February 7, 2022

Dear Partners and Friends,

Steel City Capital (the "Partnership") returned 8.4% in 2021, net of fees and expenses. During the year, the Partnership's long book contributed 9.2% to returns. Long returns were dominated by Anterix (discussed in further detail below) while several of our other top positions barely budged despite solid operational performance and strong financial metrics. The Partnership's short book added 2.7% to returns during the year. Considering the large advance of the market and the relatively modest size of our short book, I am satisfied with this outcome. The Partnership ended the fourth quarter with gross long exposure of 92% and gross short exposure of 17%.

	Steel City Capital Exposure & Returns		**Index Returns**	
	Average Net Long	Net Return	S&P 500	Russell 2000
4Q 2021	75%	(2.0%)	10.7%	2.0%
FY 2021	65%	8.4%	26.9%	14.5%
Since Inception (Annualized) [1]	59%	8.7%	16.9%	10.6%

1. Reflects returns since Steel City Capital's launch on May 21, 2018.

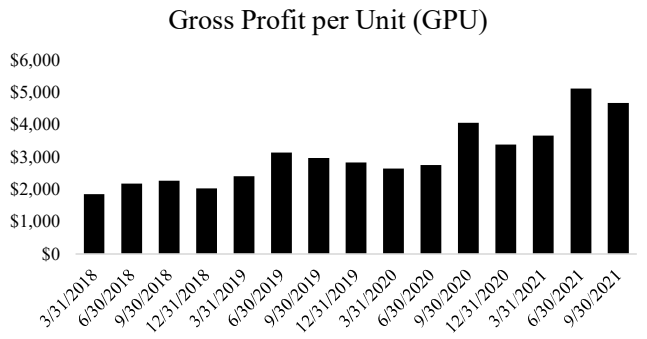
Without naming names, I noticed a curious theme among a cohort of other managers (ranging from "emerging" to well-established) who I follow from a distance: many wildly outperformed in 2020, but posted negative returns in 2021. Their results largely turned negative in the second half of last year, just as the Federal Reserve retired the adjective "transitory" from its vocabulary, expectations for inflation became more deep-seated, and rates began to rise. In certain cases, these managers have been on the other side of our short positions. I don't begrudge them (or their clients) their successes, but I can't help but wonder if their strong historical returns reflected little more than luckily timed trades into a market juiced by unsustainably low rates and teeming with speculative excess. I also can't imagine they've fared much better thus far in 2022. Time will tell. But the totality of the situation does bring to mind the old quote about not knowing who is swimming without their trunks until the tide goes out…

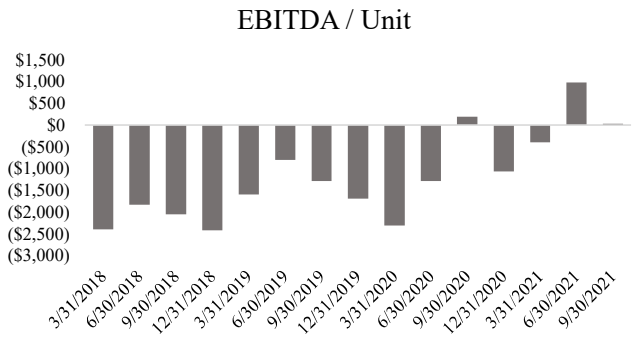
A prime example is **Carvana (CVNA)**, a company of which I have been critical for some time. From the bulls, there's been a lot of slobbering over things like customer experience (if you consider rampant issues with title transfer in multiple states a hallmark of a positive customer experience) and blind faith put in the company's long-term projections to justify today's valuation. They point to positive trends in gross profit per unit (GPU) and EBITDA per unit as signs the company is successfully scaling.

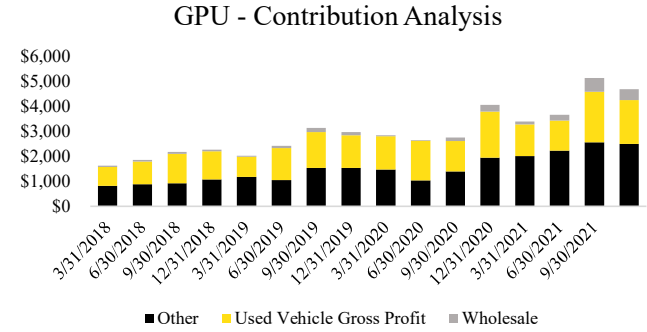
But what has driven the improving unit metrics?

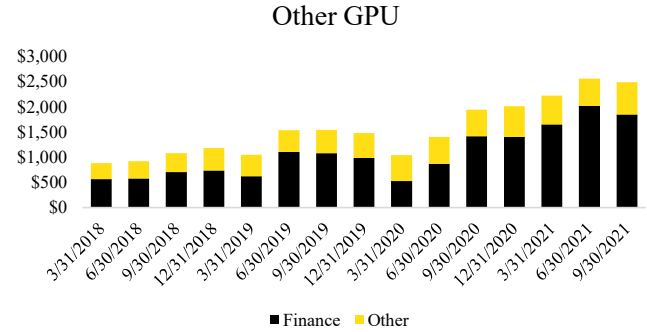
A peek "under the hood" shows that while vehicle GPU (the difference between the sale price of a vehicle and what CVNA has paid to acquire and recondition it) has remained relatively static, "Other" gross profit per unit has expanded

significantly since the onset of the pandemic. And what's behind this increase of "Other" gross profit? This has been dominated by finance related income – specifically gains on the successful securitization of customer loans. Well – what drives finance income / gains on sale? Two factors: interest rates and loan size. Until recently, interest rates were plumbing all-time lows; at the same time, the price of used vehicles reached all-time highs, driving elevated loan balances on vehicle purchases. The combination super-charged CVNA's finance profits. But as I "go to print," the yield on the 10-year treasury is at its highest level since late 2019 and there are some signs that used vehicle prices have peaked. This partially explains CVNA's retreat from its highs, but I think there's still a ways to go. More generally, I think unprofitable growth companies and other pandemic darlings will continue to struggle going forward.









Source: Company filings, Steel City Capital estimates

The Partnership's top position continues to be **Anterix (ATEX)**, which is the largest owner of 900 MHz spectrum in the United States. The company is in the process of monetizing its spectrum through sales and leases to utilities to support their ever growing data and communication needs.

ATEX just provided an investor update several days ago. I dialed into the call with an elevated degree of anxiety/fear that we were about to repeat the debacle of September 2020. At that time, expectations were running high for a contract announcement that hadn't materialized by the time of the call and shares were subsequently clobbered. Going into the call this past week, the company still had not delivered on its guidance to sign at least $200 million worth of contracts by 3/31/2022, and any *material* shift around this guide would have undoubtedly caused a repeat of the late 2020 price action.

While management opened the door to *some* slippage beyond their 3/31/2022 target, they also very bullishly framed contract execution as a matter of "when and not if" and backed-up their confidence with commentary that their "Phase 3" pipeline – which comprises contracts in the "closing phase" – has expanded to ~$400 million in value. Frankly, I couldn't care less if the contracts are announced on 3/15 or 4/15 (as long as it's this calendar year). What's important to me is the certitude of "when and not if."

Management also committed to returning the net proceeds of future contracts to shareholders through an expansion of the existing buyback program and other "tax-efficient" means. *Would they really be talking up increased capital returns if there was concern around contract execution? Probably not.*

A deluge of capital could soon be coming back to shareholders. The math is as follows: Management reaffirmed its guidance for the receipt of $300-$500 million of contracted proceeds through the end of FY'24 (ended 3/31/2024). Approximately $75 million has already been received, leaving $225-$425 million of proceeds during the next two years. Over this same period of time, combined OpEx and CapEx will run at ~$70 million p.a. Including the balance of expenditures this fiscal year, this sums to ~$165 million of future outflows. Cash on hand is ~$127 million. Netting everything together, ATEX should have anywhere from $190-$390 million of potential capital to return to shareholders over the next several years compared to a $985 million market cap. And it's important to remember, this is before 1) future cash proceeds from deals contemplated in guidance (proceeds received *after* 3/31/2024) which should be in the ballpark of $1.0 billion and 2) future spectrum sales not included in guidance.

The Partnership recently established new positions in **Suncoke Energy (SXC)** and **Green Dot (GDOT)**. I have included a full-throated thesis on SXC as an appendix to this quarter's letter. As for GDOT, the company is a collection of old-school money access/money movement operations as well as new-school "FinTech" offerings. It is perhaps best known as the banking partner behind Wal-Mart's prepaid MoneyCard debit card. Pre-paid debt is among the least sexy financial service offerings in the market and I also suspect there's a degree of snobbery among the investing class that its primary customers sit on a lower socio-economic rung. I think these factors are contributing to today's opportunity.

One of the emerging trends in the "FinTech" space is integration of banking and payment services by consumer facing companies. The idea is that by integrating these services, companies can collect more data on spending patterns, drive a "stickier" customer relationship/brand loyalty, and ultimately drive more sales. At the same time, such consumer facing companies either can't, or won't, build out these platforms on their own. Doing so would require, among other things, 1) a specific degree of technological expertise and 2) ownership and control of a banking institution. The latter of the two factors – owning a banking charter – is a significant deterrent to "going it alone." Owning a bank requires costly and time consuming compliance (AML/KYC, etc.) and ongoing regulatory scrutiny. Over the years, a long list of household names with financial services ambitions (including Wal-Mart) have either tried and failed, or proactively decided against, owning and operating a bank. This is where someone like GDOT comes in, supplying the technical know-how *and* offering use of their banking charter without the headaches of actually becoming a regulated bank. In industry parlance, this has come to be known as "Banking-as-a-Service" or BaaS, for short.

GDOT's relationship with Wal-Mart has shifted more in the direction of BaaS than "just" pre-paid debit with Wal-Mart last year converting all of their existing prepaid accounts to demand deposit accounts intended to function similarly to a traditional banking account. MoneyCard now comes complete with an app and various features like overdraft protection, early payday, and cash back on Wal-Mart purchases. Beyond Wal-Mart, GDOT has expanded its BaaS offerings with other large brands. Another interesting use case is its Partnership with Intuit's QuickBooks. When you open a new QuickBooks business account, you're given the option to open a QuickBooks branded business checking account at the same time, which is powered on the back-end by GDOT. There's a lot of white space out there for GDOT to work with additional consumer facing companies to integrate payments and other banking services into their platforms. I'll acknowledge that GDOT is far from the only "player" in the arena, but the mere fact that they've already bagged a number of large name clients on the BaaS side (Intuit/QuickBooks, Apple/Apple Cash, Uber/Uber Checking) at least suggests their capabilities and offerings have passed an intense amount of scrutiny.

In terms of valuation, GDOT currently trades at ~$30. The company is free cash flow positive, has ~$3.00/share of excess cash at the holding company level and another ~$1.50/share of excess capital in Green Dot Bank. At the beginning of 2021, the mid-point of adj. EPS guidance was $2.10. I like to start here because this was a relatively clean number that didn't assume any benefits from another round of stimulus payments or the extension of unemployment benefits (both of which provided a tailwind to earnings). From this level, there are a number of drivers that should push earnings higher in the coming years including:

- Internalization of certain card processing that, come 2023, should add $0.30-$0.35 to EPS;
- Repricing of certain early BaaS contracts away from a fixed-fee structure that would enable GDOT to participate in some of the upside associated with account balance and spending growth;
- New white-label BaaS contracts with consumer facing companies;
- Potential growth in Go2Bank, the company's own "neobank" offering; and
- Increased profitability from Green Dot Bank.

This last driver – increased profitability form the company's bank – hasn't garnered a lot of focus from investors. In 2019, GDOT bank earned $33 million of net interest income on average assets of $1.6 billion. As we enter a new tightening cycle, the bank's asset balance has more than doubled in size to $3.9 billion, thanks to stimulus and unemployment benefits. Without making heroic interest rate assumptions, the larger asset balance alone should benefit interest income. Additionally, the bank could pursue Fed approval to expand into additional lending products (i.e. credit cards) which would have a dual benefit of 1) increasing interest income and 2) generating credit related interchange fees (which are higher than the debit interchange rates from which the company generates a meaningful portion of its revenue). I have no doubt that GDOT's management team *and* the activist involved with the company are looking at this.

All told, there's probably a reasonable path to EPS reaching $3.00+ in the coming years, putting shares well below a 10x P/E multiple. The company is currently run by industry veteran Dan Henry. Henry previously ran, and sold, GDOT's primary competitor, NetSpend. He was recently joined at the company by George Gresham, who was appointed to the roles of CFO *and* COO *and* joined GDOT's board. Gresham was Henry's CFO at NetSpend at the

time of its sale and received a compensation package at GDOT that would pay out handsomely if shares were to materially re-rate *or* if the company were to be sold…which could very well be in the cards because of activist involvement.

TL;DR? GDOT is cheap and there is a catalyst.

On **Liberated Syndication (LSYN)**, I sound like a broken record. Or perhaps more aptly, a broken podcast. The company and its shares continue to be stuck in the mud. On perhaps the only positive note, the Board moved to cancel 7.5 million shares that it contends were fraudulently issued prior to the company's separation from FAB Universal Corporation. The move should effectively shrink LSYN's share count by 22%. I commend the Board for doing the right thing.

On a not-so-positive note, LSYN remains woefully delinquent on their filings and I believe the restatement process has been mismanaged. Last quarter, regarding the timing of financials, I said the following: "*Investors are continuing to fly blind with financials expected no earlier than December 1, 2021, although I think it's more likely the issue drags meaningfully into 2022 before shares regain compliance and are re-listed.*" **I have actually come to believe that even this outlook was overly optimistic, and my base case for the company becoming current has now slipped to 2023.**

I do believe there are some "self-help" initiatives the company could pursue, and I have communicated as much to the management. This includes providing an update on sales and cash figures – which is permissible despite their delinquent filing status – and even holding an investor day to provide an update on the status of the business. Investors want to know: Are hosting subscriptions growing? How fast in AdvertiseCast growing? How is the integration progressing? What is your product roadmap? I certainly understand and respect management's hesitation of further running afoul of the SEC, but I have no doubt in my mind that they could provide a meaningful amount of information *if* they felt it was important.

So why continue to hold shares? I've wrestled with this one constantly and am keenly aware of my decision making being clouded the "sunk cost fallacy." The truth is, I continue to think there's a reasonable expectation that we can ultimately exit our investment at a level well above our average entry price of $3.20.

Using the company's new share count, market capitalization is roughly $93 million (@ a $3.50 share price). At 9/30/2020 (I know, ages ago…) cash was $13.8 million. Since then, the company raised a $25 million PIPE; closed the $19.1 million AdvertiseCast and $1.2 million Glow acquisitions; paid $1.65 million as part of a settlement with former CFO Busshaus; and paid another $4.5 million to settle VAT/Withholding/Sales tax liabilities. I also assume the company fully paid down the $2.8 million Term Loan balance outstanding at the time of the PIPE's closing (as required per the credit agreement) and has paid another $1.5 million of penalties to PIPE shareholders for failing to register the shares. Lastly, I assume any free cash the company generated in the past year was allocated to professional and legal expenses associated with the ongoing restatement and the Busshaus litigation. So, give or take, I estimate the company has about $8 million of cash on hand, bringing LSYN's market cap to $85 million, net of cash. Against this, I think the company is dong about $6 million of free cash flow, which should grow in the coming years as

AdvertiseCast continues to grow and when the company begins passing sales and VAT through to customers at checkout.

What this means is – looking forward only from today, which is all that matters – LSYN is trading at a low-to-mid-teens P/FCF multiple, which isn't all that demanding for a capital light business in a growing industry. This isn't all that different than the investment thesis when I first established a position several years ago. For that reason, I am continuing to sit tight.

* * * * *

I know these updates are long, but I believe it is vitally important for partners and prospective partners to understand my thought process and rationale for making investments. I am available for any questions, comments, or concerns that you may have.

If you are an accredited investor who would like to learn more about becoming a partner, please reach out to me and we can arrange a time to have a more in-depth conversation. Please also know that even if an investment in the Partnership isn't for you, the highest compliment that you can pay me is an introduction to someone who might be a good fit.

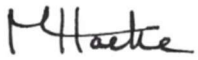
I want to thank those of you who have already joined as partners of the Fund. I am grateful for the opportunity to grow your assets alongside mine and appreciative of your trust.

"You only find out who is swimming

naked when the tide goes out."

- Warren Buffett

Sincerely,



Michael G. Hacke, CFA
Steel City Capital Investments, LLC

Appendix – Suncoke Energy, Inc (SXC) Investment Thesis

Suncoke (SXC)

Suncoke owns five cokemaking facilities in the U.S. capable of producing 4.2 million tons per annum (mtpa) of blast furnace coke. Coke is a key raw material used in the process of producing steel via the blast furnace method. In addition to its cokemaking operations, SXC owns a collection of marine terminals, the largest of which is the Convent Marine Terminal (CMT) in Louisiana. CMT has the capacity to transload 15 mtpa of coal and other industrial materials. In 2020, CMT accounted for 55% of U.S. thermal coal exports from the U.S. Gulf Coast and 15% of total U.S. thermal coal exports.

While the broader steelmaking industry recently benefitted from all-time high steel prices, resulting in record production levels, growing cash flow, and improving balance sheets, SXC has continued to trade with a free cash flow yield in excess of 20%, reflecting considerable concern about the company's prospects. I believe there is a broad misunderstanding of the SXC story driven in part by shallow analysis of the company's business model and cash flow prospects. I believe fair market value ranges from $14-$17, representing upside of 84-122% from current levels. What's more, SXC represents an attractive takeout target for industry-consolidator Cleveland Cliffs (CLF), which at a minimum provides downside protection, but also offers a potential catalyst for value realization in the future.

There are at least four factors giving rise to SXC's current mispricing:

1. Generalist investors don't know the difference between metallurgical coal (also known as coking coal) and coke. After posting this thesis to an internet investment community, I received the following question: "*are there any life of resource worries contributing to the very high free cash flow yield?*"

   This was a misguided question. **Suncoke does not mine metallurgical/coking coal. The company does purchase met/coking coal from third parties, which it then processes into coke**, which is a principal raw material used in the blast furnace steelmaking process. Coke is produced by heating the met/coking coal in a refractory oven, which releases certain volatile components from the coal, thus transforming the coal into coke. **Because Suncoke does not mine its own met/coking coal, the company does not have any life of resource worries.**
2. Another commenter stated, "*how correlated is this to coke prices […] my experience with so many commodity names like this is that they simply fluctuate with the spot price […]*"

   Perhaps a quick skim of SXC's financials causes investors to misjudge the company's business model, commodity exposure, and overall risk profile. Revenue is volatile and SXC has never reclaimed its previous sales peak of $1.8 billion generated in 2012. This causes prospective investors to incorrectly conclude that SXC is exposed to declining demand, commodity price swings, and cash flow volatility. In reality, SXC primarily produces coke pursuant to take-or-pay contracts that contain pass-through provisions incurred in the cokemaking process, *including* coal and coal procurement costs. This is why revenue fluctuates as much as it does, *lending to the appearance of commodity exposure*. In reality, changes in the cost of met/coking

coal – higher or lower – are simply passed through to customers. This cost-pass-through mechanism, coupled with the predominantly take-or-pay nature of SXC's contracts, contributes to steady and visible EBITDA generation.

3. Prospective investors are concerned about the maturity of several of the company's take-or-pay contracts over the next several years. Such concerns are overstated for a variety of reasons. SXC's main customer, CLF, has insufficient internal cokemkaing capacity to support its production targets, and a structural shortage of domestic cokemaking capacity means SXC is its only potential source of supply. Additionally, CLF's blast furnace at Indiana Harbor (which is the largest blast furnace in the western hemisphere and SXC's single largest contract) relies on waste-heat output from SXC's adjacent coke battery. If CLF fails to renew this contract when it expires, it wouldn't be able to produce steel in Indiana Harbor. This is highly unlikely given the importance of maximizing production in order to absorb fixed costs.
4. SXC is likely being shunned by an increasing number of investors in the current ESG-conscious environment. Cokemaking is a relatively dirty process. Additionally, the company's marine terminals play a vital role in sustaining thermal coal consumption both domestically and abroad.

Company Overview & Detailed Analysis

The whole concept behind SXC's existence is similar to what semiconductor companies have done over the years by going "fabless." The term "fabless" means that the company who designs and sells semiconductor chips doesn't actually manufacture them. The fabrication is outsourced to a third-party foundry. In doing so, the chip companies have swapped up-front capital investments for ongoing operating expenditures, all in pursuit of freeing up capital and improving returns on invested capital. (The concept is also similar to what companies are doing by shifting IT resources to the public cloud.) In SXC's case, the main U.S. blast furnace operators (historically U.S. Steel, ArcelorMittal USA, and AK Steel) contracted with SXC for their coke needs on a plant-by-plant basis. By forgoing up-front investments in coke batteries, the companies bought themselves incremental financial flexibility in the highly cyclical and capital intensive steel industry.

Because steel is a cyclical industry and SXC isn't in the business of doing favors for anyone, they require their customers to enter into contracts that have two favorable characteristics. First, they enable SXC to pass through their operating costs including coal and coal procurement (so there is no direct commodity exposure), operating and maintenance expenses, and outbound transportation, *plus* a fixed-margin per ton of coke. Second, the contracts are take-or-pay, meaning that even if a customer doesn't take delivery of a plant's coke, SXC is still entitled to the same cash flow they would have generated had they produced at full capacity.

SXC has had a rough go in the market since becoming publicly traded. The company suffered from operational issues that required a costly rebuild of one of their cokemaking furnaces. Prior management pursued a silly foray in the world of MLPs in the mid-2010s. And for much of the last decade, global steel markets were depressed by low price exports from China. Because a take-or-pay contract is only as strong as your customers' balance sheets, there were considerable concerns about each of SXC's customers.

Today, the marketplace looks considerably different, and I'm staking the claim that *past performance is not indicative of future returns.* Tariffs have curbed imports from China, and more recently, that country announced output reductions in order to meet environmental and electricity needs. Domestically, iron-ore producer Cleveland Cliffs forward-integrated by acquiring two of SXC's customers: AK Steel and ArcelorMittal USA. CLF is expected to account for approximately two-thirds of SXC's cokemaking capacity in 2022. **As such, the SXC story is largely one of customer credit risk. Tuck this idea away, I'll revisit it later.**

With steel prices remaining strong (albeit down from all-time highs), CLF has been running its blast furnaces near full utilization. The company has annual blast furnace steel production capacity of 19.6 mtpa, which requires ~7.8 mtpa of coke. CLF reports having 3.9 mtpa of captive cokemaking capacity, leaving them short another 3.9 million tons. **And here's the kicker: there is literally no one else they can look to other than SXC to fill this void**. Outside of CLF's 3.9 mtpa of captive capacity, the only other two scaled producers of coke in the U.S. are SXC (at 4.2 mtpa) and competitor U.S. Steel (at 4.3 mtpa, which is shrinking to 3.6 mtpa by FY'24). Who else are they going to call except SXC?

State	City	Company	Capacity (tons per year)	Owner	Notes
Alabama	Tarrant	ABC Coke (Drummond Company)	730,000		Foundry
	Birmingham	Bluestone Coke	305,000		Foundry
Illinois	Granite City	Gateway Energy and Coke Company	650,000	SXC	
Indiana	East Chicago	Indiana Harbor Coke Company	1,220,000	SXC	
	Burns Harbor	ArcelorMittal	1,371,870	CLF	
Michigan	Ecorse	EES Coke (DTE Energy Services)	1,000,000		
Ohio	Middletown	AK Steel		CLF	
	Middletown	Middletown Coke Co.	550,000	SXC	
	Warren	ArcelorMittal	500,000	CLF	
	Haverhill 1	Haverhill Coke Company	550,000	SXC	
	Haverhill 2	Haverhill Coke Company	550,000	SXC	
Pennsylvania	Monessen	ArcelorMittal	370,000	CLF	
	Clairton	U.S. Steel	4,300,000	X	700,000 tons out of service permantly by FY end 2023
Virginia	Vansant	Jewell Coke Company	720,000	SXC	
West Virginia	Follansbee	AK Steel (Mountain State Carbon LLC)	1,535,000	CLF	
Total Nameplate Cokemaking Capacity			**14,351,870**		
- Foundry			(1,035,000)		
- Canada Exports			(600,000)		
Effective Domestic Capacity			**12,716,870**		
Owner					
SXC			4,240,000		
CLF			3,776,870		
X			4,300,000		
Total			**12,316,870**		

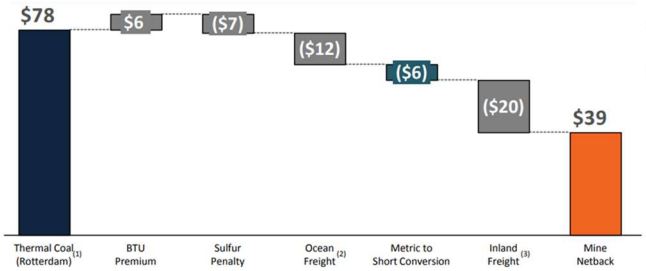
Source: American Coke and Coal Chemicals Insitute, Steel City Capital

One of the prospective risks cited by bears is the 2023 contract expiration at CLF's Indiana Harbor facility covering ~1.2 mtpa of coke. Leaving aside the argument above ("Who ya gonna call…"), there's an added layer of protection baked into that agreement that make it all but inevitable the contract will be renewed. Coke production involves the

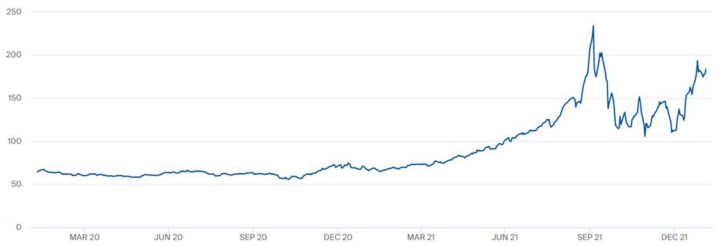
baking of coal in large ovens at several thousand degrees Fahrenheit, transforming the coal into coke. In an industrial process like steelmaking, it would be inefficient to let that heat go to waste. At Indiana Harbor, the high temperature exhaust from SXC's coke battery is transformed into heat and electricity for use at the steel plant next door. The heat and exhaust from the SXC coke battery offset 50% of Indiana Harbor's process heating needs and 25% of its power requirements[1]. This level of operational integration virtually guarantees the contract will be renewed.

Before moving to valuation, I want to touch on CMT – the company's coal export terminal in Louisiana. This puts SXC in a unique position to profit from the current global energy crisis that has, among other things, resulted in seaborne coal prices spiking. Historically, CMT operated pursuant to a take-or-pay agreement with Illinois Basin coal producer Foresight Energy, but Foresight filed for bankruptcy protection in 2020 and the take-or-pay contract was rejected during the bankruptcy process. Frankly, the timing couldn't have been more advantageous for SXC, who is now in a position to charge much higher rates just as coal exporters are enjoying the type of profits they haven't seen in years. Below, the image on the left is from a 2017 SXC presentation showing mine-mouth economics for Illinois Basin producers exporting coal to Europe at a delivered price of $78/ton. On the right, the price chart illustrates that delivered prices into Europe recently peaked more than 3x higher than levels enjoyed in 2017 and remain elevated at ~$155/ton. Notwithstanding decarbonization efforts in the European Union, my operating thesis is these elevated prices will remain for some time. The EU sleepwalked into an energy crisis that won't be resolved overnight, and any conflict between Russia and Ukraine would have knock-on effects to prices as well.

Thermal Coal Mine Netback – ILB to Rotterdam



API2 Rotterdam Coal Futures – February 2022



Source: SXC Investor Presentation; ICE

Valuation

At its current price of $7.60/share, SXC trades at a P/FCF multiple of ~5.4x, equating to a FCF yield of 19%. Allow me to provide some context around this valuation, starting with SXC's secured bonds due 2029. They were issued in June 2021 with a coupon on 4.875% and currently trade with a yield of 5.4%. Normally, equity investors would demand a couple hundred basis points of extra compensation for the added risk, not *1400* basis points.

Another way to look at SXC is through the lens of how the market is pricing CLF credit risk. In February 2021, CLF issued unsecured notes due 2029 at a coupon of 4.625%. The notes currently trade a hair below par and are priced to

[1] https://chptap.lbl.gov/profile/44/Cokenergy-Project_Profile.pdf

yield 5.1%. As I stated above, **the story of SXC is basically one of customer credit risk given its concentrated exposure to CLF.**

Think about this for a second: CLF's take-or-pay contracts with SXC flow through their P&L as o*perating expenses*. In that sense, they should be considered marginally *safer than* CLF's financing/interest expenses. So if the market is pricing CLF's long-term credit risk at 5.1%, and its operational payments to SXC are *at least as safe, if not safer than its interest payments,* shouldn't investors be discounting SXC's equity cash flows at a similar rate? SXC's bondholders are – so why not the equity owners?

Going forward, I see two separate ways for SXC re-rate higher. The first would be for the company to resume shareholder capital returns within the next year. The company has cleaned up its balance sheet by terming out its debt to 2029 and recently forecast another year of robust free cast flow generation. After paying down their revolver this year (not the worst idea), I anticipate the company will begin returning more capital to shareholders.

The second would be an acquisition of SXC by CLF. CLF – under the direction of its bull-in-a-China-shop CEO Laurenco Gonclaves – has been quite active in executing a vertical consolidation strategy. The purpose of the vertical consolidation spree is to reduce operating costs, which is vital for anyone participating in a highly competitive, price-taking, commodity industry. The combination of CLF with its former customers AK Steel and ArcelorMittal USA was all about eliminating the cost of the customers' take-or-pay contracts for CLF's iron ore. And more recently, CLF announced the acquisition of a scrap steel processor and distributor which should reduce the cost of CLF supplying its electric arc furnaces with prime scrap. By my math, CLF's annual take-or-pay contracts with SXC cost the company ~$150 million. A combination would eliminate that.

How much could CLF potentially pay for SXC? Here's how I bookend the analysis. At the low end, CLF's $775 million acquisition of the scrap steel processor and distributor represented a 7.8x EBITDA multiple. At a similar valuation, SXC's equity value would be ~$14/share, almost double its current $7.60/share price. On the high end, I frame valuation around the following question: "*At what level would CLF be indifferent between to paying SXC $150 million per year pursuant to its take-or-pay contracts or acquiring the company outright*?" Assuming an incremental borrowing cost of 5.0%, CLF could pay $2.0 billion (enterprise value) and come out break-even from a cash flow perspective. This equates to ~$17 per share of equity value. Of course, a buyout would *never* happen at this level (CLF would want to make the deal financially accretive), but I think it's helpful to understand the theoretical maximum that CLF could pay.

$MM	Status Quo	PF Acquisition
CLF OpEx to SXC	(150)	
Non-CLF Coke EBITDA		40
Logistics EBITDA		20
Acquired SG&A		(20)
Acquired CapEx		(90)
Interest on $2.0Bn of Debt at 5.0%		(100)
Total	**(150)**	**(150)**
Enterprise Value		2,000
- SXC Debt		(600)
Equity Value		**1,400**
Shares (millions)		83
$/share		*$16.87*
% upside from current price		*122%*

Source: Steel City Capital estimates

Risks

I think the key risk is some sort of headbutting contest with CLF's CEO Laurenco Gonclaves regarding contract renewals. I don't see it outside of the realm of possibilities that Gonclaves plays hardball and initially refuses to renew maturing contracts with the hope of knocking back SXC's share price in order to make an acquisition more financially attractive to CLF. I think this is partially mitigated by the fact that SXC's sales to CLF comprise somewhere in the neighborhood of 50% of its CLF's coke needs. Said plainly, CLF has significant supplier concentration risk. On balance, SXC does have a considerable degree of negotiating leverage to counter any pressure that Gonclaves might try to apply.

Another key risk is the potential non-renewal of SXC's contract with US Steel (X) at its expiration in December 2024. This is SXC's only non-CLF contract. At face value, X's ongoing shift away from blast furnace production to electric arc furnace production is a negative for this contract. However, I don't think it's as simple as assuming the contract goes away completely. EAF production relies on prime scrap steel as part of its production process, and growing domestic EAF capacity is contributing to upward price pressure on this key input. As a result, EAF producers are increasingly looking for alternative metallic inputs, including pig iron. On a ton-for-ton basis, pig iron production requires the same amount of coke as steel. To meet its metallic needs at the Big River EAF in Arkansas, X is already installing a pig iron caster at its Gary Works facility in Indiana. However, this first pig iron caster will only supply one quarter of Big River's pig iron needs (after accounting for the expansion of Big River), leaving open the possibility that X will install an additional pig iron caster. Granite City is an ideal location as it would support cost efficient shipment of the product down the Mississippi River to the new EAF.

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