CARMEL CAPITAL PARTNERS

11750 Sorrento Valley Road
Suite 110
San Diego, CA 92121

Q2 2019 Commentary

General Commentary

Thus far in 2019 we've seen strong returns from our equity, fixed income, real estate and private equity investments.

As we look across the investment landscape it's become increasingly difficult to separate signal from noise. It's like trying to tune a very old radio, one of those that required the dial to be moved until a strong signal was acquired. While searching for the signal you were forced to listen to noise (static), but once you found the signal the music came in loud and clear.

Twice a week we convene in our conference room to discuss the companies we own, potential new investments we're evaluating, and the business climate in general. Lately, during our discussions it feels like we're picking up more noise than signal.

The bond market is signaling a weaker economy ahead, as both short and long-term interest rates have fallen. The equity markets are signaling all good over the horizon as markets continue to flirt with new highs. [As a side note, this was originally written before the market decline that occurred in early August]. The strength in the U.S. dollar is signaling weaker corporate profits ahead, and the recent move higher in gold is signaling investor's need for shelter from impending distress. Adding to the noise is the ever-escalating trade war with China, and the ever-expanding levels of government debt.

It's easy to lose sight of these cross currents when prices continue to march higher. It's easy to ignore the signal even once you finally find it, especially when prices seem to be telling you "everything is good, everything is going to be all right".

Because we emphasize capital preservation over return, we work hard to ignore price (not valuation, that we focus on like a laser) and focus on the signal we're getting from the fundamentals. Our interpretation of today's signals indicates more headwinds are present then tail winds. All of these we outlined these in our Q1 2019 letter.

Despite our worry list we continue to uncover opportunities to deploy capital, however doing so with a growing emphasis on quality and conservatism to protect us should the economic winds shift in a material way.

We continue to be vigilant and emphasize capital preservation over return. We express this philosophy in our work each day through patience, discipline, conservatism, research rigor, and margin of safety.

Equity Update

Our equity returns though Q2 2019 (excluding cash) on average increased 17.5%, and on average our equity accounts increased by 12.5%.

During the quarter we initiated new positions in The Walt Disney Company (DIS), Red Rock (RRR), UPS (UPS), Carrols Restaurant Group (TAST).

Walt Disney Company (DIS) / Market Cap $261 billion

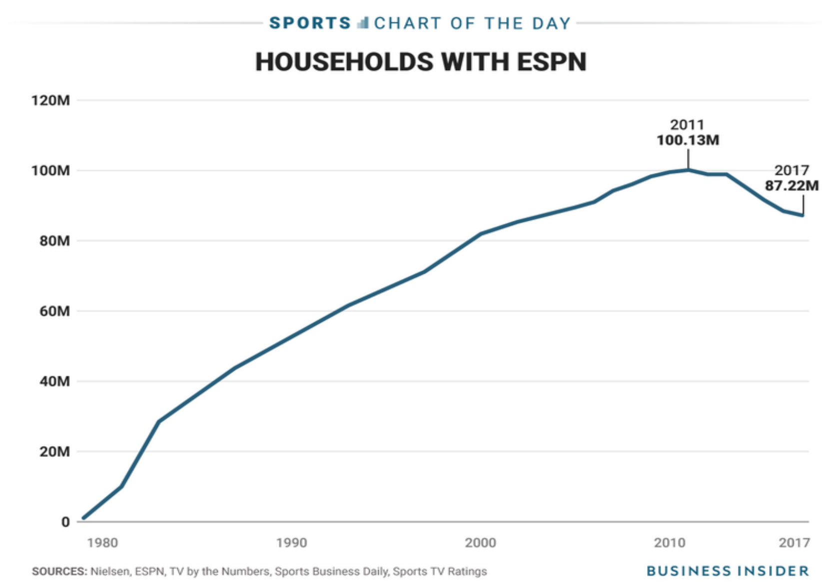
After many years admiring Disney from a distance we purchased shares during Q2.

Today DIS operates in four segments:

Parks	Disneyworld /Disneyland
Media Networks	ESPN, ABC, A&E, etc.
Studio Entertainment	Movie production. Disney, Marvel, Pixar, etc.
Direct-to-Consumer	Hulu and streaming services.

From 2015 to 2018 Disney's stock price was unchanged, and for good reasons. Despite the company's growing cash flow from its Studio Entertainment and Parks business, the Media Networks division was under pressure.

Specifically, there was concern about ESPN's financial future. In recent years as Netflix, Hulu and Amazon Prime have gained traction many cable subscribers have elected to "cut the cord" or cancel their cable TV. As each subscriber cancels their subscription ESPN's monthly revenue from the cable providers (Spectrum, Cox, etc.) declines. For many years ESPN was a large growth engine for Disney and delivered consistent annual subscriber increases in conjunction with annual price increase. Today ESPN receives roughly $9 per month for each of its 83 million subscribers. In other words, about $9 billion in annual revenue for ESPN. However, this is down from a peak of 100 million subscribers in 2011. To the right you can observe the meteoric rise in subscribers since the early 1980's, and then the peak in 2011. It was only in 2016 that Disney formally acknowledged the problem and began to take proactive measures.



At its peak ESPN accounted for 50% of Disney's operating income and any whiff of trouble with its golden goose would certainly impact Disney's financial results. Hence the unchanged stock price for three years, and a declining valuation.

On June 20, 2018 Disney announced it would purchase 21st Century Fox. At the time we believed this transaction, if approved, would be a game changer for Disney. The acquisition would result in Disney owning a portfolio of high-quality content such as National Geographic, 20th Century Fox Entertainment (Avatar, Titanic, Ice Age), Fox Sports, and TV shows such The Simpsons, Modern Family, Homeland and This is Us.

In addition to the many positives of the 21st Century Fox acquisition we believed Disney had the financial resources and talent to successfully develop a next generation streaming offering for ESPN while at the same time developing a competitive streaming service to Netflix. The combination of Disney's content, mixed with the newly acquired 21st Century Fox content, would be a viable competitor to Netflix.

Despite all this seemingly good news on the surface, Disney's financial results appeared to flounder, and its finances appeared far worse than they really were. The company was investing a material amount of capital in these next generation services and this spending directly impacted financial results. To the outside investor this looked like a negative event. To us this was a positive. We're willing to accept a little short-term pain as we believed over the long-term these investments would ultimately pay off.

In early 2019 Disney management began to discuss in more detail the future of its streaming services. The CEO described a future ESPN streaming service that would potentially allow an a 'la carte purchase of ESPN and described a movie/tv streaming service to compete against Netflix. In April 2019 Disney held an investor meeting where it provided additional detail about its streaming offering. Price, interface, offering and availability were all discussed. At the conclusion of the investor day investors had an increased level of comfort with Disney's ability to compete in this new streaming world.

We remain encouraged by management's willingness to think and act with a long-term mindset.

Red Rock Resorts (RRR) / Market Cap $2.6 billion

Red Rock resorts is a Las Vegas based company providing hotel, gaming and entertainment to the locals' market in Las Vegas. All RRR's properties are located off strip and closer to the suburbs where local Las Vegas residents live.

This is our second time owning shares in Red Rock Resorts. We previously owned the company from September 2002 through January 2007 at which point it was acquired by Colony Capital. In retrospect the acquisition was consummated with too much debt and when the 2008/2009 financial crisis hit the company was forced to file for bankruptcy. Despite the financially imperiled balance sheet the company owned (and still does) a portfolio of well-located gaming properties. In addition, RRR owns a large amount of undeveloped land in the Las Vegas market that provides a runway for future growth.

Since emerging from bankruptcy in 2011, and then coming public in 2016, RRR's stock price is unchanged. Over the past two and half years the company has been engaged in multiple renovation projects that have impacted its financial statements both by reducing profits and increasing debt. The renovation projects were led by the October 2016 announcement that RRR was purchasing the Palms Casino and soon thereafter would begin a

$650MM renovation plan. In addition, management announced a large renovation to Palace Station, one of its signature properties.

We believe RRR is under earning due to the disruption from these two major renovations projects. Based on management's comments we believe the company is at the end of its spending cycle and beginning in Q4 2019 will once again begin generating large amounts of excess cash flow. The company has committed to using the excess cash flow to reduce debt, and once debt has declined to more conservative levels, using the cash to increase its dividend, develop additional casinos, or repurchase stock.

Carrols Restaurant Group (TAST) / Market Cap $402MM

TAST is the largest Burger King franchisee in the U.S. and at year-end 2018 owned 894 stores in 18 Northeastern, Midwestern, and Southeastern states. The company has consistently grown by both building new stores and acquiring existing stores from other franchisees. The company has a unique relationship with Burger King Corporate (the franchisor) which provides a right of first refusal (ROFR) in all the markets it operates in. This means that when a store becomes available for sale, TAST has first shot at negotiating a purchase transaction with the seller. If it can't, or does not want to transact, then the opportunity becomes available to other buyers. This is a valuable and unique relationship with the franchisor.

Since Q3 2018 TAST stock price has declined 50% because its financials have been impacted by both a heavy promotional environment as well as growing wage pressure. While we don't expect the wage pressure to abate anytime soon, we do expect the promotional environment to ease in the coming quarters.

On February 20, 2019 TAST announced a transformative acquisition. The company purchase 165 Burger King stores and 55 Popeyes stores from Cambridge Franchise Holdings. As a side note, Restaurant Brands International is the franchisor for both Burger King and Popeyes.

The acquisition is a positive for TAST for two reasons:

1) Popeyes provides TAST with a new growth platform.
2) As part of the acquisition TAST negotiated a new ROFR providing an opportunity to acquire stores in higher growth States vs. its previous ROFR.

With the acquisition now closed TAST has a well-defined growth path and the ability to create significant value for shareholders.

United Parcel Service (UPS) / Market Cap: $90 billion

UPS is the largest package delivery company in the US and globally. In 2017, UPS management responded to the need for increased capacity to accommodate a rapidly growing for e-commerce commerce business, for faster delivery speeds, and expanded vendor services. The company embarked on a three-year transformation/ modernization plan with accelerated capital spending and multiple initiatives for automation and other technology investments. Their objective was to position the company to meet future volume and service requirements, and to drive internal cost efficiencies and profit margin expansion.

E-commerce has led to steady growth in package delivery volumes for the past two decades, and in recent years a growing demand for progressively faster delivery times. Amazon's Prime service has continuously raised the bar for consumer expectations, creating competitive pressure for all online sellers to offer faster and cheaper delivery, which in turn makes buying online increasingly attractive for consumers.

The transformation plan was initially well-received by investors and the stock surged to an all-time high in January 2018 on reports of exceptional e-commerce growth during the previous holiday period. Following the release of its fourth quarter earnings in February 2018 the stock fell as cost details emerged for transformation plan. Adding to the negative news were higher than expected spending levels to meet the holiday demand surge.

Elevated costs to re-position the company caused operating profits to declined last year, and YTD results continue to be impacted. However, adjusted operating results which exclude one-time costs reveal margin expansion, reflecting underlying progress in technology-driven cost efficiencies. As the company nears completion of its operational transformation, we expect margins to expand due to future unit growth being increasingly profitable. All this will produce higher levels of free cash flow.

Last year during this operational investment cycle excess cash flow was in excess of $6 billion, enough to fund a high dividend rate (3.7% yield) and repurchased $1 billion of stock. We believe UPS is positioned for long-term revenue growth and margin expansion driven by its recent investments.

During Q2 we sold CLDR and CHK.

Cloudera Sale

As a testament to how difficult technology investing can be, we sold our Cloudera investment very soon after our purchase in Q1 2019. The competitive landscape changed in a material way as both Google and Microsoft (two large cloud players) decided to focus more intensely on CLDR's market. We purposely allocated a small amount of capital to our CLDR investment because of the inherent uncertainty that comes along with investing in rapidly growing but immature technology. While CLDR's technology continues to be high quality the prospects of competing directly with Google and Microsoft seemed very unappealing.

Chesapeake Sale

After many years of owning CHK we parted ways with the oil and gas producer. Our thesis for CHK was always driven by an underappreciation for the high-quality assets the company owned. Since June 2013 when Doug Lawler joined CHK as CEO the company has materially improved its cost structure, reversed many years of empire building that occurred under the previous CEO, and introduced capital spending discipline. By every financial metric CHK's income statement and balance sheet have improved. However, despite this progress, and ongoing monetization of the balance sheet, it's become clear that CHK is tougher to turnaround then we originally appreciated. In addition, we believe the nature of the industry and returns on capital have changed to where we believe our capital can be better deployed elsewhere.

Fixed Income Update

Source: Reuters Eikon

The 10-Year US Treasury started 2019 yielding 2.5% and finished Q2 2019 yielding 2.00%. As I complete this letter the 10 Year is now yielding 1.75%. This large decline in yields, coupled with a benign default environment, has produced attractive returns in our corporate fixed income portfolio. If long-term interest rates remain at current levels, and the default environment continues to remain benign, we would expect go forward returns to moderate from current levels.

Predicting the direction of interest rates has, and continues to be, very difficult. However, if we are indeed on the cusp of a Fed loosening cycle (lower interest rates) then generating attractive returns with fixed income investments will become increasingly difficult. In the future as our bonds mature, we will be reinvesting capital in an environment that offers lower yields then available today.

Year-to-date through Q2 2019 our taxable fixed income portfolios on average have produced an 8.9% return. The strong returns we experienced in Q1 2019 continued through the second quarter. In general, the corporate bond market is stable but with limited opportunity to safely deploy capital at yields much above 5%.

Today, our corporate bond portfolio has a yield to maturity of 4.93% with an average maturity of 5.2 years. We added one new corporate bond position in in Q2 2019, CBS Outdoor 5.875% due 2025 at YTM of 5.09%.

Our municipal bond portfolios on average has delivered a 3.2% return for 2019. Today we're able to purchase municipal bonds with a maturity of 10 – 12 years at yields of 2.5% - 3.0%.

Both the corporate and municipal bond markets look less appealing with each passing day. We're less enthusiastic about deploying capital at current yields.

Real Estate

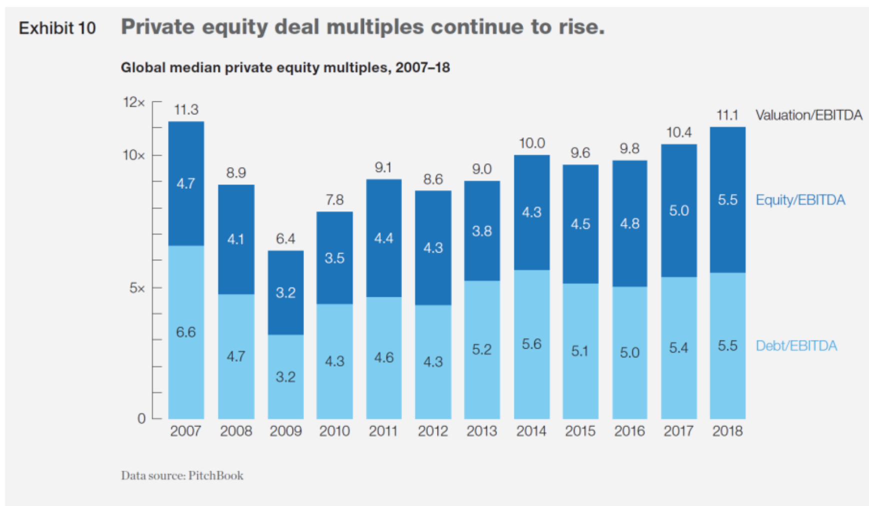
We did not make any new real estate investment in Q2 2019. Overall our real estate portfolio continues to perform well and is expected to deliver attractive returns in 2019. A more detailed description and update can be found in the "Real Estate Update" included with this letter.

Private Equity

We closed our most recent private equity investment (Fulcrum Building Group) just after the conclusion of Q2.

A detailed update on our current holdings can be found in the "Private Equity Update" included with this letter.

A quick word on private company valuations. The accompanying chart shows a slow and steady climb in multiples paid for private equity transactions, with the global median multiple paid in 2018 being 11.1X.



In an environment where competition for attractive investments is more intense with each passing day we are pleased with our disciplined process regarding price. Where possible we do not engage in active bidding rounds (auctions) and thus far have not found ourselves in the position of paying top dollar or being the high bidder. We prefer to take our time, engage sellers, proceed with a collaborative process, and drive towards a result that benefits all those involved. One unique aspect of Carmel Capital's private equity investment approached can best be described as not having to swing at every pitch. We have the luxury of waiting for those slow-moving fastballs over center plate. If we can't identify an attractive opportunity, or the right company to engage with, we'll keep the bat on our shoulder. We've purposefully structured our firm as one that does not have to transact.

CARMEL | CAPITAL PARTNERS

Concluding Remarks

Thus far for 2019 I am pleased with our investment results and the progress we’ve made in across all our investment portfolios. Wishing you an enjoyable rest of the summer.

Sincerely,

Russell Silberstein