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Portfolio Manager
Artko Capital LP

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Dear Partner,

For the second calendar quarter of 2021, an average partnership interest in Artko Capital LP returned 0.5% net of fees. At the same time, investments in the most comparable market indexes—Russell 2000, Russell Microcap, and the S&P 500—were up 4.3%, 4.1%, and 8.6% respectively. Our detailed results and related footnotes are available in the table at the end of this letter. Our results this quarter came from Northern Technologies, Research Solutions and Potbelly, offset by modest detractions from Gaia, Acorn Energy, and our hedges.

	3Q20	4Q20	1Q21	2Q21	YTD	1 year	3 year	5 year	Inception 7/1/2015	Inception Annualized
Artko LP Net	22.0%	17.2%	30.9%	0.5%	31.6%	88.1%	7.3%	13.4%	110.6%	13.2%
Russell 2000 Index	4.9%	31.4%	12.7%	4.3%	17.5%	62.0%	13.5%	16.5%	99.7%	12.2%
Russell MicroCap Index	3.7%	31.4%	23.9%	4.1%	29.0%	75.8%	14.5%	18.1%	102.3%	12.5%
S&P 500 Index	8.9%	12.2%	6.2%	8.6%	15.3%	40.8%	18.7%	17.7%	134.5%	15.3%

On Vision, Opportunities and Process

This July we began our seventh year of running the partnership. It has certainly been a wild and stressful ride, starting out with one LP at $25,000 to managing an eight-figure AUM portfolio with almost 50 LPs today. We have had a number of substantial drawdowns and subsequent rebounds which, as the saying goes, is a feature not a bug, of running a concentrated micro- and nano-cap portfolio. We feel pretty good that we are still in the middle innings of the current rebound from the wild ride of 2020. We have also made some mistakes along the way which we hope to learn from and will occasionally discuss in our letters to you. One of the mistakes we would like to discuss here is a previous lack of vision in the microcap space.

Our career, while always grounded in the naturally appealing value investing style, started out in the mid- and large capitalization space, where we got to really appreciate the difference between quality and sub-par established business models. Additionally, we got to see which small cap companies the larger ones end up buying out. All valuable experience, but one that limited our vision for potential returns; while there are certainly Amazons and Googles of the world that can offer returns in the 1000s of percent to the patient investor, those are few and far between. Realistically, seeing a 100-200% return on your large cap investment in just a few years probably equates to a pretty good time to take the gains off the table.

We followed this investment model and structured our risk management processes in terms of single position sizing to reflect our experience. Over the years we have increasingly felt that this version of our process was not the right one for our strategy and has resulted in leaving substantial gains on the table. Two poignant examples in recent years have been our investments in Joint Chiropractic (JYNT) and our current investment in HireQuest (HQI). Both of these investments have worked out fantastically for our partners with 300% plus return for each, however, our experience and our risk process where we take off at least 5% of portfolio gains when a position reaches 15% of the portfolio has limited our potential, as has limiting our vision for potential gains in 100s of percent instead of a 1000+ (as been the case with JYNT). Additionally, following this risk management model has resulted in some minor tax inefficiencies for the partnership.

There is of course the other side of the coin as microcaps can also crash spectacularly after a substantial run up, such as our investments in Hudson Technologies (HDSN) and Recro Pharma (REPH) where taking our gains off the table after the run up resulted in us having a positive return on those investments and limited our losses. This is a delicate balance of adjusting the process without taking additional risks. Over the years our portfolio has had a pretty modest turnover, with an average holding period of around three years, and one of our goals in adjusting the process is to lengthen the average holding period to closer to five years and beyond. With that adjustment, we will also likely adjust our maximum single position sizing to high teens from 15% today and make our reduction sizes smaller.

In general, our goal here is to be able to capture more upside from our winners and to be able to have more vision on the potential upside that extends higher than just low triple digit returns. No example is more poignant than the aforementioned HireQuest (HQI). Our initial ~$5.50 investment was based on the bet the company's founder and majority shareholder, Richard Hermans, would be able to use his many decades of experience in the staffing industry to transform the sleepy staffing branch owner into a franchise powerhouse with a substantially lower business model risk. The original investment, pre HQI merger, into Command Center, at a $20mm market capitalization at $5.50, has transformed into a company, that despite a shut down of a domestic economy in 2020, is likely to make $20mm in Free Cash Flow (FCF) over the next 12 months. The HireQuest high Free Cash Flow generating business model recently acquired two businesses that almost doubled their system-wide sales as well as announced an expansion into the driver staffing businesses with 35 branches already competing in the adjacent market. As of August 2021, the stock has hit $22.00, including being placed in the Russell Indexes. While we have reduced about 1/3 of our position based on aforementioned risk parameters the position remains a substantial mid-teens weight in our portfolio and we anticipate trying to hold on to it for as long as we can: excitedly watching what Rick can do. We believe we have a number of positions in our portfolio that have extremely capable entrepreneurs with substantial "skin in the game" running the companies and we are likely to hold on to these investments for a considerably long time.

Enhanced Portfolio Additions

- Global Indemnity Group (GBLI) – Over the last two quarters we have built up a 6% position at an average price of around $27.00 per share, in what we would consider a special situation investment, in $320mm capitalization specialty insurer. GBLI offers Commercial Specialty, Specialty Property, Farm, Ranch & Stable insurance in the United States and Reinsurance financial products globally. Although the company has always been statistically cheap, trading at an average of 0.7x book value and at close to 0.5x today, it was for good reason, as its average Return On Equity has hovered in low single digits vs the industry average of 8%+. Our interest in this position is mostly event driven. Approximately a year ago, the company underwent a shareholder approved re-domestication transaction which freed up over $250mm in regulatory capital. While management has yet to prove themselves as shareholder friendly, and there are questionable arms lengths transactions, we believe shareholder pressure, including an involvement of a reputable small cap activist firm, Harbert Discovery Fund, is probabilistically in a shareholder friendly transaction such as a special dividend payout in the 50% to 75% range of current share price. The company has postponed its investor day a number of times in 2021, but we believe the one scheduled for September 2021 will give the shareholders the answers they seek in terms of the company's allocation of its new found capital. In the meantime, we believe the low valuation and a ~4.0% dividend yield provide us with the margin of safety to make this a large Enhanced Value Portfolio position.

Other Portfolio Updates

- Currency Exchange International (CURN) – We have continued to build up our position in CURN to over 10% as we believe this continues to be one of the most lucrative investments in our portfolio. This ~60mm market capitalization company specializing in currency exchange in the United States and Canada, with $57mm of net cash on its balance sheet, continues to fly under Wall Street's radar. As a reminder, CURN's main legacy business, Banknotes, is managing retail and wholesale currency exchange branches throughout the United States and Canada. The company is led by its founder and 22% owner, Randolph Pinna, who has been in the currency exchange business for an incredible 34 years since he was 18 years old. As you can imagine, this business took a substantial hit during 2020 as a result of the global shutdowns. The revenues, gross profits, and Free Cash Flow went from $42mm, $41mm and $6mm in 2019 to $25mm, $24mm and a loss of $6mm in 2020. While some might see this as bad news, we view it as an incredible opportunity to invest in almost a net cash balance sheet in a company with substantial operating leverage. Of course, the company has not been sitting idly by and there are a number of substantial changes over the last 12 months that have made this investment even more compelling:

  - On the legacy currency exchange side, the Banknotes segment, the company's main competitor, TravelX, that has been operating in expensive lease airport kiosk locations that CURN did not think were profitable, has declared bankruptcy and has left the United States market completely. As a result, CURN has been able to franchise those locations and substantially increase market share without having to put up significant capital. We anticipate that as global travel ramps up back to normal, though not likely till 2023-24, the segment can return to above pre-Covid numbers in the $45-$50mm annual revenue range.

  - At the same time, Randolph has had to make difficult decisions and throughout 2020 has cut over $10mm run rate in fixed costs from its SG&A base. Additionally, by finally being approved to source currency directly from the Federal Reserve the company has eliminated its approximately $1mm in Costs of Good Sold (COGS) with that segment likely becoming a 100% gross margin unit.

  - However, while the above developments are compelling on their own, the real reason for our excitement is the long overdue monetization of a multi-year investment into currency exchange software for banks as well as medium and large corporations, the Payments segment. While the development of this software has taken longer than anyone expected, over the last couple of years, this de minimis revenue segment in 2019, is now a 30% of total revenues segment, at $1.5mm in the last quarter, growing at close to a 100% a year. This software helps banks and companies efficiently manage their currency exchange needs while focusing on the number one concern for the customers: compliance. This is a very "white board" software which can easily be integrated into the customers' operating systems. In more important developments, the company has signed agreements to be on the platforms for Jack Henry and Fiserv, which represent over 50% of the target market of bank operating systems, meaning the software is now just turnkey for the vast majority of its target market. We believe these developments are substantially underappreciated by the market and we expect this segment to generate $20-$30mm in hereto nonexistent revenues by 2023-2024.

Given the aforementioned thesis points, we expect $55mm to $70mm in revenues by 2024 and for this company to likely produce a growing $15mm - $25mm in Free Cash Flow by then as well. This is a company that we have bought at a negative Enterprise Value of $10mm in 2020 at sub $9.00 per share. This discussion was all to tie into our original discussion in the beginning of the letter. We can tell you that we believe this company is worth many multiples of today's price and we believe that it may take a handful of years to get there. The important lesson we have learned from our past mistakes is to have vision on this opportunity and to continue to hold beyond a quick double and not leave more money on the table.

Partnership Updates

We welcomed one new partner to the partnership this quarter, bringing our total to 47 at the end of June. Additionally, after six years at Interactive Brokers we have switched our brokerage firm to a reputable small cap value-oriented prime broker. We are excited about the continued growth in partners and recovery in assets under management and, as always, are thankful for your business.

Next Fund Opening

Our next partnership openings will be September 1, 2021. Please reach out for updated offering documents and presentations at info@artkocapital.com or 415.531.2699.

Appendix A: Performance Statistics Table

	Artko LP Gross	Artko LP Net	Russell 2000 Index	Russell MicroCap Index	S&P 500 Index
YTD	33.9%	31.6%	17.5%	29.0%	15.3%
1 Year	92.4%	88.2%	62.0%	75.8%	40.8%
3 Year	9.9%	7.2%	13.5%	14.5%	18.7%
5 Year	17.4%	13.3%	16.4%	18.1%	17.7%
Inception 7/1/2015	164.2%	110.6%	99.8%	102.2%	134.5%
Inception Annualized	17.6%	13.2%	12.2%	12.5%	15.3%
Monthly Average	1.6%	1.3%	1.1%	1.2%	1.3%
Monthly St Deviation	6.9%	6.6%	5.9%	6.4%	4.3%
Correlation w Net	-	1.00	0.73	0.71	0.68

Legal Disclosure

The Partnership’s performance is based on operations during a period of general market growth and extraordinary market volatility during part of the period, and is not necessarily indicative of results the Partnership may achieve in the future. In addition, the results are based on the periods as a whole, but results for individual months or quarters within each period have been more favorable or less favorable than the average, as the case may be. The foregoing data have been prepared by the General Partner and have not been compiled, reviewed or audited by an independent accountant and non-year end results are subject to adjustment.

The results portrayed are for an investor since inception in the Partnership and the results reflect the reinvestment of dividends and other earnings and the deduction of costs, the management fees charged to the Partnership and a pro forma reduction of the General Partner’s special profit allocation, if applicable. The General Partner believes that the comparison of Partnership performance to any single market index is inappropriate. The Partnership’s portfolio may contain options and other derivative securities, fixed income investments, may include short sales of securities and margin trading and is not as diversified as the indices, shown. The Standard & Poor's 500 Index contains 500 industrial, transportation, utility and financial companies and is generally representative of the large capitalization US stock market. The Russell 2000 Index is comprised of the smallest 2000 companies in the Russell 3000 Index and is generally representative of the small capitalization U.S. stock market. The Russell Microcap Index is comprised of the smallest 1,000 securities in the Russell 2000 Index plus the next 1,000 securities (traded on national exchanges). The Russell Microcap is generally representative of the microcap segment of the U.S. stock market. All of the indices are unmanaged, market weighted and reflect the reinvestment of dividends. Due to the differences among the Partnership’s portfolio and the performance of the equity market indices shown above, however, the General Partner cautions potential investors that no such index is directly comparable to the investment strategy of the Partnership.

While the General Partner believes that to date the Partnership has been managed with an investment philosophy and methodology similar to that described in the Partnership’s Offering Circular and to that which will be used to manage the Partnership in the future, future investments will be made under different economic conditions and in different securities. Further, the performance discussed herein does not reflect the General Partner’s performance in all different economic cycles. It should not be assumed that investors will experience returns in the future, if any, comparable to those discussed above. The information given above is historic and should not be taken as any indication of future performance. It should not be assumed that recommendations made in the future will be profitable, or will equal, the performance of the securities discussed in this material. Upon request, the General Partner will provide to you a list of all the recommendations made by it within the past year.

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