Investor Newsletter – July 2022
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Leading Through Ambiguity in the Market

This investor update paints a mixed picture of both good and challenging news. Through all of it, I can assure you that my team and I continue to focus on growing and optimizing our real estate portfolios and lending our support to our portfolio investment partners. We also continue to maintain a vigilant lookout for new investment opportunities that these volatile market conditions will create.

The first half of 2022 is off to a rocky start. The Russian invasion of Ukraine sent already elevated commodity markets into volatile orbit. Supply chains have continued to buckle under production and transportation disruptions and strong pent-up consumer demand. Agricultural and energy commodities are hitting multi-year highs on historic volatility. Inflation is on the run and there is no longer any mention of "transitory". As measured by the US Consumer Price Index (US-CPI), prices increased 9.1% annually through June 2022 – the largest increase since November 1981. For all of us buying gas and groceries in the real world, we know it is worse than that.

Realizing it was behind the curve, the Federal Reserve came out swinging with three increases to the Federal Funds Rate totaling 1.5% (25 BPS in March, 50 BPS in May, and 75 BPS in June). An additional increase of 50-75 BPS is expected from the Federal Reserve later this month with several more increases to follow through the rest of the year. Its last move in June, of 75 BPS, was the largest single increase since November 1994. As the saying goes, "Don't fight the Fed." This is especially true in the stock market which is having its worst start to the year since 1970. The S&P 500 index is down 20.6% year to date through June and the Nasdaq Composite index is off 30.0% for the same period. The news from the domestic economy is no better. The second quarter GDP is pointing negative following a decline of 1.6% in Q1. Recall that two consecutive quarters of GDP declines satisfies the technical definition of a recession. A second inversion of the yield curve, with 2-year Treasuries trading over the 10-year basically seals the deal. While most economists are calling for a mild recession if at all, I am not so sure. Inflation remains stubbornly entrenched and it appears we could be in for an extended period of stagflation like the country endured during the deep and extended recession of 1973-75.

I have written in the past about the importance of movement in the face of inflation. With the Federal Reserve pursuing an aggressive tightening policy the need for movement takes on even greater urgency. In our residential real estate portfolios movement takes the form of rent increases, shortened lease terms, and refinancing loans to extend terms. Hedging our bets, we took steps to sell a select subset of fully stabilized assets while market conditions allow us to monetize them at full value. We are successfully staying ahead of inflation in the seasoned portfolios with each preparing to make material semi-annual distributions in July. Strong commodity markets are also pointing to solid returns this year for our agricultural investments. We purchased most of the crop inputs last fall ahead of price increases and sold most of the crop into a strong rally this spring.

While our real estate and agricultural investments have navigated market conditions and performed well through the first half of this year, we have not been completely immune to market turmoil. Notably, after reiterating in January a strong commitment of support for the Kubat HealthCare roll-up strategy, our senior lending partner abruptly shifted gears over the course of the spring. In May the bank raised the possibility of non-renewal of the operating line that expires in August before proposing stringent conditions for its renewal on terms that will constrain our growth plans. We responded with material cuts to overhead, a balance sheet restructuring to convert some acquisition debt to equity, and an equity funding round to inject additional capital and reduce dependence on the operating line. Negotiations are ongoing, and I am optimistic that we will renew the line on terms that will allow us some operating flexibility over the coming year. With the bank unwilling to fully support our growth plans going forward, sourcing a new banking partner is a high priority. I have set a goal for moving the relationship prior to the end of this year.

Change Creates Growth

The first half of the year was a busy time at Percipio. After years of planning, we completed and moved into a new Percipio Partners corporate headquarters this spring in Omaha, Nebraska. We also recognized outstanding achievement from members of the leadership team with several promotions and continued to build out our capabilities with two new additions to the team. Bret Cain was promoted to President in recognition of his years of invaluable contribution to Percipio and his expanding role in the leadership of Kubat HealthCare, Doug Anderson joined the team as Vice President and Chief Operating Officer of Harvest Development. As asset manager, Doug has stepped into direct management responsibilities of the real estate division. Jay Bortolini and Nick Burianek were both promoted to Vice Presidents of Finance. Jay continues in his role as head of accounting and finance for Percipio and Kubat HealthCare, while Nick is focused on managing and growing the financial consulting practice when he is not supporting one of many Kubat HealthCare special initiatives. Finally, Sharon Bargas joined our team as Director of Marketing. In this role, Sharon leads marketing and supports business development initiatives both inside Percipio and for our portfolio companies.

Percipio Partners' Portfolio Update

Real Estate

Our seasoned real estate funds continued to post results in the first half of the year that translated into strong liquidity positions and material increases to portfolio company valuations. Our portfolio turnover is slightly above average, and vacancy rates are up as shortened lease terms are taking hold. These are necessary tradeoffs that allow us to continue to move rents higher. The spring saw strong leasing demand that continued into the summer months when we typically see a sharp slowdown in leasing activity. We are pleased that the performance allows us to declare robust distributions across the seasoned portfolios. Of note, the Harvest Development I distribution is modestly lower due to a significant hail event that requires siding replacement on 20 units at the Cottages property. Secondly, Harvest Development III is declaring a distribution of $3.7M resulting from strong operating results, the refinancing of a stabilized asset, and the successful sale of our 92-unit Park Avenue Assemblage that we announced we were taking to market in January. Year to date distributions are as follows:

	Jan-22	July-22	Total	TTM Yield (%)
• HD I –	$150,000	$100,000	$250,000	11.9%
• HD II –	$150,000	$250,000	$400,000	14.2%
• HD III –	$50,000	$3,700,000	$3,750,000	159.6%

Acquisitions in our fourth real estate fund, Harvest Development IV (HD IV), continued in the first half of the year. It may seem counterintuitive that we are selling assets in HD III and acquiring others at the same time in HD IV. As we have grown units under management, a strategy of acquiring B- properties with deferred maintenance, upgrading them to B+ properties, and restabilizing them at higher rents is evolving further into one where, when market conditions allow, we will selectively sell stabilized assets to recycle increasing amounts of capital into new projects. Even as interest rates have risen we continue to see opportunity in the fragmented market for B- assets. HD IV, and a related side-car investment, have collectively raised $7.4M and deployed this equity in seven transactions for a total of 330 units. Two additional transactions adding 96 units to our rural strategy (72 units in Norfolk, NE and 24 units in Columbus, NE) are under contract for a closing in August. The fund remains open for new investment but is expected to close before the end of 2022 as we focus on stabilizing assets in preparation for initiating distributions in 2024. Our portfolio metrics reflect strong performance from our legacy portfolios and the ongoing growth of HD IV.

Entity	**HD I**	**HD II**	**HD III**	**HD IV/AVL**
Launch Date	Mar-12	Apr-13	Feb-16	Aug-21
Cumulative Distributions	$1,810,000	$3,380,000	$3,900,000	N/A
6/30/22 Net Market Valuation	$6,073,000	$9,750,000	$3,000,000	$7,200,000
Invested Common Equity	$2,100,000	$2,818,021	$2,350,000	$5,891,000
Full Term Cash-on-Cash Yield	9.6%	15.0%	33.2%	N/A
Trailing 12 Month Cash-on-Cash Yield	11.9%	14.2%	159.6%	N/A
Annualized IRR	15.9%	21.8%	21.0%	N/A
Number of Units	95	201	86	330
6/30/22 Occupancy Rate	88.4%	91.0%	92.7%	76.2%
Invested Equity Per Unit	$22,105	$14,020	$27,326	$17,852
Net Market Value Per Unit	$63,926	$48,507	$34,884	$21,818

With over 300 new units in the portfolio undergoing stabilization, it is safe to say the property management team has their hands full this year. Despite a challenging hiring environment, we added maintenance technicians and leasing agents to staff through the first half of the year, and this seasoned team is up to the challenge having executed through stabilization projects many times. As I have said in the past, the HD business model is centered around this unique, fragmented, and overlooked asset class. Transitioning small and medium sized legacy assets through upgrades and increasing rents is a hands-on management challenge that is rewarded with material value creation when executed well. A round-trip of the Park Avenue Assemblage is a case study for the success of this model. The original investment in 2017 followed by three years of rehab and stabilization was rewarded with a sale this month that returned 3X the equity invested in the asset and 1.7X the equity invested in the HD III fund.

Private Equity

Kubat HealthCare – Kubat HealthCare is in its third year of a roll-up strategy. The underlying business strategy is sound, and we are executing plans to deal with any challenges. Growth of its respiratory, ProActive Living (PAL) service and long-term care pharmacy business units is particularly promising, but the Company needs time to build on this momentum to support the investments made in an executive team and a dedicated sales force. These investments directly affect trailing EBITDA. In short, Kubat HealthCare needs to grow into itself, and this is exactly what it is doing. In the midst of this strategy, our senior banking partner chose this moment to re-examine its commitment to our strategy.

We are executing through a series of cost cuts and balance sheet adjustments to improve operating income, reduce debt service obligations, and reduce the reliance on the operating line. I believe these cuts, combined with a round of equity financing, will be sufficient to shore up the relationship with our senior lender in the short-term allowing time for me to move the relationship to a new banking partner that supports our growth plans.

Year to date through June the Company has posted ($346K) in net operating income and ($236K) in EBITDA. With the cuts and balance sheet restructuring ramping up to full force in July, the forecast for the second half of the year is for net operating income of $1.575M and EBITDA of $1.610M, and for full year results of $1.230M of net operating income and $1.375M of EBITDA.

Central Stockyards

Central Stockyards (CS) continues to expand its customer base for regular weekly auctions on the Fed Cattle Exchange (FCE) platform, and the technology continues to perform and scale well with the increased demand load. In addition to revenues generated from sales on the FCE, the Company continues to build its private treaty business with cattle feeders, and advertising revenues from placements on the FCE and its weekly industry newsletter. Moving up the cattle value-chain, for the first time this fall the management team is extending private treaty transactions to Wyoming-based ranchers marketing their feeder cattle moving to feed lots in the upper Midwest. This pilot initiative with feeder cattle will expand into other regions in the spring of 2023.

Year to date, CS revenues of $132K increased 30% over the same period in 2021 but fell short of budget and were insufficient to achieve positive cash flow from operations in the second quarter as forecast. Growing revenues from the FCE, adding new revenue streams, and holding the line on expenses to hit positive cash flow before the end of this year remains a primary focus for the Company as we move into the fall. New initiatives underway to increase listing participation from feeders and packers, coupled with increased advertising revenues are needed to fill the gap. An initiative to add a revenue stream from subscription fees is also in the planning stages with an expected rollout before the end of the year.

ARB Cattle Company

Texas-based ARB Cattle Company is building a herd of breeding cattle with superior genetics that have been engineered to grade USDA Choice while also being well-suited for the south-Texas climate. This first year of operations has been one of building and setting up operating processes. As we round the corner on our first year of operations for the Company, we are managing a herd of 188 cows in their first year of production with 173 calves on the ground. Capital investments for leasehold improvements and operating equipment are mostly behind us. Our first crop of calves will start weaning next month and marketing for sale shortly thereafter. In June, we entered a banking relationship securing a term loan and an operating line allowing a partial payoff of the start-up loan. Looking forward, we are planning a capital raise this fall after our first year's operating results are published. The proceeds from that funding round will be used to double the size of the herd next year and pay down more of the start-up debt.

Other Investments

- Following the best year for our crop farming operations on record in 2021, 2022 is shaping up even better.   The crops are coming along well, and barring a weather event, we expect good yields that have been sold forward for record prices. Another round of distributions from the funds is expected next spring after all the crops are liquidated.
- Precise.ly, the consumer genetics company, continues to focus on a rollout of its software platform in the domestic market. Funding remains a constant focus for the founders as they pursue market acceptance. We continue to believe the Company offers a promising investment thesis and remain hopeful that it will secure a funding

round this year. The start of revenue generation this year would be a welcome sign of progress.

- Our consulting platform continues to expand and perform well serving our investment partners and third-party clients with a broadening array of practice focus areas. Our Staffing and Workforce Development consulting practice, led by Jim Roy, is in its second year of operations. This spring Jim added direct hire recruiting to his practice and began making the first permanent placements this month. Jim is also beginning to advise clients on merger and acquisition opportunities in the part-time staffing industry. As mentioned, Nick Burianek was promoted to Vice President this spring and is taking a leadership role in the finance and business operations practice. Together Jim and Nick are building a comprehensive suite of business operations capabilities to serve our clients.

New Opportunities

- Harvest Development IV, LLC remains open but is expected to close before the end of the year to shift focus and prepare for distributions in 2024. If, as expected, acquisition opportunities remain at the time of closing of HD IV we will open a new real estate fund (HD V) to continue taking advantage of the market conditions.
- Kubat HealthCare is raising an equity round to increase balance sheet liquidity in advance of making a change in its senior lender relationship.
- ARB Cattle Company, LLC is expected to seek funding for growth of its cattle herd this fall after the sale of its first calf crop and the publishing of its first year of operating results.

Conclusion and Thanks

We are deeply grateful for your continued confidence in our endeavors. We are proud of the durable and sustainable platform we have created and the value we are bringing to our investors. We continue to look for opportunities to deploy capital wherever we find value. We are excited about the new investment opportunities we are exploring and look forward to offering them to you.

Percipio Partners