Dear Fellow Investors,

The fund returned 10.9% for 2025 (net of fees), below the S&P 500's return of 17.9%. AI and AI-related infrastructure stocks have contributed significantly to the S&P 500's strong year. The fund had very little AI-related exposure for 2025 (and still does) as I struggle to form a strong opinion on winners vs. losers, business model viability, and ROI on AI-related capex. Additionally, I've gravitated towards more defensive names as market valuations still appear to be elevated. It's obviously too early to tell whether this positioning is right or wrong but I have been increasing my efforts to find undervalued stocks with a growth component. As a value-minded investor I think it's natural to have a preference towards undervalued stocks with a margin of safety but I always want to have positions that have strong growth prospects, as long as I can purchase them at an attractive price.

Finding and evaluating companies with more growth requires a different mindset, as they are rarely cheap on trailing earnings or even EBITDA-basis. They can also have significant fully expensed growth-related spending generating superior long-term returns but depressing current earnings. This is commonly referred to as the "J-curve effect" since profits initially dip during the heavy investment phase then grow over the long term as profits build. This is most prevalent in the SaaS/VC realm where many SaaS companies refer to their Lifetime Value vs. Customer acquisition cost ratio (LTV/CAC). This is a good framework to approach businesses in the investment phase but I've found it is very hard to screen for, which is probably a good thing as it should lead to more opportunities for those willing to dig. Each company and business model is unique and there are many factors that influence each metric, especially LTV. I also believe comfort with this type of approach is more accepted in the US vs. overseas markets as well as more common in bigger companies vs. smaller. I think this mindset provides a distinct advantage for small and micro-cap investors digging for undervalued growth opportunities abroad.

The reason these adjustments are necessary is because accounting standards have become less relevant over time as more businesses invest in intangible (R&D, new products, customer acquisition) rather than tangible assets. These costs are often expensed immediately. On the other hand, intangible asset lives are so varying and uncertain it would be very hard to apply any explicit rules to a large group of companies. Determining lives of different categories of buildings, machinery, furniture, etc. is comparatively much more straightforward. Investors must consider accounting's limitations in these types of companies, especially when companies are investing heavily through the income statement. There are many academic papers discussing this issue that provide strong evidence for more capitalization of intangible assets and the strengths of that approach, but again it seems the wide variability might make rules-based solutions impractical.

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%
2024	32.4%	25.0%	7.4%
2025	10.9%	17.9%	-7.0%
CAGR	***37.4%***	***14.9%***	***22.5%***

The fund's strongest performer for 2025 was PHI Group. PHI Group is a helicopter operator with two distinct segments, Air Medical and Oil & Gas. The business emerged from bankruptcy in late 2019. Despite an S-1 filing in 2023, shares have remained on the expert market. Because of this obscure listing, shares trade at under 3x EV/EBITDA vs. peer Bristow Group at 8x and air medical comparables even higher. Tobila Systems was the fund's 2nd strongest performer in 2025 followed closely by Azeus Systems. Azeus had a very strong first half of 2025 followed by a setback in the second half. Azeus's HK Records total contract value was reduced by around 10% and Azeus and the HK government are in disagreement over server fees. While this is unfortunate, it is likely a one-time issue and the core board portal software business continues to grow revenues ~20% per year while paying out all net income as dividends. As discussed in my previous letter, the worst performer for the year was IG Design Group. After not being able to get clarity on key questions on the NA divestment from management and a lack of concrete signs of things turning around, I decided to sell most of our IG Design stake.

I'm happy to announce I hired our first employee in 2025. After getting to know him over the past year, I felt he would be an excellent fit because of his alignment in investment philosophy, deep curiosity, and independence of thought. I'm eager to continue working together.

The fund's 10.9% net return for 2025 brings cumulative annualized returns to 37.4% since inception vs. 14.9% for the S&P 500 over the same time frame. $100,000 invested in Smoak Capital since inception (June 2018) has now grown to $1,087,386. The fund is closed to new investors for the time being but I'll reconsider adding new investors on an opportunistic and selective basis at some point in the future.

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 some of our investments:

<u>Tobila Systems (JP:4441)</u>

Tobila Systems is a Japanese company focused on fraud and spam call prevention. Tobila has successfully developed a new B2B growth engine that will accelerate revenue, profit, and free cash flow growth going forward yet amazingly trades at 4.5x EV/FCF with its B2B segment growing revenue over 50% per year. Japanese GAAP greatly understates the earnings power of the business due to long-term spam filtering license terms. Investors focused on reported earnings likely do not appreciate the transformation and cash generation of the B2B segment, which shows no signs of slowing.

The business consists of two segments: Security and Solutions. Security is a lower-growth legacy business that sells fraud and spam filtering services primarily through each of the three large Japanese telecommunication carriers. Prior to FY22, Security was almost the entire business and delivered double digit revenue and profit growth each year from FY17 to FY21 and reached 40%

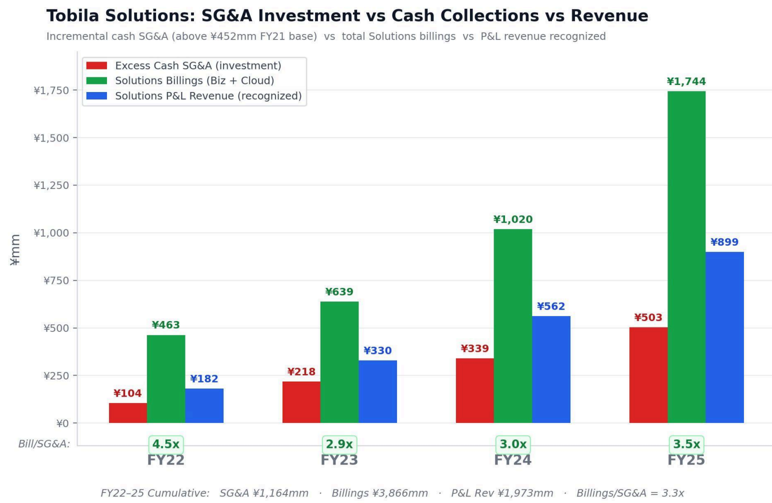
operating margins. Revenue growth from the Security segment has now slowed to mid-single digits per year but it still has very strong segment-level operating margins. The Security business has two distinct advantages: their massive spam/fraud call, SMS, and URL database and their distribution channel. The value in their proprietary, constantly updated database is obvious, it enables them to identify and block spam or fraudulent calls with 98-99% accuracy, far above competitors. With 15 million active users across all 3 major Japanese carriers and active relationships with police agencies, their database is constantly updated to enable the best protection. Their long-term relationships with each of the Japanese carriers also creates significant barriers to entry for any competitors.

While the Security business is very attractive with sticky high-margin recurring revenues, impressive operating margins, and clear competitive advantages; its fast growth days are behind it. Thankfully, management began investing in the Solutions segment in FY21/FY22. Solutions is Tobila's B2B segment and consists of two products: TobilaPhone Biz and TobilaPhone Cloud. TobilaPhone Biz is an on-premise device that connects to the existing business phone network and provides spam/fraud call protection, call recording, interactive voice response, and voice-to-text. TobilaPhone Cloud is a cloud-based business phone service that incorporates many of these same features. Importantly, the key differentiator for both of these products is their gold-standard spam/fraud call filtering protection. TobilaPhone Cloud is sold on monthly recurring revenue per seat model (MRR) while TobilaPhone Biz is sold on a unit cost + 5 year license for spam filtering.

The unit economics of both TobilaPhone Cloud and Biz are excellent, but the cash returns of TobilaPhone Biz are extraordinary. Since Tobila receives the entire purchase price (unit cost + 5 yr license) up front, unit sales are generating a massive and growing amount of free cash flow. The ongoing costs of providing the 5 year spam filtering service are likely minimal as this is already the core function of their legacy security business. In effect, I believe it is mostly pushing out database updates and providing ongoing customer service. Japanese GAAP requires this license revenue to be recognized ratably over the 5 year term despite all the cash being received up front. The main consequence of this is that <u>reported earnings vastly understate cash earnings/free cash flow</u>. If you were to analyze Tobila on a P/E basis and consolidated revenue growth it looks good but not spectacular. However, if you analyze each segment separately and understand the cash economics, you see something entirely different.

By my calculations, Tobila has invested a cumulative 1.16b in increased SG&A to drive growth in the Solutions segment from FY22 to FY25. Over that same period, Solutions has already generated well over 3b in free cash flow. LTV/CAC is well over 3 assuming zero customers repurchase a Biz unit at the end of the license term. A much more likely scenario is the majority of customers repurchasing Biz units at the expiration of their license term, as business phone/core IT products tend to be very sticky. With a strong repurchase rate and price increases, LTV/CAC could easily be 6-7+, exceptional even by enterprise SaaS standards. But even LTV/CAC doesn't do this justice, because LTV is typically the undiscounted lifetime value of the customer you're acquiring. The cash economics of TobilaPhone Biz are superior because you receive each license payment up front on day 1. In short, TobilaPhone Biz is much better in NPV terms than even its high LTV/CAC would suggest. Not to be forgotten, TobilaPhone Cloud has emerged as one of Japan's fastest growing cloud business phone services and is consistently ranked one of the highest based on customer reviews. TobilaPhone Cloud's churn rate has also remained quite low, with monthly churn below 1%.

Now that we've covered the exceptional economics of the Solutions business, how fast is it growing? Very fast. TobilaPhone Cloud grew revenue **90% YoY** in FY25 and TobilaPhone Biz grew revenue **51% YoY**. Billings for TobilaPhone Biz, the more important metric and driver of free cash flow, grew **68% YoY**. Solutions as a whole grew 60% YoY in FY25 and is projected to grow **55% YoY in FY26**. Tobila only began disclosing the Solutions segment separately last year, so this very fast growing segment was effectively hidden in the consolidated results until then. Tobila recently introduced two new products in the Solutions segment: Sagi-Training, a subscription based fraud prevention training service for businesses, and TobilaPhone Biz lite, a lower-priced Tobilaphone Biz unit with more limited features intended for SMEs. It's too early to tell whether these new products will be successful, but I have high hopes given Tobila's core competencies and their existing customer base.



All of this growth obviously can't happen without a big driver of demand. I believe the biggest factor driving demand in the Solutions segment is the increasing problem of customer harassment of employees in Japan, also known as "*Kasuhara*." Kasuhara has become a recognized social issue affecting mental health and labor shortages. It has become such a widespread problem, last year Tokyo became Japan's first city to enact laws prohibiting customers from harassing employees and **requiring** businesses to establish systems to protect employees. Japan's national government has followed in Tokyo's footsteps enacting similar laws with full enforcement beginning this year. Tokyo and other municipalities have also introduced cash incentives and grants for small and medium enterprises (SMEs) who adopt policies, procedures, and purchase equipment to combat customer harassment. I believe widespread societal awareness, legal requirements, and incentive structures have driven strong demand for Tobila's Solutions business that should continue going forward.

AI-based call screening and voicemail transcription is often mentioned as a threat to Tobila but without access to Tobila's proprietary database, I believe the effectiveness of AI-based solutions will be inferior. Apple's live voicemail doesn't even block or identify spam/fraud calls, it essentially just transcribes voicemail. Google's solution is more proactive vs. Apple, but has a higher false positive rate, potentially hanging up on real callers or discouraging real callers who don't understand why a bot is answering. Apple also has much higher market share than Google in the Japanese mobile market. Tobila's management has also addressed this threat and believes Tobila's solution is superior due to direct blocking at the carrier level, more extensive and accurate database, and instances where AI-screening could actually increase the likelihood of customers picking up a malicious call.

In summary, I believe Tobila is wildly undervalued due to a confluence of factors and presents an extremely asymmetric risk/reward investment. Tobila has over 1/3 of the market cap in cash and investments, has repurchased shares the past two years, and has a 35% dividend payout ratio. Tobila's fast growing Solutions segment was effectively hidden from investors until last year when the company began to separately disclose TobilaPhone Biz and Cloud. Investors overly focused on P/E ratio and operating profit likely underappreciate the superior cash generation and strong growth. Shares trade at only 4.4x EV/FCF and likely only 3x on an EV/Fwd FCF basis. Even at a low absolute multiple of 10-12x FCF, upside is 80-110%, and 140-180% on a forward basis. Over the long-term, if they are able to continue growing the Solutions segment anywhere near current growth rates (50-60%), I believe the upside is even greater. It is very rare to find a company with clear competitive advantages, exceptional reinvestment opportunities, and strong growth for this low of a price.

Medical Facilities (TSX:DR)

Medical Facilities' stock has traded sideways for most of the last year despite their sale of BSH at 9x EBIT and most recently OSH at 9-10x EBIT. After the BSH sale, they conducted a large tender offer. Given the large cash balance after the OSH sale, I believe there is a strong likelihood they will do another large tender offer. Shares trade at only 4.7x EV/EBIT, the company continues to buy back large amounts of stock each month, and their last two remaining hospitals, ASH and SF, are likely worth at least the same if not more than BSH or OSH. Between buybacks and dividends, the effective shareholder yield is in excess of 15%. Given the clear and consistent capital allocation strategy and fair value of the remaining facilities, I'm happy to hold shares until they converge to fair value or the entire business is sold.

Important Disclaimer

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.