Portfolio Strategy

Kingdom Capital Advisors Q2 2022 Letter

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Summary

- Year to date, the Kingdom Capital Composite returned 16.9% net of fees.
- Positioning across top holdings remained mostly steady from the first quarter.
- Kingdom Capital remains focused on identifying mispriced opportunities in small cap stocks.

Diego Thomazini

Fellow Investors,

Volatility and drawdowns impacted all asset classes during the second quarter of 2022. The classic 60/40 portfolio allocation (60% stocks and 40% bonds) is down 17% year to date[1]. Even energy ETFs (XLE) finished Q2 negative, despite soaring energy prices resulting from gas and coal shortages around the globe. Rampant recession fears have created an investing environment with few safe havens.

At a macro level, the Fed continues to raise rates, inflation remains elevated, and real estate is showing some cracks; that said, the job market remains strong, the dollar has soared relative to other currencies, and few signs of capitulation are appearing in the stock market. Record June inflation numbers reduce the odds the Fed can achieve a “soft landing” for the US economy; however, taking a definitive position on how these conflicting pressures resolve would be arrogant, and we prefer to focus on the corners of the market receiving less attention from the masses.

We established Kingdom Capital Advisors (KCA) based on the belief that markets are neither rational nor efficient and can be outperformed by active management. The ***Kingdom Capital Composite returned -11.32% net of fees in the second quarter***, vs **-16%** for the S&P and **-17%** for the Russell. Year to date, the Composite has returned **16.9%** net of fees, over **35%** outperformance vs all major indices. *Reminder, individual client returns vary based on time of onboarding.*

	Gross Return	Net Return	S&P 500 TR	Net Return vs. S&P 500 TR
Q1 2022	31.95%	31.82%	-3.83%	35.65%
Q2 2022	-8.76%	-11.32%	-16.10%	4.78%
YTD thru Q2	20.40%	16.90%	-19.32%	36.22%

Advyzon

**Note – Q1 performance fees are included in Q2’s net returns*

Strategy and Positioning

At the end of Q2, approximately 90% of capital was invested with 10% held in cash. We prioritize owning businesses we expect to perform well in the current macro environment and continue to be impressed with the execution of our top holdings against the volatile backdrop. Minimal changes were made across our top holdings, and little has changed regarding our views on these businesses.

We continue to selectively hedge certain macro risks, both at the index level and relative to our specific stocks. One example from Q2 was owning puts against our positions in both Dole PLC (DOLE) and Alto Ingredients (ALTO) prior to their Q1 earnings reports. We like both companies' long-term prospects; however, after reviewing pricing data and quarterly results across their industries, we determined earnings misses were likely. Owning short-term put positions allowed us to hedge the “event-risk” presented by these less-than-favorable reports and offset some of the impacts on our portfolio.

We continue to find advantageous setups in microcap stocks. We first researched Sysorex (OTCQB:SYSX) - a government contractor turned Ethereum cryptocurrency miner - during summer 2021. A bad debt deal and a “forgotten” liability that came due at the end of 2021 tripped a covenant with their convertible debt. This caused massive dilution resulting in shares trading below $0.01. The cheaper the stock traded, the greater the number of shares the company needed to issue to suffice the convertible debt.

The stock was in a death spiral. However, we knew outstanding shares were capped at 500m, and we were able to establish a position once the cap was hit, which corresponded to the dilution ceasing and market capitalization of the company briefly dipping below $5m. The halting of the debt conversion reduced the selling pressure in the stock, another fund established a 10% position, and shares reversed drastically - briefly trading back above $0.10. Opportunities like this are rare, but exist in microcaps, and can be executed upon in a nimble fund like ours.

Portfolio Commentary

Below is brief update on a few of the core positions in our current portfolio. Investors have complete transparency into all positions and are encouraged to contact us with specific questions at any time.

Unit Corporation (OTCPK:UNTC): Unit announced the end of their strategic alternatives process in June, selling one non-core property for over $50m and retaining the rest of their upstream assets to continue producing oil & gas. The company believes this decision is the best way to maximize the values of their drilling and midstream segments, but we were hoping for a favorable transaction to quickly re-rate the price of the stock. Unit's implied enterprise value is only ~$300m, less than half of the implied sale price of their upstream business, and possibly covered solely by their rigs segment. Management also added another $50m to their share repurchase authorization (~10% of current market capitalization). We believe the stock is far too cheap and remains better diversified than peers.

Arch Resources (ARCH): When we began following Arch, we focused on their metallurgical coal segment and viewed their thermal coal segment as a source of potential upside. However, especially since Russia's invasion of Ukraine, energy security has surged into focus and Arch's thermal operation now faces higher spot prices than their met sales. Arch retired most of their convertible debt during Q2, another example of their strong commitment to delivering shareholder value. Estimates for Q2 suggest Arch should earn over $20/share vs a $130 share price, and they remain committed to distributing half of their cash flow via dividends.

Dole PLC: Dole continues to perplex. The company has executed well in the face of significant cost inflation, yet the share price has significantly declined. Greater investor familiarity with the stock should eventually lead to price recovery; you rarely see a defensive, well-known, industry leading brand trading anywhere near Dole's current multiples. Two recent filings show some sophisticated investors share our view, with Taylor Farms and BDL Capital increasing their stakes in the business to over 5% ownership. Despite our conviction, Dole has remained one of the largest drags on our performance year to date.

A-Mark Precious Metals (AMRK): As expected, A-Mark blew away analyst estimates for Q3 earnings, providing commentary that they are increasing domestic market share and moving into international markets through their partial acquisition of Silver Gold Bull. The stock continues to trade at four times earnings, as investors appear skeptical that recent results are sustainable. Earnings won't be reported until September, but we expect full-year results to demonstrate their improved business model once again.

1847 Goedeker (POL): A position we substantially increased during the second quarter was GOED warrants - the right to buy shares of Goedeker's at $2.25, expiring mid-2026. We recently published an article on Seeking Alpha highlighting the company's floundering stock price despite strong execution. Many investors are concerned about cyclical businesses in a recession, but data shows demand for appliances remains steadier than other consumer durable categories. We believe the stock should be trading multiples higher and expect coming quarters will help alleviate investor concerns and shore up the shareholder base. Investing in warrants provides additional "torque" if/when the stock price re-rates higher.

CreditRiskMonitor (OTCQX:CRMZ): An original position in the fund, CRMZ is a $25m market cap Software as a Service ("SaaS") business with over $10m in cash and an unblemished record of growing revenue annually for 15 years. From 2007 to 2010, management grew revenues at more than 20% per annum as businesses learned the importance of business-to-business counterparty risk. As concerns about a recession swirl, we like the steady nature of CRMZ and the upside potential they have in a downturn. CRMZ launched a new Supply Chain product this year that should provide additional revenue growth. Costs for the development of the new product were not capitalized, which has obscured the margins from the legacy business. The stock is boring, cheap, and counter cyclical, making it a great fit in the current market environment.

Summary

We appreciate you entrusting us with your investment. Mike and I have invested most our net worth with Kingdom Capital and will continue to steward your capital as we do our own.

We are continuing to onboard new investors and would appreciate any referrals you deem appropriate.

Sincerely,

David Bastian, Chief Investment Officer

Footnotes

[1] (https://www.bloomberg.com/news/articles/2022-07-05/does-the-60-40-portfolio-work-why-balanced-investing-may-rebound-this-year)

This article was written by

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Disclosure: I/we have a beneficial long position in the shares of DOLE, UNTC, ARCH, AMRK, POL.WS, CRMZ either through stock ownership, options, or other derivatives. I wrote this article myself, and it expresses my own opinions. I am not receiving compensation for it. I have no business relationship with any company whose stock is mentioned in this article.

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