Dear Fellow Investors,

Our investments had another strong year with our portfolios up 60-70% (net) for the year after being up 40-50% the prior year. 2021 was also a great year for stock markets in general with the S&P 500 up 28.7%. Since inception (June 2018), managed portfolios have returned in excess of 445% over 3.5 years, vs. 85% for the S&P 500.

As I've discussed previously, the growth due to investment performance and number of client accounts led me to convert the management structure from SMAs to an investment fund. That process was completed in June 2021, and I'll just say I'm happy to have that behind me. I greatly appreciate everyone's patience in the transfer process as it was a bear at times. Luckily we won't have to deal with that again, and I'm very happy with how the current structure will scale long term. For 2021 and going forward, instead of receiving 1099s from our broker (although you will receive one covering 2021 first half activity), taxable activity will be reported on a Schedule K-1 for each account. Your K-1 will be prepared by the CPA firm handling the fund's audit and taxes, Elliott Davis. If you have any questions on this change or anything related to taxes, please don't hesitate to reach out.

As I discussed in last year's letter, I'm finding many opportunities overseas as I dig through markets that are under the radar to investors and analysts. In my opinion, these less-covered corners of the market are the most attractive for us due to the fund's small size and unrestricted investment mandate. Finding underfollowed companies with attractive economics, good growth prospects, solid balance sheets, and strong free cash flow is the part of our process I enjoy the most and one of the most important in determining our long term returns. I'll outline a couple new investments we've made recently that I am able to talk about below.

In terms of the broader market and economic picture in late 2021 and early 2022, the market has been correcting due to fears of continued inflation and the hawkish Fed policies it may cause. Companies valued at very high multiples have been hit especially hard, but luckily that's not a sector of the market we participate in. Also, a more volatile market in conjunction with less optimism should create more actionable opportunities for us to put capital to work. As always our focus will remain on the long-term picture and searching hard for undervalued opportunities regardless of macroeconomic conditions.

I sincerely thank you for entrusting me with your hard-earned resources. With patience, focus, and a process-oriented mindset, I'm confident our portfolio returns will continue to exceed the broader market over the long-term. As always, feel free to reach out anytime with questions or concerns.

Best Regards,

Below I've included a short overview of two of our investments and current holdings as well as a recent Investor Club write-up I was featured in as a Top 50 Microcap Investor:

Azeus Systems Holdings (SGX:BBW)

Azeus Systems Holdings is a Singapore-based company that has undergone a transformation from an IT services provider to a market leader in a fast growing Enterprise SaaS market. Through years of working on large projects with national governments, Azeus developed experience and a reputation for managing complex projects and developing software while meeting the highest standards for cybersecurity. Years ago, Azeus started a new software business, Convene, that built on this experience and expertise. Convene is a board portal software solution that helps organizations around the world conduct and manage board meetings (virtually or in-person) efficiently and securely. Azeus' new Convene business has all of the best qualities of a sticky Enterprise SaaS business (negative churn, >90% gross margins, extremely attractive returns on incremental capital) but has been hidden from investors due to consolidation with the legacy IT services business. Convene has grown at a very impressive rate the past 5 years, with annual revenues climbing from under $1M USD in FY16 to nearly $15M USD for FY21.

Convene is widely loved by customers as well, with their board portal software consistently ranking at or near the top among board management software offerings in terms of ease of use, quality of support, and perceived value. The best part of all is the valuation, even when considering the recent pull-back in SaaS valuations. Azeus trades at only 7x EV/TTM Revenues even if one assumes the IT services business is worthless. Top Tier Enterprise SaaS comps, albeit much larger, trade at 20-30x EV/NTM Revenues, with the median multiple at 10x. Nearly all of these comps are unprofitable as they spend voraciously to grow while Azeus has been profitable from the beginning, sports look-through cash operating margins of 40-50%+, and is generating substantial FCF. The only criticism investors may have of Azeus is their hesitancy to spend more on Sales and Marketing to obtain customers faster. Interestingly, job postings in a number of geographies in recent months suggest they may be getting more aggressive in using their capital to grow their customer base and development capabilities.

Four Corners Inc. (OTC:FCNE)

Four Corners Inc. is the largest bingo and charitable gaming supply distributor in Texas. The business is profitable, generates substantial cash, and needs very little invested capital. Because of this, Four Corners pays out nearly all of its FCF via quarterly dividends, currently yielding nearly 11%. Despite paying out all of its earnings, Four Corners has grown revenues and EBIT by 27.5% and 158% respectively since 2017, demonstrating strong operating leverage and business execution. Meanwhile, the valuation has disconnected from the financials, with shares trading at only 7x earnings ex-cash and an 11% dividend yield. Given the business strength and trajectory since 2017, I believe shares present an attractive risk/reward opportunity. If shares re-rated to a 7% yield, which is likely conservative, the stock has a near-term upside of 50%+.

At first glance, investors may worry about legalization of online gambling or sports betting impacting their charitable bingo business, but that risk is likely years away. The Texas legislature is not in session for the remainder of 2022. Even though the casino behemoth Las Vegas Sands spent $10M+ on lobbying and statewide ad campaigns in support of casino legalization last year, they gained very little traction. I also believe the target demographic for charitable bingo is different from online gambling or sports betting. Even in the event of legalization, I would expect any negative impact on charitable bingo to be modest.

So why does this opportunity exist? Prior to the new SEC rules on dark stocks (SEC rule 15c2-11), Four Corners only distributed its financials to shareholders via an email list, greatly limiting visibility for prospective investors. In response to the new SEC rule and to maintain liquidity in their stock, which is roughly 70% owned by employees and insiders, management decided to begin reporting through the OTC Pink Tier in August of last year. Due to this dynamic, I believe the company is largely unknown to investors.

Four Corners is a market-leading, stable, growing cash-cow with a high payout ratio in a profitable niche. As more investors come across Four Corners' financial progress and business strength over the past five years, I believe shares will trade closer to a more reasonable valuation of 8-10x EV/EBIT or 7-8% Div. Yield.

Additional Links

- I'm proud to have been recently featured in Co/Investor Club's List of Top 50 Microcap Investors. Please read the full feature at the following link: Co/Investor Club Write-Up

- I plan to continue updating the Smoak Capital website as well, so if anyone you know expresses any interest in learning more about my investment process or the fund, please feel free to point them to www.smoakcapital.com