



Nick Wells, CFA
*Partner, Consumer and
Materials Analyst*

MARCH 2021

Poplar Forest Analyst Insights

In this edition of Analyst Insights, Nick Wells updates us on how the pandemic has shaped consumer behaviors, e-commerce demand, and what he's looking for when evaluating investment opportunities.



Nick, what pandemic-related consumer behavioral changes are permanent versus temporary in nature and how does that affect your outlook on opportunities?

Every portfolio decision we make on the consumer side today considers both the near-term impacts of COVID and what we believe may be the long-term implications. What's interesting is that as contrarian value investors, our first instinct is often to look where something has gone wrong and assume they will return to normal over time. COVID requires a more nuanced approach because we believe some of the changes will be more permanent. I say that because if you look at research on habit formation, it takes roughly 60 to 250 days for some novel new habit to become an automatic behavior. With the entire world now in some form of lockdown for nearly a year, some of those new habits that we've all taken on will become permanent, or at least much more ingrained.

In line with that, one of the biggest factors that is top of mind for me, and for most of the investments in the portfolio, is e-commerce, and more-specifically omni-channel. So, not just having a digital presence, but having a brick-and-mortar presence that integrates well with digital. The second focus is around a structural shift towards increased working from home or working remotely. Pre-pandemic, roughly 3.5 percent of the U.S. employed population telecommuted. That's a pretty small percentage. I think that number increases in the future, enabled by improved technology (teleconference, broadband access, remote desktops, etc.) and increased willingness from both employees and employers. We own two underappreciated businesses that we see benefitting from those trends over the next few

years. The first is Advance Auto Parts, one of our largest holdings. This is an auto parts retail store that sells parts to professional mechanics and do-it-yourselfers, primarily for use on cars that are 5+ years old. As people work from home and move away from city centers, we expect less use of mass transit and more owned-vehicles per household, which should provide a steady tailwind for automotive repair.

Another portfolio company that I think is underappreciated is Conagra Brands, a food manufacturer. They are very strong in the frozen food section, so if you've heard of Birds Eye Frozen Vegetables, or Marie Callender's, that's Conagra Brands. They were an obvious early beneficiary of the pandemic-related shift from eating out to eating at home. What's interesting about Conagra is that they've taken a different approach over the last five years when compared to their peers. Rather than lean on cost cutting, Conagra has been investing heavily in improving the quality of their product. This worked greatly in their favor when COVID forced a lot of new consumers to come in and try a product that they might have had negative preconceptions toward from past experiences. Everyone has this memory of terrible frozen food dinners in front of the TV when they were kids, and that created a certain stigma. It's a very different product today, and so, Conagra has seen a big jump in new trial and better-than-normal retention rates. If you extrapolate that trend into the future, and add more people working remotely, the number of at-home meals increases very quickly. If that 3.5 percent were to double, and those people were to eat three meals a week at home, that's more than 800 million additional at-home meals a year. So again, as those numbers increase, that will benefit Conagra Brands over the next few years.

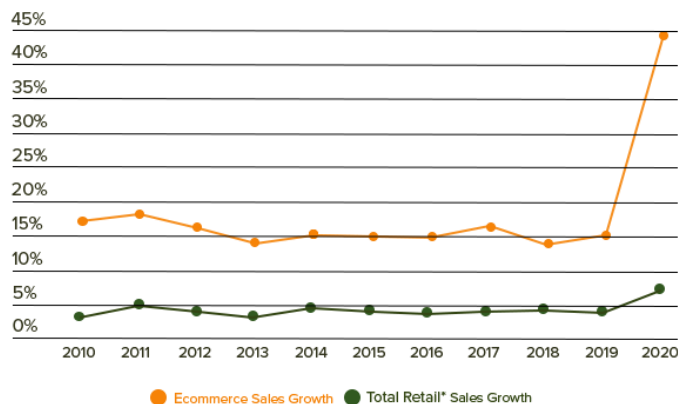


What is your outlook on e-commerce demand as it relates to the consumer discretionary sector?

E-commerce is obviously top of mind for every investment on the consumer discretionary side. Amazon is the behemoth there, with about 30% market share of all U.S. ecommerce. According to Digital Commerce, e-comm growth in 2020 was 44%, or nearly triple 2019's growth rate of ~15%. It's an absolutely huge number; e-commerce is here to stay, and the question is all about who can adapt and thrive in that environment.

Comparing Growth: U.S. Ecommerce vs. Total Retail Sales

Year-over-year Growth 2019-2020



Source: Digital Commerce 360, U.S. Department of Commerce; Updated January 2021

*Total retail figures exclude sales of items not normally purchased online such as spending at restaurants, bars, automobile dealers, gas stations and fuel dealers

Everyone knows the big players that have made the e-commerce transition successfully. If you look at Target, Walmart, Home Depot, Lowe's, or Best Buy, those guys have made the transition and are getting credit for it, based on their multiples and their future growth rates. If you were to go a step below that, we own two smaller companies that we believe aren't getting the credit they deserve yet: Tapestry and Newell Brands.

Tapestry is primarily a handbag manufacturer. So, they own the Coach, Kate Spade, and Stuart Weitzman brands. Their e-commerce growth was triple digits, and what's interesting there is that in North America, 50 percent of their sales last quarter were e-commerce. That's up from the teens last year. I think what's equally compelling about the handbag category is that it's the perfect product for e-commerce. The high unit retail prices help offset the shipping cost, purses have very low return rates because these aren't shoes or shirts that need to fit perfectly. Generally, you know exactly what you're going to get, so it's a margin accretive transaction. Long term, Tapestry is targeting 50 percent of sales from e-commerce, which I think is a great example of using the pandemic to

emerge as a much stronger and healthier brand. I'd say we're in the second or third inning of that evolution, so that opportunity is particularly exciting, and I think, underappreciated.

Newell Brands is a bit more unheralded or unexpected. Newell is a manufacturer of many random products: Contigo beverage containers, Graco baby products, Coleman tents; not exactly what you think of when you think of e-commerce. What's interesting is that last quarter, 31 percent of their sales in the U.S. were through e-commerce— either through Walmart.com, or Amazon, or Target.com, or their own e-commerce sites. They already have two or three times the penetration of their peer group and are building up core competencies around digital marketing and innovation. We think this expertise positions them well to outgrow the industry as ecommerce grows in importance.

Q What types of consumer staples companies have benefitted, or conversely, been negatively impacted by COVID pressure?

Since the beginning of the pandemic, we have been differentiating between two phases: phase one, the obvious early beneficiaries, and phase two, the companies who would see long-term benefits from the pandemic-driven changes. During phase one, Kroger, a portfolio company we sold in 4Q 2020, was an obvious early beneficiary because no one could eat out. Everyone was forced to eat at home, and Kroger took those sales and benefited in the first half of the year. The challenge there was that the second phase was tougher for them: they're still competing with Amazon, Aldi and Lidl. They now have a much larger digital presence to buy online or pick up in store, but that business is margin dilutive. That's a headwind for their future business that didn't exist to the same degree before COVID. So, we viewed Kroger as a near-term beneficiary but not a long-term one, and as a result, decided to allocate those funds elsewhere.

The flip side of that coin would be Sysco, the food distributor. We added it to the portfolio in the middle of last year. They are, essentially, the largest distributor in the country to restaurants, universities, sporting arenas, etc, so their business was devastated by COVID. That got us really interested, but what stood out about Sysco was that in the second phase, we think they come out of the pandemic a better business. Sysco cut a lot of costs out of the business during the downturn that won't come back, and that's going to make this a structurally more profitable business going forward. They also have the

balance sheet and the scale to continue to invest in the business where a lot of their smaller competitors don't, so not only do we think they are going to be more profitable, but we think they'll take a lot of market share as markets recover. That's an interesting setup, and we think the long-term outlook is brighter than ever.

Let's Discuss

We'd love to continue the conversation. Please contact Patty Shields (pshields@poplarforestllc.com or (626) 304-6045) if you're interested in scheduling a call to discuss this or any other topic of interest.

Past performance does not guarantee future results.

Mutual fund investing involves risk. Principal loss is possible.

Earnings Growth is the annual rate of growth of earnings typically measured as Earnings Per Share Growth. **Earnings growth is not a measure of the Fund's future performance.**

The Fund's investment objectives, risks, charges and expenses must be considered carefully before investing. The statutory prospectus and summary prospectus contain this and other important information and can be obtained by calling 1-877-522-8860 or by visiting www.poplarforestfunds.com. Read it carefully before investing.

Opinions expressed are subject to change at any time, are not guaranteed and should not be considered investment advice.

The S&P 500 Index is a market-value weighted index consisting of 500 stocks chosen for market size, liquidity, and industry group representation. The Russell 1000 Value Index measures the performance of the Russell 1000's value segment, which is defined to include firms whose share prices have lower price/book ratios and lower expected long-term mean earnings growth rates. One cannot invest directly in an index.

The Partners Fund top ten equity holdings and their percentage weights as of 9/30/20: Advance Auto Parts 5.8%, AmerisourceBergen 5.0%, CVS Health 4.5%, International Business Machines 4.5%, Merck 4.4%, E*Trade Financial 4.2%, Equitable Holdings 4.1%, AT&T 4.1%, Nucor 4.1%, American International Group 4.0%. Composition of sector weightings and fund holdings are subject to change and are not recommendations to buy or sell any securities.

Poplar Forest Capital, LLC (the "Adviser") is the Investment Adviser to the Fund. Poplar Forest Funds are distributed by Quasar Distributors, LLC.

POPL-20210226-0022

ML20-005363 exp 10/9/21