Petoskey CAPITAL

April 26, 2019

Dear Partners,

The objective of Petoskey Capital Fund, LP is to exceed the return of the S&P 500 over a full market cycle while experiencing only about half the downside risk. Vigorous up markets like we saw in the first quarter of 2019 challenge the defensive aspect of the Fund. In the short run, we define success as exceeding half the return of the S&P because the fund is typically only 50% invested in stocks, net of positions sold short.

The Fund returned 8.0%[1] net of all fees and expenses in the first quarter of 2019 compared to the 13.6% return for the S&P 500. We captured about 60% of the S&P's upside on a net market exposure (long positions minus short positions) consistently below 50% during the quarter.

Our success in the quarter was led by favorable reversals of a number of positions that went against us in the fourth quarter market selloff. Successful trial data and government approvals aided several of our emerging pharmaceuticals holdings. We also benefitted from a takeover of one of our holdings for a substantial premium.

In vigorous up markets, most short positions should be expected to go against us as "a rising tide lifts all boats." While we experienced a couple of notable victories on the short side, most of our short bets went against us as expected.

At the end of the first quarter, the Fund held 17 long positions and 15 short positions. Our largest long position represented 9.7% of capital, and our largest short position represented -5.7% of capital. The Fund's top five long positions were:

Company Name	Ticker	% of Capital
Air Lease Corp.	AL	9.7%
CarMax, Inc.	KMX	9.2%
Kar Auction Services Inc.	KAR	8.8%
Galapagos NV ADR	GLPG	8.6%
Skyworks Solutions Inc.	SWKS	7.2%

The Fund's top five short positions were:

Company Name	Ticker	% of Capital
Tesla Inc.	TSLA	-5.7%
YETI Holdings Inc.	YETI	-5.4%
LendingTree Inc.	TREE	-4.6%
Snap Inc.	SNAP	-4.5%
Conmed Inc.	CNMD	-4.1%

[1] Results are unaudited. Individual returns may vary based on fee structure and timing of investment. Refer to administrator statements for individual returns. Quoted returns assume a management fee of 1.5% and a performance fee of 15%. As of the date of this letter, all partners qualify for the reduced Founders Fee structure of 1% and 15%.

Major contributors to performance were:

Long Maxwell Technologies

Late last year we added a small long position in Maxwell Technologies, and it turned out to be our biggest contributor to Q1 returns. Maxwell is pursuing innovative battery and power storage solutions. We have followed the company for a long time, and its recent history has been anything but glorious. We took a position in the cash-strapped company after it divested a legacy business, bringing in sorely-needed capital to continue pursuing its research and development agenda. We do not have a strong opinion on the merits of the underlying technology that Maxwell is pursuing, but we like a balance sheet with plenty of cash. We also speculated that the divestiture could "clear the decks" for an acquisition of the remaining company.

We were right. In February Tesla offered to acquire the company in an all-stock deal that valued Maxwell at more than twice our cost basis. We sold out of Maxwell following the surprise Tesla offer.

Long Patrick Industries

Patrick Industries was our second-biggest contributor to performance in the quarter. The company is a component manufacturer and supplier to the recreational vehicle, marine, housing, and industrial markets. Its largest exposure is to the RV market, which accounts for approximately 65% of sales. As a cyclical, small-cap company, Patrick was in the eye of the storm in last year's Q4 selloff. In December, shares were down nearly 60% from recent highs. Given our general belief that the U.S. economy was not headed for an imminent recession, and that the U.S. consumer remained in decent shape, we felt the selloff was significantly overdone. Shares of Patrick, a company that employs prudent leverage in executing its acquisition-driven growth strategy, traded down to approximately 6x earnings. This appeared too cheap and we added Patrick to the fund. As the market recovered from its late 2018 swoon and data continued to reflect the general health of the U.S. consumer, shares rebounded and we were able to benefit.

Biopharmaceutical Longs

In our last quarterly letter, we complained about the market's rough treatment of three biopharmaceutical holdings late in 2018. The market's pendulum swung back in our direction in Q1. All three holdings produced gains, and two significantly outpaced the S&P 500's strong performance. The biggest contributor was Galapagos NV, a Belgian company which we own via its NASDAQ-listed ADRs. The position added nearly 2% to overall gross fund returns in the first quarter, thanks mainly to the presentation of Phase III trial data which caused a 22% pop on the last trading day of the quarter. We took some profits in early April, but Galapagos still remains one of our larger holdings.

Short Cimpress N.V.

We were on the right side of market sentiment with Cimpress in Q1. We have communicated our doubts about Cimpress in past quarterly letters, and our skepticism was vindicated this quarter when shares dropped more than 30% in conjunction with a dismal quarterly report. We have always viewed Cimpress as a third-rate company peddling a first-rate story. The truth seemed to catch up with Cimpress in the first quarter, at least somewhat. We exited the position soon after that decline for fear the market's animal spirits could quickly return. Companies that fall on bad earnings often recover in the news vacuum that occurs between quarterly reports. The shares did rebound somewhat, so our decision to exit looks good so far.

Short TSLA

Our Tesla short was a contributor to performance, as shares were down nearly 16% in the quarter. Tesla once again achieved profitability in Q4, consistent with Elon Musk's proclamation during last year's Q2 earnings that he was comfortable the company would achieve profitability "every quarter, from here on out." The results, however, were tainted by the announcement by the CFO, at the tail end of the earnings call, that he would be stepping down. Shortly thereafter, Tesla's general counsel also departed after spending just two months on the job. Turnover in the executive suite has maintained its remarkable pace.

Tesla's demand problems we wrote about last quarter have started to garner more attention. Intensifying competition is on the horizon and the federal tax credits are rolling off. Tesla reduced prices on its products during the quarter, largely in response to the reduction in tax credits at the start of the year. Notably it cut prices on the Model 3 three times in Q1, not exactly a typical move if demand is robust. Tesla even made available the long-promised $35,000 base version of the Model 3, which is down from the $46,000 minimum price at the start of the year. In order to cut costs and achieve the $35,000 price, Tesla announced it was closing most of its retail stores and moving all sales online. Landlords communicated to Tesla they were not going to let the company out of its leases. The company subsequently backtracked on the store closure plan but maintained the $35,000 price point. Perplexingly, just six weeks after announcing the lower price, Tesla stopped selling it online, making it only available via phone and in-store. We suspect this is because Tesla is trying to minimize orders for a vehicle it cannot sell for a profit.

In early April Tesla announced its Q1 deliveries declined 31% on a sequential basis. Model 3 deliveries declined 20%. Of particular note was the weakness in the higher-margin Model S and Model X vehicles, where deliveries were down over 50% from Q4. Total deliveries in the quarter were approximately 63,000, well below expectations though Tesla has maintained its guidance for full year deliveries of between 360,000-400,000 vehicles. This looks like an ambitious goal in the face of what appears to be declining demand. Tesla returned to a loss in the quarter.

Major detractors from performance were:

Short YETI Holdings

Our biggest detractor in the first quarter was a short position in YETI Holdings. YETI makes highly-engineered coolers and drinkware, which it sells for lofty prices. The YETI brand has a cult following amongst outdoor enthusiasts and, increasingly, amongst investors too. YETI advertises its coolers as bear-proof, and its stock has so far proven equally resistant to bears like us as well.

We shorted the company after it reported a respectable Christmas quarter while management seemed to dodge questions about the near-term growth trajectory. We think it will be hard for YETI to sustain momentum past Christmas into winter. Who buys a cooler in February? We thought we had chosen a clever entry point by waiting for the Christmas results to be reported and then sliding into a short position, but lots of other short sellers had the same idea. The stock has become a very "crowded" short and has shot higher as crowded short opportunities often do. YETI has increased more than 50% since we shorted it. Getting squeezed like this on a plausible—if unproven—short thesis, is one of the chief risks when selling stocks short. This is the main reason why we size our short positions much smaller than our long positions, so that we can ride out uncomfortable situations. Our plan is to roll with the punches for now and reevaluate our short thesis after first quarter results come out.

Short LendingTree

We've profited several times in the past from being short LendingTree, but this time the stock rose and put us in an unrealized loss position. LendingTree makes money by referring prospective borrowers to potential lenders through its website and app. It began by offering mortgages, a very large and lucrative lending segment. Over time, it expanded into credit cards, student loans, personal loans, small business loans, deposit-taking, and now auto and homeowners insurance. Each of these diversification moves began with an acquisition. All these acquisitions make it difficult to gauge the growth of the underlying business, and LendingTree makes it difficult by refusing to estimate "organic" revenue growth. We calculate it ourselves, and it has been steadily declining.

We felt we were on the right side of the trade when the company reported terrible fourth quarter results and a weak 2019 outlook in late February. Organic revenue growth was 4% in the quarter, and we estimated it would be even lower in the first quarter. Employee headcount doubled last year, which means it is incurring heavy expenses despite slowing revenue growth. The stock dropped on the report, but has been surging ever since. The mortgage refinance industry is very sensitive to changes in interest rates. LendingTree was hurt by rising rates last year, and investor logic is that it should now benefit from increased mortgage refinancing activity due to falling interest rates. The challenge is that mortgages are now only 20% of its business thanks to its diversification moves.

As of this writing we remain short as TREE stock trades at a stratospheric valuation which we do not believe is warranted by its pedestrian organic growth rate.

Short SNAP

We had good success shorting Snap Incorporated (NYSE: SNAP) early last year and shares continued to sink as 2018 unfolded. We didn't see anything positive with the business, so we initiated another short position that turned against us in the first quarter.

Quite a bit of the increasing share price came from a positive fourth quarter earnings call. The company was able to reduce its burn rate of cash to "only" $150 million during the seasonally strong fourth quarter. Sales grew 36%, but entirely because SNAP sold almost three times the ads at half the cost to the same number of daily users. The Android application, which had failed in early 2018, is now back in user testing and the company intends to release it by the end of 2019. First quarter guidance was stronger than expected as the company seeks to sell more ads to the same user base, including a new six-second "non-skippable" format.

With cash down to about $1.3 billion and a cash burn rate of at least $150 million per quarter, we are skeptical that SNAP shares can continue positive momentum if the company isn't able to restart user growth. Facebook's Instagram continues to grow rapidly, attracting many of SNAP's younger users. Executives continue to leave the business, including the CFO in January. At its current stock price, SNAP's valuation metrics are more expensive than profitable competitors Facebook and Twitter.

Conclusion

At the end of the first quarter, the Fund's total capital was $15.2 million, and there were 33 limited partners including members of the General Partnership and employees of the Investment Manager. We are pleased that the fund continues to deliver toward its objective of beating the S&P 500 over a full market cycle, net of all fees and expenses, with half the market exposure. Thank you to all our limited partners for your confidence in us.

The Fund also successfully completed its audit in Late April. Enclosed is the opinion letter from the fifth largest accounting firm in the country. We would be glad to provide you with the auditor's full report upon request.

Sincerely,

Scott D. Horsburgh, CFA

SDH/pjp

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