South Atlantic Capital Management Group, Inc.

Investment Management

December 31, 2013 Portfolio Review

<u>COMPOSITE PERFORMANCE SUMMARY</u>

South Atlantic Capital (SACMG) versus S&P 500
Annualized as of 12/31/2013

	1 Year	3 Years	5 Years	10 Years	Since Inception*	Total Return Since Inception*
SACMG Core Equity[1] (Net)	25.76%	13.07%	20.05%	8.91%	9.07%	301.20%
S&P 500[2]	32.40%	16.18%	17.94%	7.40%	6.03%	155.20%

**Inception date of South Atlantic Capital's composite is 1/1/98.*

South Atlantic Capital is an independent investment adviser registered with the States of North Carolina and 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 independent verifier, has verified South Atlantic's compliance on a firm-wide level for the period of January 1, 2002 to December 31, 2013. All returns are net of management fees and include reinvested dividends and interest. Past results are not indicative of future investment results.

VERIFIED

"More money has been lost anticipating a correction than in the correction itself." - Peter Lynch

<u>Valuation Backdrop</u>

Our core equity composite returned 25.76% this year, underperforming the 32.4% return for the S&P 500. The market returned 32.4% compared to earnings increases of approximately 10%. A wave of optimism created by the Fed's easy credit policies and a wave of optimism created by upward stock price momentum combined to create something of a tsunami driving prices higher. Our performance was hurt by a few mistakes, which we discuss later, plus we had cash holdings, which are a function of our ability to find investments meeting our criteria, in the low double digits earning far less than the market's return.

Are stocks overvalued after a 32% return? You can't say just looking at that. Looking further to the five year period beginning in 2009, the S&P 500 returned an annualized 18% while U. S. corporate earnings expanded 11.2% annually and per share operating earnings for the S&P 500 rose 17.8% per year. These growth rates are unsustainable but they represent a recovery from a trough. The picture changes if you go back another two years to year end 2006. For this seven year period, the S&P 500 returned just 6% annually, while U. S. corporate profits increased 3.5%, and per share profits for the S&P 500 grew 2.2% per year. Taking all of this into account gives more perspective to the year-end value for the S&P 500 which is close to historical norms at 16.5 times expected 2014 earnings.

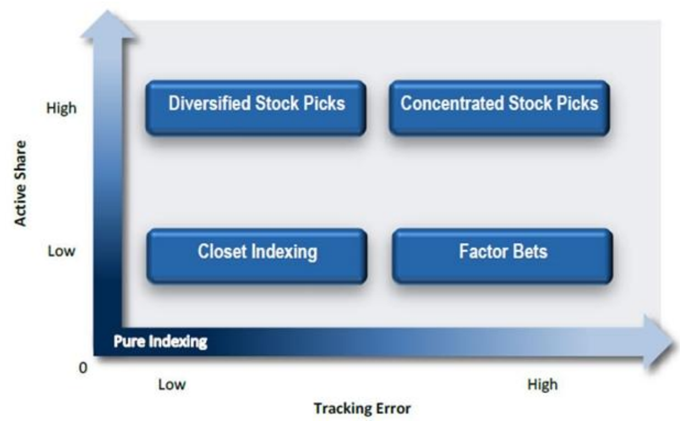
For some time, investors have been focused overwhelmingly on quantitative easing, asset price support and credit support provided by the Federal Reserve purchasing $85 billion of Treasury bonds per month. By 2013, this intense focus on monetary policy rather than corporate earnings led to three year sector returns which had the lowest differential between the best and worst sectors of the market since 1997. Throughout 2013 sector differential decreased to 12-13% compared to average differentials since 1997 of 27.75% and differentials as high as 60+% during 2000. We believe these periods of high correlation are dangerous for investors. Taking the focus away from earnings (which drive valuations over time) can detach stock prices from realistic valuations. We also believe the wide differentials in sector returns historically point to the opportunity cost of excess diversification and makes the case for concentrated portfolios.

<u>Active Share</u>

Investors forced to consider the end of quantitative easing are now refocusing on earnings. Earnings disappointments this year are more evident since quantitative easing is providing less cover. We attempt to always be focused on individual stock selection, and not issues like quantitative easing, since we believe concentrating on the prospects for individual companies increases our opportunity for long term outperformance. You should be aware that actively managed equity portfolios carry higher management fees than index funds and should have some expectation of higher performance. Investors can gauge that possibility by tracking a manger's active share, a concept developed by Antii Petasjisto and Marjtin Cremers in 2009 which measures the percentage of the holdings that differs from an index. Tracking error which calculates the difference in performance between the portfolio/fund and the index over time is also useful.

If individual managers or mutual funds employed by an investor have returns that aren't highly correlated, in theory it's possible, ***but not very probable***, for an investor to outperform indexes such as the S&P 500 even though individually the managers don't outperform by taking advantage of one manager zigging while the other is zagging. More realistically, a high active share is a better predictor of outperforming an index.

Along with finding that managers with high active shares tend to outperform their benchmark indexes, the Cremer study found that from 1998-2011, the active share for actively managed funds dropped from 28 to 24 continuing a trend towards closet indexing. That means the true cost of active management is high since most of the average fund mirrors the index while fees for actively managed funds are much higher. Assume a 1% management fee on a million dollar account, $760,000 of the portfolio mirrors an index and would be charged a management fee of roughly $760 in an index fund. This means that the $240,000 that is truly actively managed is effectively charged a management fee of $9,240 or almost 4% of the actively managed portion. That is a high hurdle to reach if you want to outperform the market after fees and a primary reason that their study found managers need an active share above 60 to be predictive of outperforming the market.



Source: Cremers and Petajisto (2009).

SACMG 10-yr tracking error = 7.3%

SACMG tracking error since inception = 11.07%

Financial Analysts Journal

Table 1.[4] Distribution of Mutual Funds across Active Share and Tracking-Error Ranges, 2009

Active Share (%)	Tracking Error (% per year) 0–2	2–4	4–6	6–8	8–10	10–12	12–14	>14	Total
90–100	0	0	6	36	66	47	44	87	285
80–90	0	0	35	83	67	55	35	50	326
70–80	0	7	56	62	63	33	17	19	257
60–70	0	22	85	60	25	13	5	6	216
50–60	0	24	49	25	14	4	2	0	120
40–50	2	28	20	6	3	0	0	0	61
30–40	4	14	9	2	0	0	0	0	30
20–30	0	3	0	0	0	0	0	0	5
10–20	5	3	0	0	0	0	0	0	8
0–10	70	0	0	0	0	0	0	0	73
Total	82	104	262	275	238	152	103	164	1,380

Notes: This table shows the number of U.S. all-equity mutual funds in each Active Share and tracking-error category. Tracking error is computed from daily returns over the previous six months.

Our performance software measures our tracking error which the study found not to be as predictive of outperformance, but not our active share. However, since we manage concentrated portfolios of 20 to 25 stocks compared to 500 companies in the S&P index, in all likelihood, we have a very high active share. Our tracking error indicates we would be somewhere between Diversified Stock Picks and Concentrated Stock Picks in the blue chart[3] above.

Performance Review

While we don't deserve high marks this year, over the last five years, ten years, and since our Core Equity Composite's inception on December 31. 1997, our outperformance net of fees has led to significantly higher account values for long term clients. A great deal of our outperformance results from better results during periods of economic or market stress due to our defensive bias. This defensive bias, which is based on investing in durable, quality companies priced below their value to create a margin of safety, tends to lead to outperformance during market downturns and can lead to underperformance during expensive markets such as during 1998-1999 and 2005-2007. Our cash levels tend to increase as valuations rise and can hurt performance when strong markets coincide with expensive markets. On the flip side, when overly optimistic expectations corrected such as in 2000-2002 and 2008-2009, we have done very well with *Cumulative Gains* of 13.2% and 6.1% versus *Cumulative Losses* of 37.6% and 19.7% respectively for the S&P 500.

This defensive bias puts this year's underperformance in context but we also clearly made mistakes. J. C. Penney and Eagle Rock Energy both hurt performance. J. C. Penney had valuable retail locations and hired a talented CEO who had a vision to drastically improve sales per square foot by turning J.C. Penney into a mall within a mall by partnering with new trendier, hipper suppliers. There was some downside protection in the value of the real estate but his vision was not realized and drove off way to many customers and lead to huge losses. Visions are more speculative than durable.

Eagle Rock Energy which had some well-placed natural gas processing plants in the Granite Wash basin in Texas took commodity price risk on a high proportion of their contracts. On many contracts, they would process the gas for no fee in return for owning the ethane and propane that resulted from processing the "wet" gas. A glut of ethane in particular caused a reduction in cash flow, a reduction in their dividend, and eventually an untimely sale of their processing plants to reduce leverage. There was no margin of safety in owning a company whose cash flow was less than their dividend and whose balance sheet didn't provide enough staying power to assume so much commodity risk. Ironically, propane prices are now much higher and I expect ethane prices to rise a few years from now as export markets are pursued and new petro chemical companies are constructed to take advantage of the low cost ethane.

Lastly, we owned many large multinational companies which were fully priced at the beginning of the year and underperformed, in large degree because a strengthening dollar hurt their overseas earnings. There was never much risk, in our opinion, of permanent capital loss with these companies but the amount of multinational companies we owned was influenced by our expectation for a weaker dollar. This flawed process of focusing on an economic trend instead of company specific issues led to owning stocks that underperformed as the dollar actually strengthened over the last few years. By the way, the strengthening dollar is due in large part to the substantial improvement in our balance of trade resulting from the transformative increase in domestic oil and gas production which is courtesy of George Mitchell who perfected fracking and also developed Bald Head Island. The degree of our investment in multi -national companies is a case in point of how letting economic trends influence your investment decisions, as opposed to focusing on a specific company's earnings prospects relative to its price, decreases the odds of outperforming the market, in our opinion.

We don't like making mistakes but we like to review them because we have a great deal of confidence that our investment philosophy will lead to good results if executed properly.

Top Ten Holdings

All that said, the bulk of the portfolio performed well and the market's rough start to the year illustrates the long term value of owning companies that have a great deal of financial flexibility provided by strong balance sheets and high returns on assets and capital to take advantage of opportunities presented by periods of economic or ***market*** stress. This is seen in the various activities taken by our top ten holdings in the past year to grow per-share value over time.

Wells Fargo - increased capital to asset ratio despite raising quarterly dividend from $.22/share to $.30/share; should have enough capital to receive approval from Federal Reserve in March to increase dividend and buy back shares.
Direct TV - reduced shares outstanding by 13% in the last year with virtually no increase in leverage.
Berkshire Hathaway - through the first nine months of 2013 their operating cash flow and $42 billion cash position allowed them to add $18bb in earning assets while reducing shares outstanding by close to 1%. This was partially funded by a $3bb increase in debt and $7bb drawdown of cash. They still maintain $35 billion in cash and have assets of $458bb against $65 billion in debt.
Phillips 66 - operating cash flow along with $1.2 billion in dispositions allowed them to invest in growth projects for mid-stream and chemical businesses, reduce share count by 5%, and substantially increase net cash balances.
Phillip Morris - operating cash flow along with a modest increase in net debt to 1.74x ebitda funded a 10.6% increase in the dividend, a 4% reduction in shares outstanding, and investments in ecigarettes.
Markel Corporation - an insurance underwriter whose important financial metric is investment assets versus unpaid losses. They have relatively high coverage of 1.73x and are very conservative about estimating losses.
21st Century Fox CL A - used part of their $6bb in excess cash to reduce shares outstanding by 3%.
Enterprise Product Partners - more debt than the other companies since their business is supported by long term fixed fee contracts and they have to pay out most of their cash flow as dividends. Strong cash flow coverage of 1.5x their dividend and among the strongest balance sheets in their industry.
Nestle ADR - shares outstanding were flat but operating cash flow and a small disposition funded a recommended 5% increase in the dividend and reduced net debt from 18.1bb Swiss francs to 14.7 bb or just 1.5x free cash flow.
Johnson and Johnson – operating cash flow helped by some dispositions allowed them to acquire Synthes for $19.7bb, increase the dividend by 5% and end the year with $11bb in net cash while only increasing the share count 3%.

Please feel free to contact us if you would like more information about our services. We would be happy to provide references upon request. The only fees we charge are on assets under management, so please feel free to contact us if you have an interest in visiting the office to discuss your situation.

Best 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.*

[3] ***Chart*** *provided as supplemental information and is an enhanced version of the chart in How Active Is Your Fund Manager? A New Measure That Predicts Performance, written by K. J. Martijn Cremers and Antti Petajistoy, March 31, 2009, page 44.*

[4] ***Table 1*** *is provided as supplemental information and was published by the CFA Institute in the July/August 2013 Financial Analyst Journal, vol. 69, num. 4, p 76. The full report is available online at www.cfapubs.org.*

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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.

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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 Bank 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 MANAGEMENT GROUP, INC.

CORE EQUITY COMPOSITE

ANNUAL DISCLOSURE PRESENTATION

Year End	Total Firm Assets (millions)	Composite Assets (USD) (millions)	Number of Accounts in Composite	Annual Performance Results Composite		S&P 500	Composite Dispersion	Three Year Annualized Ex-Post Standard Deviation	
				Gross	Net			Core Equity	S&P 500
2013	37.2	23.0	54	26.97%	25.76%	32.40%	2.23%	9.86%	11.94%
2012	28.6	17.3	47	13.18%	12.09%	15.98%	1.85%	11.18%	15.09%
2011	25.3	15.2	43	3.59%	2.55%	2.12%	2.54%	15.56%	18.70%
2010	22.0	14.4	40	20.20%	19.02%	15.07%	3.43%	17.96%	21.85%
2009	18.6	13.0	36	46.40%	44.95%	26.46%	5.28%	17.29%	19.63%
2008	12.4	8.4	38	(25.99%)	(26.69%)	(37.00%)	2.30%	12.61%	15.08%
2007	17.4	11.9	37	(2.03%)	(2.97%)	5.49%	2.69%	9.33%	7.68%
2006	22.4	12.6	36	12.10%	11.13%	15.80%	2.50%	8.74%	6.82%
2005	12.4	10.8	33	0.79%	(0.16%)	4.89%	3.12%	11.08%	9.04%
2004	12.3	11.1	30	20.37%	19.24%	10.87%	3.37%	12.64%	14.86%
2003	9.2	8.5	23	35.31%	33.95%	28.69%	4.38%	13.78%	18.07%
2002	6.9	6.4	21	(3.36%)	(4.34%)	(22.10%)	6.43%	14.11%	18.55%
2001	7.4	6.8	18	6.92%	5.86%	(11.88%)	6.23%	13.82%	16.71%
2000	6.8	6.3	15	14.47%	13.47%	(9.11%)	4.23%	13.29%	17.42%
1999	6.4	5.7	14	8.80%	7.77%	21.05%	10.61%		
1998	6.3	5.5	14	4.29%	3.05%	28.57%	3.69%		

***Core Equity Composite* contains all fully discretionary accounts invested in equities excluding accounts that use significant leverage and for comparative purposes 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. The minimum account size for this composite is $50,000.**

South Atlantic Capital claims compliance with the Global Investment Performance Standards (GIPS®) and has prepared and presented this report in compliance with the GIPS standards. South Atlantic Capital has been independently verified by Ashland Partners & Company LLP for the periods January 1, 2002 to December 31, 2013.

Verification assesses whether (1) the firm has complied with all the composite construction requirements of 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. The Core Equity Composite has been examined for the periods January 1, 2002 to December 31, 2013. The verification and performance examination reports are available upon request by calling (910) 763-4113, or by emailing info@southatlanticcap.com.

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Results are based on fully discretionary accounts under management, including those accounts no longer with the firm. Composite policy requires a three month, temporary removal of any portfolio incurring a client initiated external significant cash inflow of at least 25% of portfolio assets. The temporary removal of such an account occurs at the end of the prior month in which the external significant cash flow occurs and the account re-enters the composite at the end of the second full month after the cash flow. Additional information regarding the treatment of significant cash flows is available upon request. Composite returns represent investors domiciled primarily in the United States. Past performance is not indicative of future results.

The U.S. Dollar is the currency used to express performance. Returns are presented gross and net of management fees and include the reinvestment of all income. Returns are presented after trading expenses but before any applicable taxes. Beginning 2002, net of fee performance was calculated using actual management fees applied quarterly. Prior to 2002, the highest applicable management fee of 1% was applied. The annual composite dispersion presented is a size-weighted standard deviation calculated for the accounts in the composite the entire year. The annual dispersion and the standard deviation are calculated based on net returns. 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.

South Atlantic Capital's management fee schedule for accounts with assets up to $500,000 is 1.25%. For accounts with assets between $500,000 and $5,000,000, the management fee schedule is generally set at 1.0% per annum, and is negotiable for accounts with assets over $5,000,000. Actual investment advisory fees incurred by clients may vary.

The Core Equity composite was created on March 1, 2011.

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<u>Independent Accountant's Verification Report</u>

Mr. Edward D. Nowell, President
South Atlantic Capital Management Group, Inc.:

We have examined whether (1) South Atlantic Capital Management Group, Inc. (the "Firm") has complied with all the composite construction requirements of the Global Investment Performance Standards (GIPS® standards) on a firm-wide basis for the periods from January 1, 2002, to December 31, 2013, and (2) the Firm's policies and procedures are designed to calculate and present performance results in compliance with the GIPS standards as of December 31, 2013. The Firm's management is responsible for compliance with the GIPS standards and the design of its policies and procedures. Our responsibility is to express an opinion based on our examination.

Scope of Work
Our examination was conducted in accordance with attestation standards established by the American Institute of Certified Public Accountants and, accordingly, included examining, on a test basis, evidence about the Firm's compliance with the previously mentioned requirements; evaluating the design of the Firm's policies and procedures previously referred to; and performing the procedures for a verification required by the GIPS standards and such other procedures as we considered necessary in the circumstances. We believe that our examination provides a reasonable basis for our opinion.

Opinion
In our opinion, in all material respects,

- the Firm has complied with all the composite construction requirements of the GIPS standards on a firm-wide basis for the periods from January 1, 2002, to December 31, 2013; and
- the Firm's policies and procedures are designed to calculate and present performance in compliance with the GIPS standards as of December 31, 2013.

This report does not relate to any composite presentation of the Firm that may accompany this report, and accordingly, we express no opinion on any such performance.

Ashland Partners + Company LLP
Ashland Partners & Company LLP
February 26, 2014