STEEL CITY CAPITAL, LP

August 9, 2022

Dear Partners and Friends,

Steel City Capital, LP (the "Partnership") declined 11.2% in the second quarter of 2022, net of fees and expenses. Following flat performance in the first quarter of the year, the year-to-date decline in the Partnership matches our performance in the second quarter.

	Steel City Capital Exposure & Returns		**Index Returns**	
	Average Net Long	Net Return	S&P 500	Russell 2000
2Q 2022	88%	(11.2%)	(16.4%)	(17.5%)
YTD 2022	89%	(11.2%)	(20.6%)	(23.9%)
Since Inception (Annualized) [1]	59%	4.6%	8.4%	1.2%

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

Throughout the first half of the year, market trading was dominated by inflation-related concerns, rising rates, and a growing drumbeat of chatter about a looming recession. But since mid-June the market has changed course, with the tech-heavy NASDAQ rallying as much as 19.5% off its lows, putting the index on the precipice of a technical "bull" market. The more recent day-to-day volatility reflects confusion surrounding the macro environment and the related path of interest rates. Have rates reached a "neutral" level, as Chairman Powell recently suggested? Is the rates market correct that the Fed will soon pause the pace of increases and ultimately begin cutting next year? Has inflation peaked? Will this lead to a 1970's style policy error? Are commodity prices retreating for good, or do we have longer term structural issues to deal with? Are we currently in a recession, despite the fact that the country added 528,000 jobs last month? The list goes on and on.

In recent days, meme stocks and a long list of other unprofitable growth companies have rallied, causing discomfort (perhaps PTSD) for those of us who hold short positions in such companies. While there are myriad examples, two of our long-held (and perennially painful) short positions illustrate the phenomenon well. Let's start with **Trupanion (TRUP)**. The second quarter print and guide was a proverbial dumpster fire. The company's net loss expanded year/year, which was attributed to 1) a return of claim frequency to pre-pandemic levels and 2) a recent acceleration in claim severity (the cost per claim covered). Management tried to spin the inflationary-nature of claim expenses in a positive light, but under no circumstances should an insurance company be bragging about increasing frequency and severity – this is literally the *exact opposite* of what the company should want to see. (Along with treatment of SBC, this is another area were Buffett-Fanboi Darryl Rawlings apparently has views that diverge with the Oracle.) Alongside these trends, management revised down guidance for "adjusted operating income" growth from 25% to a range of 15-20%. One would expect an unprofitable insurance company trading at nearly 9.0x P/B to be down significantly on the news, but shares are essentially flat compared to pre-release levels.

Carvana (CVNA) shares are up more than 100% from recent lows. The quarter was predictably poor: retail unit growth slowed to ~9% year/year and the company generated negative EBITDA of $230 million. What bulls saw in the report was growth in per-unit gross profit (GPU) and a reduction in per-unit SG&A which they interpreted as an inflection in the business and a sign that the march to profitability has resumed in earnest. I think they're getting high on their own supply.

While there may be some continued improvement in the "metal margin" component of GPU, all-important finance GPU is unlikely to return to 2020/2021 levels in the absence of the ABS securitization market heating up again. At the same time, bulls have latched on to the company's so-called "stretch-goal" of SG&A reaching $4,000/unit by the fourth quarter of the year. Let me start by pointing out something that is being grossly mischaracterized: this "stretch goal" is being conflated with "guidance." *It is absolutely not guidance*. I view "stretch goal" as a sort of squishy term management can use to offer some hope for the future while simultaneously protecting themselves from getting sued if (when) they don't hit this target.

More importantly, I think there is a near-zero probability that the company comes anywhere close to this level of SG&A/unit. Notwithstanding all of the hype about cost cutting, like-for-like cash SG&A (ex. ADESA and one-time restructuring expenses) dropped from ~$690 million in 1Q'22 to $640 million in 2Q'22, a reduction of ~7.0%. Laudable, but nowhere near the levels required to reach the "stretch goal." The challenge is that CVNA has pulled in its horns with respect to retail unit volume growth in order to preserve liquidity, but the path to SG&A of $4,000/unit requires a reacceleration of unit growth in order to leverage fixed costs. This is a case of "the trend is not your friend," with alternative data points indicating unit volumes declined sequentially in each month since March. And with the pending $1.0 billion reduction of the company's floor plan facility by the end of September, the type of unit increases required to hit the target look increasingly unlikely.

What if there's still fat to trim? Perhaps it's plausible, but I think bulls need to be more intellectually honest about what would need to happen for CVNA to achieve its "stretch goal". Let's say the company successfully reduces like-for-like cash SG&A to $575 million, reflecting a 10% decline from 2Q'22. CVNA would need to sell an all-time high 143,750 retail units in 4Q'22, reflecting a reacceleration of year/year growth to ~27%. I'm not holding my breath.

And lastly – what happens if CVNA doesn't hit its SG&A targets? I estimate the company will burn through the vast majority of its available cash by the end of the year, setting it up for a liquidity event in in early 2023. **There's a reason a majority of CVNA's bonds trade at distressed levels. Bulls are whistling past the graveyard.**

Our short position in **Service Corp. International (SCI)** began to bear fruit when the company reported 2Q'22 results and I think there continues to be room for the shares to fall further. At the company's analyst day in May, management articulated long-term financial targets that included EPS growth of 8-12%, inclusive of 5-7% from organic activity and another 3-5% from inorganic activity (M&A and greenfield expansion). There are lots of moving variables associated with the outlook, but ultimately, reaching the goal is predicated upon continued strong growth in pre-need cemetery sales (which have favorable revenue recognition conditions). My view is that the recent boom in pre-need activity was a function of 1) a consumer flush with cash and "wealth-effect" driven spending with markets at all-time highs and 2) elevated awareness driven by COVID mortality, and that sooner-or-later the attractiveness of pre-paying

$10,000+ for a cemetery plot that you (hopefully) won't need for many years would become less attractive. When the company reported 2Q results pre-need growth unexpectedly rolled over. As investors come to terms with the fact that SCI is unlikely to deliver on its long-term guidance, shares should continue to retreat.

Equitrans Midstream Corp (ETRN) is a new long position for the Partnership. ETRN is the former midstream arm of Marcellus natural gas producer EQT. They own gathering assets (small diameter pipelines that directly connect to the wellhead) and long haul transportation assets (larger diameter pipelines that move gas over long distances, usually under take-or-pay contracts). The company formally separated from EQT via spin-off in late 2018. At the time, the capital structure was pretty complicated – there was a collection of three (yes, THREE) publicly traded currencies that held various ownership interests in the core assets, but this was simplified in a combination of asset swaps over the years so that there is now only one publicly traded vehicle (ETRN).

The stock has been a poor performer since its separation due to missed financial targets and increasing debt-levels, both owing to the company's struggle to complete the Mountain Valley Pipeline (MVP). The MVP is intended to provide much needed takeaway capacity from the Appalachian Basin to markets in the U.S. Southeast (where there is growing gas demand for power generation) as well as the Gulf Coast (for eventual export). The project has been an utter disaster for the company because of continued opposition from the environmentalist community. Originally targeted to come online in late 2018 at a total cost of $3.5 billion, today we're looking at a best case scenario of mid-2023 at a total cost of $6.2 billion. In support of the expanding price tag, ETRN has had to take on increasing amounts of debt. At the same time, the company has pulled the rug out from under dividend-oriented investors, first in the form of revised guidance for no growth vs. 8-12% at the time of separation, and second in the form of a (backdoor) dividend cut. So it's sort of easy to see why investors have been sour on the stock.

The Partnership began acquiring shares in late June / early July when ETRN was trading around $6.00. As a general matter, I disdain using DCF for valuation purposes, as it's a silly exercise that involves a lot of bullshit guessing about the future. But there are exceptions to every rule, and ETRN is one of them. This is a business that is fairly simple to model. Certain volumes are contractually set. Non-contractual volumes should continue flowing even in a depressed natural gas price environment (and today's price environment is anything but weak). And prices for volumes are known variables (again, with a significant portion being contractually set).

The way I went about modeling the business was as follows: First, there is a "core" or "base" business that will generate cash flows independent of MVP being placed into service. Second, there is a set of "contingent" cash flows that will be generated in the event of MVP being placed into service. Applying a 10% (equity) discount rate to expected free cash flow[1] from the base business yielded a price in the low-to-mid $6.00 range. So at our purchase price, I felt comfortable we were able to lock in an attractive return with limited downside. At this level, we also became the owners of an "option" on potential upside from the contingent cash flow stream. At the time, I estimated upside from this cash flow stream to be worth anywhere from $3.50-$4.00. Of course, the "option" is worth less than

[1] At the time, ETRN's recently issued long-term debt yielded around 8%. The yield has subsequently tightened to 6.5%. There is a strong argument to be made for an even lower discount rate, as ETRN's heavy reliance on take-or-pay contracts with EQT makes this a story of "look-through" credit risk. EQT's bonds trade in the 4.5-5.5% range.

that (because of the probability tree associated with MVP), but at $6.00/share, we were getting the option for free. Who doesn't like a free option?

Since initially establishing a position, there has been a major development with respect to the prospects of MVP. In exchange for his support of the proposed "Inflation Reduction Act," West Virginia Senator Joe Manchin secured commitments from congressional leadership and the President to support a bill that would, among other things, clear a path for MVP to be completed. As it stands today, the market appears to be pricing in roughly 50/50 odds of completion, but I think the probability is much higher.

What could go wrong? The biggest risk to completion is no longer judicial, but political. The path forward for the legislation that would support MVP's completion is a "side agreement" to the reconciliation bill. This means it can't pass with a simple majority, and instead needs a filibuster-proof 60+ votes. Republicans are a tad salty about the Democrats' recent legislative success(es) and I wouldn't put it outside the realm of possibilities that they thwart the legislation out of pure spite[2]. Time will tell, but given our purchase price, I think it's highly unlikely that we end up losing money on our position even in the event of a "worst case" scenario.

Unit Corporation (UNTC) is another new long for the Partnership. UNTC is a diversified energy company with three segments: 1) exploration and production, 2) contract rigs, and 3) midstream. I stumbled onto the company on my own but have come to realize it is somewhat popular among the "FinTwit" community. This actually has me a tad on guard, as I've been burned by the group-think and unbridled enthusiasm that often accompanies this type of popularity (yes, we once owned GAIA, and no, I'm not proud of it).

At the end of the day, I'm attracted to UNTC because of what I perceive to be a fairly large margin of safety at our purchase price. Similar to ETRN, it's hard to see how we lose money on this investment. The company has no debt and is currently sitting on $161 million of cash[3]. Subject to commodity pricing, I think the company could reasonably generate another $70 million through the end of the year. On top of this, UNTC owns 14 super-spec rigs that are fully utilized. The best bogey available for the rigs' valuation is last year's acquisition of Pioneer Energy by Patterson UTI, which valued similar rigs at $13-$14 million each. This implies the rig business is conservatively worth $140-$150 million. Against a market cap of $590 million, $140 million is covered by rigs and another $230 million will be covered by cash by year-end. Depending on production and price assumptions for 2023, the E&P assets trade at an implied multiple between 1-2x cash flow.

Management has telegraphed the potential for increased capital returns going forward, which I certainly wouldn't argue with. But I'd also like to see the company reinvest in production growth (potentially even selling the rig operations to support more drilling) which would change the dynamic of valuation. It's one thing to be a low-multiple E&P operator in run-off mode – it's completely different to be a low-multiple E&P operator with production growth coming down the pike.

[2] Here in America, we too often put party over country.
[3] Pro-forma for a recently closed asset sale.

At **Anterix (ATEX)**, another quarter of *nothing* to report on the contract front. If you would have told me three years ago ATEX's share price would be virtually unchanged from our entry point *despite* receiving everything it wanted from the FCC *and* signing three contracts *and* unveiling lofty financial targets, I wouldn't have believed you.

Observers have suggested that it's time to cut bait and begin fishing elsewhere. The challenge with the investment thesis at this juncture is that it's going to take more than just 1-2 additional contracts to drive the shares materially higher (unless the contracts are *massive*). This is valid perspective – so why maintain a position? Two reasons. First, I continue to believe in the industrial logic and demand underlying the spectrum the company has on offer. Second, the investment continues to include a significant margin of safety, which as articulated above with respect to ETRN and UNTC, is clearly important to me. ATEX has a market capitalization of ~$850 million. Against this, the company has letters of intent (I know, these aren't contracts…) totaling $450 million and is contractually entitled to another $50 million of proceeds from deals that have already been inked. The remaining stub substantially undervalues what the company is likely to realize from additional spectrum sales.

No, we haven't (yet) made the type of money that I expected when initially entering the position, but I think it's a relatively low-probability outcome that we see our capital permanently impaired, and I continue to believe that there is a relatively high probability that our five-year IRR will be quite satisfactory.

* * * * *

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.

"Confronted with a challenge to distil the secret of sound investment into three words, we venture the motto, Margin of Safety"

- Ben Graham

Sincerely,

MHacke

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

DISCLAIMER

Steel City Capital Management, LLC (the "**General Partner**") is not registered as an investment adviser with the Securities and Exchange Commission. On July 2, 2018, the Pennsylvania Department of Banking and Securities approved the General Partner as a Registered Investment Advisor within the Commonwealth of Pennsylvania. The limited partnership interests (the "**Interests**") in Steel City Capital, LP, (the "**Fund**") are offered under a separate private offering memorandum (the "**Offering Memorandum**"), have not been registered under the Securities Act of 1933, as amended (the "**Securities Act**"), nor any state's securities laws, and are sold for investment only pursuant to an exemption from registration with the SEC and in compliance with any applicable state or other securities laws. Interests are subject to restrictions on transferability and resale and may not be transferred or resold except as permitted under the Securities Act and applicable state securities laws. Investors should be aware that they could be required to bear the financial risks of this investment for an indefinite period of time.

THE INFORMATION FURNISHED IN THIS DOCUMENT IS IN ALL RESPECTS **CONFIDENTIAL** IN NATURE AND MAY NOT BE REPRODUCED WITHOUT PRIOR WRITTEN PERMISSION FROM THE GENERAL PARTNER. DISSEMINATION OF THIS DOCUMENT OR DISCLOSURE OF ANY KIND MAY CAUSE SERIOUS HARM OR DAMAGE TO THE FUND AND THE GENERAL PARTNER. PAST PERFORMANCE IS NOT INDICATIVE OR A GUARANTEE OF FUTURE RESULTS.

The information contained herein reflects the opinions, estimates and projections of the General Partner as of the date of publication, which are subject to change without notice at any time subsequent to the date of issue. The General Partner does not represent that any opinion, estimate or projection will be realized. All information provided is for informational purposes only and should not be deemed as investment advice or a recommendation to purchase or sell any specific security. The Fund has an economic interest in the price movement of the securities discussed in this letter, but The Fund's economic interest is subject to change without notice. While the information presented herein is believed to be reliable, no representation or warranty is made concerning the accuracy of any data presented.

The Fund terms, performance returns, and portfolio characteristics reflected in this document are not indicative of future returns or portfolio characteristics and do not modify the terms of the Fund as detailed in the Fund's Offering Memorandum. Positions reflected in this letter do not represent all the positions held, purchased or sold, and in the aggregate, the information may represent a small percentage of activity. The information presented is intended to provide insight into the noteworthy events, in the sole opinion of the General Partner, affecting the Fund.

Certain information contained in this document constitutes "forward-looking statements" which can be identified by use of forward-looking terminology such as "may," "will," "target," "should," "expect," "attempt," "anticipate," "project," "estimate," "intend," "seek," "continue," or "believe" or the negatives thereof or other variations thereon or comparable terminology. Due to the various risks and uncertainties, actual events or results in the actual performance of the Fund may differ materially from those reflected or contemplated in such forward-looking statements. The General Partner is the source for all graph and charts, unless otherwise noted.

A prospective investor should only commit to an investment in the Fund if such prospective investor understands the nature of the investment and can bear the economic risk of such investment. The Fund is speculative and involves a high degree of risk. The Fund may lack diversification, thereby increasing the risk of loss. The Fund's performance may be volatile. There can be no guarantee that the Fund's investment objectives will be achieved, and the investment results may vary substantially from year to year or even from month to month. As a result, an investor could lose all or a substantial amount of its investment. In addition, the Fund's fees and expenses may offset its profits. There are restrictions on withdrawing and transferring interests from the Fund. In making an investment decision, you must rely on your own examination of the Fund and the terms of the Offering Memorandum and such other information provided by the General Partner to you and your tax, legal, accounting or other advisors. The information herein is not intended to provide, and should not be relied upon for, accounting, legal, or tax advice or investment recommendations. You should consult your tax, legal, accounting or other advisors about the matters discussed herein. The Fund's ability to achieve its investment objectives may be affected by a variety of risks not discussed herein. Please refer to the Offering Memorandum for additional information regarding risks and conflicts of interest.

No representations or warranties of any kind are made or intended, and none should be inferred, with respect to the economic return or the tax consequences from an investment in the Fund. No assurance can be given that existing laws will not be changed or interpreted adversely. Prospective investors are not to construe this document as legal or tax advice. Each investor should consult his or its own counsel and accountant for advice concerning the various legal, tax, ERISA and economic matters concerning his or its investment.

This document is being furnished to you on a confidential basis and may not be used for any other purpose. Any reproduction or distribution of this document or accompanying materials, if any, in whole or in part, or the divulgence of any of its contents is prohibited. The information set forth herein does not purport to be complete and no obligation to update or otherwise revise such information is being assumed. It is meant to be read in conjunction with the Fund's Offering Memorandum prepared in connection herewith, and does not constitute an offer to sell, or a solicitation of an offer to buy, by anyone in any jurisdiction in which such an offer or solicitation is not authorized or in which the making of such an offer or solicitation would be unlawful. Such an offer to sell or solicitation of an offer to buy interests may only be made pursuant to definitive subscription documents between the Fund and an investors. The information contained herein does not purport to contain all of the information that may be required to evaluate an investment in the Fund. The information herein is qualified in its entirety by reference to the Offering Memorandum, including, without limitation, the risk factors therein.

An investment in the Fund has not been approved by any U.S. federal or state securities commission or any other governmental or regulatory authority. Furthermore, the foregoing authorities have not passed upon the accuracy, or determined the adequacy, of this document, the Offering Memorandum or limited partnership agreement associated with the Fund. Any representation to the contrary is unlawful.

Past Performance Is Not Indicative or a Guarantee of Future Results.