SMOAK CAPITAL

Dear Fellow Investors,

The fund returned 24.0% for the first half of 2024 (net of fees), ahead of the S&P 500's half year return of 15.3%. Many of our core holdings reported strong results over the last few months, which led to a rise in their stock prices. The "Mag 7" continued to drive broader markets higher as sentiment rose along with AI hype and rate cut projections. It will be interesting to see how the market trades for the remainder of 2024. As always, I have much more confidence in predicting business results for our holdings and finding attractive opportunities than any idea what the market will do for the rest of the year.

FitLife, Azeus, and Medical Facilities were the strongest performers of our portfolio for the first half of 2024. FitLife shares were up almost 75% for the first 6 months of 2024, no doubt mostly due to the MusclePharm acquisition beginning to fully impact financial results. Investor sentiment seems to also have shifted positively for FitLife, likely due to greater investor awareness of the company as well as recognition of the superb capital allocation and operating track record of the man at the helm, Dayton Judd. I'm happy to continue to hold FitLife and am eager to see further progress on MusclePharm and perhaps another acquisition if the timing and the price are right.

Azeus reported extremely strong revenue and earnings growth in May for their 2nd half of FY24. Revenue rose 43.7% YoY and operating income was up over 100% YoY as the HK electronic records contract began ramping up. I expect this contract to continue ramping up over multiple years, as well as continued double digit growth of their core board portal software business. Shares are still a far cry from what I would consider fair value, but I'm perfectly happy to collect a sizable 7-10% dividend yield while we wait for more investor recognition, continued execution, and multiple expansion. The value creation that has occurred at Azeus, all from internally generated cash flow of their legacy IT business and without a single new share issued, is extraordinary and I believe is far from over. Software revenue has grown at a 53% CAGR over the past 6 years with operating margins now above 30% and FCF margins even higher, This is despite all growth spending being fully expensed, meaning steady-state earnings are much higher.

In comparison to FitLife and Azeus, Medical Facilities is quite boring. But throw excellent capital allocation on top of a cash cow at a big discount to fair value and you have something much more enticing. Medical Facilities has continued buying back stock, paying down debt, and improving operating efficiencies. This coupled with multiple expansion has led to the stock price increasing over 40% so far this year.

The fund's 24.0% net return for 1H 2024 brings cumulative annualized returns to 44.7% since inception vs. 14.1% for the S&P 500 over the same time frame. $100,000 invested in Smoak Capital since inception (June 2018) has now grown to $917,823. I'll continue to be selective and opportunistic adding new partners or capital going forward, with my key goal being maintaining high returns for the fund.

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%
2023	14.9%	26.2%	-11.3%
1H 2024	24.0%	15.3%	8.7%
CAGR	***44.7%***	***14.1%***	***30.6%***

As the fund has grown over the years through performance and additional investors, it has required me to look for relatively larger and more liquid investments, albeit still very small and less liquid than anything close to S&P 500 constituents. Despite this continual evolution of moving up the liquidity/market cap ladder, I've been pleasantly surprised at the number of opportunities available. This is no secret to investors that know me, but some of my favorite situations are stocks where most shareholders are very pessimistic, where the business is widely misunderstood, and my favorite of all, when practically no one is even looking at it. The third scenario is obviously much more likely to occur at the smallest of market capitalizations but still happens from time to time with companies with a market cap of $500M or even $1B+. This gives me confidence in our future runway for investment opportunities as we continue to grow. I'll discuss a new position later, which despite being large in terms of market cap, has very few eyes on the story.

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,

Please keep reading below for an in-depth discussion on one of our investments:

<u>Leon's Furniture (TSX:LNF)</u>

Leon's Furniture is the largest furniture retailer in Canada and was founded over 100 years ago. Despite being the market leader and generating strong earnings and FCF nearly every year since 2002, Leon's only trades at about 11x 2024e earnings. This by itself probably warrants a closer look, especially in light of Fairfax's recent acquisition of Sleep Country at almost 17x fwd earnings. But the real catalyst is Leon's plan to spin out its vast real estate holdings into a REIT. Importantly, Leon's real estate is all held on the books at cost, with much of it purchased many decades ago. Some basic number crunching reveals substantial value in their 5.6M sq ft of real estate, which is a mix of retail and industrial space all across Canada. With conservative assumptions, it's easy to arrive at a total value of their owned and unencumbered store footprint of $1B+. This strategy to unlock hidden real estate value has been followed before by two other large Canadian retailers, Canadian Tire and Loblaws, whose public REITs trade at cap rates of roughly 5-6%.

Leon's also has one more substantial source of real estate value. Leon's owns 40 acres of land near downtown Toronto which they recently had rezoned and they intend to develop a master-planned community of 4,000 residential units along with retail and other mixed-use space. Importantly, construction is likely at least a couple years away and secondary approvals from the City will be needed to finalize total buildable square footage. But the proposed 4.6M buildable sq ft would likely value the land from $400M to potentially close to $1B based on the sale of a similar master planned development property in Langstaff. The company itself describes it as part of a “massive opportunity to unlock value” in their real estate portfolio.

Incredibly, at current prices investors are getting the leading Canadian furniture retailer at 11x fwd earnings and real estate worth somewhere near the entire market cap for free. And not only this but there are clear catalysts to unlocking the value of this real estate with the REIT IPO and development of the 40 acres. One important consideration is the impact of the additional lease payments of the business to the newly formed REIT. While these lease payments would be material, since the corporation plans to maintain majority ownership in the REIT, it would also receive dividends from the REIT to offset those lease payments. And most importantly, earnings in the REIT would receive a much higher earnings multiple than they’re currently receiving embedded in the company financials. So all in all, while it may reduce earnings of the business by 10-20%, it's a small figure in relation to the value created by the REIT.

Another interesting aspect of Leon's is the background of the current CEO, Michael Walsh. He’s the first non-family member to be appointed CEO in the company’s history (became CEO in July 2021), and he worked for Canadian Tire from 2012-2015. Canadian Tire formed their REIT in late 2013. When considering these circumstances along with the CEO’s obvious focus on Leon’s real estate value based on his public comments, it seems clear he was brought in specifically to lead the charge on unlocking Leon’s real estate value.

Putting this all together yields total value well in excess of the current stock price, with total equity value of $40 with conservative assumptions and of almost $60 per share on more aggressive assumptions, or 65-150% higher than the current share price. Downside is very well protected as well given the company has no net debt and has three separate sources of value (the operating business, the retail/industrial real estate, and the 40 acre Toronto development).

Important Disclaimer

The information in this document has been prepared solely for prequalification and informational purposes and is not intended as an offer or solicitation of an offer with respect to the purchase or sale of any security and should not be relied upon in evaluating the merits of investing in any securities. The information in this document is superseded by, and is qualified in entirety by, the offering memorandum, limited partnership agreement, and subscription agreement for Smoak Capital, LP.

An investment in the Fund is speculative and involves a high degree of risk, including the risk of loss. The Fund's performance may be volatile and there is no assurance that the Fund will achieve its investment objectives or that investors will receive a return on their capital. The fees and expenses charged in connection with an investment in the Fund may be higher than those charged with other investments, and in some cases, may offset their trading profits. Investors could lose all or a substantial amount of their investment in the Fund. Investors must read and understand all the risks described in the Fund documents before making a commitment.

Smoak Capital Management launched in July 2018 and separately managed client accounts until launching the Fund in June 2021. The firm's investment strategy has remained consistent since inception, but results presented prior to June 2021 consist of qualified client SMA results net of fees.

Past performance is not indicative of future results or a guarantee of future returns. The performance returns presented herein represent the average return of the Fund's limited partners, include the reinvestment of dividends, interest, and other earnings, and are shown net of operating expenses, management fees and incentive allocations. An individual investor's actual returns will differ from the results shown herein due to factors such as the timing of capital contributions/withdrawals, different fee arrangements, and treatment of loss carryforwards. Thus, individual investor performance as well as the Fund's aggregate performance will differ from the performance presented herein.

The Fund's performance is shown compared to the S&P 500 Total Return Index. The S&P 500 Index, a widely used benchmark of US equity performance, consists of 500 large cap companies chosen for market size, liquidity, and industry group representation. Each company's weight in the S&P 500 Index is proportional to the total market value of all outstanding shares of such company. The S&P 500 Total Return Index measures the performance of the S&P 500 Index by assuming that all cash distributions are reinvested, in addition to tracking the components' price movements. Indices are unmanaged and are not subject to fees or expenses, nor can you invest directly in an Index. Due to their differences, performance of the Fund and the Indices is not comparable. Smoak Capital Management is not aware of an index that is directly comparable to the Fund's strategy.