# South Atlantic Capital Management Group, Inc.

### Investment Management

## December 31, 2017 Portfolio Review

**COMPOSITE PERFORMANCE SUMMARY**

South Atlantic Capital (SACMG) versus S&P 500
Annualized as of 12/31/2017

| | 1 Year | 3 Years | 5 Years | 10 Years | 15 Years** | 20 Years** | Since Inception * | Total Return Since Inception* |
|---|---|---|---|---|---|---|---|---|
| SACMG (gross) | 23.80% | 9.40% | 12.46% | 10.61% | 11.25% | 9.92% | 13.35% | |
| SACMG Core Equity[1] (Net) | 22.57% | 8.32% | 11.36% | 9.53% | 10.17% | 8.85% | 12.24% | 1913.31% |
| S&P 500[2] | 21.83% | 11.41% | 15.79% | 8.49% | 9.92% | 7.19% | 9.61% | 986.49% |
| Russell Value | 13.66% | 8.65% | 14.04% | 7.10% | 9.56% | 7.34% | 10.22% | 1156.43% |

**Inception date of South Atlantic Capital's composite is 1/1/1992.*
***Actual is 14.75 years, 19.75 years*

*South Atlantic Capital is an independent investment adviser registered with the State of North Carolina and the Commonwealth of Virginia. South Atlantic Capital claims compliance with the Global Investment Performance Standards (GIPS®). The firm maintains a complete list and description of composites, as well as GIPS® compliant presentations, which are available upon request by calling (910) 763-4113, or emailing info@southatlanticcap.com. Ashland Partners & Co., LLP, our previous independent verifier, has verified South Atlantic Capital's compliance on a firm-wide level for the period of January 1, 1992 to September 30, 2016. ACA Performance Services has verified our firm-wide compliance for the period of September 30, 2016 to December 31, 2016. All returns are net of management fees and include reinvested dividends and interest. Past results are not indicative of future investment results.*

Our returns net of fees for the fourth quarter were 7.99% compared to 6.64% for the S&P 500 and 5.3% for the Russell 1000 value index. For the full year, our net returns were 22.57% compared to 21.83% for the S&P 500 and 13.7% for the Russell 1000 value index. Our best and worst performers are outlined below:

| **Top 5 Positions** | | **Bottom 5 Positions** | |
|---|---|---|---|
| Twenty First Century Fox | 31.8% | Allergan | -19.9% |
| CF Industries | 22.6% | CVS Health | -10.2% |
| Wells Fargo warrants | 27.0% | Oaktree | -9.3% |
| JPMorgan warrants | 22.9% | Sirius Radio | -2.4% |
| Bank of America | 17.0% | Moody's | 6.3% |

**INVESTMENT PHILOSOPHY**

We run concentrated portfolios of our best ideas and recently the bank positions and media positions have done very well versus the market. It can take quite a while for a company to escape the grip of an inaccurate view and valuation from the market and then the results can be quite good. However, the returns will be lumpier if you focus on undervalued situations instead of market favorites. We are cautiously optimistic that a couple of our biggest holdings will escape this same grip in the not too distant future and we appreciate your patience.

Although the returns are lumpy, I think our investment philosophy works and has allowed us to have strong performance over time. Since our inception in 1992, we have executed our strategy through many investment cycles and market shocks including the emerging market crisis in the late 90's, the dot-com bust in 2000, and the credit crisis in 2007. While searching for companies that in our view are undervalued and not well liked by the market creates inconsistent returns, we feel this approach also creates an opportunity to outperform the market overtime creating much larger nest eggs which we have been able to do and also feel it provides downside protection for long term investors compared to investing in stocks that the market likes too much and has overvalued.

Our philosophy emphasizes avoiding mistakes and owning companies that can withstand and benefit from economic or market downturns more than most managers we are aware of. When you invest in conservatively managed companies with strong financial positions, they are more in control of their own financial destiny and you benefit not only from their current opportunities but importantly their ability to take advantage of attractive future opportunities prevalent in downturns, not to mention their financial flexibility to respond to unforeseen changes in their industry. On the other hand, a market darling which has become overleveraged as they read their own press clippings can become vulnerable overnight if the market's perception changes and their access to funding their overleveraged balance sheet becomes challenging. We consider these market darlings mistakes waiting to happen.

In addition to screening for resilient companies, our goal is to invest with a 10% hurdle rate. In other words, we don't invest in companies that are relatively cheap compared to the market. We are looking to invest in companies where we hope to achieve our goal of an absolute return of 10% overtime based on our estimate of earnings growth, dividends received plus or minus any change in their valuation (price earnings ratio or free cash flow yield). Particularly for situations where a company with excess cash flow is buying back their stock, which we like a lot, this hurdle rate helps us get out of overvalued situations by creating two negative feedback loops. An excessive valuation will hurt that part of the formula as well as our estimate of earnings growth since a stock with a low free cash flow yield won't be able to reduce their shares outstanding as rapidly. I think these two things have created a lot of downside protection for client's overtime which is what differentiates us.

<u>Downside Protection</u>

We are compliant with the Global Investment Performance Standards, GIPS which means the firm's policies in composite construction have been verified as being compliant with GIPS by ACA Compliance Group. They have also examined the returns of our core equity composite back to 1992. ACA gives in-depth review of data, methodologies, records, controls and disclosures to support calculating investment performance.

We then send our returns to PSN a global database of approximately 2,000 Investment Managers representing more than 20,000 domestic and international investment products and a division of Informa Investment Solutions, Inc.

Over extended periods of time our downside capture ratio compares favorably to other large cap managers on their database which includes large cap managers of growth, core, and value- oriented portfolios. The full downside capture report is attached.

**Downside Capture Ratio for Our Net Returns**

| | 7 years | | 10 years | | 20 years | | Since Inception | |
|---|---|---|---|---|---|---|---|---|
| | VALUE | RANK | VALUE | RANK | VALUE | RANK | VALUE | RANK |
| South Atlantic Net | 95.53 | 28 | 67.73 | 1 | 43.89 | 1 | 43.89 | 1 |
| Standard & Poors 500 | 100 | 38 | 100 | 65 | 100 | 78 | 100 | 79 |
| Valid Count | 883 | | 796 | | 353 | | 167 | |

DOWNSIDE MARKET CAPTURE RATIO MEASURES THE MANAGER'S PERFORMANCE RELATIVE TO THE PERFORMANCE OF THE MARKET (INDEX) ITSELF. A DOWN MARKET IS DEFINED AS ANY PERIOD (QUARTER) WHERE THE MARKETS RETURN IS LESS THAN ZERO. THE LOWER THE DOWN MARKET CAPTURE RATIO, THE BETTER THE MANAGER PROTECTED CAPITAL DURING A MARKET DECLINE. A VALUE OF 45.28 SUGGESTS THAT A MANAGERS LOSSES WERE ONLY 45% OF THE MARKETS LOSS WHEN THE MARKET WAS DOWN.

**RETURNS THROUGH INVESTMENT CYCLES**
We believe two things stick out from our investment philosophy which have been in large part responsible for good returns overtime, i.e. through investment cycles. A defensive bias tends to avoid permanent losses of capital and provide liquidity when stressed markets create better opportunity. Both are helpful to returns.

Having Liquidity at the Right Time

**Example 1 -** If you have funds available during downturns and find a company trading for 70% of its intrinsic value of 15 times earnings of $1 per share or just $10.50 and its earnings grow 7% annually, your 5- year annualized return if the company returns to a normal valuation is 14.9%

Year 1--$10.50
Year 5- $21.03> **14.9% annual return**

Avoiding Permanent Loss

**Example 2 -** To achieve a 5-year annual return of 8%, if you suffer a 25% permanent loss in year 1 requires a return on the remaining 75% of your capital over the next 4 years of 18.32% which is way above historical norms.

Under the same 25% permanent loss in year 1 scenario, to achieve the 14.9% annual return achieved by the patient investor outlined in example 1 requires an annual return in years two through five of **27.83%----**GOOD LUCK.

Some examples of portfolio holdings which in the past had the liquidity to take advantage of downturns are discussed below:
**BERKSHIRE HATHAWAY -** In August of 2011 when other investors were worried about the capital needs for the banking industry, Berkshire was able to buy $5 billion of 6% preferred stock from Bank of America. The attractive deal included warrants to purchase 700 million shares at $7.14 per share. After funding the purchase of the 700 million shares with proceeds from the preferred being called, the original $5 billion investment is now worth $24.5 billion including dividends and interest for **a 27.2% annual return**.

**TWENTY FIRST CENTURY FOX-** We have thought Fox's shares were trading cheaply since the third quarter of 2015 because the fear of cord cutting was overdone and Fox had undervalued assets such as SKY B in Europe, Hulu and Star India which were unappreciated by the market. Recently Disney made a firm offer for those assets and others comprising about 75% of Fox's total assets which values the whole firm at approximately $39 per share. If AT&T's acquisition of Comcast is approved by the anti -trust court as we expect that frees Comcast to make a bid for the assets Disney is trying to buy from Fox and they have expressed an interest in the past to make an offer that values Fox at approximately $45 per share.

While Fox's stock was trading cheaply over the past two years, they had a strong enough balance sheet to fund significant losses at Hulu while they built value in that strategic asset as well ***as repurchase 9.5% of Fox's outstanding shares at $26*** per share, significantly ***below the approximate value put on the company by Disney and Comcast of $39 per share and $45 per share, respectively.***

**Enterprise Product Partners –** Enterprise has always managed their company conservatively avoiding fees to their general partner, avoiding commodity risk by providing mostly fee based midstream energy services and avoiding new projects that aren't backed by long term contracts. As a result, they maintained their BBB+ balance sheet during the recent oil and gas downturn caused by the sharp drop in the price of oil.

In October of 2014, when many of their competitors were cutting their dividend or diluting shareholders with big capital raises to shore up their balance sheets, Enterprise was able to make a strategic acquisition improving their long- term value by acquiring Oiltankers for roughly $6 billion. They were able to see the need for export capacity as long term the oil, gas, and natural gas liquids production of their customers would far exceed domestic demand. The value of the acquisition is slowly becoming apparent as oil exports from the U.S. handled by Enterprise have more than doubled in the last year and they recently announced they were the marine terminals acquired from Oiltankers.

Going forward we feel the portfolios are well positioned to handle a downturn. During the current turmoil in the markets many of our holdings are buying back shares. Berkshire has over $100 billion in excess cash and annual free cash flow of approximately $25 billion versus a market value of approximately $505 billion. Lastly, Oaktree Capital a distressed debt manager and a large holding has $100 billion in assets under management but approximately $20 billion in dry powder and an excellent reputation which enabled them to raise new funds and grow their assets under management by 38% from 2007-2009 during the credit crisis when opportunities to invest in distressed debt became much more attractive.

**Summary**

Being disciplined about executing our investment philosophy has helped us achieve good returns overtime which is outlined below. Besides ranking our downside protection, PSN also ranks our performance gross of fees and net of fees against more than 250 other core and value oriented large cap managers on their database. We are pleased our results compare favorably against other large cap managers on their database which includes: Alliance Bernstein, BAM Investments, Capital Group, Deutsche Bank Private Wealth Management, Fidelity Institutional Asset Management, Goldman Sachs, JP Morgan, and UBS Asset Management.

Since the vast majority of other managers on the database have much larger average account sizes their fees are much lower than ours so our gross of fee rankings are higher than our net of fee performance. Since inception in 1992 as well as for the last ten years our performance gross of fees ranks in the top 1% compared to the Large Cap Core managers on PSN's database. Against large cap value managers, gross of fees we rank in the top 1% for the last one year, ten years, and since inception. Net of fees our rankings against the same managers over the same time periods are top 3%, and 16%, and top 5%, 10%, and 3%, respectively.

**Please see the following attachments to see the full results:**
South Atlantic Capital Core Equity vs all PSN Large Cap Value Managers
South Atlantic Capital Core Equity vs all PSN Large Cap Core Managers

Please feel free to contact us if you would like further information.

Regards,

Eddie Nowell

**DISCLOSURES**

[1]***Core Equity Composite*** *contains all fully discretionary accounts invested in equities excluding accounts that use significant leverage. For comparative purposes it is measured against the total return for the S&P 500. It includes accounts managed for capital appreciation as well as accounts managed for a combination of capital appreciation and current income. The equity securities are typically mid cap and large cap value oriented U.S. equities and ADR's of similar capitalization. The portfolios also include equity securities that provide higher current income such as master limited partnerships, real estate investment trusts and similar securities that "pass through" most of their cash flow as distributions. The portfolios may from time to invest in fixed income securities and various hedges such as gold backed ETF's as conditions warrant. The portfolios are typically invested in 15-25 positions but have held fewer than 15 positions in the past.*

[2]***S&P 500 Index*** *has been widely regarded as the best single gauge of the large cap U.S. equities market since the index was first published in 1957. The index has over U.S. $4.83 trillion benchmarked, with index assets comprising approximately U.S. $1.1 trillion of this total. The index includes 500 leading companies in leading industries of the U.S. economy, capturing 75% coverage of U.S. equities and includes the reinvestment of dividends of companies in the S&P 500.*

*Returns are presented net of management fees and include the reinvestment of all income. The U.S. Dollar is the currency used to express performance. Policies for valuing portfolios, calculating performance, and preparing compliant presentations are available upon request, as is GIPS compliant presentations and lists and descriptions of South Atlantic Capital's composites, by emailing Info@SouthAtlanticCap.com or calling (910) 763-4113. Portfolio composition is subject to change at any time and references to specific securities, industries, and sectors referenced in this letter are not recommendations to purchase or sell any particular security. Current and future portfolio holdings are subject to risk.*

*The discussion of our firm's investments and investment strategy (including current investment themes, the portfolio managers' research and investment process, and portfolio characteristics) represents the firm's investments and the views of the investment adviser, at the time of this letter, and are subject to change without notice.*

*Past results are not indicative of future investment results. An investor should further understand that future results may result in losses for account holders.*

**EDWARD D. NOWELL**

Edward D. Nowell is President, founder and sole portfolio manager of South Atlantic Capital Management Group, Inc.

Mr. Nowell has over thirty years of experience in the finance business. Prior to founding South Atlantic Capital he worked in the structured finance department of Bankers Trust Company, New York as an Assistant Vice President. His primary responsibility was arranging bank financing for leveraged buyouts led by Kohlberg Kravis Roberts & Company. During graduate school, he interned with Merrill Lynch's Capital Markets Group in New York. Later, he served as an institutional fixed income sales representative for Carolina Securities/Prudential Bache Securities and worked with Fox, Graham, and Mintz, Securities. Mr. Nowell graduated from the University of North Carolina with a B.S. in Economics and received his M.B.A. from the University of Virginia.

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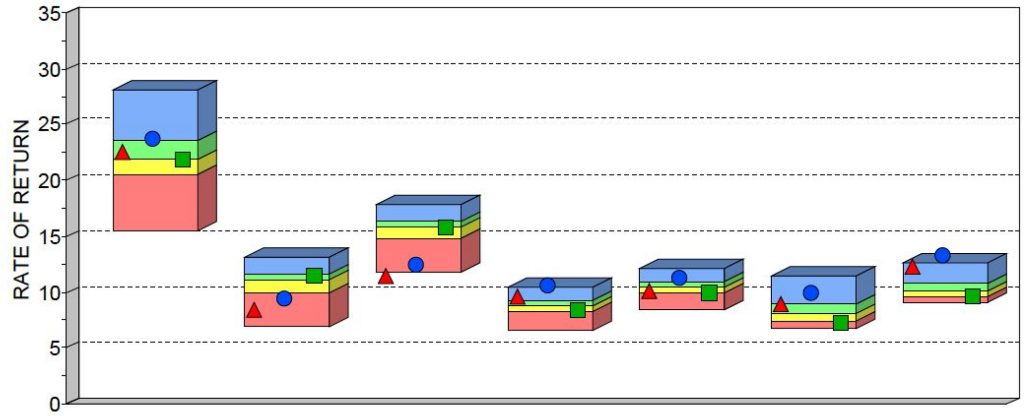
# SOUTH ATLANTIC CAPITAL (SACM) CORE EQUITY
# VS ALL PSN LARGE CAP CORE MANAGERS, PERIOD ENDING DECEMBER 31, 2017
# SOUTH ATLANTIC RANKS IN THE TOP 1% SINCE INCEPTION*




| | 1 Year | 3 Years | 5 Years | 10 Years | 15 Years | 20 Years | Since Inception |
|---|---|---|---|---|---|---|---|
| HIGH (0.05) | 28.11 | 13.19 | 17.82 | 10.50 | 12.09 | 11.36 | 12.58 |
| FIRST QUARTILE | 23.60 | 11.58 | 16.39 | 9.30 | 10.87 | 8.84 | 10.80 |
| MEDIAN | 21.84 | 11.09 | 15.75 | 8.78 | 10.42 | 8.05 | 10.12 |
| THIRD QUARTILE | 20.61 | 9.96 | 14.84 | 8.24 | 9.96 | 7.43 | 9.66 |
| LOW (0.95) | 15.45 | 6.97 | 11.72 | 6.52 | 8.44 | 6.68 | 9.06 |
| MEAN | 21.87 | 10.77 | 15.51 | 8.76 | 10.44 | 8.20 | 10.28 |
| VALID COUNT | 303 | 293 | 282 | 250 | 185 | 115 | 54 |

| | 1 Year | | 3 Years | | 5 Years | | 10 Years | | 15 Years | | 20 Years | | Since Inception | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | VALUE | RANK | VALUE | RANK | VALUE | RANK | VALUE | RANK | VALUE | RANK | VALUE | RANK | VALUE | RANK |
| South Atlantic SACM Core Equity NET | 22.58 | 35 | 8.34 | 95 | 11.38 | 99 | 9.53 | 16 | 10.18 | 65 | 8.85 | 23 | 12.24 | 3 |
| South Atlantic SACM Core Equity | 23.80 | 22 | 9.41 | 83 | 12.47 | 97 | 10.61 | 1 | 11.25 | 11 | 9.92 | 7 | 13.35 | 1 |
| Standard & Poor's 500 | 21.83 | 50 | 11.41 | 33 | 15.79 | 47 | 8.50 | 69 | 9.92 | 80 | 7.20 | 87 | 9.61 | 79 |

*PSN'S LARGE CAP MANAGER'S RETURNS AND SOUTH ATLANTIC LARGE CAP RETURNS ARE REPORTED AND RANKED GROSS OF FEES. ADDITIONALLY, SOUTH ATLANTIC CAPITAL REPORTS PERFORMANCE NET OF FEES. SOUTH ATLANTIC CORE EQUITY INCEPTION DATE IS DECEMBER 31, 1991.

PSN IS A GLOBAL INVESTMENT MANAGER DATABASE OF APPROXIMATELY 2,000 INVESTMENT MANAGERS REPRESENTING MORE THAN 20,000 DOMESTIC AND INTERNATIONAL INVESTMENT PRODUCTS, AND IS A DIVISION OF INFORMA INVESTMENT SOLUTIONS, INC. (IIS). ALL PRODUCTS ARE REVIEWED QUANTITATIVELY ON A QUARTERLY BASIS AND ON THIS REPORT, RANKED AGAINST OTHER INVESTMENT MANAGERS IN THE LARGE CAP EQUITY ASSET CLASS. THE ABOVE REFERENCED SOUTH ATLANTIC CAPITAL MANAGEMENT PERFORMANCE AND OTHER MANAGERS PERFORMANCE RESULTS ARE GROSS OF FEES. SACM PERFORMANCE NET OF FEES COULD BE AS MUCH AS 1.5% LOWER THAN PERFORMANCE GROSS OF FEES. ALL RATES OF RETURN OVER 1 YEAR ARE ANNUALIZED. RANKINGS ARE NOT INDICATIVE OF FUTURE PERFORMANCE. THIS INFORMATION IS PROVIDED AS A SUPPLEMENT TO A GIPS COMPLIANT PRESENTATION.

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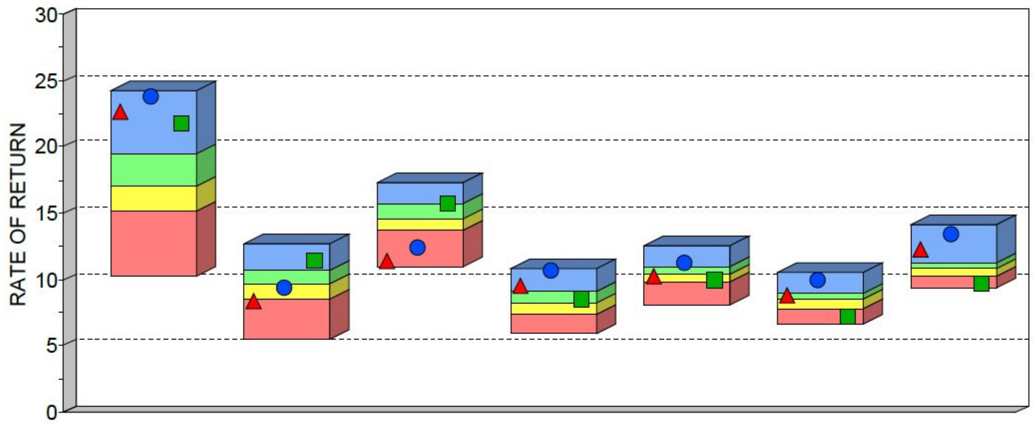
# SOUTH ATLANTIC CAPITAL (SACM) CORE EQUITY
# VS ALL PSN LARGE CAP VALUE MANAGERS, PERIOD ENDING DECEMBER 31, 2017
# SOUTH ATLANTIC RANKS IN THE TOP 1% SINCE INCEPTION*




| | 1 Year | 3 Years | 5 Years | 10 Years | 15 Years | 20 Years | Since Inception |
|---|---|---|---|---|---|---|---|
| HIGH (0.05) | 24.26 | 12.68 | 17.30 | 10.83 | 12.55 | 10.47 | 14.07 |
| FIRST QUARTILE | 19.43 | 10.69 | 15.69 | 9.02 | 10.91 | 8.99 | 11.31 |
| MEDIAN | 16.99 | 9.62 | 14.61 | 8.22 | 10.34 | 8.51 | 10.86 |
| THIRD QUARTILE | 15.12 | 8.56 | 13.66 | 7.42 | 9.83 | 7.77 | 10.22 |
| LOW (0.95) | 10.17 | 5.50 | 11.00 | 5.85 | 8.13 | 6.60 | 9.35 |
| MEAN | 17.33 | 9.48 | 14.60 | 8.19 | 10.35 | 8.43 | 10.86 |
| VALID COUNT | 293 | 288 | 276 | 238 | 179 | 104 | 53 |

| | 1 Year | | 3 Years | | 5 Years | | 10 Years | | 15 Years | | 20 Years | | Since Inception | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | VALUE | RANK | VALUE | RANK | VALUE | RANK | VALUE | RANK | VALUE | RANK | VALUE | RANK | VALUE | RANK |
| South Atlantic SACM Core Equity NET | 22.58 | 5 | 8.34 | 77 | 11.38 | 99 | 9.53 | 10 | 10.18 | 58 | 8.85 | 28 | 12.24 | 3 |
| South Atlantic SACM Core Equity | 23.80 | 1 | 9.41 | 54 | 12.47 | 92 | 10.61 | 1 | 11.25 | 14 | 9.92 | 4 | 13.35 | 1 |
| Standard & Poor's 500 | 21.83 | 7 | 11.41 | 10 | 15.79 | 23 | 8.50 | 39 | 9.92 | 71 | 7.20 | 91 | 9.61 | 92 |

*PSN'S LARGE CAP MANAGER'S RETURNS AND SOUTH ATLANTIC LARGE CAP RETURNS ARE REPORTED AND RANKED GROSS OF FEES. ADDITIONALLY, SOUTH ATLANTIC CAPITAL REPORTS PERFORMANCE NET OF FEES. SOUTH ATLANTIC CORE EQUITY INCEPTION DATE IS DECEMBER 31, 1991.

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