1949
VALUE
ADVISORS

Quarterly Review – Q1 2016

Global equity markets were essentially unchanged during the first quarter of 2016, recovering from an unprecedented 11.5% loss through February 11th. Worries over slowing economic growth gave way to renewed confidence in global central banks' ability to counter these trends with potential further monetary and fiscal stimuli. Despite this roller coaster market environment, your portfolio acted well, declining less than 3% through the February 11th low and advancing more than the market average during the ensuing recovery. For the quarter ended March 31, 2016 the 1949 Global Value strategy advanced 13.5%, outperforming the Morgan Stanley Capital International (MSCI) World Index which declined 0.2%.

	Q1 2016	Since Inception (7/31/15)
1949 Global Value Strategy:	+ 13.5%	+ 2.4%
MSCI World Index (US$):	- 0.2%	- 5.1%
Outperformance:	*+ 13.7%*	*+ 7.5%*

Since inception eight months ago, we have managed to eke out a small positive return within a generally declining global equity market environment. We have achieved this by sticking to our longstanding recipe for investment success, despite the certainty of occasional periods of underperformance. Over the last twenty three years, mostly preceding the establishment of 1949 Value Advisors LLC, we have had reasonable success by investing in three general types of investment ideas, all deeply rooted in sound value investing principles:

1. Quality companies earning sustainable returns on capital run by competent and honest management focused on creating long term shareholder value, but only when the share price represents a material discount to what an informed buyer would pay for the entire business. This is our preferred area of investment, as the longer term nature of these opportunities can create tremendous value over time as the power of compounding returns works its magic.
2. Deep value opportunities in average companies – those in highly cyclical industries or unable to generate sustainably high returns over time – when their shares are deeply out of favor and undervalued. Here we look for valuation support from tangible assets, oftentimes buying at prices below liquidation value in order to mitigate the risk of a permanent loss of capital. While these opportunities can offer great reward with low absolute risk, their below average business returns over time requires us to sell when business conditions are favorable again.
3. Special situations involving corporate events that we think will unlock latent value. Examples include restructurings, spin-offs, post-bankruptcy equity, recapitalizations/deleveraging and acquisition targets. Special situations allow us to capitalize on corporate change and are typically not highly correlated to the general trend of global equity markets.

Although not mutually exclusive, in all three categories we have a strong bias toward companies with clean balance sheets, generating substantial free cash flow, with a strong competitive position within their industry, low cost of production and a demonstrated management attitude of shareholder friendliness. While we occasionally make exceptions to one or two of these preferences, our driving principle of only buying securities with a margin of safety against permanent capital loss is the overriding feature throughout your portfolio. We have found that the flexibility to invest across these categories allows us to take advantage of whatever market environment prevails at the time, since varying market environments will offer more opportunities in one category than another through the business cycle. Today, for example, we are finding many more opportunities among deep value and special situations than we are in the high quality category, as the market has driven these reliable and consistent growers to unusually lofty valuations. Paraphrasing Benjamin Graham, the market is there to serve us, not to instruct us. Our disciplined yet flexible approach is designed to take advantage of disparities such as these.

Portfolio Commentary

In our last quarterly letter, we described the market's obsession with companies with stable earnings and cash flow profiles, "driving these fully valued stocks even higher, while punishing already deeply undervalued cyclical stocks with uncertain short term earnings and cash flow growth prospects". After having found many deeply undervalued opportunities in various cyclical industries, we expect this short term underperformance to reverse over time as fears of slowing global economic growth recede. The key ingredient required in this equation is *patience*. While our patience has been tested many times in the past in situations similar to this, we didn't have to wait very long this time. During the first quarter of 2016, we witnessed a dramatic reversal in the performance of deeply undervalued cyclical sectors from their recent extreme lows, while last year's momentum driven winners faltered.

Portfolio positions which helped performance the most during the first quarter were Birchcliff Energy (+3.1% contribution), New Gold (+2.2% contrib.) and Anglo American plc (+2.1% contrib.). Shares in **Birchcliff Energy** rose 31% during the quarter, and nearly 75% from its mid-January low, after the company announced favorable 2015 full year financial and operational results. Birchcliff Energy represents a deep value opportunity in a highly cyclical industry whose longer term and fundamentally derived intrinsic value is ignored by investors because of the depressed spot price of natural gas. The company's gas-weighted production is derived from assets concentrated within its one core area, the Peace River Arch in Alberta, Canada (along the resource-rich Montney/Doig fairway). The recent El Nino weather pattern across North America helped drive natural gas prices to new multi-year lows as increased supply greatly exceeded demand. Despite the unfavorable natural gas price environment, the company reported record average annual production and record low operating costs. Birchcliff Energy is one of the lowest cost producers in Canada. In addition to favorable operating results, the company announced a 23% increase in proven and probable reserves, surprising some investors. When commodity producers endure periods of cyclically depressed spot prices, there is risk of asset impairment and write-down to reserves, since the prevailing low price environment makes higher cost assets uneconomic. We have seen many companies report asset impairments of late, typical during periods like this. It is highly unusual, however, to see a significant *increase* in reserves. Birchcliff's recent 23% increase in proven and probable reserves is a testament to the quality of the company's assets, which are highly economic even at today's depressed natural gas price. Although the company's balance sheet is indebted, we believe that their ability to generate positive cash flow at today's prices and the remaining undrawn credit facility without any financial covenants should provide it sufficient liquidity and financial flexibility to continue along their profitable growth path while patiently awaiting a recovery in gas prices.

New Gold shares advanced 50% during the period under review as the price of gold rose 17%. We have long advocated some exposure to gold and gold equities as a portfolio diversifier and a potential store of value during tumultuous times. Having peaked at $1,900 per troy ounce in September 2011, after Standard & Poor's unprecedented downgrade of the AAA credit rating of the US federal government, the price of gold has since fallen 45% to a low of $1,051 per ounce in December 2015. Shares in most gold companies have declined even further, with the notable exception of gold-focused royalty company Franco-Nevada (which we also own), whose shares appreciated by more than 50% over the same time period. With renewed fears of slowing global economic growth, competitive currency devaluations, negative nominal and real interest rates in many countries and the diminished prospect for further interest rate increases by the US Federal Reserve, the appeal of gold's status as a safe haven asset regained investor favor, driving gold higher. Against this backdrop, shares in New Gold rose 50%, reflecting the leveraged impact of higher spot gold prices on New Gold's prospective earnings and cash flows.

Despite **Anglo American plc** being among our smallest positions at the start of the year, it was one of the biggest contributors to our favorable performance during the quarter. Last year, Anglo shares declined to levels not seen since the depths of the global financial crisis, and the company was among the worst performers in the United Kingdom in 2015. Because of this extreme negative sentiment, and the resulting share price declines among miners globally, we have found meaningful long term value in the beleaguered sector. At the start of 2016, Anglo American traded for less than 25% of tangible book value, an historic low that bears no justification on longer term commodity price assumptions. While Anglo's shares benefited greatly from a broad rally among mining companies globally, the investment thesis supporting Anglo American centers around the company's efforts to restructure and maximize profitability by cutting costs, selling non-core assets and paying down debt. If the company is successful in their efforts, we believe there remains material upside in Anglo's depressed shares irrespective of a recovery in the spot prices of the commodities that Anglo American produces. This is the key attraction to special situation investing, especially in the low return environment that we expect going forward. Companies in the midst of significant change can act to unlock latent value, driving shares higher despite a static market environment. Execution risk, as well as Anglo's indebted balance sheet, warranted a relatively small position size in your portfolio. In conjunction with their full year earnings results, Anglo American announced a revised and more radical restructuring plan, driving shares 84% higher during the quarter.

Portfolio positions which detracted the most from performance during the quarter under review include Western Digital (-0.7% contribution), Tokio Marine Holdings (-0.6% contrib.) and AIG (-0.6% contrib.). **Western Digital Corp.** shares declined by 20.5% during the first quarter following a negative development with regard to their proposed acquisition of SanDisk Corporation. During February, Unisplendour Corp. of China terminated their agreement to buy a $3.8 billion stake in Western Digital, which would have helped to finance the purchase of SanDisk. Plans to acquire SanDisk will proceed under slightly different terms, and despite the full price being paid by Western Digital, we fully subscribe to the rationale for the deal. With SanDisk, Western Digital is gaining access to NAND flash memory supply, a key source of COGS synergies resulting from the proposed deal. NAND flash memory is a type of storage technology that does not require power to retain data. Its higher cost per bit and lower chip capacity are reasons why older magnetic storage technologies such as Western Digital's hard disks are still preferred in certain memory intensive applications. As costs per bit of NAND flash memory decline, Western Digital's older hard disk technology will continue to be replaced by NAND. The acquisition of SanDisk will ensure Western Digital's strong competitive position in storage as the industry evolves. We view the current weakness in Western Digital shares as an excellent buying opportunity, and materially added to the position during the quarter.

Shares in **Tokio Marine Holdings** declined by 16.3% during the period as the company announced uninspiring quarterly financial results in mid-February. Domestic Japanese property and casualty (P&C) insurance has been de-emphasized within the group in recent years as the company's overcapitalized balance sheet has been a rich source for significant overseas acquisitions. The company continues to sell down strategic cross shareholdings, raising further funds to diversify their business away from the challenged domestic Japanese market. European and US acquisitions have expanded non-Japanese profits to nearly 50% of the group. The profit growth picture of these niche P&C insurance acquisitions is much better than the core Japanese business, and should result in a higher ROE (as unproductive capital is put to work in profit generating entities) and a lower risk profile for the group (as their broader geographic spread mitigates over-concentration on the Japanese market). The combination of these two elements should result in a re-rating of Tokio Marine's depressed valuation – shares presently trade near a 25% discount to estimated fiscal year-end (3/31/16) book value per share of ¥4,900. We believe that as investors come to realize Tokio Marine's prominent global footprint, its shares will deserve to trade at a comparable premium to book value per share, consistent with other global P&C insurers.

Shares in global insurer **American International Group (AIG)** declined more than 12% during the first quarter after the company reported dismal quarterly results. The company did, however, yield to pressure from activist investors Carl Icahn and John Paulson by offering a seat to each on AIG's expanded Board of Directors. With the stock trading near 70% of tangible book value and management firmly committed to operational improvement, further asset sales and capital returns to boost shareholder value, we believe that the current weakness represents an excellent long term investment opportunity. Operationally, the company has committed to reduce expenses by $1.6 billion over three years, while focusing on improved underwriting should enable AIG to meet their 6% loss ratio improvement goal. Promises to return substantial excess capital will be very accretive with shares trading 30% below book value. AIG has committed to buying back $25 billion in shares – worth nearly 40% of shares outstanding at present – over the next two years. While execution risk is critically considered, AIG seems to offer a low risk asymmetric return to disciplined conservative investors with a multi-year investment time horizon.

Portfolio Changes

The silver lining on clouds that hung low over world markets during January and early February was the opportunity to buy shares of a few quality companies at significant discounts to fair value. We look forward to dark days like these for the opportunity to be rational and disciplined investors in the face of emotional and short term oriented traders. In mid-January, we initiated positions in two new securities. From our ongoing research on the North American poultry industry, and having recently established positions in leading poultry producers Sanderson Farms (US) and Industrias Bachoco (Mexico), we had a bit of a running start with our work on the North American fresh shell egg industry. During the market rout, shares in **Cal-Maine Foods**, the largest fresh shell egg producer in the US declined to levels that we would characterize as extremely attractive. Cal-Maine is the largest producer and marketer of shell eggs in the US, supplying 23% of domestic consumption in fiscal year 2015. While historic demand for shell eggs has increased generally in-line with overall population growth (1-2% p.a.), Cal-Maine has exceeded this growth by acquisition and also by investing in new production and processing facilities. An important growth driver for the company is value-added specialty eggs, accounting for approximately 24% of sales by volume, but 31% of revenues. Nutritionally enhanced, cage-free and organic specialty eggs enjoy higher profit margins, while selling prices are less cyclical than traditional eggs. The company has been a beneficiary of high egg prices since the outbreak of Avian Influenza in the upper Midwestern US last May. While this is a temporary condition, it has allowed Cal-Maine to generate significant free cash flow to fund further growth initiatives. With shares trading in January below 3.5x current fiscal year EBIT, a 17% free cash flow yield (to EV), and net cash exceeding 15% of Cal-Maine's market capitalization, we believe there is a compelling margin of safety against a permanent loss, while the

company's longstanding track record of 15-20% normalized returns on capital should provide a long runway for value creation in the future.

Also during January, a position in **Value Partners Group** was initiated, after shares dropped more than 60% from their May 2015 peak. Value Partners is one of Asia's largest asset managers, with more than $13 billion in assets under management as of February 29, 2016. The firm has a 22 year history of value investing in the Greater China region, winning many awards over the years for solid investment performance in a variety of products including absolute return long-biased funds, long-short hedge funds, ETF's, quantitative strategies and fixed income products for institutional and individual investors around the world. Led by co-founder Cheah Cheng Hye, Value Partners is uniquely positioned to greatly benefit from the attractive long term growth potential for the asset management industry in Asia. Similarly committed to the time honored principles of value investing, in combination with exceptional on-the-ground research capabilities, we believe that Value Partners will further succeed in building one of Asia's pre-eminent asset management firms. With shares down significantly on the back of rampant fears about China, trading at 10x current fiscal year EBIT, generating free cash flow and consistently earning above average returns on capital, we believe these factors combine with its net cash balance sheet to minimize the chance of permanent capital loss and the likely prospect for significant creation of value over time.

One position was liquidated during the period under review as shares in **Biostime International Holdings** were sold at a significant gain. Shares in Biostime surged more than 40% during January, and a further 8.4% during February, hitting our three year price target of HKD 25 per share in only eight months since our initial purchase last July (+75%). Strong sales of nutritional products from their newly acquired Swisse Wellness business, Australia's leading dietary and nutritional supplements company, drove the stock higher. While we believe the company's acquisition will breathe new life into Biostime's tepid growth profile, we remain disciplined with respect to what price we are willing to pay for growth. In addition, the debt financing required to buy Swisse Wellness changes the financial risk profile of Biostime dramatically. Previously, Biostime had net cash equivalent to 13% of its market capitalization, a war chest of cash we viewed as enhancing our margin of safety against permanent capital loss. With shares now trading near 20 times current year's estimated earnings, versus 8.5 times earnings when we initiated the position, downside no longer appears limited and further upside is greatly dependent upon perfect execution within the nascent dietary and nutritional supplements industry in China that is subject to potentially cumbersome regulatory oversight and restriction. There are generally three reasons why we would sell a position – the preferred exit for us is when a security appreciates to what we consider to be fair value. The second instance occurs when we are reluctant sellers of an undervalued position, but are happy to redeploy proceeds into a much more compelling, usually more undervalued new position. The third reason is when the investment thesis changes materially such that our perceived path to capital appreciation, or reliance upon financial attributes supporting capital preservation, are no longer present. In this case, Biostime International Holdings' risk profile deteriorated as a result of a transformational acquisition, altering our original investment thesis, but investors' optimism about its newly acquired growth prospects helped us to realize our original valuation target.

Outlook

While buying deeply out of favor companies can offer great potential reward over the long term, contrarians consistently run the risk of short term underperformance despite our disciplined approach. The key to both client and portfolio manager satisfaction is alignment of investment time horizon. Our short term performance will differ greatly from the global equity index as we seek to outperform over the long term with a differentiated portfolio of high conviction undervalued stocks from around the world.

We are of the belief that generally loose monetary policy across the globe should be enough to keep the world economy growing at a modest pace in 2016. While we do not make or rely upon economic forecasts, we are confident that current valuations adequately discount an overly negative environment for global growth. This disconnect between short term expectations and longer term eventual reality is a source of opportunity for the disciplined and conservative value investor. We remain steadfast in our conviction in the underlying fundamental long term value of the securities in your portfolio.

As a benchmark agnostic global investment strategy, we have the flexibility to take advantage of changing market opportunities through time. Our experience in navigating these varied environments since 1993 gives us the confidence to act in a prudent yet opportunistic fashion. We will be diligent in our search for undervalued securities of quality companies that will help us meet or exceed our investment objectives.

Thank you for your support, and we look forward to serving your global investment needs for many years in the future.

Matthew T. Haynes, CFA
Chief Investment Officer, Portfolio Manager

This summary does not constitute an offer to sell or the solicitation of an offer to purchase any security or investment product. Any such offer or solicitation may only be made to qualified investors and only by means of an approved confidential private offering memorandum or investment advisory agreement and only in those jurisdictions where permitted by law.

This summary reflects select positions of the current portfolio of a managed account advised by 1949 Value Advisors. There is no guarantee that a commingled investment vehicle or another investment account managed by 1949 Value Advisors will invest in the same investments set forth in this summary. The investment approach and portfolio construction set forth herein may be modified at any time in any manner believed to be consistent with the managed account's overall investment objectives.

While all information herein is believed to be accurate, 1949 Value Advisors makes no express warranty as to the completeness or accuracy nor does it accept responsibility for errors appearing in the summary.

This summary is strictly confidential and may not be distributed.