Dear Fellow Investors,

The fund returned 10.6% for the first half of 2023 (net of fees). While this is a respectable result, it was behind the S&P 500 at 16.8% for the same period. As some of you already know, the S&P 500's positive first half return was nearly entirely due to only 7 companies (Apple, Microsoft, Google, Amazon, Nvidia, Facebook, and Tesla) which are up over 80% YTD on average (heavily skewed by Nvidia which is up almost 180%!). These are all no doubt great companies but most trade at high valuations relative to their forward earnings, from as low as around 20-30 times to as high as 50-70 times. They also each have hordes of analysts covering them, who mostly have rosy expectations for their futures, as evidenced by their stock prices. These valuations look even more stretched when considering the current high interest rate environment. Because of these reasons, prospective returns for this group of companies appear challenged while there is no shortage of bargains in less followed areas of the market.

The top three contributors to our performance for the first half of 2023 were Azeus, Xpel, and Citizens Bancshares. Azeus has been a core holding for a couple years now and was up modestly, likely due to continued earnings growth and excitement around new software verticals, including their large ongoing electronic records contract with Hong Kong. Given the excellent revenue and earnings growth, superior unit economics, large dividend yield, and attractive prospects for further business execution, I'm very pleased to have Azeus as one of our largest positions. Xpel was a smaller position at the beginning of the year but rose over 40%, largely due to more positive investor sentiment vs. the beginning of the year. We continue to own Xpel but have trimmed a portion of our position due to a steeper valuation and other attractive opportunities. Citizens Bancshares rose 30% for the first half of the year due to greater recognition of the large discount to economic fair value given strong earnings and excess capital from the ECIP program, all despite the brief banking scare in March. Citizens remains a core position as a large discount to economic fair value still remains, earnings will continue to be very strong, and small community banks have fared well in terms of deposit flight.

The banking fears in March were the biggest drag on our portfolio for the half year. In addition to Citizens, we held and continue to hold smaller positions in a few other banks and their stocks sold off more during March. With the benefit of hindsight it's clear the banking crisis was centered around a few banks with bad balance sheets (exacerbated by interest rate increases) combined with customer concentration which further exposed them to deposit flight. At the time I was confident our banks would have very little deposit flight given their long-standing customer relationships and immaterial exposure to the loudest, panicked customers (VCs and Silicon Valley). There has also been concern (rightly so) around banks which hold large amounts of loans in commercial real estate given the decline in commercial office demand. Our banks have very little exposure to these loans in addition to having far superior capital ratios vs. large regional banks. In summary, I believe our banks were victims of indiscriminate selling as many investors who held shares in banks were unprepared or unwilling to properly analyze relevant risks and/or acted on fear alone. Q1 results supported this view as many of our banks reported very strong if not record earnings and minimal deposit flight. I expect more of the same in Q2.

Due to our small size and limited constraints, I'm able to sift through thousands of companies all over the globe to find the most attractively priced stocks. I continually find many good businesses trading at less than 10 times earnings or FCF, and more recently even a surprising number trading at 5 times or less. These are not dying businesses either, some are even growing revenue 20%/yr or faster. I'll discuss two of these attractive opportunities which are now core holdings later in my letter.

In comparison to the large, relatively expensive, and intricately researched large companies driving index returns this year, I'm much more confident in the prospective returns of our holdings given their attractive valuations, solid capital allocation, and durable business models.

Year	Net Return	S&P 500	Alpha
2H 2018	11.5%	-6.9%	18.4%
2019	108.3%	31.5%	76.8%
2020	38.7%	18.4%	20.3%
2021	69.1%	27.9%	41.2%
2022	18.2%	-18.1%	36.3%
1H 2023	10.7%	16.9%	-6.2%
CAGR	***48.1%***	***12.2%***	***35.9%***

As I discussed in my previous letter, Smoak Capital Management's 5 year anniversary was at the end of June and I'm pleased we've generated **48.1% annual returns** since inception with returns by year in the following table:

$100,000 invested with Smoak Capital Management since inception (June 2018) has now grown to $712,890. I'm open to adding aligned investors as well, so if you know of anyone who may be interested in learning more about Smoak Capital, please forward along my contact information.

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 more details on some of our investments:

Medical Facilities Corp. (TSX:DR)

Medical Facilities Corp. is a relatively straightforward situation where there has been a positive change in capital allocation and corporate strategy that has gone completely unnoticed by investors. Medical Facilities Corp. owns surgical hospitals and ambulatory surgical centers (ASCs) in the United States but the stock trades in Canada. Historically, Medical Facilities paid a very large annual dividend in monthly distributions, yielding 6-8% and even above 10% at times. This large dividend attracted a Canadian retail investor shareholder base and things hummed along nicely until 2019. Subpar acquisitions financed by debt were underperforming and the dividend was outpacing profits so the company was forced to slash the dividend by 75%. This led the retail investor base, which largely owned the stock for the dividend, to rush for the exits pushing the stock price down over 65% in 6 months.

Not long after all this happened in 2019, COVID further impacted the business and outlook beginning in early 2020 and the stock languished for some time. Although partly due to government assistance, the company delivered strong FCF and paid down debt considerably in 2020 and 2021. With a cleaner balance sheet, manageable dividend payout, and improving business prospects the company was finally in a position to more effectively allocate excess FCF. Some institutions took notice and began purchasing stock, appointing their own board members (now a majority of the board), and eventually replacing most of the management team. The new institutional shareholders had clear goals: end all acquisitions, divest non-core assets, and put excess FCF towards buying back stock. The company publicly announced this strategy change in September of last year and repurchased over 10% of the company in a tender offer. Since then, the company has pursued further corporate costs cuts, continued repurchasing stock (100k-150k shares/month), and is still exploring more divestiture options for non-core assets.

When you cut through all the obvious negative shareholder sentiment (largely due to the large dividend cut) and focus on the financials, it's easy to see why a number of institutional investors took notice and are so eager to divest non-core assets and repurchase as much stock as possible. The company produces lots of FCF and nearly all of the FCF comes from two high-performing, orthopedic-focused surgical hospitals. The stock also trades at only 3.6x EV/EBITDA and 5.5x P/FCF. These multiples are attractive on an absolute basis due to the steady, durable profits and long-term tailwinds of their orthopedic-focused surgical hospitals. The multiples are even more attractive on a relative basis. While not a perfect comparable due to its larger size, operational expertise, and an effective roll-up strategy, US-listed Surgery Partners (SGRY) trades at over 22x EV/EBITDA and regularly acquires smaller, less-attractive surgical hospitals/ASCs than Medical Facilities at 8x EBITDA or higher. There are also many other transactions in the ASC space that further support valuation ranges of 7-10x EBITDA for smaller transactions and 10-12x EBITDA or more for much larger practice groups or higher quality facilities.

Given these huge disparities, continuing to divest non-core assets, direct all excess FCF to share repurchases, and eventually sell some or all of the facilities should result in very attractive returns for shareholders. Simply selling the existing business at 8x EV/EBITDA would result in a return of over 100%, but smart capital allocation until selling the facilities will be very accretive and further increase returns. I also believe the top performing facilities are likely worth 10x EBITDA or more given their strong operating histories and orthopedic-heavy procedure mix.

In summary I believe this is an attractive special situation where selling pressure has led to a large price decline that has nothing to do with the business fundamentals. And now with the right capital allocation strategy in place to take advantage of the undervalued stock, prospective returns over the next 2-3 years look very attractive (in excess of 100%) as they execute and eventually sell some or all of the facilities.

Unnamed Position

This company is an educational products provider whose business transformation over the last few years is not being appreciated by investors. While the company is known in investor circles, I don't believe it is followed closely enough given the ascension of their digital products business. In short, their legacy business has been decently profitable (10-15% EBIT margins), generated good FCF, and paid a nice dividend. But recently, their digital business has taken off with digital revenues growing at an over 40% CAGR since 2017 and even more impressive 46% CAGR since 2020. It's also important to note the digital business has very high gross margins (>90%) and can largely be sold through their existing (albeit growing) salesforce. The result is excellent operating leverage with operating margins likey above 30% for 2023 and FCF margins even higher. And although there can be lumpiness in the top line, there are recurring revenue aspects to their legacy and digital business.

This greatly improved profitability has benefited the balance sheet tremendously with cash making up almost half of the market cap. The last time the company had this much cash, they paid a large special dividend. I expect them to do this again at some point in the future and believe the dividend could easily be 25% or more of the current market cap. This is in addition to the company paying out a majority of GAAP earnings through their annual dividend (currently just shy of a 6% yield).

The valuation today makes no sense given the massive pile of cash, fast-growing business generating increasing amounts of FCF, and history of returning capital to shareholders. In a conservative scenario, valuing the business at 12x earnings (likely too low given their growth, unit economics, and competitive position) and adding the value of their existing cash pile leads to an expected return of 100% for the stock. I plan to disclose more about this position in the future.

Azeus Systems (SGX:BBW)

I've mentioned Azeus previously and it has been a holding since 2021, but I believe it's time for an update given their continued execution and the upcoming impact of their massive HK e-records contract win. In May of last year, Azeus announced they had won a HK$1B+($132M USD) contract with the HK government to build and implement a new central recordkeeping software system. They also disclosed that 75% of the value of the contract is for licensing and maintenance, i.e., higher-margin software-like revenue streams. This is a long-term project with a 4.5 year implementation period then a 10 year ongoing licensing/maintenance contract period. In rough figures, I believe annual revenues during the implementation period (now until 2025/2026) will climb to well over $100M HKD/yr and then to at least $35M HKD/yr for the 10 year follow-on period. And even after the end of the contract, it is highly unlikely the HK government wants to discontinue use of the custom built records software so I view this more as perpetual annual revenues for as long as HK uses the records software rather than focusing on the contract length. Given Azeus has already begun staffing up for this project and started it last year, once material revenues begin to be recognized they will drop straight to the bottom line.

Azeus' core enterprise software business continues to grow quickly, develop new software products, and still pays a nearly 5% dividend yield. Azeus' billings growth (think of it as cash revenue) for the most recent period was 35% YoY, a very impressive figure given their strong profitability and FCF. By my estimates, Azeus trades at only 15x EV/FCF before even considering upcoming material contributions from the HK contract. Once that is considered, Azeus likely trades at less than 10x fwd EV/FCF. This valuation is far too cheap for a market-leading enterprise SaaS business growing recurring revenue at 30%+, an impending material revenue bump from a large contract win, and committed to paying out all GAAP profits to shareholders via dividends. High-margin, recurring-revenue enterprise SaaS businesses regularly transact at 9-10x Sales, and even higher multiples of EBITDA. In the near future, I expect Azeus's software segment alone will be generating $350M HKD per year in revenue, or roughly $2 per share. In comparison to the stock price today of $8.50 and almost $1/sh in net cash, that would be a lowly valuation of 3.75x EV/Sales.

SMOAK CAPITAL

Additional Links

- Please see the most recent firm summary document at the following link: Smoak Capital - June 2023

- If anyone you know is interested in learning more about the fund, please feel free to point them to **www.smoakcapital.com**, have them email me at **dsmoak@smoakcapital.com**, or feel free to forward on the most recent summary document above