Petoskey CAPITAL

July 22, 2019

Dear Partners,

Petoskey Capital Fund, LP returned 4.1% net of all fees and expenses in the second quarter of 2019[1], capturing 95% of the S&P 500's solid 4.3% total return. The Fund continues to produce results in line with its objective, which is to exceed the return of the S&P 500 over a full market cycle while experiencing only about half the downside risk. Given the defensive nature of the Fund, we generally expect to lag the market during rallies and were pleased with our ability to enjoy nearly all of the upside during the quarter despite a net position that was consistently below 50% long.

Both longs and shorts contributed to total return in the quarter. Our long portfolio didn't fully keep pace with the market due in part to remaining modestly below 100% gross long. Despite performance drag from some smaller long positions, we were aided by particularly strong results from our highest conviction longs. In a strong market, our short portfolio also contributed more than 0.5% to overall return with a host of short positions helping drive the positive result.

We generally kept our net long exposure below 50% for the quarter, reflecting the fact that in the current environment we see more compelling short opportunities than attractive opportunities on the long side. At the end of June, the Fund held 19 long positions and 19 short positions. Our largest long position represented 11.4% of capital, while our largest short position represented -4.4% of capital. At the end of the reporting period, the Fund's top five long positions were:

Company Name	Ticker	% of Capital
Air Lease Corp	AL	11.4%
The Walt Disney Company	DIS	8.3%
Booking Holdings Inc.	BKNG	7.2%
Dropbox, Inc.	DBX	6.8%
Galapagos NV	GLPG	6.7%

[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 July 2019, all partners qualify for the reduced Founders Fee structure of 1% and 15%.

The Fund's top five short positions were:

Company Name	Ticker	% of Capital
Tesla Inc.	TSLA	-4.4%
LendingTree Inc.	TREE	-4.3%
CONMED Corporation	CNMD	-4.1%
Jazz Pharmaceuticals plc	JAZZ	-4.0%
Keurig Dr. Pepper Inc.	KDP	-3.9%

The major contributors to performance in the quarter were:

Long Air Lease

Air Lease Corp. tied (with Disney) as the largest contributor to Petoskey Capital Fund in the second quarter. This success resulted from a 20% rise in its stock price and its status as the largest holding in the portfolio. Air Lease owns 280 Airbus and Boeing aircraft which it leases to airlines around the world. The travel industry is booming globally as more people join the middle class. At the beginning of the year, Air Lease anticipated the largest fleet growth in its history. About 35% of its planned purchases were the Boeing 737 Max 8 that has been grounded following two well-publicized crashes. Air Lease's fleet will still grow about 20% this year even without any further deliveries of Max 8s and airlines are looking to extend leases as they struggle to fill holes in their schedules created by the grounding of the Max 8. Air Lease will also likely collect some of the $5 billion in compensation Boeing plans to offer to affected customers; some of this will likely be passed on to Air Lease customers. The Max 8 problem will extend the period of strong growth enjoyed by Air Lease as deliveries are delayed into 2020 and perhaps beyond. It remains a strong grower at a cheap price, and the largest holding in the Petoskey Fund.

Healthcare

Our healthcare sector picks produced modest negative alpha in Q2, dragging on overall gross portfolio returns by about -1.5%. Our shooting percentage was a little low, with six of our eleven positions—long and short—going against us during the quarter. The bigger story was the magnitude of a couple losses. Our two weakest portfolio longs were both speculative drug companies. One of these has been sold, while the other remains in the portfolio at a very small position weight resulting from its price decline.

The damage could have been worse. In each of our last two quarterly letters we have written about our healthcare positions being whipped around by the pendulum of market sentiment. We have adapted by reducing the average size of our position weights, especially on the long side. Q2 did not feel like the right time to be bold, and this was proven out in our results. We remain on the hunt for timely opportunities and would love to find one (or two!) healthcare names warranting a high-conviction bet. Periods of sector volatility can produce such opportunities, and we plan to keep shooting smaller ammunition while we wait for the big opportunities to reveal themselves.

Long Disney

Disney was a strong contributor to performance in the quarter. Shares responded favorably after the company outlined plans for its new streaming service, Disney+. The service, which will feature offerings from Star Wars, Marvel, Disney, and Pixar, will launch November at a price of $6.99 per month or $79.99 per year. This pricing was lower than many expected and substantially below pricing for Netflix's most popular offering. Furthermore, Disney indicated it expects between 60 million and 90 million Disney+ users after five years, at which point it expects to achieve profitability. This forecast was also ahead of consensus expectations. Sentiment was also aided by greater than expected availability for certain content, which some feared would be unavailable due to existing licensing deals.

Subscriber growth numbers for Disney+ following the launch will be closely watched; however, based on the details provided Disney+ looks to be a highly compelling offering given its unmatched content and relatively low subscription price. We remain bullish on Disney+ and what it ultimately means for the rest of the Disney ecosystem. Be on the lookout for the launch of the service on November 12th!

Short Tesla

The biggest winner in our short portfolio was Tesla, as we benefitted from poor Q1 results that helped highlight the demand concerns we have been expecting to draw more attention. In Q1 the company reported a $700 million loss while cash on hand declined more than 40% versus the prior quarter, to $2.2 billion. Deliveries declined 31% versus Q4, which the company blamed on the pull forward of demand before tax credits rolled off at the end of 2018 and challenges it faced in exporting the Model 3 overseas for the first time.

The poor quarter resulted in CEO Elon Musk reversing his prior stance that the company did not need to raise additional funds. Shortly following the announcement of Q1 results the company raised an additional $2.35 billion via a stock and convertible bond offering. Despite his insistence to investors the additional capital was simply a "buffer," Musk subsequently indicated to employees that costs going forward would be controlled more tightly and that the business risked running out of cash. We were somewhat surprised that once the company chose to tap the capital markets, it didn't do so for a larger amount. Musk's comments to employees lend support to our belief the company should have looked to achieve a larger "buffer" with its capital raise. Time will tell.

Following quarter end Tesla reported some positive news, announcing it delivered 95,200 cars in Q2, which was above consensus expectations of approximately 91,000. Deliveries were aided by a large number of vehicles in transit at the end of Q1. Furthermore, deliveries likely once again benefitted from a pull-forward of demand given the 50% decline in the federal tax to $1,875 on July 1st. Notably, Tesla delivered fewer of the more profitable Model S and Model X vehicles in Q2. How this, and the decision to further cut prices during the quarter, impacts Q2 results we won't know until earnings are announced. Despite the better-than expected Q2 deliveries, the company will need to meaningfully ramp deliveries in the second half of the year to achieve even the low end of its full year guidance for 360,000-400,000. The company remained silent on any changes to its guidance when it reported Q2 deliveries, after reiterating annual guidance with its Q1 delivery release. We will have more clarity when the company releases its earnings.

Long Cognizant

We purchased Cognizant Technology Solutions before its first quarter earnings announcement expecting good news based on management's confidence in its 2019 forecast, reiterated as recently as February, combined with an easy earnings comparison. Unfortunately, this thesis didn't pan out as the company disappointed us by reporting sluggish first quarter results and, more importantly, much slower long-term growth expectations. Its newer digital information technology services, while growing rapidly, are too small to offset much larger legacy services that now appear to be declining rather than remaining stable. A new CEO started April 1st, introducing more uncertainty as it is unknown how he will reaccelerate growth at a large, complex company like Cognizant. We closed out the position at a loss.

Long KAR Auction Services

KAR Auction Services was one of our largest long positions during the quarter and a key contributor to performance. At the end of June, KAR completed the long-planned spinoff of its salvage auction business, IAA, into a new publicly traded company. KAR continues to house the whole car auction business as well as a financing operation that primarily supports that business. The strategic thinking behind the spinoff was sound, as each company is well positioned as an industry leader in what is effectively a duopoly. While both companies possess interesting growth prospects, the opportunities in front of each differ, as do the priorities for capital allocation. IAA also benefits from a direct comparison with Copart, its primary competitor, which possesses a significantly higher multiple than pre-spinoff KAR possessed.

Though investors were positive on the planned spinoff there was initially some concern it would not occur, as the expected timing for completion had been pushed back multiple times. Early this year the company put in doubt that the spin would occur at all, which was not favorably received by investors. With its Q1 earnings announcement the company stated its firm intention to complete the spin by the end of Q2, which gave shares a boost. Since the spin the market has responded favorably. On a combined basis at quarter end KAR and IAA would have been one of our five largest holdings.

Conclusion

At the end of the second quarter, the Fund's total capital was $16.2 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.

The Fund will experience ups and downs in the future. We will have reporting periods in which we fail to meet our goals, and hopefully many more in which we exceed them. We extend our thanks to all our limited partners for your confidence in us, and we very much hope to reward your trust with strong investment results.

Sincerely,

James M. Skubik, CFA

JMS/pjp

Disclosures

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