STEEL CITY CAPITAL, LP

May 4, 2022

Dear Partners and Friends,

Steel City Capital, LP (the "Partnership") was essentially flat in the first quarter of 2022, net of fees and expenses. And because I have been so delinquent in providing an update following the close of the first quarter, I can also report that the Partnership declined 1.4% in April, bringing YTD'22 results to negative 1.5%. Markets remain highly volatile as a result of a number of factors including unhealthy levels of inflation, slowing growth, the ongoing conflict between Russia and Ukraine, COVID-related lockdowns in China, etc. Suffice it to say I can provide no guarantee that the outperformance we've experienced on a year-to-date basis will sustain.

	Steel City Capital Exposure & Returns		**Index Returns**	
	Average Net Long	Net Return	S&P 500	Russell 2000
1Q 2022	72%	(0.1%)	(5.0%)	(7.5%)
Since Inception (Annualized) [1]	59%	8.1%	14.2%	7.7%

1. Reflects returns since Steel City Capital's launch on May 21, 2018.

In the first quarter, returns in our short book largely matched losses in our long book. Considering our net long exposure averaged ~72% during the quarter, I view this as quite a satisfactory result. Shorts which generated a positive return included REA Group (used to hedge our long position in NWSA), WDFC (an overvalued cyclical with oil price exposure), VRM (like CVNA, but worse), BFI (great burgers, terrible franchise economics) and SRG (it's SHLD all over again). On the long side, SXC generated a strong positive return, but this was offset by declines in nearly every other long position.

Thus far in the second quarter, the same dynamic has sustained – roughly offsetting long and short returns with similar net long exposure. On the short side, the largest contributor by far has been **Carvana (NYSE: CVNA)**. While I'm elated to see this short finally working, I'm nowhere near taking a "victory lap." In totality, the Partnership remains underwater on the position. With this in mind, I thought it would be helpful (to both me and you) to share what I've learned along the way and articulate why I've been so persistent in pursuing this particular short.

Over the years, I've described my affinity for shorting CVNA like being in an abusive relationship: **We** kept getting hurt, but **I** kept coming back for more. I just couldn't let go of what I perceived to be atrocious fundamentals, strained liquidity, and other red flags such as a web of related-party transactions and ongoing insider sales. *But none of this mattered*. Why not? Because I failed to accurately reflect on *what made the stock go up and down.* What do I mean by that? Let me expand on that concept by drawing on a quote from one of the world's greatest investors (and native Pittsburgher), Stanley Druckenmiller:

"When I first started out, I did thorough papers covering every aspect of a stock or industry. Before I could make the presentation to the stock selection committee, I first had to submit the paper to the research director. I particularly remember the time I gave him my paper on the banking industry. I felt very proud of my work. However, he read through it and said, "*This is useless. What makes the stock go up and down?*" That comment acted as a spur. **Thereafter, I focused my analysis on seeking to identify the factors that were strongly correlated to a stock's price movement as opposed to looking at all the fundamentals.** Frankly, even today, many analysts still don't know what makes their particular stock go up or down."

So what makes CVNA go up and down? The stock is driven by a combination of 1) unit volume growth/growth rates 2) unit economics, and 3) expectations around the company's path to profitability. Across much of 2020 and 2021, unit volume accelerated (1) and reported GPU improved (2), resulting in improving EBITDA margins (3). The company was *nearly* breakeven from an EBITDA perspective last year. Never mind my questions about the factors underlying the improvement in profitability or the sustainability of the trends – for the time being, everything was on the up-and-up and the market extrapolated those trends into perpetuity. The stock followed suit.

When CVNA reported horrendous 1Q'22 results, management partially attributed performance to solvable logistics challenges and overall market weakness. (They actually used the word *transitory* to describe the factors impacting sales!) But that explanation only tells half of the story. Last year, CVNA's unit economics were buoyed by massive increases in finance income – specifically gains on the sale of auto loans it had originated. That was a function of rising vehicle prices, higher loan balances, and tighter ABS spreads (lower funding costs). Unfortunately for the company, all of these factors have started to roll over. Unless 1) used car prices arrest their recent decline, thus supporting continued high loan balances at origination, and 2) ABS spreads narrow, the company is likely to struggle in returning to GPU north of $4,000 anytime soon.

As for leveraging fixed costs in support of a path to profitability – *it's been nothing but a mirage.* I'm still not sure the bulls realize this. Many lazily point to the steady march higher in EBITDA margins as de facto proof of operating leverage. In reality, this has been scarcely more than a function of the higher GPUs, which as noted above, have been driven *almost entirely* by finance profits. Cash SG&A per retail unit has hardly scaled at all during the past five years (it actually *de-levered* in 2020 and 2021) and there's a strong possibility that it will clock in north of $5,000 this year.

Source: Company filings, Steel City Capital estimates

All companies hit "bumps in the road" during their lifecycles, but such issues are more acute in CVNA's case because of their heavy reliance on external funding. As someone who used to cover MLPs, I've seen this cycle play out before: *you need strong growth to support a low cost of capital, and you need a low cost of capital to support strong growth*. In the event that something breaks this virtuous cycle, companies will find themselves in a boatload of trouble. With its 1Q'22 results, all signs point to CVNA having broken the cycle. Shares are down ~30% from the $80 level of its equity raise only several weeks ago (and down ~75% year-to-date) while the company stretched to place $3.25 billion of notes at 10.25% (along with other very friendly creditor terms) vs. only 4.875% less than a year ago.

Notwithstanding the capital raise, CVNA's liquidity position remains fragile. Bulls have pointed to the raw figure – $2.2 billion of excess cash! – and seemingly stopped there, without giving much thought to just how long the cash will last. At least $1 billion of the excess cash is already spoken for, set aside for the build out of the ADESA network. That leaves ~$1.2 billion for general corporate purposes, which the company will quite possibly burn through before the end of the year. Then what? Back to the market, hat in hand, all over again?

As an appendix, I've included a series of charts and tables (including a liquidity analysis) that I think puts the situation into perspective.

Bottom line: The key drivers of CVNA's business are rolling over, it's unclear they'll rebound any time soon, and the company is up against the clock from a liquidity perspective. It's been said that you "don't need to make it back the same way you lost it." But in the case of CVNA, I don't think that applies.

Another humbling example where I whiffed on the question of "*What makes the stock go up or down?*" was **Service Corporation International (NYSE: SCI)**, in which the Partnership held a short position in the early days of the pandemic. SCI is the largest provider of funeral, cremation, and cemetery services in North America. The original thesis was as follows: SCI generates a meaningful portion of their earnings from "pre-need" sales of funeral services and cemetery plots. Such sales are often driven by face-to-face sales calls and "death dinners." I expected pandemic-related restrictions on in-person meetings (and funeral services) would cut into this important sales channel. Interesting thesis, but wildly off base. "*What makes the stock go up and down?*" This is a death-care provider, so more deaths equals more business. And what could be better for business than a deadly pandemic? (No shit, Sherlock.) It took a couple quarters, but I scrapped the original thesis and let sleeping dogs lie for a while.

As with CVNA, I have reestablished a short position in SCI, hopefully with the right thesis in place this time. As the pandemic wanes, SCI shouldn't be any more immune to a "pull-forward" effect than the Pelotons and Zooms of the world. I also expect lucrative "pre-need" sales to eventually come down as well. Many such sales are made at the time of a relative's death ("How would you like to secure this beautiful plot right next to your loved one?") and have probably benefitted from a consumer flush with stimulus cash. They are also costly outlays of cash for something that hopefully won't be consumed any time in the near future and I would expect an increasingly strained consumer to hold off on making such a purchase (it would be quite morbid to call this delayed "gratification"). In addition to SCI, the Partnership is also short peer **Carriage Services (NYSE: CSV)**. Management there is living in a state of denial – while SCI's management has at least acknowledged the meaningful COVID-bump will likely recede, CSV's leadership has attributed their strong performance over the past several years to managerial prowess.

On the long side of the portfolio, our positions largely remain unchanged, with the exception of some small investments in oil and gas E&P companies whose valuations are out of lockstep with the commodity price backdrop. Below are some brief updates on several long positions:

- **Anterix (Nasdaq: ATEX)**: During its last earnings call, management warned that the goals it laid out for FY'22 (ended March 31) were at risk of slipping beyond quarter end. As a general matter, the slippage in and of itself doesn't bother me that much – a month here or there doesn't detract directly from the value of the company's spectrum holdings. What *does* irk me about the delay is that management should have already learned their lesson about over-promising and under-delivering by even a hair (see September 2020). The gap between private market value and ATEX's share price will persist until management starts putting points on the board consistently.

- **Liberty Latin America (Nasdaq: LILA)**: LILA is the Rodney Dangerfield of the John Malone empire – it don't get no respect. The company is a leading telecommunications provider (broadband, television, wireless) operating in over 20 countries across Latin America and the Caribbean. Shares have had a tough go since spinning out from Liberty Global in 2018. At separation, the valuation was rich, but a lot of so-called value investors rushed in anyways because they thought any investment opportunity that checked the boxes of "spin-off" and "John Malone" had to be a money-maker. Wrong. Add to this some pretty ugly financial performance brought about by Hurricane Maria in Puerto Rico and a cumbersome (but not all the complicated) capital structure, and it's easy to see why shares have performed so poorly. But as you've no doubt read in prior quarters' letters, I'm a big believer in the notion that *past performance is not indicative of future results*. Today's market cap is ~$2.1 billion (and shrinking via an ongoing buyback program) and I can very easily underwrite free cash flow north of $400 million in 2024. This reflects a P/FCF multiple of 5.25x / a free cash flow yield of nearly 20%. This is exceptionally cheap for a company with recurring cash flow streams and a very long opportunity to grow via penetration in the years to come.

- **Liberated Syndication (LSYN)**: In mid-March, LSYN provided a modicum of financial information alongside news of a small capital raise. The details were encouraging. AdvertiseCast, the advertising network that LSYN acquired in June 2021, generated revenue that "exceeded $18 million in calendar year 2021." On a comparable basis, AdvertiseCast reported $12 million of revenue on 2020. Given the importance of the company moving away from commoditized hosting into the fast growing world of advertising, it was quite pleasing to see this portion of the business growing at an implied rate somewhere north of 50%. Additionally, the company reported that following the $4.75 million capital raise, and after giving effect to its $5 million acquisition of a separate podcast advertising company, its pro-forma cash balance was ~$13 million. This figure was telling because the last cash balance reported in the public domain was $13.8 million *all the way back on September 30, 2020.* So what this tells me is that notwithstanding all of the expenses associated with the ongoing restatement and other business transformation initiatives, the underlying business continues to generate cash. Unfortunately, not all is rainbows and butterflies, as LSYN's inability to timely file financials resulted in the SEC revoking the company's registration. I still believe there is a viable path for the company to re-list and that once it does, the Partnership should reap the benefits of our patience.

- **Evolution Petroleum Corporation (NYSE: EPM):** EPM is a small oil & gas company that owns a portfolio of diversified oil, natural gas, and NGL producing properties. EPM is atypical in the sense that it specifically focuses on non-operating working & revenue interests of producing assets that are in the twilight years of their lives. These assets require fairly minimal capital and have steady, predictable production profiles. Historically, EPM was a less attractive single-asset business, owning only a 23.9%/26.2% working/revenue interest in Denbury's Delhi field, which is predominantly an oil asset. In recent years, however, management has meaningfully diversified, adding a total of four additional production assets to its portfolio. Pro-forma for its most recent acquisitions, EPM's production mix is 43% oil, 40% natural gas, and 17% NGL. One of the more important factors that attracted me to EPM was management's philosophy to operate an unhedged book[1]. I subscribe to the school of thought that 1) years of underinvestment in upstream projects has resulted in a structural supply deficit that should be supportive of pricing for some time and 2) commodity exposure is an important hedge against rising inflation. Shares trade at an EV/EBITDA multiple in the mid-2x range and offer a mid-single-digit dividend yield.

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I know these updates are long, but I believe it is vitally important for partners and prospective partners to understand my thought process and rationale for making investments. I am available for any questions, comments, or concerns that you may have.

If you are an accredited investor who would like to learn more about becoming a partner, please reach out to me and we can arrange a time to have a more in-depth conversation. Please also know that even if an investment in the Partnership isn't for you, the highest compliment that you can pay me is an introduction to someone who might be a good fit.

I want to thank those of you who have already joined as partners of the Fund. I am grateful for the opportunity to grow your assets alongside mine and appreciative of your trust.

"If you invest in the present, you're going to get run over."

- Stanley Druckenmiller

Sincerely,

MHacke

Michael G. Hacke, CFA
Steel City Capital Investments, LLC

[1] EPM's credit agreement requires the company to hedge 25% of its forward 12-month production following recent borrowings made in support of several acquisitions. However, management has indicated that it intends to use its cash flow to reduce debt and is unlikely to replace any of its expiring hedges.

APPENDIX A: 2022 Estimates (excluding ADESA Contribution)

$MM	3/31/2022	6/30/2022	9/30/2022	12/31/2022	2022E
Total Revenue	3,497	4,156	4,652	4,697	17,002
Gross Profit	298	410	522	591	1,822
Cash SG&A	(690)	(690)	(690)	(690)	(2,760)
Other non-operating	13				13
Total EBITDA	**(405)**	**(280)**	**(168)**	**(99)**	**(951)**
Gross Profit Margin	8.5%	9.9%	11.2%	12.6%	10.7%
Cash SG&A / Revenue	(19.7%)	(16.6%)	(14.8%)	(14.7%)	(16.2%)
Other non-operating / Revenue	(0.4%)	-	-	-	(0.1%)
EBITDA Margin	**(11.6%)**	**(6.7%)**	**(3.6%)**	**(2.1%)**	**(5.6%)**
Total Retail Units	**105,185**	**125,000**	**139,936**	**141,270**	**511,391**
Total Revenue / Retail Unit	$33,246	$33,246	$33,246	$33,246	$33,246
Total Gross Profit / Retail Unit	$2,833	$3,283	$3,733	$4,183	$3,562
Cash SG&A / Retail Unit	($6,560)	($5,520)	($4,931)	($4,884)	($5,397)
Other non-operating / Retail Unit	$124				$25
Total EBITDA / Retail Unit	**($3,850)**	**($2,237)**	**($1,198)**	**($701)**	**($1,860)**
Margin Check	(11.6%)	(6.7%)	(3.6%)	(2.1%)	(5.6%)

Source: Company filings, Steel City Capital estimates

Assumptions

- *Retail Units:* Assumes 125,000 units in 2Q'22 (consistent with real-time indications of the current quarter's sales pace), followed by a reacceleration of growth to 25% in each of 3Q'22 and 4Q'22. Note that the company had originally guided to selling north of 550,000 retail units in 2022.
- *Gross Profit / Retail Unit:* In the company's 4Q'21 shareholder letter, management stated "in Q2 through Q4 **taken in aggregate (emphasis added)**, we expect total GPU over $4,000 […]" So the company wasn't forecasting a rebound to $4,000 immediately after a soft first quarter, but instead that GPU would climb sequentially in 2Q through 4Q such that the average across that nine month period would be north of $4,000. In the 1Q'22 shareholder letter, management updated its GPU outlook, stating "we now expect a return to over $4,000 GPU and positive EBITDA to be pushed back a few quarters […]" What I've modeled is a sequential increase of $450/unit/quarter through the balance of the year, such that the *average* figure for the remaining nine months of the year is $3,750/unit.
- *Cash SG&A:* Holding this flat at $690 million per quarter through the balance of the year. For context, cash SG&A has been growing *sequentially* at a mid-to-high teens rate. It remains to be seen how much the company can slow the pace of growth to right-size its cost structure with its new GPU expectations.

APPENDIX B: Historical Annual Financials & Unit Metrics (excluding ADESA Contribution)

$MM	2017	2018	2019	2020	2021	2022E
Total Revenue	859	1,955	3,940	5,587	12,814	17,002
Gross Profit	68	197	506	794	1,929	1,822
Cash SG&A	(212)	(402)	(745)	(1,052)	(1,928)	(2,760)
Other non-operating	1	1	4	(1)	6	13
Total EBITDA	**(145)**	**(206)**	**(243)**	**(257)**	**(5)**	**(951)**
Gross Profit Margin	7.9%	10.1%	12.9%	14.2%	15.1%	10.7%
Cash SG&A / Revenue	(24.7%)	(20.5%)	(18.9%)	(18.8%)	(15.0%)	(16.2%)
Other non-operating / Revenue	(0.2%)	(0.1%)	(0.1%)	0.0%	(0.0%)	(0.1%)
EBITDA Margin	**(16.9%)**	**(10.5%)**	**(6.2%)**	**(4.6%)**	**(0.0%)**	**(5.6%)**
Total Retail Units	**44,252**	**94,108**	**177,549**	**244,111**	**425,237**	**511,391**
Total Revenue / Retail Unit	$19,409	$20,779	$22,190	$22,885	$30,134	$33,246
Total Gross Profit / Retail Unit	$1,539	$2,090	$2,852	$3,252	$4,536	$3,562
Cash SG&A / Retail Unit	($4,787)	($4,269)	($4,199)	($4,311)	($4,534)	($5,397)
Other non-operating / Retail Unit	$30	$13	$21	($6)	$14	$25
Total EBITDA / Retail Unit	**($3,279)**	**($2,191)**	**($1,367)**	**($1,053)**	**($12)**	**($1,860)**
Margin Check	(16.9%)	(10.5%)	(6.2%)	(4.6%)	(0.0%)	(5.6%)

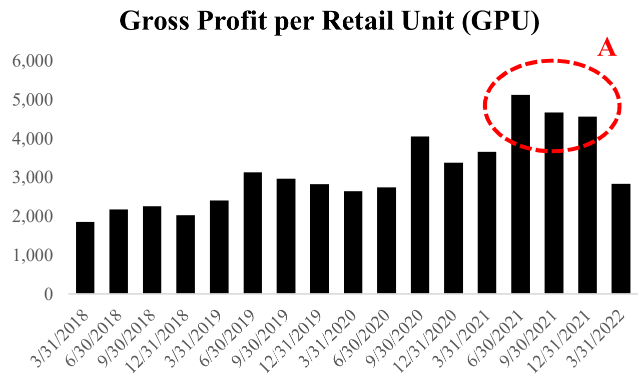
Source: Company filings, Steel City Capital estimates

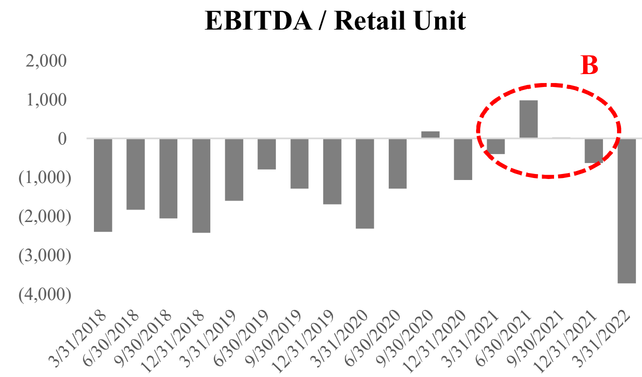
APPENDIX C: Liquidity Analysis (2Q'22-4Q'22 Estimate)

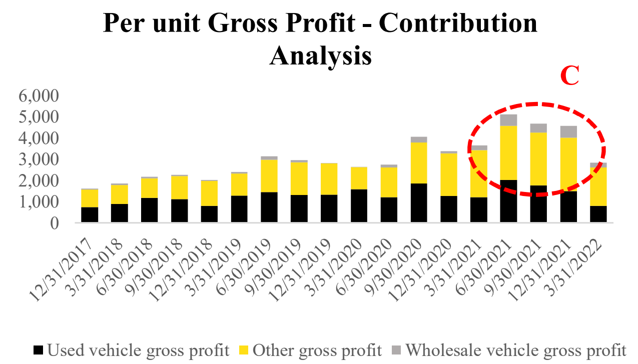
2Q'22-4Q'22 Estimate	**$MM**
EBITDA	**(546)**
+ ADESA EBITDA	75
- Interest on Existing Debt	(193)
- Interest on New 10.25% Notes	(222)
-Capex	(350)
Leveraged Free Cash Flow	**(1,237)**
- ADESA Acquisition & Fees	(2,342)
+ New Equity	1,250
+ New Debt	3,250
Change in Cash	**921**
Cash at 3/31/2022	247
+ Change in Cash	921
Cash at 12/31/2022	**1,168**
- Cash for ADESA Buildout	(1,000)
Available Cash Resources at 12/31/2022	**168**

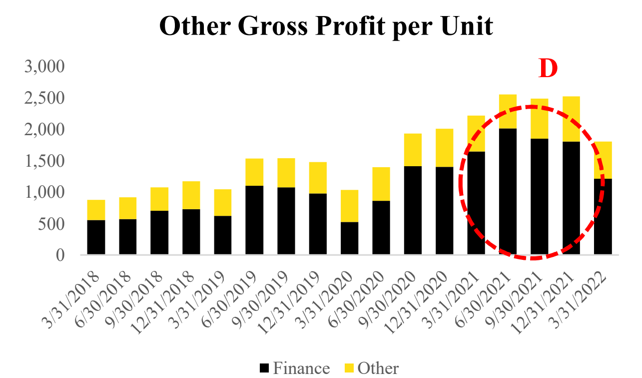
Source: Company filings, Steel City Capital estimates

APPENDIX D: Unit Economics









Source: Company filings, Steel City Capital estimates

A) CVNA's gross profit per retail unit (GPU) jumped meaningfully across 2021.

B) The improvement in GPU fell through to the bottom line, enabling the company to report roughly break-even EBITDA per retail unit for much of 2021.

C) While used vehicle gross profit (the difference between the sale price of a vehicle and what CVNA has paid to acquire and recondition it) improved marginally in 2021, "Other" gross profit improved meaningfully.

D) Other gross profit was turbo-charged by finance income, which benefitted from 1) all-time high used care prices, 2) increases in loan balances at origination, and 3) tight funding costs, which collectively enabled the company to record large gains on sale of loans via securitization.

CVNA is a finance company that just happens to sell used cars.