

SRK CAPITAL

August 2024

Dear Partners,

SRK Fund I, LP depreciated -7.14% during the first half of 2024. In contrast, the S&P 500 and the Russell 2000 appreciated 15.29% and 1.73%, respectively. Since inception, the Fund has appreciated 800.68% compared to 129.29% for the S&P 500 and 44.20% for the Russell 2000.

SRK Fund I, LP Returns (%) as of June 30, 2024

	YTD	2023	2022	2021	2020	2019	Since Inception*
SRK Fund I, LP	-7.14%	17.15%	35.31%	46.71%	127.72%	77.99%	800.68%
S&P 500 TR	15.29%	26.29%	-18.11%	28.71%	18.40%	31.48%	129.29%
Russell 2000	1.73%	16.93%	-20.47%	14.78%	20.00%	25.52%	44.20%

**Inception date of 05/01/18*

Being down in any given 6-to-12-month period doesn't necessarily demand disappointment, given that in order to outperform I am going to look foolish at times. What I am disappointed in is the amount of mistakes I have made. It is often said that experience is best defined as making mistakes and learning from them, and I sure have made more than my fair share during this period of underperformance. It has felt as if I have been living under constant Murphy's Law, where anything that can go wrong has gone wrong. It is unfortunate, but I am not discouraged. My core investment principles and process are still intact, and idea generation continues to produce attractive opportunities. As a result of this underperformance, I believe that our portfolio is trading at its largest discount to intrinsic value since the inception of the Fund, outside of the covid bottom. I am confident that the Fund will produce significant investment returns, and it is only a matter of time before the tide turns in our favor.

Portfolio Updates

Innovative Solutions & Support (ISSC)

My initial analysis of ISSC was flawed. I failed to correctly analyze the company's recent reliance on the cargo plane conversion market for sales of its flat panel displays. This mistake led me to overestimating earnings as the cargo conversion market has experienced a significant pullback after several years of impressive growth. Despite this mistake, ISSC still presents attractive returns as there is a clear path for the company to earn greater than \$0.50 of earnings per share over the next year. The Honeywell integration is nearly complete, I expect margins will continue improve in this business during FY25 as the workforce becomes more efficient and the manufacturing of some components are brought in house for which Honeywell had historically outsourced. Following the quarter, the company completed an additional acquisition of Honeywell product lines and announced a new military display contract which will add several million dollars of revenue combined. The business outlook appears positive as its likely the cargo market has reached a trough with any improvement providing upside to earnings and additional growth is likely with the Textron and Pilatus contracts.

Vaso Corporation (VASO)

Vaso reported break-even results for the first half of the year. The muted results were largely driven by increased operating expenses due to one-time transaction costs associated with the business combination and continued investment in headcount to support the new ultrasound sales program. The business combination with Achari Ventures, originally expected to close in Q1, is now on track to close by the end of Q3. Vaso is heading into its seasonally strongest quarters with historically high deferred revenue and backlog. The company has indicated they are optimistic about the remainder of the year as both top- and bottom-line numbers are tracking ahead of their 2024 goals year-to-date. Vaso is currently valued at five times earnings after subtracting \$25.7M of cash on the balance sheet, with organic and inorganic growth initiatives and an imminent uplisting to the Nasdaq. I will hopefully have more information to report on after the company holds a special meeting on August 26th to approve the business combination.

Heritage Global (HGBL)

The good news is that HGBL's core businesses reported solid performance with an optimistic outlook driven by continued growth in consumer credit, charge-offs, and bankruptcies. I believe the market has a misperception of the company, specifically the charge-off brokerage business, as merely a beneficiary of a recession and values it as such. The company certainly will benefit from a recessionary environment as the rate of consumer credit charge-offs and bankruptcies increase, however, the business is more an extension of credit and economic growth than only a counter-cyclical beneficiary. Economic growth and consumer credit growth go hand in hand, and in turn an increased value of charge-offs that will need to be sold even as the rate of charge-offs remains the same. It appears the market is valuing the business as if the rate of charge-offs are estimated to revert to levels seen during the pandemic, I believe that is highly unlikely.

The bad news is that the largest borrower from the company's specialty lending segment remitted less than its required minimum payment in the second quarter and as a result the borrower's loans were placed into default status. The borrower is still making payments albeit at a lower amount than is required in the loan terms, which forced the company to place the loans in non-accrual. Going forward all payments received will be allocated fully to reducing the principal, leading to lower earnings for the foreseeable future from these troubled loans. As a result of this issue arising, the Company's board has hired an advisor to help it evaluate potential strategic options for the specialty lending segment. My advice to the company is to divest or wind-down the lending segment and commit to returning a significant amount of capital to shareholders. The segment earns returns below their cost of capital while increasing the risk and complexity of the company. The core business is trading at a mid-single digit earnings multiple combined with an optimistic outlook for growth.

ImmuCell Corporation (ICCC)

ImmuCell (ICCC) is an animal health company focused on improving the health and productivity of dairy cows and beef cattle. The company's core business, scours prevention, has grown at greater than 10% a year for a decade, taken market share from competitors by offering a more effective product, and is nearing significant fundamental improvement after being plagued by production issues for nearly two years. The profitability of the Scours segment has

been obscured by product development expenses to pursue FDA approval of a promising new product. I believe the market is severely overlooking ImmuCell as the company is likely at a key infection point and is set to substantially increase earnings over the next several years as product development expenses decline and operating expenses normalize.

Scours, or calf diarrhea, is one of the most prominent illnesses in young calves and can be costly due to health, well-being, and performance. The primary cause of scours in newborn calves are pathogens such as rotavirus, coronavirus, and E. coli, which calves' immune systems are not able to fully defend against. If not promptly treated, scours will lead to dehydration, weight loss, and sometimes death. Additionally, calves that contract scours typically have lasting effects throughout their lives as less productive cows (less milk and growth) and are more susceptible to disease. The economic harm caused by scours to the U.S. dairy and beef industries is estimated at approximately \$741 million annually. Historically, the most common tool to help combat scours has been to vaccinate the mother cow prior to calving with the prospect that she will impart antibodies into her colostrum (milk) to protect her calf. This is not a foolproof method though, as scours vaccines effectiveness can be influenced by numerous factors such as the timing of administration, the overall health of the cow, and the timing of calving from when the vaccine was given. Furthermore, there can be significant variability in individual immune responses to the vaccine, which means that some cows may not develop sufficient levels of antibodies needed to protect the calf.

ImmuCell offers a more effective alternative to vaccination with its First Defense product. Unlike vaccines that depend on stimulating the cow's immune system, First Defense eliminates the uncertainty of a vaccine response and guarantees consistent antibody protection by delivering preformed antibodies directly to the newborn calf. This is achieved through a proprietary process involving the vaccination of source cows, which antibodies are then harvested from her colostrum and manufactured into the First Defense product. This direct delivery of a guaranteed level of antibodies bypasses the challenges associated with scour vaccines. Following the introduction of the Tri-Shield format in 2018, which added valuable rotavirus claim, First Defense has been able to more effectively compete against and take market share from vaccine competitors.

This period of growth has presented ImmuCell with a number of temporary, yet significant, challenges. For nearly two years, production issues have led to revenue declines and margin deterioration. Supply chain disruptions in 2022 delayed much needed equipment for expanding production capacity. As new equipment came online in late 2022, three major contamination events, originating from supply farms, further impacted production and margins throughout 2023. ImmuCell believes it has addressed the root causes of these contamination events through increased supply farms and enhanced quality control procedures. Revenue for the first six months of FY24 increased 82% to \$12.73M, but gross margins were only 28%. Capacity utilization for the first six months of FY24 averaged 85% and management has guided to 95% utilization for the remainder of the year. This increased capacity utilization will likely lead to a significant improvement to gross margins on top of record revenue and operating income from the First Defense segment during the remainder of 2024. If gross margins are able to return to management's target of 40%, I believe the scours segment is likely to generate greater than \$8M of operating income in FY25.

The profitability of the scours segment is not evident in the company's bottom line as it has been obscured by product development expenses to pursue FDA approval of Re-Tain. Re-Tain is a potentially revolutionary product developed by ImmuCell specifically for treating subclinical mastitis in lactating cows. Mastitis is an inflammation of the cow's mammary gland caused by a bacterial infection. It's the most prevalent disease affecting cows, costing the U.S. dairy industry approximately \$2 Billion in economic loss each year. Current medical treatment involves the use of antibiotics, which requires the cow's milk to be discarded for a period of time until the antibiotics have cleared their system. The cost of antibiotics combined with lost profits from discarded milk often leads to mastitis going untreated until the infection becomes severe enough to make economic sense for antibiotic treatment. Re-Tain is revolutionary because it is antibiotic-free and requires zero milk discard, making it more economically feasible for dairy producers to treat Mastitis at early onset. Although the company failed to receive FDA approval following its third submission of the final section, management indicated that only minor

questions remain, allowing for a potentially shortened review period. The company intends to make the fourth submission shortly, with an expected response from the FDA by the first quarter of 2025. The revenue potential for Re-Tain is conservatively twice the size of the scours prevention market; eventual approval will establish a path to a doubling of revenues over time with \$10 million of production capacity presently in place.

Irrespective of the outcome of the fourth submission, I believe the company is at a definitive turning point. First Defense production issues have been rectified but have not shown up as improved gross margins due to the lag effect to COGs from the long production cycle. As Re-Tain nears eventual approval, product development expenses are set to decline, leading to lower operating costs and less obscured financials. ImmuCell is worth multiples of its current value.

Exited Positions

During the first half of the year, we sold Sigmatron International (SGMA) and parted ways with Surmodics (SRDX) following a buyout offer for \$43/share.

Closing Thoughts

While the recent underperformance has negatively impacted our results, it presents a valuable opportunity for both existing and potential investors to achieve higher returns moving forward with our portfolio trading at its largest discount to intrinsic value since the inception of the Fund. Additionally, I believe we have the opportunity to substantially influence and unlock the value of several of our holdings if necessary.

Sincerely,

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