January 2024

Dear Partners,

SRK Fund I, LP appreciated 17.15% during 2023. In contrast, the S&P 500 and the Russell 2000 appreciated 26.29% and 16.93%, respectively. Since inception, the Fund has appreciated 869.94% compared to 98.88% for the S&P 500 and 41.75% for the Russell 2000.

SRK Fund I, LP Returns (%) as of December 31, 2023

	2023	2022	2021	2020	2019	2018*	Since Inception*
SRK Fund I, LP	17.15%	35.31%	46.71%	127.72%	77.99%	2.90%	869.94%
S&P 500 TR	26.29%	-18.11%	28.71%	18.40%	31.48%	-4.03%	98.88%
Russell 2000	16.93%	-20.47%	14.78%	20.00%	25.52%	-11.72%	41.75%

**Inception date of 05/01/18*

2023 was the first year the Fund underperformed the S&P 500. The underperformance can be attributed to a combination of my own mistakes and factors I consider out of my control. With reference to the latter, equity markets surged higher during the final two months of the fourth quarter on the back of expected rate cuts, the majority of our holdings did not experience this same surge due to our portfolios positioning towards small obscure securities. The mistakes I made concern our position in Harrow (HROW). In April, when the stock was trading in the $20's, I decided to sell a chunk of shares due to valuation and position size risk. In hindsight, the entire position should have been sold at that time. I did not fully exit the position, I'm embarrassed to say, because I allowed the big picture of significant revenue and earnings growth to cloud my judgement causing me to overlook the amount of execution risk and optimism that was priced into the stock. This mistake weighed on our performance in the second half of the year. At this time, we no longer hold a position in Harrow. While I still have conviction in the company and believe they will be highly successful, I have chosen to allocate the majority of the capital to a new opportunity that has similar upside as Harrow with minimal downside and a higher degree of predictability with several catalysts over the next 12-18 months that I believe will cause the stock to rerate. *(A separate communication to partners will provide further information about this new holding).*

Portfolio Updates

Innovative Solutions & Support (ISSC)

ISSC is a previously undisclosed position operating in the aerospace sector with robust double-digit growth, attractive margins, operating leverage, and an acquisition strategy in place to take advantage of significant incremental margins from increased manufacturing capacity utilization.

The company's products are focused within the cockpit and cabin of business, cargo, and military aircraft for OEMs as well as aftermarket retrofits. Products consist of flat panel displays, flight management systems, and proprietary flight control technology such as their utility management system (UMS) and autothrottle which reduce pilot workload and enhance safety.

The appealing opportunity with ISSC is for the company to continue growing their existing product lines at historical growth rates of ~20% while bolting on acquisitions and bringing the acquired products into their existing operations to increase capacity utilization. In July, the company announced their first acquisition of inertial, communication, and navigation product lines from Honeywell that produced $9.5M of net income in 2022 for a purchase price of $36M or 4x earnings. The acquisition has the effect of increasing capacity utilization to 50% and nearly doubling earnings for FY24. ISSC was one of seven bidders and were chosen for their expertise and reliability as these products still have decades of life left and Honeywell was interested in finding a buyer who will be able to perform to their standards for large OEMs like Boeing, Airbus, Embraer, and Gulfstream rather than accepting the highest bidder. The acquisition was funded through a combination of cash and debt, which has been rapidly paid down from $18M to under $12M in less than 6 months. The debt paydown is a testament to the high level of cash flow the company generates and has afforded them increased funding from their lenders. Currently the market is valuing ISSC at less than 12x FY24E earnings, a material discount to peers, and is giving zero benefit to the impact additional acquisitions will have on the company's future earnings power. I think it's likely that the company will complete an additional acquisition this year, possibly with Honeywell again.

Vaso Corporation (VASO)

VASO reported relatively disappointing earnings for Q3 as revenue decreased 2% year-over-year and net income was impacted as operating expenses increased due to investment in new programs and the impact of inflation on wages. In December, Vaso announced that the company is uplisting from the OTCQX market to the Nasdaq Stock Market via merger with a SPAC. The transaction is expected to be completed by the end of this quarter and values Vaso at a pro forma equity value of approximately $176 million. From the S-4 that was filed by Achari Ventures (AVHI) the pro forma equity value of $176 million is equal to a current value of $0.93/share for VASO. This is a significant discount to the current trading price of $0.28/share. This significant discount exists for several reasons, but mostly because $176M is an arbitrary number that doesn't hold much meaning, it will be up to the market to determine the fair value for the Nasdaq listed VASO. This is a rather odd transaction as SPACs don't typically merge with already publicly traded companies, but I believe a Nasdaq listed Vaso with improved investor relations and governance is worth a premium to its current status. We will receive new shares of the Nasdaq listed Vaso that I believe will initially trade somewhere around $9.31 and will have to decline by approximately 70% for us to lose money from today's market value of VASO. Also, due to a put option provision that the SPAC founders have, Vaso is incentivized to keep the newly traded stock above $8/share for six months following the initial twelve months from the closing of the transaction or they will be required to repurchase shares from the SPAC founders.

Heritage Global (HGBL)

HGBL reported Q3 earnings that failed to meet expectations due to a credit loss reserve that was taken in the specialty lending segment, caused by their largest borrower experiencing slower charged-off collections. I don't believe this is a long-term issue as slower collections are being experienced industry-wide as the level of charge-offs continues to normalize to pre-pandemic trends. This normalization continues to benefit Heritage's brokerage business with operating income growth of 64% year-over-year and 140% for the nine months of 2023. Reports from credit card issuers indicate that net charge-offs continue to increase above 2019 levels. An interesting anecdote driving charge-offs is the millions of Americans whose credit worthiness improved during the pandemic thanks to less spending, government stimulus, and forbearance on some payments. This migration to better risk tiers appears to have deceived many of these lenders as they optimistically lent to this group of individuals who have now seemingly reverted back to their historical credit worthiness and are falling behind on their debt payments. This trend should drive continued growth in revenue and earnings for Heritage Global. The stock sell-off following the Q3 earnings report provided us with an attractive opportunity to add to our position at less than 10x expected earnings.

Sigmatron International (SGMA)

SGMA is a provider of electronic manufacturing services that was added as a holding during the first half of the year. As a contract manufacturer, Sigmatron is far from a glamorous business with its razor thin margins, capital intensity, and the ability of its customers to delay purchase orders with limited warning. These unattractive attributes along with a heavy debt load, declining earnings, and management's capital allocation checkered past are why SGMA can be purchased for less than one third of book value and 3x normalized earnings. SGMA has been near breakeven through the first two quarters of FY24 and has already indicated that Q3 appears challenging. The consumer products segment of their business appears to be struggling the most as higher interest rates have led to a significant slowdown in large consumer goods purchases. Slowing inflation and Fed rate cuts could provide a tailwind for the consumer products segment to return to growth. On a positive note, the company was able to release nearly $20M from inventory during the first six months. I expect inventory levels to decrease further to more historical levels of revenue, providing an additional $20-30M for debt paydown. The company also announced several large new contracts but are not expected to provide a benefit until FY25. The immediate future looks pessimistic but reduced debt, lower interest rates, and the impact of new contracts will eventually have a positive impact on Sigmatron's fundamentals.

Closing Thoughts

I'm disappointed in our results for the second half of the year. Bouts of volatility and periods of underperformance are to be expected with our concentrated strategy. Unfortunately, our lagging performance is not entirely due to market volatility but rather my lack of discipline as I chose to overlook valuation. Our strategy doesn't require that I sell stocks with precise execution, but I believe it was an opportunity that I missed which partly set us up for a difficult second half of the year. Our future performance will largely be driven by the underlying operating results of the businesses we own. I'm never comfortable predicting short-term stock price movements and can't guarantee performance, but I am optimistic about the current outlook of our portfolio. I believe our holdings present a significant opportunity with minimal fundamental downside and several catalysts on the horizon that should help to generate reasonable results throughout the next 12-18 months.

Thank you to each one of you for your continued trust and patience. Your attitude towards long-term investing provides us with the opportunity to see our theses play out in pursuit of market beating returns. As always, feel free to reach out with any questions or concerns.

Sincerely,

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