Poplar Forest Partners Strategy Quarterly Update

September 30, 2017

Poplar Forest Capital

To My Partners,

A few weeks ago, I was fortunate to see Taj Mahal perform live at a small venue in Minneapolis. I've loved the blues since first hearing a grizzled sax player wail on his horn at my uncle's wedding reception back in 1983. I've long wanted to see Mahal live and his performance exceeded my expectations. It didn't hurt that he is touring with Keb Mo, another seasoned blues artist. Onstage, Keb Mo treated Mahal with the kind of respect and deference befitting a living musical legend. It was a packed house and the duo, backed up by a handful of talented artists, put on a heck of a show. It's clear that after 50 years of performing, Mahal still loves what he does and he brought joy to the crowd at the sold out show.

Born Henry Saint Clair Fredericks, Jr., Taj Mahal plays what he calls the country blues. He may sound like he was raised on a farm in Mississippi, but he was actually born in Harlem to musically inclined parents. The music he heard at home was different from the popular music he heard on the radio. Instead of conforming to the tastes of the day, he started making music that was his own. He tied together traditional blues, jazz and gospel with Caribbean and African musical traditions to create a unique sound that his fans love.

In the same way that Taj Mahal puts his own unique spin on the blues, at Poplar Forest, we put our own spin on value investing. In developing my "sound," I've drawn from traditional value investing principles, but I've made it my own by concentrating on under-earning companies. I don't feel compelled to conform to the popular style of current times (even though we might attract a larger crowd). I don't want to be the Justin Bieber of investing. We aren't trying to fill the biggest stadiums in the country; I prefer smaller places packed with people who appreciate our distinctive approach to investing. Like Mahal, we bring optimism to our work investing in out of favor and unloved companies. Like Mahal, I expect to be doing what I love at age 75 and I hope you'll all still be in the audience enjoying the work of the Poplar Forest ensemble decades from now.

In the same way that particular styles of music come into and then fall out of favor, investor tastes also change over time. As those of you who read my letters know, I have believed that the Federal Reserve's first interest rate increase back in December 2015 was going to usher in a new multi-year period of outperformance for value-based investment strategies. Value beat growth in 2016 and we did even better in delivering results that beat the Russell 1000 Value Index. All that has reversed in the first nine months of 2017 as dysfunction in D.C. has dimmed expectations for accelerating economic growth. While investor perceptions have shifted back to a mindset of low growth and low inflation for the foreseeable future, I believe that consensus is too pessimistic.

Surprises and Questions

I believe that securities prices can be "reverse engineered" in order to assess the expectations of investors. For example, the current 2.24% yield on a ten year Treasury bond suggests fixed income investors either 1) see a recession in the short term, 2) expect falling inflation in the next decade, or 3) are willing to accept a return above inflation that looks ridiculously low relative to history (please see the Appendix for more information). With respect to the risk of recession, relatively tight spreads between government and corporate bond yields suggest this isn't the concern. Thus, it seems fair to reason that market participants generally expect a continuation of the low inflation environment we've lived with for roughly eight years now.

Central bankers around the world have expected inflation to be much higher given the extraordinary liquidity they've provided. The global economy seems to be expanding in a synchronized way, unemployment rates have fallen dramatically, and indicators such as metals prices suggest inflation should be running much higher than it is. The models used by the world's leading economists don't seem to be working any more. Why hasn't there been more inflation? It's the conundrum of the last decade.

Looking ahead, the Federal Reserve has plans to slowly reduce its massive ($4.5 trillion) holdings of bonds purchased as a tonic for the illness of the Great Recession. How will the great unwinding impact markets? Consensus opinion on this subject seems surprisingly calm, but I'm less sanguine. Extrapolating the past well into the future could be particularly frustrating given that we may have a new Chair of the Federal Reserve in a few months' time. Will President Trump really appoint a new maestro who'll deliver more of the same? It seems unlikely, given his rhetoric.

Complacency on the part of fixed income investors will prove sound if the future resembles the recent past, but markets have a way of confounding the consensus. So far this decade, inflation has averaged 1.88% and 10 Year Treasury bonds have yielded 2.19% - a 0.31% spread to core inflation. This is an historically low spread - a reversal to levels seen in prior decades and/or an increase in inflation, could create some serious dissonance in the bond market.

If there is market turbulence in coming years, due to rising rates or other potential shocks, currently popular passive investment strategies could get severely tested. ETFs and index funds are fully invested portfolios that offer no downside protection if markets correct, as happens from time to time. If the massive flow of money into index funds were to reverse, would that exacerbate a market decline?

Given these unanswered questions, and a stock market at new all-time high levels, it doesn't surprise me that it's becoming cool to be bearish. There is a slowly growing list of pundits urging caution. While I will acknowledge being less bullish on the broad market than I have been in recent years, **I continue to believe that it's too early to build cash defensively**. With our portfolio generally moving sideways this year, we aren't seeing many stocks hit our target prices and we're continuing to find what we believe are compelling new investment ideas.

In this more challenging investment environment, I feel even better about managing a strategy that only owns 30 stocks. We can be patient making new investments; **unlike an index fund, we aren't forced to buy more of everything we own just because a new client invests with us**. We can build cash if we stop finding good new investment opportunities and we can hopefully avoid the higher flying parts of the market that may suffer the brunt of a market decline, whenever it occurs. **In my opinion, if ever there were a time for value-based, active management, it's now.**

Picking Stocks is an Imperfect Process

When looking at stocks, I think from the perspective of someone who owns the whole business with plans to own it indefinitely. The enterprise is sure to have both good and bad years, but what I concern myself with is the average year – what I consider "normal" – or, said another way, what the business should be able to do as opposed to what it currently is doing. Where others may get scared away by sub-normal results, the opportunity to close the gap between current and normal whets my appetite.

When an enterprise is off key, the question to be answered is simply: is this the fault of management or has the company structurally changed for the worse? In any case, many investors will simply sell the stock because 1) they don't want to be invested in what is perceived to be a bad business, regardless of the price and 2) they do want to invest in companies with good management. I'm more open minded – price matters. **The market generally does a good job of reflecting current fundamentals in the price of stocks, but a poor job assessing changes to fundamentals.**

For a fundamentally sound business producing sub-par results, I'm usually willing to patiently stay invested with the idea that one of several things will lead to a brighter future:

- The current management team will get the band back on track, or
- The board will fire existing management and a new conductor will fix things, or
- An activist investor will force the board to make changes, or
- A third party firm will acquire the company.

I suppose there is a fine line between being appropriately patient and ill-advisedly hard headed. To help address this challenge, as part of our investment process, we often use a "designated bear" to argue the smartest sellers' perspective on a company we are evaluating. It's important to understand as many angles as possible when evaluating individual stocks and I believe the "designated bear" process helps reduce the number of value traps into which we fall. That said, I don't know of any investment process that plays every note perfectly.

The three stocks that have hurt us the most this year are Avon, Mattel and Signet Jewelers. Avon and Mattel were both turnarounds with new management teams promising growing revenues and rising margins. Our work suggested that the targets were reasonable and we felt confident in the companies' outlooks. The price of each company's stock reflected investor skepticism about managements' plans. This is the type of investment I've generally had success with over my career. However, in the cases of Avon and Mattel, the skeptics were right – the new management teams failed to deliver.

With Avon, I have long believed that growth and improved profitability were likely, but after years of reinvestment, the company has not been able to stop the decline in the number of representatives selling its products. Having hoped for a better future for far too long, I have recently concluded that there is something I just don't understand about the business. This is a case in which my patience has hurt our results. We have liquidated our position and expect to stay on the sidelines at least until a new leader can better explain the root issues while providing a well-conceived plan to change the trajectory of the business. Even then, I will approach any new management strategy with skepticism.

At Mattel, a second new CEO, Margo Georgiadis, is now in place and one of her first decisions was to cut the dividend to free funds for reinvestment in the business. We had thought the dividend was safe; the cut suggested underlying fundamentals were worse than we appreciated. Ms. Georgiadis appears to have a clear vision about Mattel's challenges and a plan that follows Hasbro's winning formula to get the company back to growing revenues and mid-teens margins over time. What's less clear is just how much short-term pain will be required to set the company up for long-term gains. In the short term, we have decided to exit the investment. We may revisit the idea once the dust settles if we believe the stock price reflects undue pessimism about the company's long term potential.

A few months ago, our investment in Signet Jewelers looked like another mistake. The Company had announced a second consecutive quarter of disappointing results and the stock fell to about half of its December level. We had a special discussion about Signet with a "designated bull" arguing to buy more and a "designated bear" making the case to sell out. Through this process, we teased out the bear case in a way that helped me understand just how pessimistic investors had become – we added to the position. Our patience was rewarded - the stock has rallied by over 35% since our discussion and it still looks cheap relative to our assessment of normalized earnings.

We're Still Finding Opportunity

With a portfolio of roughly 30 stocks and a three to five year holding period, we generally make six to eight investments a year. There are times, like 2009-2011, when there are an abundance of compelling ideas from which to choose. Not surprisingly, as the market goes higher, great values become harder to find. Such is the case today. We are turning over more rocks than usual in our search for new ideas, but fewer stocks are surviving our triage process and meriting a more in-depth look. As a result, we have made just three new investments so far this year. While fewer in number, these new investments are consistent with our framework – **with the market at all time high levels, we haven't and won't relax our standards**. If the new idea process fails to unearth what we believe are compelling long-term values, then our cash position may grow. Provided we can continue to find ideas like the ones I discuss below, we will stay close to fully invested.

Ally Financial - we started building our position in Ally during the first quarter. Ally is the former lending arm of General Motors, though the business has been repositioned since being spun off from GM during the financial crisis. Our average cost is roughly 70% of book value. Investors appear unduly concerned about negative developments on the credit side in the auto lending business. We believe the company is well reserved and cognizant of the auto finance cycle. Stocks that trade at a discount to book value reflect investor expectations for a bleak future. In contrast to the market's perspective, we see room for higher earnings and an improving return on equity as Ally continues to shift its funding from expensive debt securities to much cheaper bank deposits. This change in funding costs is key to our investment thesis. This is a potential double play of growing book value with the potential for a higher price-to-book valuation over time.

Johnson Controls - we started building our position in Johnson Controls, a multi-industry company primarily focused on building controls and HVAC systems, during the second quarter. Investors have long valued Johnson Controls at a P/E discount to the market based on the historically large contribution (65-70% of earnings) of their automotive businesses. In 2016, the business was transformed by the spin out of their highly-cyclical auto interiors business (Adient plc) and subsequent merger with Tyco International. The new company has far more dependence on industrial businesses with their remaining automotive business (primarily less-cyclical replacement car batteries) now contributing less than 40% of total corporate earnings. Our average costs basis is roughly 16x 2017 expected earnings - a 10% discount to the S&P 500 and an even larger discount to a broad cross section of industrial companies. While the stock is trading at a below average valuation, we believe the company should be able to grow earnings at an above average rate as they recognize cost savings and other synergies from the Tyco merger. Delivering merger synergies and improving the conversion of earnings to free cash flow are key tenets of our investment thesis.

Advance Auto Parts - we started accumulating shares of Advance Auto in the third quarter. The stock price of this auto parts retailer had fallen over 40% this year before we made our initial investment. The stock doesn't look cheap given expectations of around $5 of earnings per share this year, but we believe current results are not reflective of the business’s normalized earnings power. The Company grew through acquisitions, but they never got around to rationalizing them. The management team has targeted $750 million of productivity enhancements which would bring their margins to 15% and their earnings to $15 a share. Given the company’s track record, we are skeptical that the management team will deliver everything they are promising despite the fact that, at 15%, the Company’s targeted margins would still be below the ~19% reported by competitors AutoZone and O’Reilly Automotive. Delivering improved productivity is key and we conservatively assume that management will deliver about 60% of their target. We also assume the shares will trade at just 13-15x normalized earnings of ~$11 per share - a P/E discount to the market given the potential for electric vehicle penetration and internet disintermediation to provide a long term headwind to revenue growth.

I am excited about all three of these new investments - investor expectations are low as reflected in each stock’s valuation relative to our assessment of their normalized earnings. I hope that the descriptions of these stocks helps you see that we aren’t being forced out of our traditional comfort zone despite the market being at all time high levels. I believe these new investments look good on an absolute basis and even better relative to the broad market. Perhaps more importantly, **I continue to feel great about the other 26 stocks in the portfolio that we purchased prior to the start of the year**. We don’t see stretched valuations in the portfolio.

Closing - Many Thanks for a Great 10 Years

Taj Mahal wasn't the only musical legend I saw perform live this year - my all-time favorite band is Tom Petty and the Heartbreakers. I saw them three times this summer and I loved every show. Perhaps it's our shared southern roots, but there is something in the lyrics to many of their songs that really speaks to me. In this, the third year out of four in which value stocks have underperformed the S&P 500, one song seems particularly relevant: “I Won’t Back Down:”

No, I'll stand my ground
Won't be turned around
And I'll keep the world from draggin' me down
Gonna stand my ground

Poplar Forest is now ten years old. We've come a long way from a three-piece garage band managing $42.5 million on behalf of nine clients. After starting Poplar Forest, I learned that one of the biggest factors influencing clients who invested with us was trust. We consider ourselves stewards of our client partners' funds and I'm proud of what we've accomplished in that regard since taking the stage a decade ago. I feel even more confident about the next 10 years. We've assembled an outstanding ensemble who all care deeply about our mission - about taking care of Mrs. Jones, as we say at Poplar Forest. I love coming to work every day and I'm thankful to have a great band with which to work.

As we move into the future, we will be doing so without the skills of our bandmate Peter McAniff. Peter was the first analyst I hired and an equity partner from day one. In addition to his analytical work, Peter was our first Chief Compliance Officer; he handled recruiting and lease negotiations; he's been our in-house historian and he's always been willing to do whatever was asked of him along the way. We will miss Peter's many and varied contributions to Poplar Forest and we wish him well as he pursues his entrepreneurial interests and returns to writing and teaching.

While Poplar Forest will continue to grow and evolve in the years to come, our commitment to you, our client partners, is unwavering. You are our priority and our interests are aligned. Everyone at Poplar Forest has personally invested in our strategies. For a decade now, virtually all of my liquid assets have been invested in Poplar Forest strategies. While an independent financial advisor might say I shouldn't have all my eggs in one basket, I believe that the investment process we use at Poplar Forest offers the potential for market-beating, long-term returns. If I knew of a more promising way to invest, I'd pursue it.

While the prevalent fashion today is passive investment strategies that simply mimic returns of the broad market, I am more convinced than ever that actively managed, contrarian investment strategies, like those pursued at Poplar Forest, offer the potential for better than average returns. Long term, contrarian value investing is what I believe in and I am grateful for the opportunity to manage your money exactly as I manage my own – as Tom Petty put it:

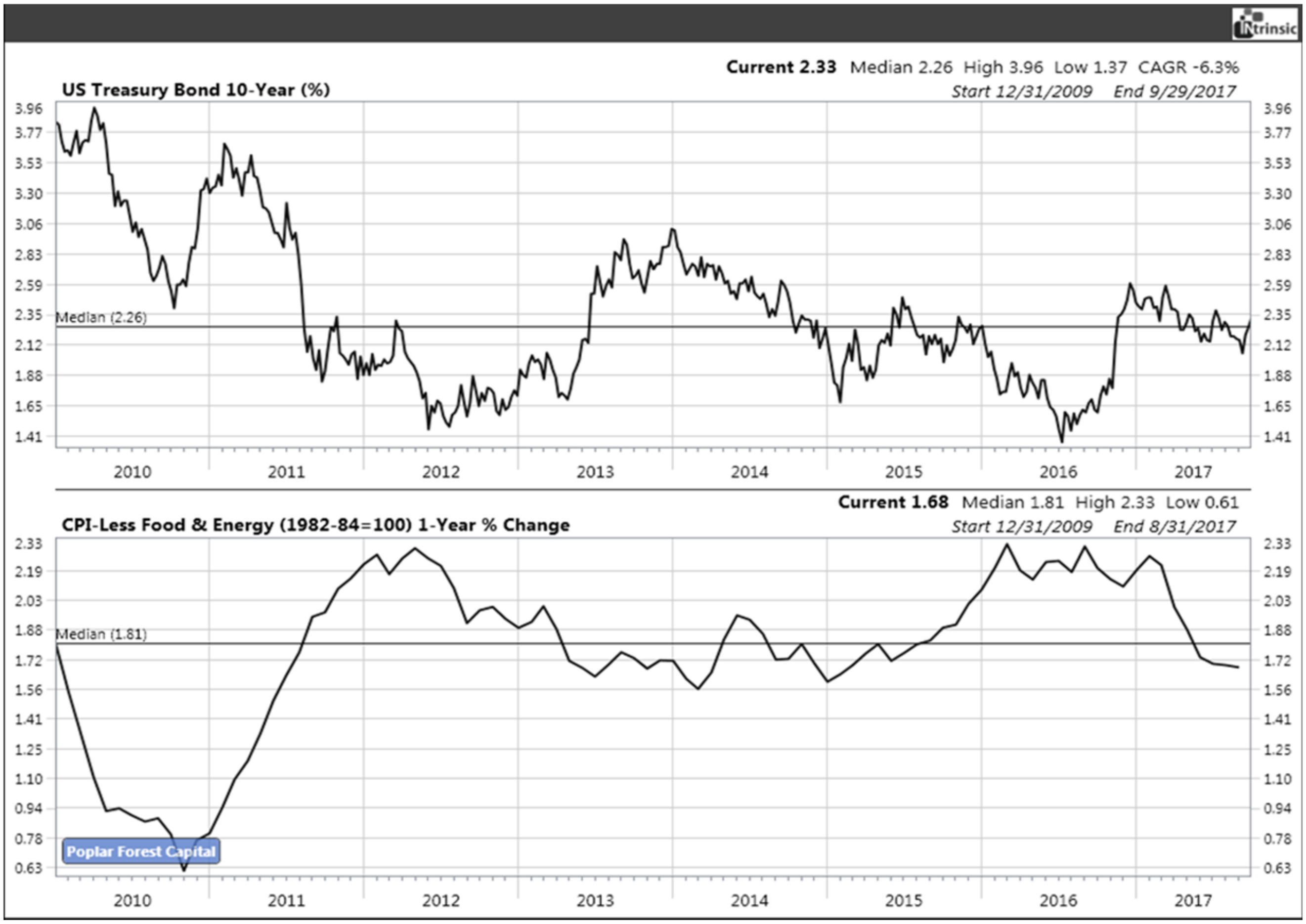
Well I know what's right
I got just one life
In a world that keeps on pushin' me around
But I'll stand my ground
And I won't back down

Thank you for putting your trust in Poplar Forest,

Dale

J. Dale Harvey
October 1, 2017

Appendix – Historical Interest Rates and Inflation



Source: Intrinsic Research

	Median 10 Year Treasury Yield	Median Core CPI	Spread of Yield Over CPI
Most Recent	2.33%	1.68%	0.65%
2010s	2.19%	1.88%	0.31%
2000s	4.22%	2.14%	2.08%
1990s	6.33%	2.79%	3.54%
1980s	9.56%	4.54%	5.02%
1970s	7.62%	6.54%	1.08%
1960s	4.65%	1.63%	3.12%

Contrarian Value - Partners Strategy

Poplar Forest Capital
Contrarian Value - Partners Strategy
Average Annual Total Returns as of September 30, 2017

	QTR	YTD	1YR	3YR	5YR	Annualized Since Inception (11/1/2007)
Composite Gross	3.00%	1.91%	12.51%	7.20%	16.18%	8.60%
Composite Net	2.74%	1.15%	11.40%	6.14%	15.02%	7.44%
S&P 500	4.48%	14.24%	18.61%	10.81%	14.22%	7.33%
Russell 1000 Value	3.11%	7.92%	15.12%	8.53%	13.20%	5.97%

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 2.74% return versus the S&P 500®'s 4.48% in the quarter ending 9/30/17. This period 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 3.11%.

For the quarter, the Strategy benefitted from investments in the industrial, healthcare, information technology, and financial sectors with our top contributors being Aecom (industrials), Abbott Laboratories (healthcare), Hewlett Packard Enterprise (technology), Ally Financial (financial services), and Citigroup (financial services). The bottom detractors to our results were Coach (consumer), Avon Products (consumer), MSC Industrial Direct (industrials), Mattel (consumer), and Zimmer Biomet Holdings (healthcare).[1]

We eliminated Avon Products, Dun & Bradstreet and Mattel from the portfolio this quarter, while establishing a new investment in Advance Auto Parts, an underearning retailer of auto parts. Hewlett Packard Enterprises ("HPE") successfully completed the spinoff of its software businesses, which merged with Micro Focus International, and MetLife completed the spinoff of Brighthouse Financial, its U.S. retail business. The Strategy ended the quarter with 30 investments and roughly 3% cash.

[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.

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 September 30, 2017, the Contrarian Value Partners Strategy's 10 largest holdings accounted for 46.97% of total assets. The Strategy's 10 largest holdings at September 30, 2017:

Abbott Laboratories	**5.60%**
Citigroup	**5.40%**
Lincoln National	**5.00%**
Zimmer Biomet Holdings	**4.81%**
Signet Jewelers	**4.51%**
MetLife	**4.46%**
AECOM	**4.35%**
Bank of America	**4.35%**
TE Connectivity	**4.24%**
Reliance Steel & Aluminum	**4.23%**

Active investing generally has higher management fees because of the manager's increased level of involvement while passive investing generally has lower management and operating fees. Investing in both actively and passively managed funds involves risk, and principal loss is possible. Both actively and passively managed funds generally have daily liquidity. There are no guarantees regarding the performance of actively and passively managed funds. Actively managed mutual funds may have higher portfolio turnover than passively managed funds. Excessive turnover can limit returns and can incur capital gains. Exchange-Traded Funds (ETFs) are securities that track an index, a commodity or basket of assets like an index fund, but trade like a stock on an exchange. ETFs experience price changes throughout the day as they are bought and sold. Mutual Funds are structured and maintained to match their investment objectives and generally are priced and traded only once a day at the market close.

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.

Consumer Price Index (CPI) is a measure of the average change over time in the prices paid by urban consumers for a market basket of consumer goods and services. The annual percentage change in a CPI is used as a measure of inflation.

Earnings Per Share (EPS) is the net income of a company divided by the total number of shares it has outstanding.

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.

An Index Fund is a type of mutual fund with a portfolio constructed to match or track the components of a market index, such as the Standard & Poor's 500 Index (S&P 500).Normalized earnings are adjusted to remove the effects of seasonality, revenue and expenses that are unusual or one-time influences. Normalized earnings help business owners, financial analysts and other stakeholders understand a company's true earnings from its normal operations.

Price/Book Ratio (P/B) is the price/book ratio of a fund is the weighted average of the price/book ratios of all the stocks in a fund’s portfolio.

Price / Earnings (P/E) Ratio is a common tool for comparing the prices of different common stocks and is calculated by dividing the earnings per share into the current market price of a stock.

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.

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.

Composite Specific Disclosures

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, 2017. 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.