July 26, 2017

Dear Investor:

The Russell 2000 slightly trailed the S&P 500, finishing up +2.5% for 2Q 2017 as the S&P 500 moved up +3.1%. Taken together, this puts our Small / Large Blended Benchmark up +2.6%. Choice Equities Fund, LP (CEF), was up +1.7% and +1.2% on a gross and net basis for the quarter, respectively.

EXECUTIVE SUMMARY

As is usual in our quarterly letters, we will offer some brief comments on the portfolio and the current investment environment. In this letter, we will provide a little further detail on our investment approach and highlight the thought process behind our recent investment activity.

NOTABLE PORTFOLIO PERFORMANCE DRIVERS

BXC again performed well and was the largest positive contributor to quarterly results with shares up about +20% for the period. HDS sold off nearly -20% on earnings day and was the largest negative contributor. By design, we were intentionally carrying a much smaller position size than when we entered the year, but the decline still reduced the fund return by about -2% for the quarter. The company reported the expected sale of their Waterworks division at a fair price, but continued subpar results in their Facilities Maintenance division created the adverse stock reaction. The price action on earnings day was severe, and with the stock down so much, we initially looked to add to our position. However, dynamics associated with welcoming new investors into the fund played a role in our decision to exit the position. Given the new capital contributions, we had recently bought additional shares of HDS even though we did so at a level that led to a smaller weighting of the position in the portfolio. As a result of the recent purchases and new investment opportunities that availed themselves shortly thereafter, we sold the position to take a tax loss and reallocate the funds to more attractive uses of capital. LAWS, the portfolio's largest holding, was basically flat for the quarter.

INVESTMENT COMMENTARY

> *"If I could know one thing in looking at an investment, I'd like to know how much confidence is in the price. I want to buy when confidence is low… that's when price is low relative to value." – Howard Marks*
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> *"I always thought if you looked at ten companies, you'd find one that's interesting, if you'd look at 20, you'd find two, or if you look at a hundred you'll find ten. The person that turns over the most rocks wins the game." – Peter Lynch*

At the intersection of the quotes from these investing greats lies the blueprint for our investment approach. In first examining the quote from Marks, he has distilled much of his approach in evaluating investments down to determining one critically important thing: confidence. Naturally, this compels one to ask: why? Why is confidence the single most important piece of information one should want in a landscape of potentially thousands of economic and financial variables? As is often the case, thinking about this from the vantage point of one extreme may help illuminate the answer. For example, let us take the case of any hated security or out of favor industry. If all market participants hold a negative view of a business and its likely performance, poor earnings results or bad news flow is unlikely to induce existing shareholders into new selling; these shareholders already hold dim expectations for anticipated business results. On the other hand, any positive developments are likely to attract new investors which will of course be quite rewarding for existing shareholders. So clearly then, on balance, benefits will accrue to those holding assets that incorporate little confidence or optimism. This notion explains Marks's enthusiasm for assets with little of it.

Thus, if one can understand what optimism and economic expectations are embedded in the price of any given asset, one has an uncovered a truly important piece of the investment puzzle and likely holds an edge against other market participants. So how then do we determine investors' collective confidence in any particular investment's prospects? Price is part of the answer, but more specifically, it is price in relation to the expected underlying cash flows. Accordingly, valuation becomes a critical tool in assessing securities and calibrating the investor views that likely accompany them. This notion explains our daily quest for cheap or out-of-favor stocks. And if we can find these securities that embed minimal economic optimism in areas we feel offer underappreciated or overlooked investment merits, it is all the better.

From here then, it is simply a matter of looking at opportunities. And as Peter Lynch succinctly states, more is preferable to less. With this impetus providing us our daily marching orders, we have spent a great deal of time this spring and summer persistently turning over rocks. And now, rather than being strictly focused on a list of about 40 distribution companies across a few industry verticals, we have a number of other attractive business models in other industries to examine too. We are looking in many consumer verticals in areas like leisure, media, and retail, but we are also scouring the market in some of the more overlooked and out-of-favor corners as well. While our increased rock count has not dramatically impacted our portfolio just yet, we believe a broader opportunity set only increases our odds of finding these unappreciated diamonds in the rough.

However, pursuit of investment success is not all about rock count; it is also a lot about rock quality. One must know how and where to look, so developing a reliable process is critical in producing a consistent source of opportunities to examine. Given our recently broadened opportunity set, we have taken a couple initiatives to maximize our chances of finding compelling investment ideas. In the 1Q 2017 letter, we highlighted a trip to a "best ideas" dinner we attended. Because of our attendance there, we were pleased to receive an invitation to St. Louis this past May where we had the opportunity to sit at another investment roundtable and share ideas with several esteemed investors for a few days. More recently, we gained admission to a second online only investment community where we can see and share investment ideas with other likeminded investment professionals. And of course, we are continuing to do what we have always done in talking to friends, fellow investors, contacts in the field and our own limited partners. But unlike before, this wider investment universe is providing us a greater opportunity to benefit from our network, and we are starting to see some exciting actionable opportunities.

Somewhat ironically then, as we have moved forward and begun searching in new investment areas, the majority of our recent portfolio additions simply turned up on our doorstep from our own backyard. In Q2 we added five new positions to the partnership, four of which are distributors we have followed for quite some time. These distributors have many things in common. For starters, all were trading off 20% or more from a recent high. All are quality operators with sound competitive positions. And all meet our four criteria for good businesses which all happen to start with the letter M and as a reminder are:

- Moat: sound competitive position supported by attractive returns on capital
- Management: proven execution prowess and capital allocation acumen
- Money flows: predictable, understandable and growing
- More: opportunities for reinvestment at attractive rates of return

While none are screaming cheap on normal and obvious valuation metrics, all four are cheaper than both the market and their peers and likely offer greater earnings growth than one would find by simply investing in the S&P 500. Although this proportion of distributor additions will likely prove to be an aberration in comparison to quarters to come, we expect this base of companies which we know well will continue to provide a stream of attractive investment opportunities while we spend more of our time looking for diamonds in the rough and their sometimes more exciting investment prospects.

PORTFOLIO ACTIVITY

Without further ado, let us look at what we bought in Q2. We will start with our largest positions first.

PFGC – Performance Food Groups is the third largest distributor of food supplies to restaurants. The company serves a growing and fragmented market that has benefited from the multidecade trend towards greater eating away from home. As the founder of company subsidiary Vistar, CEO George Holms is a customer-obsessed industry veteran with significant skin in the game and a long track record of operating excellence in the food distribution market. Company operations are primarily biased to the Southeast and Atlantic seaboard, where the company has enjoyed organic case growth for the last 28 quarters at 6% or above, a level that is more than double that of both its larger two public company peers.

Despite this operating excellence, the company's EPS growth trajectory has been impaired in the short-term due to headwinds from food deflation and a few growth-related investments made in FY16. The food deflation – where prices were down on a year over year basis for nearly two years in a row and is the longest period of sustained deflation in over 30 years – looks to be subsiding while the company should lap the investment spending later this year. We initiated a position early in the quarter when shares traded at 17x NTM EPS, a two turn discount to its larger peers despite its history of outsized organic growth. The company has a long runway for growth, and we view it as a candidate to be a long-term compounder of wealth.

LKQ – LKQ is a distributor of aftermarket auto parts primarily from salvage yards to repair centers which we have invested in profitably before. Shares sold off early in 2Q along with much of the auto and auto aftermarket complex on fears of plateauing new car sales and increasing competition from Amazon. While some pieces of the company's business may be susceptible to online fulfillment and Amazon encroachment, most of the company's collision repair parts are not offered by the retailing behemoth. Additionally, the company looks intent on duplicating its status as US market leader in Europe where its investment and acquisition dollars are currently focused.

When shares traded down to a NTM PE multiple of 15x, their lowest forward multiple relative to the market in the last ten years, we initiated a new position. While the company may not repeat the 19% average EPS growth of the last ten years, good growth still appears likely, though the valuation seems to imply otherwise. We believe the company is likely to remain in the compounder camp, a place its track record deservedly puts it.

VRTV – Veritev is the largest distributor of paper and packaging products. The company was formed in 2014 when International Paper spun off its distribution operations and merged them with its number two competitor, UniSource. Company operations are grouped into four business segments: Paper, Print, Publishing and Packaging. The Paper and Print segments provide materials for businesses such as newspaper and magazine publishing, carry the lowest operating margins and are in secular decline. Originally, these segments accounted for approximately a third of the whole company's EBITDA. Now they account for closer to a fifth of the whole company's EBITDA though they continue to provide a good source of cash flow to direct towards more profitable operations. The Facilities Solutions and Packaging segments are growing, carry the highest margins and are the future of the company. The Packaging segment looks particularly attractive, given its stable, GDP like growth that is supplemented by increasing shipping activity from the rapid growth in eCommerce. Here the company has a high single digit market share and a meaningful leadership position on other competitors, the largest of whom come in around 2% of the total market. While competition is fierce from smaller independent players, the company's scale positions it well to capture further market share.

Our entry point was created when shares sold off meaningfully after the company reported disappointing 1Q results. Management blamed seasonality and analysts seemed to concur they had not captured this impact correctly in their models. While the company could have tipped its hand a bit better on the short-term weakness, it does cite seasonality as a risk factor in the 10K which supports these claims. Despite the shortfall, the company maintained its full year guidance and shortly thereafter the CEO and three other insiders stepped in and bought some shares. At 8x EBITDA with a double digit free cash flow yield, valuation does not look overly demanding and the setup appears favorable. While this distributor is unlikely to outgrow the S&P 500 on FY17 EPS numbers this year, we see improved growth on the horizon as the company transitions to a better business mix with higher growth potential. This one might not fit in the long-term compounder bucket, but it is quite cheap and possesses a valuable asset in regard to its leadership position in the attractive packaging distribution market.

NXEO WARRANTS – Nexeo Solutions is a global distributor of chemicals and plastics and the third largest player in the highly fragmented North American distribution market. It came public in 2Q 2016 as a target of WL Ross & Co.'s specialty purpose acquisition company (SPAC). Before that, it was owned by private equity firm TPG, which created the company when it bought Ashland Inc.'s distribution operations in 2011 in an LBO. The TPG investment was not the quick flip success story originally envisioned, and the private equity firm put additional capital into operations and subsequently turned to the WL Ross & Co. team to partner on the deal. Now the company has upgraded systems but an unfilled distribution network and is seeking to grow both organically and through bolt-on acquisitions.

SPACs are often seen with a dubious eye due to their checkered success as investments and the way in which deals are structured. They often serve as a backdoor entry for financial sponsors to get companies into the public markets and incentives are frequently tilted in favor of the sponsors. While many have unimpressive track records, there are certainly plenty that have performed well once the deal has been inked and the target begins to trade as a normal public equity. (Hostess Brands, owner of Twinkie, is a recent success story many may know.) The SPAC deal structure is also unique in that it creates warrants on the company which allow the sponsors and managements to participate in the upside of the company.

When Nexeo debuted as a SPAC IPO in early 2016, it was missing its original annual guidance and underperforming estimates. This is a bad look at any time, but particularly for a newly public SPAC. Our view was these shortfalls were generally explained by a difficult operating environment and a more favorable one was likely nearby on the horizon. Even so, we continued to watch from the sidelines through 2016 and much of this year. But when shares traded to 8x expected FY17 EBITDA, or two to three turns cheaper than its two larger peers, we initiated a position. We should note our position is not in the equity, but the warrants that are outstanding as a result of the SPAC deal. They will function like long dated call options and will not expire until August 2021. If the company can execute solidly and achieve its plan of double digit EBITDA growth, it will likely close the valuation gap with its peers and the warrants could be worth three to four times their current trading value. Despite the upside and by no means our base case, we know there is a not immaterial chance the warrants could expire worthless, so we have limited the position to around a 3% level.

DS – Drive Shack, our first non-distributor of the new additions, comes to us off the 52 week lows list and is the successor company to Newcastle Investment Corporation (NIC). NIC was previously a REIT primarily focused on distressed debt investing and operated by investment manager Fortress Investment Group. Recently renamed Drive Shack, the company is the corporate home for three business lines: Debt

Recovery, American Golf and Drive Shack. The company is in the process of exiting the legacy Debt Recovery business. The American Golf business began through the investment in the debt of golf courses and is the current owner and operator of 78 public and private golf courses. It is a slow but steady grower in the lethargic and some might say secularly-challenged golf business. Drive Shack is the youngest and most promising of the three business lines.

Drive Shack, an up and coming competitor to golf entertainment and lifestyle company Topgolf, is potentially a fast follower in the category of entertainment-focused, supersized luxury golf driving ranges. Given their similarities, a study of Topgolf's success is useful in understanding the potential here. While it is not immediately clear how large the market potential is, in terms of creating a new category, Topgolf is off to a great start. The concept initially developed slowly when the first three facilities were opened in the UK in 2000. The US launch did not follow until 2005 when the first site opened in Alexandria, VA. But since then the buzz and new facilities have been growing quickly. Industry contacts suggest the US market could hold as many as 100 to 150 sites, and the concept is just now spreading around the globe. The facilities are huge, and typically span 20+ acres, ~65,000 square feet and three levels. They are not cheap either. Buildout costs typically range from \$15M – \$25M, but once up and running, they have proven to be highly profitable, with most facilities doing \$5M – \$6M of EBITDA and in some cases more. In February 2016 with 24 golf entertainment complexes in operation and an eye towards 41 in the near-term, Topgolf entered a minority investment with Providence Equity Partners that implied a valuation of \$1.4B. This investment suggests a near \$60M valuation on each of the then 24 facilities or close to 12x EBITDA. This multi-billion-dollar valuation all sounds very favorable for Drive Shack, particularly by comparison to its current market cap of about \$200M.

In many ways, the set up offers a number of characteristics we seek. Drive Shack shares have been selling off for most of this year since the company announced the conversion from a REIT to a C Corp just before the end of 2016. This decision to adopt the C Corp operating structure was likely motivated by taxes, given a sizeable tax shield from net operating losses accrued through the downturn in 2008 and 2009 were not much use to a company with a REIT structure. So, the company abandoned their REIT status, and investors who had been in the stock for the 10% dividend yield in turn abandoned the new company. While the prior shareholder base was exiting, NIC and Fortress founder, Randy Edens, was wading in, ultimately buying over \$15M in shares. Summing it all up, we have indiscriminate selling, insider buying and a very promising market opportunity.

But there are so many open questions, it is hard to draw definitive conclusions on what the company may really be worth. Is the market ready for a fast follower? Can Drive Shack execute? Will they compete rationally? Is the Fortress installed CEO, a 28-year-old Fortress Managing Director, a precocious talent? Or will she be learning on the job? Why have some of the original openings been delayed? Do they even want to open these facilities? Or are they just acquiring permits in the most attractive tertiary markets (Orlando, Richmond, Raleigh and Palm Beach) Topgolf is yet to enter in hopes of negotiating a sale? And just how big is the market opportunity really?

Of course, the real question is: what are we getting and what are we paying? The company has stated it will get a cash infusion from the monetization of the remainder of its debt portfolio later this year. And it looks to be on track for the \$28M of FY17 EBITDA management is guiding to in the American Golf business. Putting it all together, we can buy American Golf, a clean balance sheet and capital to spend on Drive Shack for a little under 7x EBITDA. By comparison, private equity firm Apollo just bought ClubCorp which is like American Golf but larger for about 9x. So essentially, we are buying some golf courses for about two turns cheaper than a recent transaction and getting the Drive Shack opportunity for free. This provides us a comfortable margin of safety as we watch the Drive Shack opportunity unfold. We will monitor progress closely and adjust our currently small position size accordingly.

ETFs – We hold small short positions in three ETFs. Two are building products related which provide a moderate hedge to our heavy exposure in that area during a period of typical seasonal trading weakness. The other ETF dampens our exposure to the Russell 2000 and also enables us to own a bit larger positions in our stocks while still maintaining a level of net exposure that is lower than the overall market.

2017 OUTLOOK

We have no significant updates to offer from our outlook just a few months ago. Broad market valuations continue to look to be skewed toward the full side of fair, an unsurprising condition given a widespread view that the economy is on solid footing as some confidence has filtered its way into market valuations. Though the market has performed well this year, several of the so-called Trump trades have been unwound as the administration struggles to push forward its pro-business agenda. While politics can be a messy process and it remains unclear what if any major initiatives may move forward, at a minimum we believe some regulations will be rolled back and the tone towards business has improved. This seems to be paving the way for a moderately improved business climate while better growth abroad is an added tailwind for many domestic companies doing business internationally. All in all, economic growth appears solid, though likely reflected in the market multiple. But we are striving to do better, and believe our portfolio presents more attractive valuations and better growth than the market itself offers.

CONCLUSION

As always, we are happy to discuss any portfolio holdings or our investment outlook with you at any time. Please simply contact us at your convenience. In closing, we are honored and privileged to have the responsibility you have entrusted in us in managing your capital, and we look forward to continuing our relationship further into the future.

Best regards,

Mitchell Scott, CFA
Portfolio Manager

1. All market and company data is sourced from Factset and company filings and is current as of 6/30/17.
2. CEF uses the S&P 500, Russell 2000, a custom Blended Small/Large Benchmark and the Barclays Hedged Long/Short indices as its primary benchmarks. The S&P 500 and Russell 2000 are common large and small cap US equities-based indices. The custom Blended Small/Large Benchmark is provided to capture a larger proportion of small cap performance versus large cap performance (at a 3:1 ratio) due to the similarly high proportion of small caps found on the Good Businesses Focus List as well as the strategy's general preference of having an investment mix more heavily weighted towards investment in small caps. The Barclays Hedged Long/Short index (an index of equities-based hedge funds) serves as an appropriate benchmark over the long-term given the index has a similar long-term goal of capital appreciation through equities investing.
3. CEF Net Returns are hypothetical results calculated from actual gross results in a manner consistent with the 1% management fee and 18% performance fee offered to clients.

APPENDIX

CEF GOALS, PHILOSOPHY, APPROACH AND ALIGNMENT

GOALS – We seek to generate market-beating returns over any rolling multiyear investment horizon while minimizing the risk of permanent impairment of capital. Additionally, we seek to communicate with our investors in a transparent and straightforward manner and ask only that they accept investment risks that we ourselves are willing to take. *Given the majority of our investable capital is invested alongside theirs, we invest our limited partners' capital as if it were our own, because it is.*

PHILOSOPHY - We approach investing in public equities as an opportunistic businessman would. We spend most of our time studying businesses and building circles of competence in areas likely to offer attractive investment prospects and invest in only our most compelling opportunities. We view risk primarily as the likelihood of a permanent impairment of capital and pursue a carefully balanced willingness to trade some short-term portfolio fluctuations for the opportunity to earn higher returns over the long-term. We focus on growing, understandable businesses and seek to buy them at a substantial discount to our estimate of their intrinsic value. When we find them trading at attractive prices, we often act in size and weight our best ideas accordingly. And all things being equal, we prefer to devote more of our efforts to small stocks where we believe greater price/informational inefficiencies can often be found.

APPROACH – We invest via a long-bias hedge fund structure and concentrate our long investments in our best 10 to 15 ideas. Our work begins with a two or three-year outlook, and we only pursue investments we believe are likely to offer us a reasonable chance to generate an annualized return of 20% or better. While we pursue long-term oriented investments and seek to compound capital in a tax efficient manner, we readily acknowledge the often-turbulent markets do not always fit neatly into this framework and know some trading activity is sure to follow as a result. In the short book, we seek to generate absolute profits in a few stocks where we have uncovered a company entering financial duress or an excessively optimistic valuation where we feel their earnings outlook is likely to worsen materially. We will also use industry or market specific ETFs to mitigate market risk and will look to employ options and other opportunistic hedges when conditions appear favorable.

ALIGNMENT – We believe appropriate alignment of interests is the bedrock upon which all successful partnerships are built. Our primary means of ensuring proper incentive alignment is through significant co-investment of our personal wealth alongside our limited partners. Secondarily, we offer an investor friendly fee structure. We charge a modest management fee to support investment operations and charge an annual incentive fee on new profits only. Finally, commensurate with our fee structure which is intentionally structured such that the majority of fund earnings will be earned only if we generate compelling investment results, we commit to operating the fund as a boutique shop with a limited asset size. As many of our best investments often come from small stocks, we believe it is important to preserve our ability to take concentrated positions in our best ideas. Our size and structure ensure we are incentivized to generate compelling returns, not gather assets.

Think of it this way. *On the one hand, we are incentivized to generate the best investment results possible. On the other hand, we are unwilling to invest in a way we feel is likely to result in a meaningful loss of our own investment capital. What more could one want from an investment manager?*