL

Broyhill Asset Management is a boutique investment firm, initially established as a family office in 1980 and guided by a disciplined value orientation. Founded in the foothills of North Carolina's Blue Ridge Mountains, we operate outside of the fray and invest with a rational, objective, long-term perspective.

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Performance is calculated using time-weighted rates of returns, net of fees. Since these platforms report returns to Broyhill gross of fees, in order to report net returns, a 1.5% annual management fee has been subtracted from gross reported returns. This methodology has also been applied to the extracted attribution returns. Average position size is calculated from the average capital invested divided by the average portfolio capital in fully invested accounts.

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