August 2021

Dear Partners,

SRK Fund I, LP appreciated +59.17% during the first half of 2021. In contrast, the S&P 500 and the Russell 2000 gained +15.25% and 17.53%, respectively. Since inception, the Fund has appreciated 570.71% compared to 72.21% for the S&P 500 and 56.14% for the Russell 2000.

SRK Fund I, LP Returns (%) as of June 30, 2021

	H1 2021	2020	2019	2018*	Since Inception*
SRK Fund I, LP	59.17%	127.72%	77.99%	2.90%	570.71%
S&P 500 TR	15.25%	18.40%	31.48%	-4.03%	72.21%
Russell 2000	17.53%	20.00%	25.52%	-11.72%	56.14%

**Inception date of 05/01/18*

The Fund is off to a strong start through the halfway point of the year. Like usual, I will warn partners from extrapolating these returns into the future as it will be difficult to maintain this level of outperformance over many years.

As previously mentioned, our new format going forward is two letters per year to partners. The decision was made based on: 1.) I believe commentary two times per year is sufficient in evaluating our progress 2.) a letter every six months instills our long-term thinking 3.) realistically, there are not many changes on a quarterly basis, and I typically do not have much to say. My job and goal are to deliver long-term market beating returns, thus, research and finding new opportunities are the most valuable uses of my time.

In May, we surpassed the three-year anniversary of the inception of the Fund and a minimum length of time I feel is fair to judge your managers performance. Since inception, we have turned a dollar into six dollars and seventy cents, compared to the S&P 500 which would have added around seventy-two cents to that dollar. This has been achieved without the use of leverage, options, or shorting; just plain vanilla bottom-up concentrated stock picking. It's not completely fair to compare our returns to a specific index since our strategy is in no shape or form representative of an index, but the S&P 500 has historically proven to be a difficult opponent to beat over time for many investors alike and we have done a respectable job thus far.

When speaking with prospective investors I have recognized that some have found it difficult to compartmentalize our strategy because we are unconventional. We do not require flashy marketing material to explain how we approach investing. Our strategy is simple: I look to buy businesses that are worth much more than I can buy them for today. I try to keep it simple, stick with what I know, and wait for an opportunity that is obvious to me (there is no fear of missing out over here). Therefore, I do not find many ideas that I have great conviction in, which leads to our concentrated portfolio. When determining how to size positions in the portfolio I am typically sizing stocks the largest that I determine have limited downside from the prices we are paying and the potential for significant upside. Position sizing has been a significant driver of our returns since inception and will continue to drive our returns into the future. I struggle to understand the concept of finding an opportunity that I have high conviction in only to make it a 3% position, just for the sake of diversification. In a perfect world, if I could find fifty ideas with equal return opportunity and level of conviction, we could allocate an equal amount of our portfolio to those stocks and not have to live with the volatility of a concentrated portfolio. In reality, I do not know of fifty equally great opportunities that I am confident in at any one point in time. To get a better idea of how I think about portfolio concentration and conviction, I will refer to a simplified version of the Kelly criterion. The Kelly criterion is a formula that can be used to determine how much of one's capital should be allocated to an idea based on the probability (conviction) of being right. If we come back to the 3% portfolio allocation and solve for probability, $3\% = ((2.1*p) – 1.1)$, we can see that this allocation correlates with a conviction level that is barely higher than 50/50. There's a lot of ideas that I would consider to be 50/50 outcomes and I'm not too optimistic about betting on those odds nor should I be paid to fill a portfolio full of 50/50 ideas, so I pass on them until I find something with a higher probability of getting the outcome correct. Is this perfect? Certainly not, this is simply to help you understand how I think about position sizing and conviction. There are multiple variables that determine position sizing in our portfolio, understanding the downside and level of conviction are two of them.

<u>The Market</u>

During the second quarter many stocks that went straight up over the past year appeared to have had some of the air let out of their balloons. Many of these stocks that I leisurely follow for entertainment value may appear cheap because they are 30-50% off their highs, but fundamentally they have not reached anywhere near a floor of value. The excitement and speculation in SPACs have also dissipated with a portion of them now trading below their original trust value. Over the next year I won't be surprised to see de-SPACed companies disappoint as they fail to hit their egregious projections and the shareholders begin to realize they own overpriced pigs covered-up in shiny lipstick. As far as inflation concerns go, I don't have an opinion whether it is transitory or here to stay. I do know from history that more has been lost by investing with the fear of macro-economic concerns than by choosing to mostly ignore them and focus on individual company fundamentals.

<u>Portfolio Updates</u>

Tile Shop Holdings Inc. (TTSH)

The Tile Shop has continued to contribute to our performance so far in 2021. The company has been able to execute on the back of strong housing trends. In June the company's up-listing to the Nasdaq was completed; TTSH will now be eligible to be included in indices during the next rebalance at the end of the year which could prove to be a catalyst for the stock price from index buying demand. More importantly, the business has continued to move in the right direction. The company reported Q2 revenue of $96.2 Million, a quarterly sales record and an 8.2% increase over Q2 2019 revenues, with Pro customers now representing over 60% of revenues vs retail customers. This has translated to increased operating margins and earnings over previous quarters. The company has experienced supply chain issues like so many others, but management commented that these issues seem to be improving. The balance sheet has strengthened even further with cash accumulating to approximately $45 Million, and no debt. This leaves the company with a capital allocation decision. What to do with the cash? If history is any indication of what Peter Kamin controlled companies do, we can speculate that there is potentially a return of capital in shareholders future. With improving fundamentals and a strong runway for renovation and remodeling trends the Tile Shop could be a buyout target with the current valuation that it sports.

Salona Global Medical Device Corp. (SGMD.V)

Salona Global began trading again in early June after its merger was approved by stockholders, and the stock price has appreciated significantly (remember, we have owned Salona since it was trading below the cash on its balance sheet). Salona was and still is an interesting situation; to date the company has acquired two medical device companies with combined revenues of approximately $27 Million. Salona's strategy will be to continue acquiring small niche medical device companies in the U.S. with the goal of expanding their distribution to international markets. The future success of an investment in Salona largely resides on management's ability to execute this acquisition strategy. Luckily, the players involved have immense insight in running this exact playbook successfully in the past with experience in acquiring, integrating, and scaling up operations. Most acquisition strategies give me cause for concern, but I think there could be enormous potential for Salona to attractively grow into the future. The appeal of Salona's business model is the ability to acquire companies for private company multiples in an industry ripe for consolidation that is littered with small niche players that are typically undercapitalized with insufficient scale to expand their sales. It's too early in the game to pass much judgment on the company and their strategy, but I am pleased so far.

Nocopi Technologies Inc. (NNUP)

It seems my recommendation for the company to repurchase shares has fallen on deaf ears and now the share price has rallied by more than 30%. Q1 results showed a promising improvement in licenses, royalties, and fees, which tend to lead product sales higher as product at the end market is bought and needs restocking. Looking forward I expect Nocopi to continue its growth as it has the past several years. The main question persists, will they commit to returning capital to shareholders.

Harrow Health Inc. (HROW)

Harrow Health is a new position added to the portfolio during the first half of the year. I believe the company is overlooked by the market due to its small market cap, accounting masking the attractiveness of its core business, and failure to price in the current transformation that is taking place. I believe the business has reached a fundamental inflection point as operating leverage begins to take effect and management is able to strengthen and de-risk the platform with favorable partnerships and acquisitions. The core business is ImprimisRx, a market leading FDA-registered ophthalmic pharmaceutical drug compounder serving over 10,000 prescribers, institutions, and their patients. Since 2014, they have grown this business from zero revenues to over $51 Million. Their research has shown that over 90 percent of ophthalmic prescribers regularly used compounded drugs in their practices due to the fact that FDA-approved products were not adequately meeting the needs of a vast number of ophthalmologists, optometrists, and their patients. A sizeable portion of Harrows revenues come from cataract surgery patients; currently about 4 million cataract surgeries are performed each year in the U.S., and this is conservatively expected grow at 4% per year over the next decade as the population ages. Covid has resulted in pent-up demand for cataract surgeries that were put on hold last year due to limitations on elective surgeries. This should result in additional increased revenues over the next two years as approximately 1.6 million additional cataract surgeries need to be completed. The quality of the ImprimisRx business has been partly obscured due to investments in three separate pharmaceutical companies held on their balance sheet and how their change in valuation is accounted for on the income statement (Harrow values these investments around $40 million, but I have left them out of my valuation). Comparing ImprimisRx's 4Q20 to 4Q19, gives us an idea of the growth and operating leverage inherent in the business; ImprimisRx did $5.0 Million Ebitda in 4Q20 compared to $2.2 Million Ebitda in 4Q19. During the first half of the year Harrow was able to raise $75 Million+ of new capital without diluting shareholders. They plan to use this new capital to leverage the scale and sales relationships they have created to add accretive FDA-approved products to their platform and in effect meaningfully de-risk and improve the quality of their business. As this business continues to scale and operating leverage inflects higher, I expect operating margins to increase to over 30% in the years to come with remarkably high returns on the capital invested in the ImprimisRx business. I believe Harrow Health is potentially worth multiples of its current valuation.

During the first quarter we sold the rest of our Bragg Gaming position for a respectable gain. A handful of other positions round out the portfolio with some larger than others. We have been buying several new positions that I will leave unnamed for now.

Closing Thoughts

The past three years have been fun and abundantly profitable, and I am opportunistic about what the next three years and more will be for us. Realistically, it will be hard to one up our performance since inception. I realize that certain previous opportunities will not be accessible to us as the Fund grows in size but that does not give me cause for concern, because what is most important to our strategy is our temperament and our thinking. Those are truly what have and will hopefully continue to deliver long-term market beating returns.

The next opening for the Fund is October 1st. If you want to make an additional contribution or someone you know is an Accredited Investor and would like to learn more about the Fund, please feel free to reach out to me at info@srk-capital.com and we can set a time for a more detailed discussion to determine if we are a good fit.

Sincerely,

Sean Kirkwood

SRK Capital, LLC

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