MD Sass Concentrated Value

MD SASS

Q3 2020 Commentary *October 19, 2020*

The MD Sass Concentrated Value ("CV") strategy was up +4.2%, net of fees, in the third quarter of 2020, vs. +5.6% and +5.4% for the Russell 1000 Value and Russell 3000 Value indices, respectively.

CV is down -11.7% YTD thru the end of Q3, vs. -11.6% and -12.2% for the Russell 1000 Value and Russell 3000 Value indices, respectively.

From inception (January 2019) thru the end of Q3 2020, CV was up +24.7% net of fees, vs. +11.9% and +10.8% for the Russell 1000 Value and Russell 3000 Value indices, respectively. We are pleased that the inception to date return places CV in the top 10th percentile of eVestment's universe of large cap value equity managers during the same period.

Negative consensus earnings revisions for the S&P 500 troughed at the end of Q2 and the subsequent positive revisions lifted the stock market higher in Q3. Positive earnings revisions generally lead to positive stock price performance and this time is no different. According to Jefferies, this was the best positive earnings revisions the markets have seen in some time. Inventory restocking was likely a big driver of this. Intermodal railcar volumes are up year over year and is seeing some of the best levels of growth since early 2020. Furthermore, broad market semiconductor companies such as *Qorvo* **(QRVO)**, *ST Micro* **(STM)** and *NXP Semiconductors* **(NXPI)** have positively preannounced earnings for Q3. We believe railcar volume and semiconductor strength speak more to the increased demand in inventories as opposed to fundamental end market demand strength. Nonetheless, the relative resilience of consumer demand for physical goods in the face of this pandemic-induced recession is impressive. Pre-COVID, the growth in demand for experiences exceeded the growth rate in demand for goods. However, the pandemic flipped this trend on its head. According to the Bureau of Economic Analysis, personal consumption of "goods" dropped only 3% in the third quarter whereas consumption of "services", excluding housing and utilities, dropped 19%. The abrupt and seismic shift in consumption towards goods explains the need for the inventory re-stocking that is occurring in Q3 ahead of the all-important holiday season.

We expect elevated levels of market volatility over the next couple of months and into year-end largely due to uncertainty over the elections, which are likely to be highly contested. The consensus has shifted markedly over the past couple of months with respect to which outcome is perceived to be most favorable to markets. Previously, it was believed that a Democratic win would lead to higher taxes (bad!) and would be a negative outcome for several sectors of the economy such as healthcare and oil & gas. However, we believe the narrative has shifted with the prevailing view now being that a Democratic sweep will be bullish for markets as it would equate to a higher likelihood of a large stimulus program and infrastructure spending. Although the idea of an infrastructure package has generally received bipartisan support in theory, a divided Congress stood in the way of its enactment and a Democratic sweep of both the Senate and the House would eliminate that obstacle. Significant fiscal stimulus and infrastructure spending would probably lead to higher inflation expectations and, likewise, a steeper yield curve which is bullish for cyclicals and financials. This likely explains the outperformance of value stocks vs. growth stocks in September.

The resilience of the tech sector (which dominates the growth stock universe) has been nothing short of astonishing. According to Credit Suisse, approximately 76% of the market cap of the Russell 1000 Growth index is expected to report 2020

EPS above that of 2019, an incredible feat given the economic devastation resulting from the pandemic. Furthermore, the rolling twelve-month EPS for the Russell 1000 Growth index has not experienced a yr/yr decline this year. The relatively strong performance out of large cap Growth stocks was not lost on anyone. The 12-month performance spread of Growth vs. Value is approximately 3,000 basis points which is the widest gap since March of 2000.

Despite the positive earnings revisions, market valuations remain elevated with the Russell 1000 Value now trading for 22x consensus 2020 EPS estimates. However, we continue to believe that rich multiples are warranted given the fact that the 10-year U.S. Treasury currently generates a negative real rate of return. In fact, the spread between the S&P 500 earnings yield and the 10yr Treasury remains wide relative to the spreads seen from 2014-2019. Furthermore, 2020 EPS is temporarily depressed due to the impact of COVID on corporate profits (ex-tech). The Russell 1000 Value trades for "only" 16.7x consensus 2021 EPS although we question whether the consensus growth expectations are reasonable for next year given the lack of visibility in the elections, widespread vaccine availability and future public health policies. We continue to focus our research efforts on finding companies whose future is likely far brighter than consensus expectations assuming a non-robust economic outlook. With respect to the top 10 positions in the Concentrated Value portfolio, our internal estimates are 12% above consensus, on average, for 2021 EPS.

Previously, we've articulated that our investment process, while disciplined and institutionalized, is a dynamic one. We look for ways to enhance our process to drive better future returns recognizing that we make mistakes and judgement errors and need to incorporate our learnings into our process so as not to repeat them. Usually, our process enhancements are evolutionary, not revolutionary, but a series of evolutions compound over time to make for material improvement over the long run. One recent example of a change was brought to me by one of our senior equity analysts, Tanner Coyle. As Tanner pointed out, stock valuations don't react merely to changes in growth rates but also to the drivers of the growth. For example, a company that can accelerate earnings growth by deploying no incremental capital into the business should see relatively greater degrees of multiple expansion vs. a company whose growth came with copious amounts of incremental capital. We have learned that we, at times, focused too much on growth but not the driver of the growth and the latter is a critical driver of valuation. Some of our best performing holdings, such as *Target* **(TGT)** and *Charles River Labs* **(CRL)**, experienced accelerated levels of growth with diminishing levels of capital which greatly expanded their ROE, ROIC and, hence, their multiple. TGT's return on equity increased from 23% in fiscal 2017 to over 28% in fiscal 2020 and saw a corresponding increase in its P/E ratio from 12x to 22x. As a result, we are focusing more of our time on return on invested capital and return on equity and the second derivative of these metrics prospectively. Historically, we focused on ROE and book value for asset intensive sectors like banks but these metrics are equally relevant to asset light businesses. Regarding book value, we have noticed certain companies report highly adjusted, non-GAAP EPS to show "growth", yet these adjustments tend to hide a problem – namely, a decline in book value. We believe adjusted EPS growth at the expense of book value leads to value traps as declining book values tend to reflect melting ice cubes (although there are exceptions to this such as certain franchise business models where the company returns all capital to shareholders). What good is short term growth if the longer-term terminal value is in question? *Bausch & Lomb* **(BHC)** has seen its book value erode meaningfully since 2017 yet adjusted EPS has grown. This is due to the significant amortization of acquired intellectual property which is backed out of adjusted EPS but erodes book value over time. Amortization of intangibles is a real expense only to the extent it is directly related to intellectual property with a finite life, as is the case for BHC. Moving forward, all our models include historical growth of book value/share and our projections for future growth. Unsurprisingly, BHC's stock price hasn't gone anywhere over this timeframe despite the earnings "growth". Despite this rather bearish assessment of BHC's past, we are enthusiastic investors in the stock. We believe the company is about to turn the corner such that book value/share will grow, and ROE will accelerate as the company laps the expiration of high margin patents and new product launches overwhelm declines in the

legacy portfolio. Ultimately, we believe the best investments will check three boxes – EPS projections greater than consensus, increasing ROE & ROIC and growing book value/share.

Of course, investing isn't just about analyzing ratios and perhaps the qualitative evaluation of a company is of greater relevance. Assessing the staying power of a company's moat, its competitive advantages and technological disruptions that may loom on the horizon cannot be solved with formulas. We have found that answering relatively simple, straightforward questions based on logic vs. numbers is a critical part of an investment process. One question that I find crucial when evaluating a stock is: "*is time a friend of this business?*" Explicitly answering that question tends to be quite revealing. If the answer is "*no*" then the stock is at best a trade but certainly not a wise investment. In sum, asking oneself the most obvious of questions may sound trite but nonetheless important.

Q3 PORTFOLIO REVIEW

The biggest contributors to performance in Q3 were Charles River Labs (CRL), Target Corp (TGT) and *Crown Holdings* **(CCK)**, which collectively contributed approximately 279 basis points to performance.

CRL is a contract research organization ("CRO") that provides research tools and services to support drug development on behalf of pharmaceutical companies, biotechs and academic institutions. When we initiated a position in the stock, the company was demonstrating good organic growth, but margins were depressed due to several temporary factors including a material investment in a new facility in Pennsylvania and a one-time bump in wages. We believed the company had a significant opportunity to expand margins despite the recent track record of margin compression and eroding returns on capital. Fortunately, CRL has executed very well in 2020 and the company is witnessing significant margin expansion with further opportunities for growth in the coming years. Likewise, the multiple on CRL has expanded as earnings have accelerated and the stock rose 29.9% in the quarter.

TGT was up 31.9% in the third quarter as the company handily beat fiscal Q2 consensus estimates. We believe TGT is in the "winners" bucket amongst its retail peers given its effective multi-year investment in omni-channel distribution capabilities. In a previous quarterly letter, we discussed our focus on companies that we believe will be structural winners post-COVID and TGT is firmly in that camp. According to TGT CEO, Brian Cornell, "*share gains accelerated in the second quarter and we gained double the dollars compared with the first quarter bringing our year-to-date share gains to more than $5 billion.*" This is a staggering number. TGT's 270% growth in same-day services proves that Target is well positioned to capture its fair share (and more) of a rapidly evolving retail landscape that has witnessed a step change function in e-commerce demand due to COVID-19.

CCK is one of the largest manufacturers of aluminum cans in the world. In Q2, its North American beverage can volumes were up 16%, supporting our thesis that aluminum cans are taking considerable market share away from glass and plastic in multiple beverage categories including carbonated soft drinks, beer and water. According to *Ball Corp.* **(BLL)**, 67% of new SKUs in North America in 2019 were packaged in cans vs. just 36% of new SKUs in 2015. This was driven by fast growing new product categories like spiked seltzer as well as legacy categories transformed by sustainability trends such as craft beer. The stock was a strong performer in the third quarter and was up 18.0%.

The biggest detractors to performance in Q3 were *WR Grace* **(GRA)**, *Perrigo* **(PRGO)** and Bausch & Lomb (BHC), which collectively hurt performance by 317 basis points.

The recovery that GRA was seeing it its business stalled out in July as the second wave of COVID interrupted the improvement in miles driven. An overabundance of inventory will lead to gross margins below our expectations although we believe this is just a temporary phenomenon. Although the trajectory of GRA's recovery is shallower than we expected, we still believe the stock is attractively priced at 10x our 2021 EPS estimate vs the company's average valuation of 18x over the past 5 years. The stock declined 20.1% in the quarter.

PRGO handily beat consensus expectations, but management did not raise its full year earnings forecast which spooked investors as the implied Q4 guidance is weaker than expectations. We believe management is simply taking a conservative approach to guidance and the full year numbers will ultimately prove to be higher than consensus expectations. The company also recalled a drug called ProAir which was a significant source of growth for PRGO's generic drug business. Yet, despite the recall, PRGO reiterated full year guidance suggesting that trends in its consumer health business are better than expected. Although we are disappointed with the recall, we believe PRGO will resolve ProAir's dispensing/clogging issues and the 16.6% drop in the stock was an overreaction. PRGO now trades for just 10.4x our 2021 EPS estimate which we think is very attractive relative to the double-digit earnings growth we expect over the next couple of years.

BHC declined 15% in the quarter as the company reduced full year guidance due to COVID-19 related uncertainty. Additionally, BHC announced its intent to spin off its eye health business into a separate company to unlock value. This news was met with a lukewarm reception by Wall Street as it lacked details on timing and structure and the potential for equity issuance (dilution to existing shareholders) is on the table depending on the timing of the transaction. We believe that BHC will not recklessly execute a spin and will likely dispose of certain assets ahead of the spin to de-leverage the balance sheet. Furthermore, while some form of equity issuance is likely, we believe that BHC will not do it at any price and as the stock price heals concurrent with end market demand for its products, a more opportune time for issuance will present itself. We believe BHC is significantly undervalued and the company is reaching a pivotal juncture where growth should accelerate as the impact of expired patents become overshadowed by the growth of new products.

We initiated four new positions in the quarter – *Brunswick Corp.* **(BC)**, *Equity Commonwealth* **(EQC)**, *Performance Food Group* **(PFGC)** and *Globe Life* **(GL)**. The following is a synopsis of our investment thesis for each:

BRUNSWICK CORP (BC)

BC is the leading global manufacturer of recreational boats (16% of segment EBIT), marine engines (40% of segment EBIT) and marine parts and accessories (44% of segment EBIT). BC's leading boat brands include Boston Whaler, Sea Ray and Bayliner while its Mercury marine engine brand powers 50% of all recreational boats. BC also operates Freedom Boat Club which is a hassle-free boat membership that boasts 35,000 members across 235+ club locations.

The global pandemic has revitalized interest in boating which we believe will have positive ramifications for the industry for years to come. *MarineMax* **(HZO)**, the largest boat retailer in the U.S., saw a 37% increase in same store sales last quarter as consumers flocked to safe, outdoor recreational activities. Sales to first-time purchasers represented nearly half of all boat

sales in recent months which likely means that the installed base of boats is growing. A larger installed base will feed BC's after market growth for years to come. Additionally, word-of-mouth is one of the most powerful forms of marketing in boating and the significantly greater number of new boaters will lead to greater shared experiences with other prospective buyers. First time boat buyers are now more likely to be younger with larger families - the average age of a new boat buyer in 2020 is 3 years younger than the average buyer in 2019. According to the company, there is a strong correlation between new waterfront home sales and first-time boat buyers and as the migration from urban cities to suburban homes continues, it should provide a positive tailwind to boat demand. This strong demand, coupled with the suspension of production at certain facilities, means that dealer inventories are now at record low levels and it will take well into 2021 and beyond for dealer inventories to normalize. According to management, Brunswick has the lowest mid-season pipeline inventory levels in almost 20 years, with 34% fewer boats in dealer inventory versus the second quarter of 2019. "*If you think about the fact that we're probably 12 weeks to 13 weeks behind where we should be, which is a quarter of a year's production. So, we -- our ability to add a quarter of a year's production on top of meeting demand is going to take us well through 2021, even in modest demand scenarios. We just can't produce 125% production and expect to normalize pipelines and meet demand in a short period of time. This is going to be an extensive long-term rebuilding process.*"

BC's propulsion engine business should grow faster than the industry as it continues to take market share. Recently, *BRP Inc.* **(DOOO)**, a competitor to Mercury with its Evinrude brand, announced it is terminating its outboard propulsion engine business and partnering with Mercury to supply BRP's boat brands, Alumacraft, Manitou and Telwater. We believe this could be a $80M+ opportunity for BC which would be 5% accretive to the Engine segment's sales. Mercury also signed an agreement with Frydenbo to become the preferred engine partner of the company's boat brands, Sting and Nordkapp, in all global markets.

We believe BC can earn over $7 EPS by 2022 which is nearly 25% higher than consensus estimates. The stock is trading for less than 10x our '22 estimate which suggests the Street believes the strong demand for boating is transient. We disagree as we believe the inflow of new boaters in 2020, the migration of city dwellers to single family homes in the suburbs, the strong increase in Freedom Boat Club members (which, in turn, drives new boat conversions) and market share gains for Mercury will fuel growth for years to come.

EQUITY COMMONWEALTH (EQC)

In 2014, Corvex Management and Related Companies engaged in an activist campaign and ousted the former management of CommonWealth REIT and set the stage for Sam Zell and his CIO at Equity Group to take over the management of EQC. At that time, CommonWealth was externally managed by a family run real estate group that made questionable acquisitions and destroyed shareholder value at CommonWealth. After the departure of the legacy management team, CommonWealth changed its name to Equity Commonwealth and became internally managed. Since the new management team took over, EQC disposed of 161 properties totaling 43M square feet for $6.9B. EQC used those proceeds to repay $2.3B of debt and preferreds, distribute $734M of cash to shareholders, repurchase $245M of stock and build a war chest of $2.8B of net cash for future opportunities. This cash equates to $23/share or 86% of the current share price. EQC currently owns 4 properties that generate cash NOI of approximately $35M which are worth $5/share at a 5.75% cap rate.

We believe EQC has a favorable and asymmetric risk/reward to the extent EQC deploys its massive cash hoard wisely in the commercial real estate downturn. Sam Zell and his Equity Group have a strong, long-term track record in buying distressed real estate with Zell's previous office REIT, Equity Office Properties, having generated a compound annual return of over 17% from 1997 until its sale to Blackstone in 2017. His other publicly traded REITs have also performed quite well as both *Equity Residential* **(EQR)** and *Equity Lifestyle* **(ELS)** generated compound annual returns of 11.2% and 16.1% respectively from 1993 thru June 30th, 2020, handily beating the single digit returns of the Dow Jones REIT Index.

It is nearly impossible to forecast expected FFO/share for a cash rich REIT seeking acquisitions, but we can look at hypothetical scenarios at various cap rates. If EQC invests $3B of cash with an incremental $1.4B of debt at an 8.5% cap rate, it would add over $2 of FFO/share and at an 18x multiple equates to $39 of value or $44 inclusive of existing assets. Every 50 bps of favorable cap rate on the purchase price would equate to an incremental $3 of equity value such that EQC is a potential double if the average cap rate on acquired assets is 11%. With the stock trading right around book value, we think the downside is limited with the bigger risk being the opportunity cost of our capital to the extent it takes EQC a long time to put the capital to work. With Sam Zell owning over $100M of stock and CEO, David Helfand owning over $20M, management is highly incentivized and aligned with shareholders to maximize value.

PERFORMANCE FOOD GROUP (PFGC)

PFGC is one of the largest food distributors in the United States and markets and distributes more than 200,000 SKUs from 109 distribution centers to over 200,000 customer locations. 66% of PFGC's foodservice customers are chains and 34% are independent restaurants with "center of the plate" items accounting for 40% of foodservice revenues. PFGC has a much stronger presence on the East Coast and Midwest which was further bolstered by their acquisition of #5 player Reinhart for $2B which closed right before COVID hit. Despite its size, PFGC has a small share of the $300B foodservice market with approximately $20B of proforma sales or ~7% market share. PFG also operates a leading distributor of candy, snacks and beverages called Vistar which accounts for 30% of sales/EBIT and caters to convenience stores, theaters, vending machines, retail and other outlets.

Prior to COVID, PFGC was a market share gainer amongst the Big 3 (which includes **SYY** and **USFD**) largely due to its faster penetration into the independent restaurant channel. It's difficult to ascertain PFGC's long term organic market share performance since it didn't go public until 2015 but from 2005-2018 the foodservice industry overall grew at a 4.5% CAGR. Looking forward, the opportunity for the larger players to take market share looks more promising. The steep decline in demand due to COVID means many smaller players are left with precarious balance sheets. As an example, Maines Paper & Food Service, a 100+ year old distributor with over $3B in sales, filed for bankruptcy in June. Conversations with industry participants revealed that many smaller distributors cut back on SKUs and service personnel during the downturn whereas the bigger players leaned into customer support, particularly PFGC. This enabled them to win new business given their superior availability of goods and customer support. Whereas many distributors were able to cushion free cash flow by depleting inventory and inflating payables (including PFGC), smaller players may lack the financial resources to invest in working capital during the recovery which will be critical. On the fiscal Q4 earnings call, the CEO commented, "*as far as new accounts...our average salesperson is writing more business than we've ever had...so we look at how much new business we have that we didn't have the previous year, and that number as we got deeper into April, and into May and June and even more so in July, that*

number continued to go up." New account wins benefit the topline but also the margins as route density is a big driver of margins for a logistics business.

PFGC's acquisition of Reinhart Foodservice for $2B in 2019 was ill-timed but the merits of the deal still stand. In addition to strengthening PFGC's presence in the East and Midwest, there are significant margin enhancement opportunities. PFGC guided to $50M of cost synergies which equates to 30 bps of margin expansion, a material number relative to the 3% margin in the Foodservice segment. Additionally, the mix shift to take-out from dine-in is positive as it leads to an increase in sales of disposables (bags, utensils, condiments, etc.) which are higher margin. Additionally, the increased demand for cleanliness and sanitation will drive higher margin sales of cleaning products. Fewer restaurants serving more customers over time is favorable for margins as it would reduce the number of stops. Finally, the continued mix shift from chains to independents drives margins for two reasons - 1) independent cases carry 2x the gross margin/case (although not quite 2x to EBIT margin) and 2) independents purchase more private label product which is higher margin and is now a $3B business within PFGC. From 2013-2019, independent customers went from 25.6% of the mix to 33.8% while private label went from 39.2% of the independent channel mix to 47.3%. During this time, Foodservice margins increased from 2.2% to 2.8%. We believe margins will continue to improve as the business mix shifts towards independents and private label. One final upside to margins is permanent cost structure changes. In the month of July, PFGC experienced EBITDA growth despite HSD revenue declines in foodservice. On a recent call, management stated that not all 3,500 furloughed employees will return and this, coupled with system enhancements, should lead to more permanent cost structure improvements.

As U.S. cities and towns open their economies and businesses, foodservice demand continues its recovery. On a pro forma basis, PFGC's weekly sales decline improved to -4.2% for the week ending Sept 5th. Although Labor Day shifts benefitted the comp, the two-week average was down ~7% which was a material improvement from a month earlier (despite negative impact from the hurricane) when sales were running down 12%. According to OpenTable, approximately 70% of U.S. restaurants are accepting reservations, up from 60% at the end of June and 30% at the end of May. Restaurant industry same store sales ("SSS") trends have continued to improve, with Black Box Intelligence reporting August SSS of -12.3% and traffic of -17.7%, the best performance since the onset of the pandemic, and following July SSS of -15.1% & traffic of -19.9%. Based on data from Knapp-Track, August Casual Dining SSS were -21.7%, a ~380bps improvement from -25.5% in July. SSS trends improved each week in August, exiting the month at -18% (week ended 8/30), relative to -24.1% in the first week of the month.

On the fiscal Q4 earnings call, PFGC stated they achieved EBTIDA growth in foodservice in July whereas Vistar was running breakeven EBITDA. Since then, sales have improved materially yet consensus has 7% EBITDA decline in fiscal Q1. We believe the Street under-estimates incremental margins that will come from much lower inventory write-offs and bad debt. Consensus revenue estimates for fiscal Q1 seem too low and our estimate is $300M higher than consensus. We estimate a 9% decline in organic revenues which is in-line with the pace of PFGC's weekly sales disclosures. Longer term, we believe PFGC should generate $2.35 EPS in fiscal 2023 which is less than the proforma earnings power back in 2019. Consensus is materially below this. PFGC historically traded for 20x EPS given its steady, predictable business, market share gains and M&A opportunities. PFGC could very well trade for 20x our 2021 EPS estimate or $48 (25% upside). In two years, PFGC could be a $52 stock based on our '23 estimate (36% upside). PFGC stock was nearly $60 in early 2020.

GLOBE LIFE (GL)

Globe Life, previously known as Torchmark, is a life and supplemental health insurance company that sells a simple portfolio of products, primarily term and whole life insurance, as well as illness and accident health insurance. The company's offering doesn't have interest rate or equity market risk inherent in products like annuities and the monthly premiums are typically very low. GL's differentiation isn't in its product offering as much as its agent network, which was built over the last 50+ years. GL has a network of 12,000+ agents under four wholly owned brands focusing on rural America, more specifically middle-income customers. It is a network that is very expensive to replicate and helps the company maintain pricing power and margins. The products are "sold, not bought" which generally means customers don't shop around for better pricing. GL invests its premiums predominantly in long duration corporate bonds. Approximately 40% of the portfolio is rated A- or better, 55% is BBB rated and 5% is below investment grade.

When we purchased the stock in July, it was under pressure for several reasons – 1) a public health crisis is bad for life insurance and GL will experience a spike in the loss/benefit ratio in 2020, 2) declining interest rates creates additional reinvestment risk on the interest income as GL primarily invests in corporate credit and 3) heightened fears about the credit risk embedded in GL's long duration BBB portfolio. We think #3 weighed the most heavily on GL given the company operates close to the minimum 300% risk-based capital ("RBC") ratio required by the regulators to remain investment grade,

During the Global Financial Crisis, GL didn't cut their dividend or issue equity to buttress capital ratios. Instead, they protected capital by halting the buyback (they were the last insurance company to pull this lever, and the first to re-implement the buyback). The current crisis is likely to be handled the same way. At the end of Q1, the RBC ratio was 316%, giving them an ~$80M cushion in addition to ~$800M in cash at the parent available for capital needs. After dividends and capital needed to support premium growth, excess cash generation is ~$100M per quarter. Management estimates that over the next 1-2 years, defaults could be a 35bps to 60bps headwind to the RBC ratio which translates into $100M to $235M in capital needed to maintain the 300% RBC. The assumption behind this is 14% of the portfolio would be downgraded and 12% would be below investment grade at that time. Even if it is at the high end of the range ($235M), it is the equivalent of ~2 quarters of share buybacks; hardly a capital event and already in the numbers with most sell-side analysts already assuming no buyback in 2020. A proprietary analysis of the portfolio using default probabilities from the CDS market, suggests losses of ~$185M or less than 3% of book value. Yes, this is a negative in terms of headlines, but the reality is that it hardly moves the needle and it creates a rare opportunity in GL shares.

GL currently trades for 11.9x/10.7x our 2020/2021 EPS estimates and 1.4x price/book (excluding accumulated other comprehensive income, or AOCI). The median valuation over the last 5 years is 13.5x P/E and 2.0x price/book (ex. AOCI).

As of October 18th, our five largest positions are *Charles Schwab* **(SCHW)**, Crown Holdings (CCK), *AmerisourceBergen* **(ABC)**, *LKQ Corp* **(LKQ)** and *NRG Energy* **(NRG).**

We are pleased that Concentrated Value outperformed the bull market in 2019 and, thus far, the Value stock bear market in 2020. However, we are never content with negative returns even if they appear favorable vs. our Value benchmarks. Fortunately, October has been a strong month so far for Concentrated Value and we are up +6.4% MTD thru the 16th.

We hope everyone is safe and healthy. Thanks, as always, for your continued support and confidence.

Sincerely,

Ari Sass

President & Portfolio Manager, MD Sass

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