SOUTHERNSUN U.S. VALUE FUND

SouthernSun Asset Management Commentary – Third Quarter 2017

The performance of the SouthernSun U.S. Value Fund during the third quarter was positive on an absolute basis. The Y Share Class returned +3.29%, the Investor Share Class returned +3.14, and the Institutional Share Class returned +3.18% on a net basis, while the Russell 2500™ Index returned +4.74% for the period.

Management assessments of existing and prospective holdings remain a key component of SouthernSun's investment process. This part of our research extends from the board room to the break room, and we find discussions with plant and operational management revealing and as significant as those in which we engage with senior management of a company. We attempt to determine whether a management team is "rightly fitted" for the current challenges and opportunities facing a company, whether financial, operational or customer-related. Many of our management teams have remained in place for more than ten years, although we certainly see and analyze turnover when it occurs. We continually evaluate the capital allocation decisions that our managers make in acquisitions, share buybacks, debt retirement, dividend increases and capital expenditures. As value-oriented investors, we often find companies trading at attractive cash flow yields that are managing through a turnaround or what we believe is a temporary setback in their business. We value management teams with experience and capabilities in these transitions.

During the period, we participated in a greater than usual number of meetings with the management teams of existing and prospective holdings at their headquarters and facilities, at conferences, and in our Memphis office. We believe that the content of these meetings reinforced to us the value of knowing these companies and their leaders over an extended period of time. Topics discussed included capital allocation, product development, the competitive landscape, operational initiatives and improvements, and the importance of having the right leadership in place. We contend that these meetings produce conversations and cover topics often not found in regulatory filings or in company marketing materials and the content they generate better informs our research process and ability to judge the quality of the investments in the long term.

The producer durables sector remains our largest overweight as it has been historically. We have trimmed **Centene Corp. (CNC)** and **Thor Industries, Inc. (THO)** during the period as their share prices rose, while adding to **Envision Healthcare Corp. (EVHC)** and **Newfield Exploration Company (NFX)** on weakness.

Stock selection in the health care and technology sectors led by **Envision Healthcare Corp. (EVHC)** and **Knowles Corp. (KN)**, respectively, drove most of the underperformance in the period. This was offset, in part, by stock selection in the consumer discretionary sector led by **Thor Industries, Inc. (THO)** and an underweight allocation to the financial services sector.

Envision Healthcare Corp. (EVHC), a leader in the consolidation of ambulatory surgical centers (ASG) and physician practice services (PPS), was the leading detractor from performance on a relative basis in the period. The company was formed from the 2016 merger of **EVHC** and AmSurg Corp. Its specialties include ophthalmology and orthopedics in its ASC division and radiology, anesthesiology, and emergency medicine in the PPS division. The company has a history of acquisitions in both the PPS and ASC spaces and has identified PPS as an area with future consolidation opportunities. **EVHC** believes that the PPS model provides hospitals the ability to outsource a significant cost center so that they can focus their attention on profit centers and physicians the ability to focus on providing medical care and not managing the business elements of their practices. We believe that the company has scale, a flexible cost structure and a technology backbone which provides streamlined back office management, robust billing and collections capabilities, and enables efficient integration of acquisitions. We met with management during the period and discussed the continued integration of the new company, specifically regarding synergies and corporate culture. The discussion also focused on the balance sheet and **EVHC**'s views on capital allocation. We continue to believe that this is a less cyclical business, with manageable risks and the potential to better demonstrate its value proposition to the broader investment community once the moving parts surrounding the merger settle down.

Murphy USA, Inc. (MUSA), a low-price, high volume operator of filling stations and small-format convenience stores located largely on **MUSA**-owned land in front of Wal-Mart supercenters in the South and the Midwest, was another leading detractor from performance on a relative basis in the period. The company typically sells 3-4 times the fuel volumes of its competitors that include MAPCO, the retail divisions of integrated energy companies, regional chains and jobbers. **MUSA** operates roughly 1,200 stores in its current footprint, with another 1,200 potential locations in that footprint and 800 potential locations in other regions of the U.S. It maintains a conservatively-levered balance sheet and has developed a track record of reinvesting in its business in new stores that generate returns on invested capital (ROIC) in excess of 10% and remodeling existing locations. **MUSA** also generates supplemental income through the sale of Renewable Identification Numbers (RINs), environmental credits that it generates in the logistics portion of its business and then sells to companies in other portions of the energy industry. Its CEO spent nearly two decades in Booz, Inc.'s energy practice. The CEO and the board put a tremendous focus on **MUSA**'s return on invested capital. We believe that **MUSA**

repurchased shares in recent months at attractive prices and that its plans to build new stores and to raze and rebuild stores at current locations demonstrate continued superior capital allocation. Management's recent comments regarding customer demographics and spending habits as well as its assessment of the competitive landscape suggest to us an effort to continually improve its knowledge in these areas of the business. The company has continued to generate positive financial results and we believe is taking steps to improve its inventory of prospective new locations.

Centene Corporation (CNC), a multi-line managed care organization providing Medicaid and other related services through government subsidized programs, was the leading contributor to performance on a relative basis in the period. **CNC** closed its acquisition of HealthNet in 2016 and the stock responded positively. We contend that the company continued to generate consistent levels of discretionary cash flow during the last year and that the stock is valued attractively versus those cash flows. We believe that the HealthNet acquisition provided **CNC** entry to the large and potentially lucrative California market and adds to its competencies in non-Medicaid programs, where existing customers have expressed further interest in its capabilities. Additionally, we assert that **CNC**'s investments in people and technology have contributed positively to its growth and the execution of its strategy. We believe that the headline risk surrounding the Affordable Care Act (A.C.A.) provided a short-term headwind to the stock price. Our analysis indicates that approximately 10% - 15% of **CNC**'s revenue is tied to the A.C.A., whose repeal and replacement failed in the U.S. Congress earlier this year. During the period, the company announced the acquisition of Fidelis Care. We believe that this deal is attractive because it is accretive to earnings from the outset, it adds to the company's scale and provides it entry to New York State, the country's second leading Medicaid market. We contend that **CNC** continues to capitalize on existing opportunities in Medicaid and Medicare management for state governments while exploring relationship extensions in areas such as the delivery of health care solutions to corrections facilities. We believe that **CNC** has strong prospects for growth over the long term and that it provides affordable solutions of high quality to its customers in the health care sector.

Thor Industries, Inc. (THO), a leading manufacturer of towable recreation vehicles (RVs) and motor homes, was another leading contributor to performance on a relative basis in the period. We remain impressed with **THO**'s financial flexibility, specifically its capital allocation acumen which we believe is evidenced by a history of acquisitions and divestitures and a lean organization that employs flexible manufacturing and is responsive to changes in consumer preferences and encourages competition between business units. We contend that attractive demographics and elevated consumer confidence should increase demand for recreational vehicles and that towable RVs' lower price point may sustain demand in economic downturns and periods of higher energy prices. In our opinion,

THO's balance sheet should also enable the business to withstand adverse conditions better than competitors, many of whom lack the same financial flexibility. In 2016, **THO** announced the acquisition of Jayco Corp. for $576 million in cash. We believe that this news, record net income, positive news regarding backlog, and strong recent product introductions drove the stock higher. We trimmed our position during the period.

We assert that several characteristics distinguish us in the marketplace – including, consistent onsite assessments of operational management, our long-term perspective and the duration of ownership, and the significant stakes that we take in many of our portfolio holdings. We assert that each of these reflects the importance of meeting with management teams on a regular basis and using these meetings to continually inform and enhance our investment theses. Time spent with executive and operational management at our businesses has been a hallmark of our investment process and we look forward to its continued role in our research and to reporting on what it reveals in this forum.

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