October 6, 2022

Quarterly Report - Kalo Capital Management, LP

Net Performance	Jul'22	Aug'22	Sep'22	Q3'22	YTD 2022
Kalo Capital Management, LP	(3.6%)	11.7%	(4.5%)	**2.9%**	**(18.3%)**
Russell 2000 (IWM)	10.6%	(2.0%)	(10.1%)	(2.6%)	(25.9%)
S&P 500 (SPY)	9.2%	(4.1%)	(9.6%)	(5.3%)	(24.8%)
Small Cap Momentum ETF (DWAS)	11.3%	0.9%	(10.2%)	0.9%	(23.9%)
Gross Alpha Performance	(7.0%)	12.3%	(1.0%)	3.2%	(7.4%)
Gross Beta Performance	3.8%	(0.4%)	(3.4%)	(0.2%)	(10.7%)

Performance

In the third quarter, Kalo gained 2.9% net versus a 2.6% loss for the Russell 2000. During the quarter our longs positively contributed 565 bps of performance against our shorts which negatively contributed 204 bps.

In Q3 things continued to look bleak for the economy and the stock market. With continuous short term up and down volatility, the first month and a half had the market bouncing back strongly, before falling again, down to new lows. These are wide swings – in fact the Russell 2000 and S&P 500 increased 18% and 13%, respectively, from July 1 to mid-August, before falling 18% and 17% from mid-August through September 30 (with many additional swings within).

Outlook

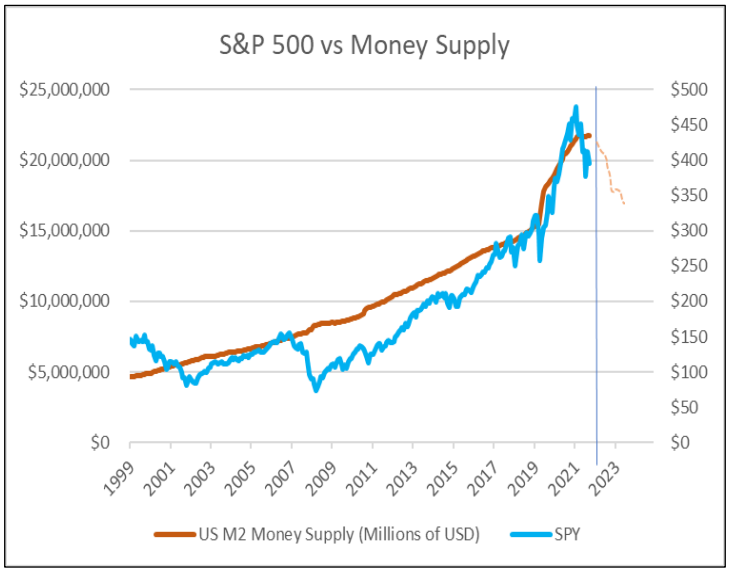
Overall, not much has changed since our outlook last quarter. And despite some wild swings, both the S&P 500 and the Russell 2000 are roughly where they were after Q2. We are expecting a continuation of the wide swings and up/down volatility, but overall expect the market to continue to be down to flattish. Despite our negative slant, we recognize that bounces to the upside can be dramatic, and while we have a macro view that impacts our portfolio, our true alpha comes from individual stock selection. As a result we generally manage the portfolio in our typical range of 30-50% net long. We currently have a 39% net exposure with gross long exposure of around 90%.

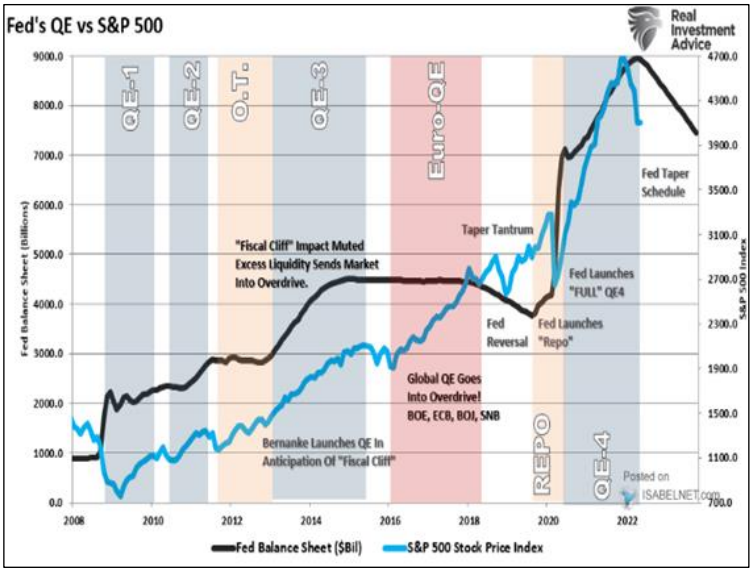
Our longs have already fallen to excellent risk/reward levels, and we believe they will generate significant alpha in the near future. As we said last quarter, but worth repeating: Despite our negative view on the broader market, we are excited by excellent value opportunities on the long side (in fundamentally growing businesses), the likes of which remind us of 2009/2010 after the 2008 financial crisis. We continue to focus on companies with the staying power to survive a weak economy and to increasingly penetrate their markets. While it is difficult to predict when these stocks will move significantly higher, at some point soon when investors re-engage with microcap names, we expect these stocks to materially increase. Our conviction comes from recognizing the deep discounts these stocks trade at vs. reasonable conservative cash flow power driven multiples. As these stocks get focused on, we expect significant alpha and material positive absolute performance for the portfolio. Our shorts are targeted on stocks that have seen limited pullback to date, where we believe fundamentals will slow and valuations are still high.

Macro themes we've been thinking about

The following few pages lay out some themes that frame our general outlook on the market.

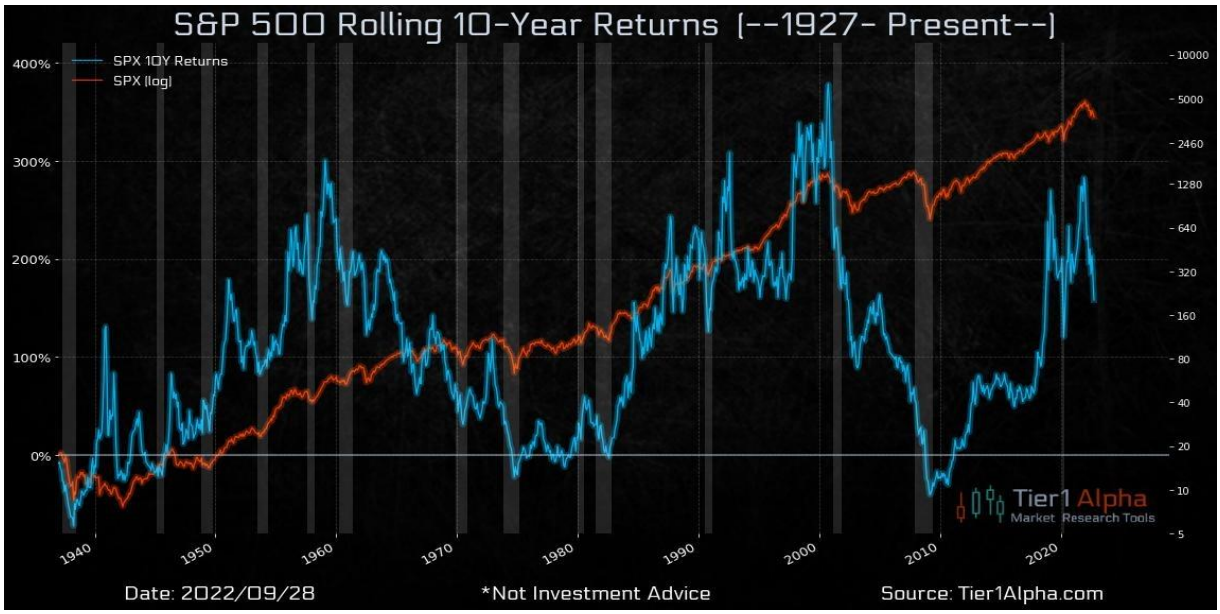
Inflation continues to be a big problem and the Fed continues to remain focused on addressing this by raising interest rates. Further Quantitative Tightening is finally coming (after many years of an expanding Fed balance sheet) as can be seen in the below left chart of M2 money supply (past and projected). The below right chart shows a similar view of how Quantitative Easing has driven much of the S&P 500 returns over the last 15 years. Without the support from Quantitative Easing, I believe the S&P 500 will continue to post meager to negative returns for many months to years. And given the heightened levels of persistent inflation, there does not seem to be a path for the Fed to return to material QE for years (however, there are those that believe they will nonetheless).



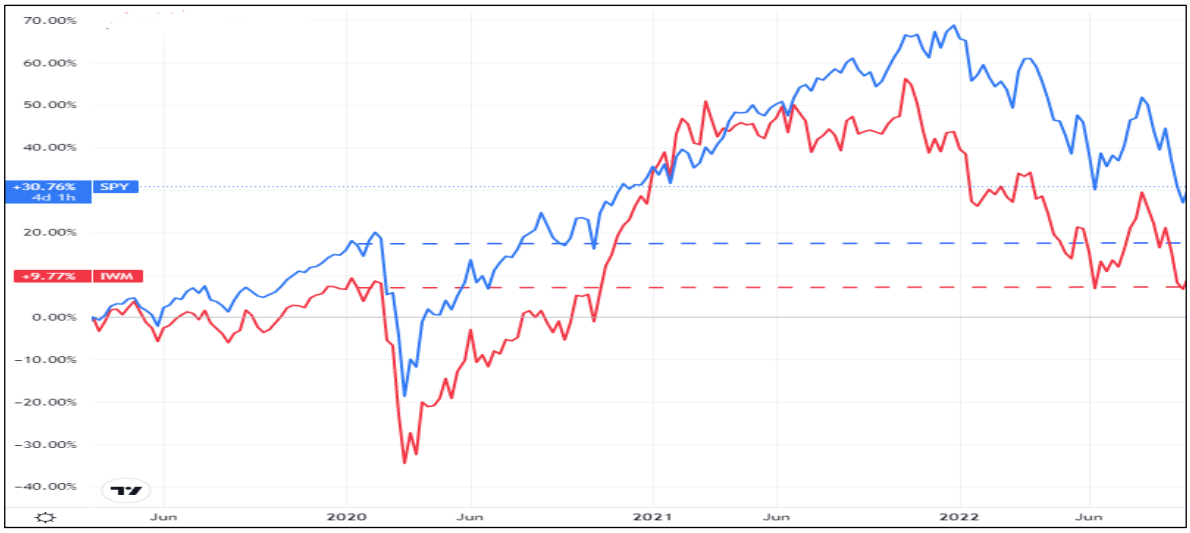


Consensus market views seem to be that the Fed is raising rates too aggressively and that this will severely damage the economy. Investor market bearishness is very high. However, after a 14-year Quantitative-Easing bullish run, I believe there is still more material downside to come for the broader market, which remains significantly higher than the start of 2020 (before the dramatic acceleration in government stimulus). Even with further downside, we do expect some volatile bounces in the market. At a high level, things seem a lot worse than they were before Covid, and now the artificial support from stimulus/growing Fed balance sheet is over (and actually reversing).

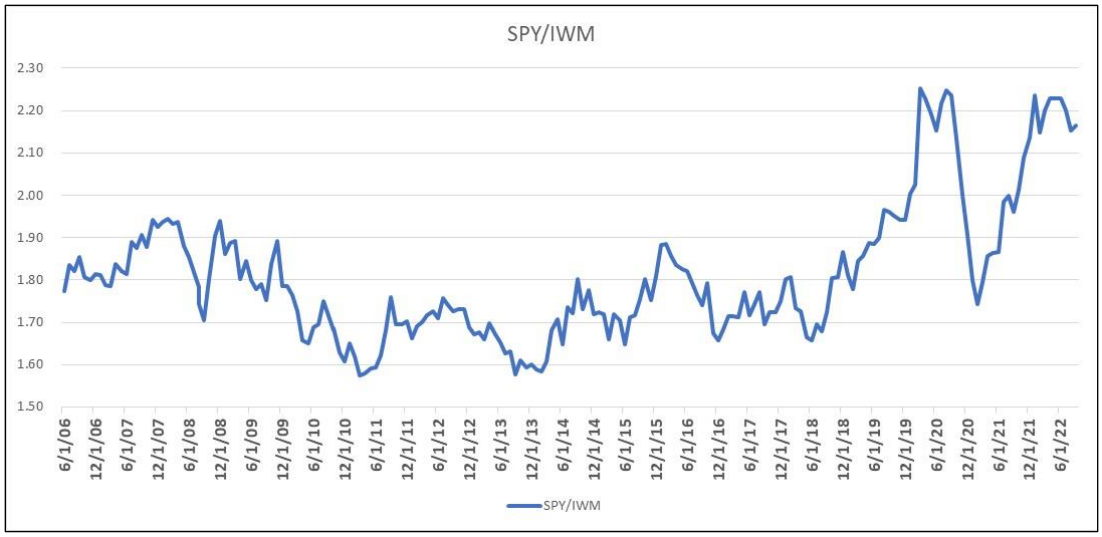
The following chart (courtesy of Tier1 Alpha) shows 10 year rolling returns for the S&P 500. In it you can see that the market goes through periods of positive returns, followed by extended periods of minimal returns. We are concerned that we may be at the front of a multi-year extended period of minimal returns for the S&P 500. It is in these times where our focus on emerging companies penetrating a market can generate differentiated alpha. To be clear, we believe Kalo can and will generate strong absolute returns even in a long term flattish market.



The chart below demonstrates how the broader stock market and mega-cap stocks react much later than the smaller market cap companies. We have experienced this as microcap/small caps suffered significant falls in 2021 and H1 2022 and are already at levels below the start of 2000 (the category of our longs). Meanwhile, the broader market/mega caps are still far from these early 2000 levels (where many of our shorts reside). In the chart below you can see the S&P 500 in blue (still at least 10% up from the start of 2020 before Covid hit and the Fed stimulus), while the smaller market cap Russell 2000 in red (is back to its start 2020 levels).



This chart below reflects the performance of the megacap S&P 500 divided by the Russell 2000. A rising line reflects the larger cap stocks outperforming vs the smaller caps (tougher environment for Kalo), while a falling line reflects the larger cap stocks underperforming (better environment for Kalo). As can be seen in the chart, we have just gone through a particularly strong relative time for large caps and this large cap outperformance is at extended levels, and we believe is due for a reversion to the mean…which would foretell a better environment for Kalo.



Investment Spotlight: ibex (IBEX)

Ibex helps companies connect with their customers and saves them money by offering a one-stop shop of contact center outsourcing, digital marketing, and customer feedback services. Ibex has transformed its business from a traditional call center labor arbitrage play to a digital transformation partner, helping brands with billing and tech support, digital marketing, lead generation, and much more. Their new customer experience (CX) platform has led to strong revenue growth from digitally focused brands, which have replaced low-margin legacy telco clients that now only represent 15% of revenues. In combination with their high quality CX experience, they also deliver call center agents from lower cost countries, combining for excellent returns and cost savings for clients. Clients won since 2016, which now represent ~3/4 of total revenues, have grown at a 78% CAGR and includes Amazon, Lyft, Sam's Club, Netflix, Walmart, and DoorDash. Going forward, we expect these clients to continue to grow at high-double digit rates with ibex, leading to continued margin expansion and outsized growth versus the market and peers.

Despite strong revenue prospects and strong margins and cash flows, shares trade at only ~ 4x this year's consensus EBITDA and only ~7x free cash flow, despite capex requirements declining and free cash flow set to inflect in the next couple of years. We believe this is largely due to the stock being unknown and trading with low liquidity, as well as its private equity ownership hangover. These stock overhangs are being addressed, and we believe will lead to a boost in the stock valuation over time. Ibex's significant private equity investor, TRG, has recently distributed a

sizable chunk of its shares, freeing up float for new institutional buyers, while management has engaged with the sell-side and brought on new coverage. Furthermore, the company is buying back shares as part of a $20M buyback program and the company has a strong balance sheet with ~$50M of cash available for opportunistic M&A or further share buybacks.

We believe that as the stock becomes more well-known, it should trade at least in-line with or at a premium to other peers in the space, which would lead to at least a doubling of the share price, just on multiple appreciation to peers alone. Alongside continued growth while peers slow, we could see shares potentially triple from here over the coming years as management continues to execute their transformation playbook, gain market share, and become better known in the investing community.

Conclusion

The economy is clearly worsening and investors are generally bearish. While we believe the broader market may have more pain to come, we feel our long positions have extremely powerful upside from their significantly depressed valuations. We appreciate your confidence in us. Wishing you, your family, and your business health and happiness.

Sincerely,

Steven D. Friedman, CFA
Founder and Portfolio Manager

Please note that Kalo's expectations and strategy can change regularly and the views expressed here may change.

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KALO CAPITAL MANAGEMENT

September 2022

Fund: Kalo Capital Management, LP
Portfolio Manager: Steven D. Friedman, CFA
Inception: March 2011
AUM: $19.7M

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Firm Summary

Kalo Capital is a fundamental long/short equity fund, targeting alpha-driven returns with controlled downside risk. Kalo was originally founded in 2011 to manage family assets and has since opened to outside investors. The strategy is designed for strong alpha driven returns with controlled downside risk. The equity long/short strategy is focused on small/micro market cap companies overlooked by the broader market, with fundamentally driven growth opportunities. Combined with valuation and catalyst timing criteria, this focus generates positions we believe will rise even in poor markets or a weak macro economy. Our process is a key differentiator - it enables us to consistently find these new ideas, which are not obvious to find nor easily replicable, and leverages off years of past manual analysis. We aim for positive absolute returns in any year as well as to outperform and have lower volatility than the Russell 2000 and S&P 500 over multiple years.

Historical Performance (Net)

	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	Year	IWM	Alpha
2022	(3.7%)	1.9%	(5.8%)	(10.5%)	(0.1%)	(3.9%)	(3.6%)	11.7%	(4.5%)				**(18.3%)**	(25.9%)	(7.4%)
2021	10.9%	13.3%	(4.5%)	(4.9%)	(3.0%)	(0.8%)	(7.2%)	(6.6%)	(4.1%)	7.0%	(5.8%)	(2.7%)	**(10.4%)**	13.5%	(13.6%)
2020	4.5%	0.6%	(16.1%)	10.8%	4.2%	3.4%	0.7%	7.6%	(2.1%)	2.4%	6.5%	13.4%	**38.2%**	18.3%	49.1%
2019	8.9%	4.2%	0.4%	1.3%	1.2%	(0.6%)	1.6%	1.1%	(2.7%)	0.8%	(0.1%)	(0.9%)	**15.8%**	24.9%	16.7%
2018	(1.2%)	3.0%	2.2%	1.6%	10.8%	3.5%	(1.3%)	4.9%	(3.3%)	(7.2%)	0.0%	(6.9%)	**4.8%**	(11.1%)	12.3%
2017	4.1%	(2.7%)	1.7%	1.7%	(2.3%)	6.1%	(1.0%)	(0.6%)	7.8%	0.1%	5.2%	(0.4%)	**20.9%**	14.6%	22.1%
2016	(5.1%)	2.4%	0.5%	1.7%	(2.6%)	0.4%	4.3%	1.5%	3.5%	(3.7%)	(0.9%)	0.8%	**2.5%**	21.6%	0.9%
2015	(5.3%)	4.9%	1.1%	0.8%	1.4%	(1.8%)	(4.3%)	(2.2%)	(2.5%)	8.5%	4.6%	0.8%	**5.3%**	(4.5%)	12.6%
2014	2.0%	5.0%	1.7%	(1.4%)	1.2%	2.3%	(2.0%)	0.1%	(1.6%)	0.5%	(2.6%)	2.2%	**7.7%**	5.0%	11.9%
2013	2.2%	2.5%	1.2%	0.9%	3.4%	2.4%	3.2%	0.8%	1.6%	1.4%	1.1%	2.7%	**26.0%**	38.7%	15.6%
2012	5.1%	2.2%	0.7%	(2.6%)	(2.9%)	3.6%	(2.0%)	3.5%	(0.3%)	0.1%	0.3%	0.3%	**7.7%**	16.7%	3.6%
2011			0.4%	0.8%	(2.2%)	(0.2%)	(1.7%)	(2.7%)	(5.1%)	2.1%	(2.2%)	(0.9%)	**(11.3%)**	(9.1%)	(4.2%)

Attribution (Gross)	Longs	Shorts	Alpha	Beta
Month-to-Date	(9.0%)	4.7%	(0.9%)	(3.4%)
Year-to-Date	(33.4%)	19.4%	(7.4%)	(10.7%)

Exposure (Month End)			
Long	Short	Gross	Net
88%	(55%)	143%	34%

Concentration	
Top 5 Longs	30%
Top 10 Longs	46%

Benchmark Comparison (Net)

through September 2022

	Kalo Capital	Russell 2000 (IWM)	S&P 500 (SPY)
Month-to-Date	**(4.5%)**	(10.1%)	(9.6%)
Quarter-to-Date	**2.9%**	(2.6%)	(5.3%)
Year-to-Date	**(18.3%)**	(25.9%)	(24.8%)
Trailing 24 Months	**(9.5%)**	10.1%	6.7%
Inception-to-Date	**107.7%**	127.3%	219.8%
Since Inception (March 2011-Present)			
Inception-to-Date CAGR	**6.5%**	7.3%	10.6%
5 Year CAGR	**5.2%**	2.7%	8.1%
3 Year CAGR	**0.3%**	2.9%	6.4%
Annual Downside Volatility	**9.3%**	13.0%	9.3%
Max Drawdown	**(45.5%)**	(32.8%)	(24.8%)
Sharpe Ratio	**0.49**	0.46	0.76
5 Year Sharpe Ratio	**0.34**	0.23	0.52
Sortino Ratio	**0.79**	0.68	1.18
5 Year Sortino Ratio	**0.55**	0.32	0.76

Alpha Performance Driven Stats	
Annualized Alpha (Gross)	9.7%
5 Year Annual. Alpha (Gross)	11.5%
Correlation to Russell	64%
Correlation to S&P	47%

Fund Terms	
Fees:	1.5% / 20%
Min Investment:	$100k
High Water Mark:	Yes
Liquidity:	Monthly
Lockup:	None

Service Providers	
Prime Broker:	Jefferies
Auditor:	Berkower LLC
Legal:	Crow & Cushing
Admin:	Theorem Fund Services
CFO Support:	Constellation

Note: Most recent month performance may be preliminary. Past performance is not indicative of future results. Performance calculations are net of all fees, 1.5% management fee and 20% performance fee. Index comparisons for IWM (Russell 2000 ETF) and SPY (S&P 500 ETF) adjust for dividend reinvestments. Alpha performance calculated vs IWM (Russell 2000) and is gross (before fees). Exposure levels adjust for inverse ETFs and net boxed positions. Concentration shows exposure as percentage of assets. Performance from longs versus shorts may not adjust for boxed positions.

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*Past performance is not indicative of future results.