

# SRK CAPITAL

February 2025

Dear Partners,

SRK Fund I, LP declined -8.74% during 2024. In contrast, the S&P 500 and the Russell 2000 gained 25.02% and 11.54%, respectively. Since inception, the Fund has appreciated 785.17% compared to 148.62% for the S&P 500 and 58.31% for the Russell 2000.

## ***SRK Fund I, LP Returns (%) as of December 31, 2024***

	2024	2023	2022	2021	2020	2019	Since Inception*
<b>SRK Fund I, LP</b>	-8.74%	17.15%	35.31%	46.71%	127.72%	77.99%	785.17%
<b>S&amp;P 500 TR</b>	25.02%	26.29%	-18.11%	28.71%	18.40%	31.48%	148.62%
<b>Russell 2000</b>	11.54%	16.93%	-20.47%	14.78%	20.00%	25.52%	58.31%

*\*Inception date of 05/01/18*

Our 2024 performance was undeniably disappointing. Any year that results in a loss is unsatisfactory, even more so when the broader market delivered such strong returns. Our concentrated investment strategy, while designed to maximize long-term outperformance, inherently entails a greater degree of variability in returns relative to market indexes. This was clearly evident in 2024, as some of our holdings were negatively impacted, while others simply didn't meet expectations, resulting in the first year of negative performance since inception.

While I aim for annual outperformance, my primary focus is on achieving superior long-term investment results. This requires a patient multi-year perspective, allowing time for investment theses to play out and the market to recognize the true value of our holdings. During this multi-year outlook (18-24 months), I have a high degree of conviction to what is going to happen, the exact timing on when the market will agree with me is somewhat less certain. Throughout this period of underperformance, specifically from September 2023 to September 2024, several of our high conviction holdings have taken longer to materialize than originally thought. While some might quantify this as being wrong, I believe that if the investment thesis remains valid with an acceptable rate of return, achieving the outcome in 2 years rather than 1.5 years still provides a highly attractive outcome. A slight delay in the realization of the investment thesis

does not diminish the attractiveness of the opportunity, as long as the fundamental premise remains intact.

Below I discuss two core holdings, two holdings that contributed to our negative performance, and two new holdings added during the second half of the year. As a reminder, these are only the positions I have chosen to disclose and doesn't represent the entirety of the portfolio.

## **Portfolio Updates**

### **Innovative Solutions & Support (ISSC)**

ISSC ended their fiscal year on a high note, showcasing growth across multiple financial metrics. The company's revenue, net income, EBITDA, and free cash flow all increased year-over-year. Specifically, net income reached \$7 million, marking a 16% rise from the previous year. Furthermore, total EBITDA was around \$12 million, which signifies a 36% increase compared to the previous year.

In the fourth quarter, ISSC saw over 18% growth in revenue compared to the same period last year, driven by new military programs and recently acquired platforms. The recent quarters have demonstrated heightened demand in military markets along with a rebound in the cargo market. The company continued its acquisition spree from Honeywell at the end of the quarter with a \$14.2 million acquisition of product lines that will expand ISSC's military exposure. This acquisition will be immediately accretive, increasing both capacity utilization and operating leverage. As a result, I believe the company is now capable of achieving over \$18 million of EBITDA in FY25.

New product line acquisitions are strengthening the company's military market position and diversifying its portfolio. With a \$6 million facility expansion underway, the company is positioning itself for continued growth through additional acquisitions.

### **ImmuCell Corporation (ICCC)**

ImmuCell continues to be priced as an attractive investment opportunity. After overcoming significant contamination challenges that negatively affected revenue and margins for nearly two

years, the company appears to have implemented effective solutions. Fourth quarter preliminary results indicate record revenue of \$7.8 million, resulting in an impressive annual revenue figure of \$26.5 million, a 52% increase compared to the prior year. Notably, production reached 103% of capacity, signaling a high level of operational efficiency. This productivity should take gross margins towards the 40% target established by management. These results were driven entirely by the Scours segment, as the Mastitis segment continues to operate at a loss while pursuing FDA approval for Re-Tain. The losses incurred by the Mastitis segment effectively mask the substantial profitability of the Scours business. Assuming a 40% gross margin, the Scours segment likely generated more than \$2.3 million in operating income during the quarter. On a stand-alone basis, the Scours segment's strong growth and profitability would warrant a significantly higher valuation than the current market capitalization of the company.

In early January, ImmuCell resubmitted its Re-Tain application to the FDA, marking the fourth submission of the final section required for approval. To be clear, the remaining obstacle to commercialization is not about whether Re-Tain works, its efficacy has already been established. The final hurdle relates to manufacturing specifics of the product. ImmuCell states that the FDA's concerns regarding this section are minor and readily addressable. However, a slight uncertainty remains with their manufacturing partner, Norbrook Laboratories, responsible for aseptically filling the Re-Tain syringes. Norbrook's facility issues, previously identified by the FDA, delayed ImmuCell's resubmission until January. It should be noted that Norbrook is a large company and is incentivized to rectify their facility issues above and beyond just ImmuCell. Given the expedited review, ImmuCell will likely receive an FDA decision by the end of the first quarter.

As disclosed during the third-quarter earnings call, the company has initiated preliminary discussions regarding potential strategic alliances to mitigate expenses and potentially broaden Re-Tain's market launch penetration. Irrespective of the outcome concerning Re-Tain, I believe ImmuCell's long-term strategic direction is likely to point towards the Scours segment and its First Defense product line. This focus should contribute to reduced product development expenses and improved overall financial performance. I believe ImmuCell is capable of generating more than \$6 million of EBITDA and \$5 million of cash flow in FY25.

## **Vaso Corporation (VASO)**

Vaso has been a disaster. The proposed merger with Achari Ventures, plagued by delays, was ultimately terminated by Vaso just a week after shareholder approval, causing a precipitous decline in the share price of over 50%. Management's handling of this situation has reinforced concerns about their competence and strategic decision-making. While recent progress had fostered optimism and suggested a potential change in tune, this setback highlights a pattern of inconsistency that raises questions about their ability to consistently deliver value to shareholders. In retrospect, I should have placed more emphasis on this risk.

These challenges were then further exacerbated by the company's deteriorating profitability, which seemingly has created uncertainty regarding future prospects. Vaso reported a third-quarter net loss of \$1.2 million, driven primarily by non-recurring expenses and increased headcount. These expenses, related to investment banking fees incurred in connection with the proposed Achari Ventures merger and increased headcount to support the expansion of the company's ultrasound sales division within the GE Healthcare equipment sales segment, masked the company's underlying profitability and year-to-date cash flow generation of \$3.6 million. However, excluding the non-recurring items, Vaso remained marginally profitable.

Vaso is currently being valued at less than the cash on their balance sheet. Despite a likely warranted discount due to concerns surrounding management, that is far too significant of a discount for a profitable company. The fourth quarter will likely be a period of improved financial performance, reflecting the GE Healthcare Sales segment's historical seasonality strength and the anticipated absence of material non-recurring expenses. Any improvement in sentiment will likely result in a higher share price for Vaso.

## **Heritage Global (HGBL)**

After record results in 2023, Heritage Global faced a challenging 2024. Difficult year-over-year comparisons and issues within their lending segment led to a significant share price decline. Third quarter results were particularly impacted by the industrial asset segment due to the absence of larger auctions, management indicated that these larger auctions were pushed out to the fourth quarter and first quarter. Additionally, it appears that issues with the troubled borrower

have been contained as there was no change to the credit loss reserve. Going forward, HGBL will continue to operate their lending segment under stricter lending criteria and diversify its borrower base; I don't expect the segment to be material to the company's long-term results. Despite a challenging year, Heritage Global remains debt free with \$27 million in net cash, is actively repurchasing shares, and is strategically positioned for accretive acquisitions in a consolidating auction industry. I believe HGBL is poised for a return to growth in 2025, while currently trading at an attractive single-digit P/E multiple.

### **Nanophase Technologies, Inc. (NANX)**

Nanophase specializes in the manufacture of zinc oxide, a key mineral ingredient increasingly sought after for sun protection products. Through its subsidiary, Solésence, the company supplies this material to cosmetic companies, enabling them to formulate products that effectively shield against UVA and UVB radiation. The growing consumer preference for mineral-based sun protection, combined with multiple industry awards recognizing the efficacy and innovation of Solésence's proprietary formulations, has resulted in substantial growth for Nanophase. The Solésence business has grown revenue by over 60% annually since 2020, from \$6.7 million to a projected \$46 million by the end of 2024.

Rapid expansion led to production bottlenecks in 2022, which in turn caused margin deterioration and impacted the company's ability to fulfill supply commitments to BASF, its largest legacy customer in a separate business segment. This resulted in litigation initiated by BASF, creating uncertainty and putting pressure on the stock. As of April, this legal matter has been resolved favorably, with BASF remaining a valued client. The settlement removes a significant burden on management resources and eliminates the uncertainty that surrounded the proceedings. To combat margin compression, the company has made substantial investments in key areas, including facilities, equipment, and personnel, expanding production capacity to \$100 million. These investments appear to be having a positive impact, as evidenced by the expansion of gross margins to 36% in the third quarter.

Looking ahead, management expects continued growth and positive momentum for 2025. This projection is supported by a substantial order book of \$34 million as of the third quarter's end,

reflecting an 80% increase year-over-year and indicating record revenue for both the fourth quarter and the subsequent first quarter. At \$2.80, NANX shares trade at approximately 15x my estimate of FY25 earnings per share, a sizable discount to my estimate of intrinsic value. I believe continued execution of growth and margin stability over the next several quarters will serve as a catalyst for shares to re-rate. Additionally, shares currently trade over-the-counter, a potential indication of an uplisting during the second half of the year to a major exchange will serve to increase liquidity and broaden investor awareness.

### **Sanuwave Health, Inc. (SNWV)**

Sanuwave is a rapidly growing company in the medical device sector. Its patented UltraMist Therapy System represents a novel approach to wound care, employing low-frequency ultrasound energy delivered through a unique fluid mist. This technology promotes healing below the wound surface by modulating cell membranes, which in turn drives increased blood flow and the formation of new capillaries. UltraMist has demonstrated superior efficacy and significantly reduced cost compared to the current standard of care for healing wounds, specifically diabetic foot ulcers. The medical community's growing preference for evidence-based treatments over traditional approaches like skin grafts and hyperbaric therapy has been a significant catalyst for growth. This trend, combined with increasing reimbursement for energy-based therapies from both Centers for Medicare and Medicaid Services (CMS) and commercial providers, has created a favorable environment for UltraMist. Notably, UltraMist is one of only two energy-based products currently eligible for a schedule one reimbursement code for wound care.

The company's razor-razorblade model generates recurring revenue through single-use applicators for its UltraMist Systems. Revenue is driven by the number of active systems, the attach rate (consumables used per system), and the price per consumable. With an estimated system price of \$29,500 and average quarterly applicator use of 90 units, each system recoups its cost for practitioners in roughly three months, becoming a lucrative revenue source.

Preliminary estimates indicate that Sanuwave's full-year 2024 revenue will be approximately \$32.5 million, representing a 60% increase compared to the prior year. The company is poised to

maintain this positive momentum in 2025, with the primary determinant of future growth being the volume of system sales. Management has estimated year end total active systems between 1,600 and 2,000, requiring systems sales of 544 to 944 for the year. I believe this level of system sales would result in EBITDA of \$14 to \$25 million. The median EV/EBITDA multiple for medical device companies is 20x, suggesting a price range of \$30 to \$55 for SNWV. However, given Sanuwave's strong fundamentals, including its rapid growth, high margins, and dominant product offering in a niche market, I believe the company warrants a premium to the median multiple.

Following the third quarter, Sanuwave successfully executed a capital restructuring, effectively resolving the default status of its outstanding debt and removing onerous penalty interest that had been accruing. Additionally, these actions have put the company on a path to uplist to the Nasdaq. As of January 21<sup>st</sup>, the company has met the eligibility criteria for uplisting, and I expect an announcement regarding their intentions in the near term.

### **Closing Thoughts**

I know these are not the returns that you and I have come to expect. However, I remain confident that we will return to outperforming the market in the near future. This confidence is supported by two key factors: First, the portfolio holds significant unrealized value, and I believe it's only a matter of time before this potential is recognized. Second, it is highly unlikely the broader market indexes will continue to produce returns over 20% per year, allowing us to catch up and surpass the markets returns over the previous two years.

Sincerely,

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