

# SMID Cap Composite Commentary

## THIRD QUARTER 2019

While equity markets were volatile in August and September, our portfolio companies, on the whole, continue to see opportunities for organic growth and margin improvement. While the market seemed to be focused on headlines surrounding China/US Trade, Fed actions, Hyped/Failed IPOs, our management teams remain focused on new product introductions, R&D / Innovation, sales strategies, operational excellence and productivity along with selective and disciplined M&A. We believe that shareholder value is built over time through the incorporation of technology into new products/services, by improving cost structures, by optimizing supply chains, and by targeting new applications for new end-markets, etc. Disciplined capital allocation continues to be a key requirement for our team as we watch so many companies and market participants add to record levels of leverage and chase record high valuations. We believe the quarterly results of our portfolio companies demonstrate solid progress toward building long-term value, and we believe the opportunity for price appreciation from this point forward is significant.

At a higher level, we have seen a return to volatility and some small movements from Growth to Value - shifts which could certainly add a tailwind to the market recognizing the quality/valuations in our portfolios. We believe the increased volatility creates opportunity for stock pickers and a view toward fundamentals is always supportive of our approach.

For the third quarter of 2019, the SMID Cap Composite returned approximately -2.34% on a gross basis (-2.53% net\*) versus the Russell 2500™, which returned -1.28%, the Russell Midcap®, which returned +0.48%, and the Russell 2500™ Value which returned +0.13, over the same period. On a year-to-date basis, the composite returned approximately +16.17% on a gross basis (+15.50% net\*) versus the Russell 2500™, which returned +17.72%, the Russell Midcap®, which returned +21.93%, and the Russell 2500™ Value, which returned +15.41 over the same period. The strategy continues to outperform the indexes on a since inception annualized gross and net basis.

**Centene Corp. (CNC)**, a multi-line managed care organization providing Medicaid and other related services through government subsidized programs, was the leading detractor to performance on an absolute basis in the period, although there was not much to note on the quarter's business results. Margins in the company's exchange business decreased due to lower attrition, but the business was profitable and lower customer churn is a positive long-term. The exchange business is within expected profitability targets and was anticipated to give some of the margin back after strong results in 2018. Management remains confident in its previously identified synergies regarding the WellCare Health plans (NYSE:WCG) acquisition, and the deal is expected to close in the first half of 2020. As a reminder, CNC announced at the end of 1Q19 that it will acquire WCG, which will leverage its position as the largest Medicaid managed care organization in the country. The combined

entity will have greater scale and diversification across 50 U.S. states, making it one of the largest providers of government insurance. We assert that CNC's continued investments in people and technology have contributed to its growth and the execution of its strategy. Furthermore, we believe that CNC continues to have strong prospects for growth over the long term and that it provides affordable, high quality solutions to its customers in the health care sector. We believe valuation remains compelling after the pullback in the stock.

**Timken Co. (TKR)**, which designs, engineers, manufactures and markets bearings, transmissions, gearboxes, chain and related products and aftermarket services, was another leading detractor to performance on an absolute basis in the period. **TKR** reported solid operational results with 2% organic and 11% acquisitive topline growth along with significant margin expansion, but the stock declined after management lowered full-year guidance due to softening off-highway and heavy truck markets. Localized weakness in these end markets appeared to overshadow the continued strength in other end markets such as solar, wind, marine, aerospace, and rail. Management highlighted that even after lowering guidance, they are on-track to reach an all-time high in earnings per share for the year. In the short-term, **TKR's** varied end markets will invariably go through ups and downs, however, over the long-term, we believe the company's excellent competitive positioning is set up for continued success.

**Western Union (WU)**, the money transfer and payment services provider, was the leading contributor on an absolute basis in the period. **WU** completed the sale of their Speedpay bill payment business for \$750 million, generated solid 4% constant currency topline growth, and announced a new cost cutting initiative that will generate annual savings of \$100 million starting in 2021. The company also held an investor day in September and outlined a strategy to grow the earnings power of the business with very little capital investment. Over 3 years (2020-2022), the company expects to generate more than \$3 billion of operating cash flow and return approximately \$2.5 billion to \$3 billion to shareholders through dividends and share repurchases.

**Knowles Corp. (KN)**, a leading manufacturer of small acoustic components, was another leading contributor on an absolute basis in the period as strength in ear, IoT and Precision Devices drove 9% top-line growth despite a difficult mobile phone environment. The company held its first investor day since it was spun out from Dover in 2014 and highlighted some strong growth opportunities as the Voice as a User interface continues to gain adoption. **KN** also highlighted expectations for significant margin expansion due to higher value product mix, operating leverage, and R&D optimization. Leverage has continued to come down post spin out and is now at 0.7x Net Debt/EBITDA, providing management with significant flexibility to pursue value creating investments.

The Investment Team continues to travel a great deal to meet with management teams of current and prospective holdings. We believe that our companies continue to demonstrate the niche dominance,

financial flexibility and management adaptability that we value in our portfolio holdings and that technical innovation, capital allocation and balance sheet strength support this. Given where we are in the current market cycle, we believe we are entering a phase in which investors will be rewarded by allocating to managers whose portfolios are comprised of high-quality companies trading at attractive valuations. We believe we are well positioned for this type of environment.

Our investment strategy is differentiated by our “private-equity-like approach” to owning small and mid-cap public companies. By that, we mean that we are making long-term investments in businesses, instead of making short-term “bets” on stocks. Our portfolio’s long-term absolute and relative outperformance on a

since inception basis versus its peer benchmarks is driven by our in-depth knowledge of our companies. This gives us a competitive advantage when selecting securities and managing our portfolio. We get to know our companies intimately through a research process that involves regular communication with senior management, repeated on-site tours of facilities and discussions with a company’s suppliers, customers and competitors. We are differentiated by the amount of time we devote to field work, traveling to and spending time with our companies. This intensive process has been in place since the inception of our firm and it fosters a culture of deliberate buying and selling of shares of businesses.

### Top Contributors and Detractors (Preliminary; Absolute Return Basis)\*\*

Top Contributors	Ticker	Average Weighting (%)	Contribution-to Return (bps)	Top Detractors	Ticker	Average Weighting (%)	Contribution-to Return (bps)
Western Union Co.	WU	4.3	68	Centene Corp.	CNC	5.1	-96
Knowles Corp.	KN	4.3	48	Timken Co.	TKR	5.5	-83
Clean Harbors, Inc.	CLH	5.1	41	Dycom Industries, Inc.	DY	6.1	-78
First Horizon National Corp.	FHN	3.2	27	Extended Stay America, Inc.	STAY	4.9	-61
The Brink’s Co.	BCO	5.8	14	Hanesbrands, Inc.	HBI	4.9	-35

*\*Inception Date of SMID Cap Composite: January 1, 1997. Net returns are actual and reflect the deduction of management fees. Please see composite performance and disclosures on page 3 for further information. Returns include the reinvestment of all income. Past performance is no guarantee of future results.*

*\*\*Supplemental information. Composite Top Contributors and Detractors will not include positions added to the portfolio within 30-days prior to the most recent month-end. Additionally, securities held at the request of individual client(s), such as ETFs, have been excluded. The Holdings identified above do not represent all of the securities purchased, sold or recommended for advisory clients. Holdings are subject to change and should not be construed as investment advice. Statements received directly from the account custodian should be regarded as the official record for a client’s account. To obtain a complete list of all positions in the strategy and their contribution to the portfolio’s performance and an explanation of performance calculation methodology, contact Client Relations at either 901-341-2700 or clientservice@southern.sunam.com. Source: SouthernSun Asset Management, Advent Portfolio Exchange, FactSet.*

**SMID CAP COMPOSITE**

SMID CAP COMPOSITE - ASSET WEIGHTED RETURNS												
Year	SouthernSun		Russell 2500	Russell MidCap	Composite Dispersion	Composite 3-Yr Standard Deviation (%)	Russell 2500 3-Yr Standard Deviation (%)	Russell Mid Cap 3-Yr Standard Deviation (%)	Accounts in Composite (#)	Total Composite Assets (\$Mil)	% of Firmwide Assets	Total Firmwide Assets (\$Mil)
	Gross	Net										
2018	-21.14%	-21.75%	-10.00%	-9.06%	0.12%	15.24%	14.10%	11.98%	38	\$693	46%	\$1,519
2017	12.33%	11.46%	16.81%	18.52%	0.17%	13.91%	12.13%	10.36%	70	\$2,309	55%	\$4,213
2016	18.05%	17.19%	17.59%	13.80%	0.33%	15.13%	13.67%	11.55%	62	\$1,242	30%	\$4,187
2015	-10.91%	-11.55%	-2.90%	-2.44%	0.27%	15.08%	12.42%	10.85%	77	\$1,120	25%	\$4,542
2014	2.33%	1.60%	7.07%	13.22%	0.24%	13.56%	11.67%	10.14%	95	\$1,186	21%	\$5,696
2013	43.17%	42.27%	36.80%	34.76%	0.19%	18.71%	15.63%	14.03%	51	\$882	17%	\$5,317
2012	19.56%	18.86%	17.88%	17.28%	0.25%	22.89%	18.97%	17.20%	24	\$378	14%	\$2,615
2011	4.86%	4.30%	-2.51%	-1.55%	0.18%	27.75%	23.40%	21.55%	24	\$309	15%	\$2,106
2010	43.20%	42.47%	26.71%	25.48%	0.31%	31.58%	26.80%	26.46%	16	\$222	11%	\$1,974
2009	49.73%	49.08%	34.39%	40.48%	0.00%	28.16%	24.25%	24.22%	7	\$142	11%	\$1,339
2008	-36.75%	-37.03%	-36.79%	-41.46%	1.28%	22.71%	19.37%	19.36%	6	\$105	10%	\$1,025
2007	12.89%	12.40%	1.38%	5.60%	0.07%	13.65%	11.52%	9.48%	6	\$175	13%	\$1,341
2006	15.78%	15.28%	16.17%	15.26%	N/A <sup>1</sup>	14.33%	11.93%	9.62%	≤5	\$153	14%	\$1,100
2005	2.42%	1.96%	8.11%	12.65%	N/A <sup>1</sup>	16.75%	13.48%	11.22%	≤5	\$135	18%	\$733
2004	27.64%	27.09%	18.29%	20.22%	N/A <sup>1</sup>	18.51%	16.92%	15.28%	≤5	\$133	32%	\$410
2003	45.59%	44.97%	45.51%	40.06%	N/A <sup>1</sup>	22.33%	19.93%	18.51%	≤5	\$97	60%	\$162
2002	-3.39%	-3.77%	-17.80%	-16.18%	N/A <sup>1</sup>	20.97%	21.92%	19.65%	≤5	\$39	36%	\$107
2001	7.19%	6.76%	1.21%	-5.63%	N/A <sup>1</sup>	20.20%	21.16%	18.35%	≤5	\$40	34%	\$120
2000	14.15%	13.68%	4.26%	8.26%	N/A <sup>1</sup>	20.55%	22.35%	18.96%	≤5	\$38	28%	\$137
1999	14.39%	13.92%	24.14%	18.24%	N/A <sup>1</sup>	18.79%	19.46%	17.22%	≤5	\$33	23%	\$145
1998	-2.23%	-2.62%	0.38%	10.10%	N/A <sup>1</sup>	N/A <sup>2</sup>	N/A <sup>2</sup>	N/A <sup>2</sup>	≤5	\$29	21%	\$135
1997	27.32%	26.80%	24.36%	29.02%	N/A <sup>1</sup>	N/A <sup>2</sup>	N/A <sup>2</sup>	N/A <sup>2</sup>	≤5	\$14	11%	\$123

<sup>1</sup> Information is not statistically meaningful due to an insufficient number of portfolios in the composite for the entire year.

<sup>2</sup> Information is not statistically meaningful due to an insufficient number of periods.

SouthernSun Asset Management, LLC, an SEC registered investment adviser, is a research-driven investment management firm implementing long-only domestic and global equity strategies for institutions and individuals. SouthernSun provides investment advisory services for its clients using a proprietary investment research process based on fundamental analysis and seeks to invest in niche-dominant, attractively-valued companies with financial flexibility and uniquely-fitted management teams.

SouthernSun Asset Management, LLC claims compliance with the Global Investment Performance Standards (GIPS) and has prepared and presented this report in compliance with the GIPS standards. SouthernSun Asset Management, LLC has been independently verified for the periods January 1, 1990 through June 30, 2019. A copy of the verification report(s) is/are available upon request.

Verification assesses whether (1) the firm has complied with all the composite construction requirements for 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.

Subsequent periods are currently undergoing verification by ACA Performance Services, LLC and, as such, performance may be subject to change.

Performance results shown above are included as part of a complete disclosure presentation. SouthernSun SMID Cap Composite contains fully discretionary equity accounts invested in small cap to mid-cap (SMID cap) securities (defined as equity securities with market capitalizations that are within the range of the Russell 2500 at the time of initial purchase during the most recent 12-month period) and for comparison purposes is measured against the Russell 2500 and Russell MidCap indices. The minimum account size for inclusion into this composite is \$1,000,000. Prior to July 1, 2015, the minimum account size for inclusion in this composite was \$500,000. Prior to July 1, 2009, the minimum account size for inclusion in this composite was \$1,000,000. Composite policy requires the temporary removal of any portfolio incurring a client-initiated significant cash inflow or outflow of 20% or more of the portfolio assets. Prior to April 1, 2004, composite policy required the temporary removal of any portfolio incurring a client-initiated significant cash inflow or outflow of 50% or more of portfolio assets. Additional information regarding the treatment of Significant Cash Flows is available upon request. The firm maintains a complete list and description of composites, which is available upon request. Results are based on fully discretionary accounts under management, including those accounts no longer with the firm. Trade date valuation has been used since inception. The U.S. dollar is the currency used to express performance. Returns are stated gross and net of management fees and include the reinvestment of all income. Net of fee performance was calculated using actual management fees. The management fee schedule is as follows: \$0 - \$50,000,000 is .90%, \$50,000,001 - \$100,000,000 is .85%, and above is .75%. This schedule is subject to a \$180,000 minimum annual fee. Actual investment advisory fees incurred by clients may vary. The annual composite dispersion presented is an asset-weighted standard deviation of gross returns for accounts in the composite the entire year. The three-year annualized standard deviation measures the variability of the composite and the benchmark returns over the preceding 36-month period. Policies for valuing portfolios, calculating performance, and preparing compliant presentations are available upon request. The SouthernSun SMID Cap Composite was created January 1, 1997.

The Russell 2500 Index measures the performance of the small to mid-cap segment of the U.S. equity universe, commonly referred to as "smid" cap. The Russell 2500 Index is a subset of the Russell 3000 Index. It includes approximately 2500 of the smallest securities based on a combination of their market cap and current index membership. The Russell Midcap Index measures the performance of the mid-cap segment of the U.S. equity universe. The Russell Midcap Index is a subset of the Russell 1000 Index. It includes approximately 800 of the smallest securities based on a combination of their market cap and current index membership. The Russell Midcap Index represents approximately 30% of the total market capitalization of the Russell 1000 companies. Frank Russell Company ("FRC") is the source and owner of the Russell Index Information contained or reflected in this material and all trademarks and copyrights related thereto. The Russell Index Information may contain confidential information and unauthorized use, disclosure, copying, dissemination or redistribution is strictly prohibited. For more information on either index, please consult Frank Russell Company.

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