



<u>Year</u>	<u>MPE Capital (qualified, net)</u>	<u>MPE Capital (non-qualified, net)</u>	<u>S&P 500 TR</u>
2017 ¹	17.7%	19.0%	18.6%
2018	1.1%	0.1%	-4.4%

¹Inception January 25, 2017

Fee assessment began July 25, 2017 due to state regulatory approval. Actual client results will vary due to the separately managed account structure. Performance numbers assume you were a client since the inception date. Qualified client fees are a 1% fixed management fee and a 10% performance fee subject to a high watermark. Non-qualified client fees are solely a 2% fixed management fee.

January 8, 2019

Dear Fellow Investors and Friends,

An arbitrary twelve-month period of performance shouldn't be overly scrutinized because its sure to contain a lot of noise, performance should instead be measured over a full market cycle. Nonetheless, we generated net returns in excess of our benchmark, the S&P 500 TR, for the year ended December 31, 2018. MPE Capital generated a 1.1% return net of fees for qualified clients and 0.1% return net of fees for non-qualified clients. This compares favorably to a -4.4% return for the S&P 500 TR during the same time period.

I've updated the 2017 MPE Capital performance numbers in the table above to reflect actual brokerage account statements of a model account. Previously, I had adjusted net results to reflect hypothetical fees being assessed since the inception date. However, net results now assume no fees were assessed until regulatory approval, which more closely reflects economic reality and the results experienced by actual clients of MPE Capital since the inception date.

Our gross and net returns since inception are now ahead of the S&P 500 for both fee structures. This is not an easy task considering a reported 85% of investment managers fail to beat the S&P 500. One might ask if I have my head screwed on right considering my long-term objective is to be part of a small minority of managers who add value in this industry. A few reasons I believe we have a shot are: a small capital base affords us the luxury of a large opportunity set, a concentrated portfolio ensures results will vary materially from market averages, and a strong vigilance towards permanent capital loss should hopefully steer us clear of any proverbial icebergs. Most importantly, having clients who are patient and measure results over the long-term is paramount. You can also rest assured that I have nearly all of my wealth invested alongside yours, and as one of the largest individual clients of MPE Capital, my incentives are fully aligned with yours to achieve favorable long-term results.

Nevertheless, two years is far too short a period to gain any meaningful insight from performance numbers, we could have just as easily underperformed since inception. I will repeat

what I've said in earlier letters (you will keep hearing this from me), results over a full market cycle are far more important. We are guaranteed to have periods of underperformance, what matters far more is our results over the *long-term*.

CUSTOMER CENTRICITY

One common ethos I have noticed among many successful and well respected companies is their laser-like focus on the value they deliver to customers. They are constantly iterating and improving the value their products or services add. These companies seem to be more so focused on adding value, as opposed to just maximizing profits.

I recently took a tour of the Huy Fong Foods headquarters in Irwindale, CA. The company's name may not ring any bells but I'm sure most of you will recognize a bottle of their famous Sriracha hot sauce. It's the one with the unmistakable rooster on the front and fitted with a bright green cap. Huy Fong Foods was founded in 1980 by a man named David Tran. He came to the United States in 1978 from Vietnam, arriving by boat amongst a few thousand other refugees. He got his start selling his now famous hot sauce by van in Chinatown Los Angeles. The company has never done any advertising, relying instead on the product to speak for itself and spread via word of mouth.

Throughout their near forty-year history, the company has never raised the wholesale price of their hot sauce. This is proof that David Tran doesn't care much about maximizing his personal fortune, instead he wants everyone who wants his hot sauce to have access to it at a reasonable price. Our tour guide said he's famous for saying: "Make a rich man's sauce at a poor man's price."

Today, the company generates an estimated \$100 million in sales and delivers over 40 million units per year, with sales said to be growing at nearly twenty percent per annum. The story of Huy Fong Foods is an exemplar of the American dream and a model for what can happen when management's highest priority is delivering the absolute best product or service at a reasonable price.

Looking around, many other very successful businesses seem to follow a similar approach. Jeff Bezos of Amazon is famous for his customer centric approach to online commerce. His company's mission statement is, "Our vision is to be earth's most customer-centric company; to build a place where people can come to find and discover anything they might want to buy online." Considering he's one of the richest men on the planet and Amazon's extreme success, there might be something to companies adopting a customer centric approach.

Many investment managers I respect also have a similar customer centric philosophy. The value they create for those who have entrusted them with the allocation of their hard-earned capital is far more important to them than their take home pay. Warren Buffet is famous for only receiving a \$100k salary from Berkshire Hathaway, despite being responsible for the allocation of about half a trillion dollars; a bargain management fee considering his value add since inception has

been enormous. Nearly all of Warren Buffet's wealth has been generated alongside his shareholders, by the appreciation of Berkshire Hathaway stock.

I try to manage MPE Capital by the same customer centric ethos I have observed among the likes of David Tran, Jeff Bezos, Warren Buffet, and many others. For even if I don't achieve nearly the same level of success (a sure bet), I can sleep at night knowing I put my client's interests above my own. As I stated in my first letter last year, my utmost objective is to generate value for my clients. This is what motivates me to get up in the morning and go to work. I believe with hard work, a disciplined adherence to my investment philosophy and the consistent elimination of ignorance, I can satisfy my long-term investment objectives for MPE Capital.

QUOTATIONAL LOSS AND PERMANENT CAPITAL LOSS

I think it's very important to differentiate between quotation loss and permanent capital loss. The stock market is usually very efficient at pricing securities, quickly closing the gap between price and intrinsic value. However, in some instances, the buying and selling of a security is fueled by reasons completely unrelated to the intrinsic value of the business. One example could be a large fund shutting down and the fund must liquidate its holdings to meet redemptions. Another common reason is fear and greed driving investment decisions as opposed to the application of sound investment principles. Whatever the reason, stocks will at times trade at prices that are very different from the actual value of the underlying businesses. This kind of discrepancy between price and value is exactly what an enterprising investor can use to generate outsized returns.

However, even after initiating a new position at a discount to the intrinsic value of a business, the stock price can diverge even further. This is one reason that it's imperative to judge investment results over the long-term. During the short-term, stock prices can greatly diverge from true business values, which may show up as short-term quotation loss. However, over the long-term, price and value do end up converging, rewarding the patient and enterprising investor with outsized returns.

When a loss is actually realized, meaning the stock is sold at a loss, permanent capital loss has occurred. This is something I try to avoid with vigilance but it will happen, hopefully rarely. Avoiding permanent capital loss is paramount to superior long-term results. This is the reason that when I analyze a business for potential investment, the foremost factor I take into consideration is risk. Risk that the business will be earning less in the future, risk of a superior substitute product coming to market, risk of an incumbent aggressively cutting prices, these are just some of the risks that I take into consideration when analyzing a business for potential investment. Any risk that can contribute to an impairment in the intrinsic value of the business can lead to permanent capital loss.

There will be times during broad market sell offs and economic contractions where we will experience severe quotation loss. It is important to not forget that we own actual businesses that produce cash flows, sell a need based product or service, and have an inherent intrinsic value. During these periods, I will seek to sell these businesses only if an even better opportunity comes

along, otherwise I will react with equanimity, waiting patiently for price and value to once again converge.

PORTFOLIO UPDATES

I think it's far more important to focus on business performance as opposed to stock prices over the short-term. During 2018 most of our businesses generated healthy revenue and free cash flow growth, increased their market shares versus peers, generated very healthy returns on capital, and allocated capital intelligently. We are very fortunate to be part owners in the underlying businesses our stocks represent. I believe over long periods of time, all of our holdings will generate healthy returns in excess of market averages.

I am constantly reassessing the relative attractiveness of our holdings. As some of our holdings approach intrinsic value, I will be disposing of them in order to purchase securities at even bigger discounts. I also seek to constantly upgrade the cumulative quality of our portfolio, disposing of names in preference for higher quality businesses at even more attractive valuations.

We ended the calendar year owning five different businesses and about a 15% cash position. I disposed of one holding as it approached intrinsic value during the first half of the year and allocated capital to two new positions throughout the year.

I would like to thank all of you for entrusting me with the allocation of your hard-earned capital. I look forward to updating you again at the first half of 2019.

Sincerely,

A handwritten signature in black ink, appearing to read "M Ershaghi". The signature is fluid and cursive, with a large initial "M" and a trailing flourish.

Michael P. Ershaghi

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Past performance is not indicative of future performance. Inherent in any investment is the possibility of loss.

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