Poplar Forest Partners Strategy Quarterly Update

March 31, 2017

Poplar Forest Capital

To My Partners,

After being down three goals, my youngest daughter's water polo team – the Polytechnic Panthers -- had battled back to tie the game. Now, with two seconds on the clock, the ball was in the hands of Poly's star player. She launched a rocket, but it bounced off the right post, sending the game into overtime. Both teams were tired, but the Poly girls' conditioning ultimately paid off in a victory. The win capped an incredible turn-around: the team had entered the season the lowest ranked of the division's 33 teams; now they were headed to the Championship Game!

For seven years, I'd watched my two daughters play water polo. I knew virtually nothing about the sport before Caroline, a competitive swimmer since the age of four, took it up as a high school freshman. Three years later, her younger sister Lucy began playing, too. For seven thrilling seasons, I'd been a proud dad at the side of the pool watching my girls give their all for the team. They didn't always win, but they always did their best – what more can a father ask? After spending 17 years (a third of my life) as an ardent coach/fan of my kids' soccer, football, volleyball, tennis, swimming, baseball, softball, cross country and lacrosse teams' competitions, I was headed to a final game.

The Championship started in a familiar way: once again, our girls found themselves down by three as the first quarter neared its end. But they didn't give up, and stuck with their game plan, increasing the defensive pressure. When the rival team swarmed Poly's best shooter, the Panthers passed the ball to an undefended teammate who was free to shoot. The game was soon tied. As you have probably guessed by now, the Poly Panthers prevailed to win the Division 5 Title!

In a couple short months, Lucy will not only be a CIF water polo champ, she'll also be a high school graduate starting the transition to college, leaving me an empty nester. Transitions sometimes prompt discomfort, but change can also bring opportunity.

Recent Strategy Results – Behind After the First Quarter

As you will read on page 8, the start of 2017 has been as frustrating for Poplar Forest as were the first periods of Lucy's final water polo games. We didn't lose money, but our results have lagged behind the S&P 500®, which is up over 6% in the three months ending March 31st. In some cases, this is simply a case of stocks that were strong in the last six months of 2016 giving back some of their gains, but in a handful of cases we hit a bump in the road on turnarounds that had appeared to be on track. We continue to have high conviction in these investments and, like the Poly Panthers, we believe that sticking to our game plan -- focusing on the normalized results of the companies in which we invest -- will deliver market-beating, long term results.

As I've discussed in the past, I wish I knew how to generate great results each and every quarter, but that's not how investing works. In order to generate above average long term results, one needs to hold a different than average portfolio. In the short term, intrinsic value can matter far less than changing sentiment. As sentiment swings, formerly in-favor stocks become unpopular. Those who have followed us for years have noted that, historically, periods of weak results have been followed by strong periods as the market ultimately recognizes the formerly underappreciated value of the stocks that we, as contrarian investors, own. As recently as this time last year, the Strategy was down in absolute terms and well behind its benchmark. We stuck with our game plan and the year turned out to be a very good one. I don't know if our 2017 results will follow the same pattern as they did in 2016, but with a long-term view, we see tremendous value in the investments we own today.

For many investors, the current investment environment feels challenging. The new administration in Washington is charting a very different path than that pursued by the Obama team. For much of the preceding eight years, the Federal Reserve was the focus of investor attention. Now it's the White House and President Trump's Twitter feed. For eight years, it seemed as if the ever present question was: "Risk On or Risk Off?" Now we seem to have transitioned to an environment of "Trump On or Trump Off?" The rules of the game seem to have changed and investors aren't quite sure what to make of it.

The cacophony of voices of criticism and support on Capitol Hill competes with talking heads and pundits on TV, all trying to predict what can and can't get through Congress. It seems as if everyone has an opinion and they all think they're right. In times like this, it is easy to get sucked into speculating on the future, but I don't think anyone can correctly predict how this will all play out. Insiders don't know any better than the rest of us; just ask Paul Ryan. If he couldn't get heath care reform through a Republican-controlled Congress, then how can we possibly make a call on the other big issues of the day? While it's likely that tax rates will decline, it's too early to confidently know how low they will go or what form they might take. And while the need for infrastructure spending seems obvious, it is unclear how much of President Trump's proposed $1 trillion plan will actually get funded just as there's no telling when any such projects might begin. If it were up to me, I'd save infrastructure spending for a recessionary rainy day, but of course, it's not up to me.

Transition periods are rife with uncertainty, and the one we are currently living through seems particularly uncertain. But as I remind myself, **life is always uncertain**. In the same way Poplar Forest didn't let Central Bank speculation drive the investments we made over the last eight years, we aren't going to let guesses about what Congress will or won't pass or repeal drive our process today. We readily acknowledge the big questions of the day, but we remain focused on a bottom up investment process that tries to identify companies about whom investors have unduly low expectations – stocks that we believe can produce market-beating, long-term results regardless of the reactions to today's goings on in Washington (or President Trump's latest 140-character tweet).

As my youngest readies for her first year as an undergraduate, I can't help but reflect on one of the most important events in my development as an investor. When I was at the University of Virginia, the final class for finance majors taught us to develop statistical models to predict economic growth. We were then told how to translate that outlook into expected growth for an industry of our choice. Finally, with that backdrop, we were asked to predict the fortunes of an individual company. In many ways, this class was practice for the approach many investors use in selecting stocks for their portfolios. It was a group project and our team got an A; we had done it exactly right, according to the professor. Based on all the available evidence, we demonstrated that the future was bright for Digital Equipment Corporation (a computer company often referred to as "DEC".)

Despite the good grade, however, it turns out we were completely wrong - the company for whom we'd projected rapid growth was soon in decline. Work that earned an A in the classroom earned an F in the stock market. I hate to be wrong and I detest losing money, and this final collegiate project really got my attention. In addition to delivering a healthy dose of humility, it taught me that top-down forecasting and investing in businesses perceived to have rosy futures could be hazardous to my financial health. I was determined to find a better way.

I found my answer in value investing and the writings of Graham & Dodd and Warren Buffett. Though they weren't doing it the way I had been taught in school, their approach made intuitive sense to me. They turned the problem on its head by focusing on value over macroeconomics. In essence, **when a company deemed to be troubled becomes less troubled, its stock price often experiences a large gain**. Conversely, **when a great company becomes merely good, its owners often suffer a terrible decline**. My work on DEC was a stark demonstration of this principle.

In 1991, when I started at the Capital Group, I was assigned research coverage of the energy industry. In thinking about this task, I identified oil prices as the key variable in assessing the worth of these companies. Much of the investment research I read on these companies included a healthy dose of oil price forecasting, just as it does today. As I contemplated the problem, I concluded that I had no special ability to correctly discern hydrocarbon prices with any degree of precision. I felt comfortable that prices were unlikely to sustainably fall below $15 or exceed $25 a barrel given the economics of the business, but within that range, it wasn't clear to me that $18 made any more or less sense than $20. That $2 difference doesn't sound like much, but it had a big impact in determining which stocks looked attractive. I decided to focus on trying to identify investments that didn't need a precise price projection to be profitable.

The energy business has changed a lot since 1991. Extraction and operating costs have gone up dramatically since then and these higher costs suggest that, in the current environment, a realistic range of price for oil is $45 to $75 per barrel, in my opinion. When oil prices got towards the low end of that range, we started seeing an increased number of opportunities in energy stocks. When oil got to $30, many investors threw in the towel and we excitedly bought more at what we thought were bargain prices. A big reason for our great results last year was oil prices returning to a reasonably normal range based on long-term economics. Now that prices are back in an economically justified range, our focus has turned to ensuring that our investments have company-specific factors that can drive their future results.

The Poplar Forest Game Plan – Avoid Unanswerable Questions

Having experiences with DEC and energy stocks early in my investing career convinced me it was **necessary to distinguish between important questions that are knowable and those that can't be answered with confidence**. Take corporate tax rates, for example. I am fairly confident that tax rates aren't going up in the next few years. Furthermore, I think there is a better than 50% chance rates will go down - but to what level? What form they will take? Will taxes be border adjusted? I don't know, but I do know that **if** we get material tax reform, some companies will be big winners. How then does one invest when the answers to key questions like this are unknowable?

I like to start with valuation multiples. For me, the valuation of a stock suggests the consensus opinion of investors about an individual company's prospects. While I find the ratio of a company's price to its sales or book value to be even more informative, for the sake of simplicity, I'll use the price/earnings (P/E) ratio (stock price divided by earnings per share) for this discussion as it is probably the valuation metric used most widely by investors. In simplest terms, **a below average P/E ratio suggests that investors expect the company in question to either grow earnings at a below average rate or to have higher than average risk**. A higher than average ratio implies just the opposite.

Instead of spending time trying to answer unanswerable questions, **I look for situations where the consensus opinion, as expressed in a stock's valuation multiples, seems to imply that we might be able to make money without having to correctly forecast some macroeconomic variable**. For example, let's take President Trump's $1 trillion infrastructure plan. As I discussed in my year-end letter, I worry that the country simply doesn't have the resources to do all that the President wants to do. That said, the country has real infrastructure needs and it would be easy to put a lot of money to work, if the money were available. Furthermore, improved infrastructure would likely improve the job market and the nation's productivity. We are near a generational low in productivity, largely stemming from weak capital investment. While we have the need, and while the potential returns likely justify the investment, we simply may not have the money to spend. Will a massive infrastructure bill get through Congress and onto the President's desk? If it does, on what will the money be spent? Honestly, I don't know.

What I do know is that the shares of AECOM are trading at roughly 12x earnings at a time when the average stock in the S&P 500® is being valued at 17-18x. AECOM is an engineering, design and construction company that would likely be a big beneficiary if we build lots of new roads, bridges, water systems and airports. The market is saying that AECOM has well below average prospects relative to the average company. I find this curious. Effectively, the current valuation of AECOM suggests there will not be a big new infrastructure program in the U.S. What makes this particularly notable is a comparison of AECOM's valuation to other, better-known companies that would be expected to be beneficiaries of a big U.S. infrastructure program. As you can see below, many of these companies have above average P/E ratios suggesting investor optimism about the future. Disconnects like this make me very excited!

	Price 3/31/17	Consensus 2017 EPS	Price/ Earnings Ratio*	Market Value ($billion)
Caterpillar (CAT)	$92.76	$3.08	30.1x	$54.7
Deere (DE)	$108.86	4.81	22.6x	$35.0
Vulcan Materials (VMC)	$120.48	4.01	30.0x	$16.1
Martin Marietta (MLM)	$218.25	8.20	26.6x	$13.8
AECOM (ACM)	$35.59	$2.93	12.1x	$5.5

*Forward NTM Price/Earnings Ratios

We were invested in AECOM well before the election as we were attracted to the company's potential to improve its margins through cost cutting and by the free cash flow that was being directed at debt reduction. We were enthused about AECOM regardless of who was elected last November, but now the odds feel even more firmly in our favor. Investors appear to be pricing AECOM shares as if there will be no big infrastructure bill. If nothing comes to pass, then we would appear to have little to lose given the current 12x forward P/E ratio, but if a big spending bill makes it through Congress, as is suggested by the 23-30x multiples on the other companies listed above, we may be handsomely rewarded.

In situations like this, I try to determine why we seem to be seeing something other investors aren't. Why are we getting such a seemingly compelling opportunity? First, AECOM isn't well known - and its name does not provide a clue as to the company's line of work. Second, it isn't a big company - the market value is just $5 billion. As a result, it's an easy company for many investment managers to ignore. The stock hasn't been selected for inclusion in the S&P 500®, despite it being larger than several other companies on the list. In an environment increasingly dominated by large, often passive funds, it is easy for a company like AECOM to slip through the cracks. Given our size and structure, a situation like this is ideal for Poplar Forest. We own the stock in all of our investment strategies, though the lack of a dividend has led us to a smaller position in the more conservative Balanced Strategy. Searching for overlooked opportunities like AECOM is something I particularly enjoy; it's why I love going to work every day.

In Closing – We See Opportunity

In mid March, I attended a conference for the U.S.'s top 200 financial advisors. It was an impressive group and it attracted several well-known investors. These brave men and women were not afraid of the unanswerable questions – they claimed to have the answers! Interestingly, their presentations suggested a wide range of outcomes for stocks. One economist demonstrated that stocks were priced at a 65% discount to fair value; others predicted increasing volatility and low returns. All the presenters were experienced and spoke with conviction. With so many smart people making such widely divergent forecasts, it was hard to know what to think. I'm glad that you don't count on us for general market forecasts. I may have opinions, but most of the time I think the broad market is within 5-10% of fair value.

In my experience, two things kill a bull market: excessive optimism and/or a flattening of the yield curve engineered by the Federal Reserve. From my vantage point, I continue to see evidence of skepticism on the part of investors, despite the recent new high in the S&P 500®. The yield curve is still upward sloping, though a little less so than it was last week.

Trying to determine where the market is going in the short term doesn't seem like a good use of our time. At Poplar Forest, we acknowledge that markets have generally moved higher over the long run, but it's never a straight line. There have been corrections along the way and we assume there will be more in the future, but trying to predict when they will occur seems like a fool's errand. I'll stick to what I've done for more than 20 years: working from the bottom up to find opportunities that we believe will be rewarding over a multi-year investment horizon.

In much the way my daughter's water polo coach was confident his team would pull out a victory despite starting off behind, I feel great about the prospects for the companies in our portfolios. Yes, the year has started out on a less-than-robust note, but our assessment of fair values suggests considerable upside potential for the companies in our portfolio on both an absolute and relative basis. At Poplar Forest, we tend to go shopping in the parts of the market where stocks appear to be on sale, and that sometimes means our results lag as we make new investments. In 2011-12, we saw lots of bargains in financial service companies. In 2014-15, energy and materials stocks were on sale. In both cases, our willingness to buy what others were discarding proved rewarding.

I don't know how long this current period of weakness will continue, but we love what we own and we continue to find what we believe are attractive new investment opportunities. Everyone on the experienced Poplar Forest research team has invested his or her own money in our investment strategies, and we look forward to hopefully reporting better results as we move through the remaining quarters of the year.

Thank you for your continued confidence in Poplar Forest,

Dale

J. Dale Harvey

March 31, 2017

Contrarian Value - Partners Strategy

Poplar Forest Capital
Contrarian Value - Partners Strategy
Average Annual Total Returns as of March 31, 2017

	QTR	YTD	1YR	3YR	5YR	Annualized Since Inception (11/1/2007)
Composite Gross	0.88%	0.88%	24.80%	8.84%	15.42%	8.96%
Composite Net	0.62%	0.62%	23.58%	7.76%	14.25%	7.79%
S&P 500	6.07%	6.07%	17.17%	10.37%	13.30%	6.89%
Russell 1000 Value	3.27%	3.27%	19.22%	8.67%	13.13%	5.80%

Past Performance is not indicative of future results and individual account performance may vary. Please see additional disclosures at the back of this document.

The Partners Strategy produced a 0.62% return versus the S&P 500®'s 6.07% in the quarter ending 3/31/17. The recent period saw an unwinding of the "Trump trade" which had benefitted many of our energy, industrial and financial service investments. This reversal was difficult for value strategies like those employed by Poplar Forest; the Russell 1000® Value index, for example, also lagged the S&P 500® with a gain of 3.27%. Despite the weak quarter, results for the last twelve months were still quite strong on an absolute basis with a 23.58% total return as compared to 19.22% for the Russell and 17.17% for the S&P.

For the quarter, the Strategy benefitted from investments in several different industries with our top contributors being Coach (consumer), Zimmer Biomet Holdings (healthcare), Abbott Labs (healthcare), MSC Industrial Direct (industrial), and Bank of America (financial services). The bottom detractors that were most detrimental to our results were Chevron (energy), Baker Hughes (energy), Ralph Lauren (consumer), Dun & Bradstreet (industrial), and Signet Jewelers (consumer)[1].

In my last letter, I discussed our new investment in Signet Jewelers, the leading jewelry retailer in the country. Shares of Signet, like those of many retail oriented companies, declined in the recent quarter as investors grew worried about weak consumer spending. An unusually slow pace of tax refunds and shifting of some holiday dates on the calendar have been challenging for many retailers. Worries that Amazon will slowly drive traditional retailers out of business don't help.

The industry is going through a tough time right now and we recently learned that as many jewelry stores closed in 2016 as in 2009. But jewelry is something consumers seem to want to see, touch, and hold in their hands before they buy, and Signet seems positioned to take share of this fragmented

[1] The top five and bottom five securities were objectively selected from among all securities holdings included in the Strategy for the measurement period. The identified securities represent the top five and bottom five based upon calculation of contribution-to-strategy return. The holdings identified do not represent all of the securities purchased, sold, or recommended for advisory clients. Past performance does not guarantee future results.

market. There is room for cost reduction and elimination of risk via divestment of their credit operation. Our estimate is for revenue growth of just 3% for the next few years, but with cost cutting and deployment of free cash flow, earnings per share should grow roughly in line with the market. What makes the stock so compelling is the valuation: its trading a P/E ratio of less than 10x. In our opinion, the outlook for earnings growth seems to be in line with the average company in the S&P 500®, yet the stock trades at a 40% discount. Attention shoppers, Signet's on sale! We used the recent weakness as an opportunity to add to our holdings and we now have a full position in the stock.

In addition to building up our Signet stake, we've continued to find new investments that we believe offer returns that exceed our three-year return expectation. We made new investments in AmerisourceBergen and Ally Financial, while eliminating Halliburton, Intersil, and JPMorgan. In addition, our investment in St. Jude was converted into shares of Abbott once the merger of the two companies was completed. As a result of these changes, the Strategy ended the quarter with 30 investments and roughly 2% cash.

Disclosures

Investing involves risk. Principal loss is possible. Investments in medium-sized companies involve additional risks such as limited liquidity and greater volatility. Investments in foreign securities involve greater volatility and political, economic and currency risks and differences in accounting methods. Investments in debt securities typically decrease in value when interest rates rise. This risk is usually greater for longer-term debt securities.

Opinions expressed are subject to change at any time, are not guaranteed, and should not be considered investment advice. Discussion of a particular security should not be considered a recommendation to purchase or sell that security. There is no assurance that any security discussed will remain in our portfolios for any particular length of time. Securities discussed do not represent an entire portfolio and in the aggregate represent only a small percentage of a portfolio. It should not be assumed that any securities discussed were or will prove to be profitable.

As of March 31, 2017, the Contrarian Value Partners Strategy's 10 largest holdings accounted for 45.69% of total assets. The Strategy's 10 largest holdings at March 31, 2017:

Zimmer Biomet Holdings, Inc.	**4.89%**
MSC Industrial Direct Co., Inc.	**4.86%**
Lincoln National Corporation	**4.84%**
Citigroup Inc.	**4.83%**
MetLife, Inc.	**4.64%**
Abbott Laboratories	**4.54%**
Hewlett Packard Enterprise Co.	**4.50%**
Reliance Steel & Aluminum Co.	**4.49%**
American International Group, Inc.	**4.07%**
Signet Jewelers Limited	**4.04%**

Book value of an asset is the value at which the asset is carried on a balance sheet. Book value is also the net asset value of a company, calculated as total assets minus intangible assets (patents, goodwill) and liabilities.

The Russell 1000® Value index measures the performance of the Russell 1000's value segment, which is defined to include firms whose share prices have lower price/book ratios and lower expected long/term mean earnings growth rates.

Free cash flow is revenue less operating expenses including interest expenses and maintenance capital spending. It is the discretionary cash that a company has after all expenses and is available for purposes such as dividend payments, investing back into the business or share repurchases.

Price/Earnings (P/E) Ratio is the ratio of a firm's closing stock price and its earnings per share.

Price/Book is the ratio of a firm's closing stock price and its fiscal year end book value per share.

Price/Sales ratio represents the amount an investor is willing to pay for a dollar generated from a particular company's operations.

The S&P 500® Index is a market-value weighted index consisting of 500 stocks chosen for market size, liquidity, and industry group representation. It is not possible to invest directly in an index.

<u>Composite Specific Disclosures</u>

Contrarian Value – Partners Strategy Composite contains fully discretionary contrarian value accounts that will generally hold 25 to 35 companies with (i) an investment-grade debt rating, (ii) a history of paying stock dividends, and (iii) a market capitalization among the top 1,000 companies in the United States. These accounts are managed using a long-term approach to security selection. We define value investing as buying businesses at a discount to our assessment of fair value. We believe fair value is a function of sustainable free cash flow and the growth of that free cash flow. This perspective leads to an investment process that considers both valuation and growth. The balance between these two metrics will vary over time based on where we see opportunity. As no single benchmark is constructed in a manner consistent with our process, we present two indices: the S&P 500® Total Return Index with its balance of growth and value and the Russell 1000® Value Index which is comprised of companies with lower price-to-book ratios and lower expected growth rates.

Poplar Forest Capital LLC is an independent SEC-registered investment advisor that commenced operations in October 2007. Poplar Forest Capital LLC claims compliance with the Global Investment Performance Standards (GIPS®) and has prepared and presented this report in compliance with the GIPS standards. Poplar Forest Capital LLC has been independently verified for the period October 31, 2007, through March 31, 2016. A copy of the verification report is available upon request.

Verification assesses whether (1) the firm has complied with all the composite construction requirements of the GIPS standards on a firm-wide basis and (2) the firm's policies and procedures are designed to calculate and present performance in compliance with the GIPS standards. Verification does not ensure the accuracy of any specific composite presentation.

The Contrarian Value – Partners Strategy Composite was created on November 1, 2013, and has an inception date of November 1, 2007.

The S&P 500® Total Return Index focuses on the large cap segment of the market and includes 500 leading companies in leading industries of the U.S. economy, capturing approximately 75% coverage of U.S. equities. The Russell 1000® Value Index is market-cap weighted and measures the performance of the large-cap value segment of the U.S. equity universe. It includes those Russell 1000 companies with lower price-to-book ratios and lower expected growth values. The benchmark definitions and returns have been taken from published sources.

Composite results are based on fully discretionary accounts under management, including those accounts no longer with the firm. The U.S. dollar is the currency used to express performance. Returns are presented gross and net of management fees and include the reinvestment of all income. Net-of-fee performance is calculated using the monthly fraction of the highest annual management fee incurred, applied monthly: for the period from composite inception through March 31, 2013: 1.15%, and for the period April 1, 2013 through current: 1.00%. The annual internal dispersion measure presented is an asset-weighted standard deviation calculation based on accounts in the composite the entire year. External dispersion is not presented prior to December 31, 2010, because 36 monthly composite returns are not available. Additional information regarding policies for valuing portfolios, calculating performance, and preparing compliant presentations is available upon request. Past performance is not indicative of future results and individual account performance may vary. The firm maintains a complete list of composite descriptions, which is available upon request.

The investment management fee schedule is as follows: for pooled investment vehicles management fees are 1.00% with breakpoints outlined in the specific offering documents; for separate accounts it is 1.00% on the first $25 million and 0.60% on the remainder. Actual investment advisory fees incurred by clients may vary.

The compliant presentation and a list of composite descriptions are available upon request by calling Patty Shields at (626) 304-6045.