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THE WALL STREET TRANSCRIPT
Connecting Market Leaders with Investors

# Value-Oriented, Low-Volatility Investing

**ROGER W. VOGEL, CFA**, joined Silvercrest Asset Management Group as a Managing Director and Lead Portfolio Manager of the firm's domestic equity capabilities. Prior to the firm, Mr. Vogel was Managing Director at Credit Suisse Asset Management, co-managing both small-cap and large-cap portfolios. He arrived at CSAM as a result of the merger with Donaldson, Lufkin & Jenrette, where he worked since 1993 in a similar capacity. Previously, Mr. Vogel was a Portfolio Manager at Chemical Bank and Manufacturers Hanover Trust. He attended New York University.

**SECTOR — GENERAL INVESTING**

**TWST: Please begin with a brief introduction to Silvercrest, and tell us a bit about your role at the firm.**

**Mr. Vogel:** Silvercrest Asset Management was founded in April 2002 by former senior management of DLJ Asset Management. All of Donaldson, Lufkin and Jenrette, including DLJ Asset Management, was acquired in the summer of 2000 by Credit Suisse. It was a somewhat different operating environment for us under Credit Suisse compared to DLJ. Moffett Cochran and our Co-Founder, Marty Jaffe, started Silvercrest with the idea of trying to recapture the spirit and operating environment that we enjoyed at DLJ Asset Management.

It's been a great run. We started with nearly nothing as far as assets or clients, but now 12 years later the firm oversees more than $16 billion of client assets and has been quite successful. We became a public company last July.

At Silvercrest, I head up our internal long-only equity offerings. We're value-oriented, and I have a team of five analysts who work with me. We offer six strategies under the Silvercrest umbrella: large-cap value, small-cap value, multicap value, an equity income product, a small-mid product, and a product called Focused Value, which is our most concentrated strategy and probably furthest out on the risk/reward spectrum.

In total, we have approximately $5 billion of assets in these strategies. All are similar in their philosophy and process. While we are value-oriented, we don't do distressed value. Instead we try to find what we believe are better operating companies run by capable management teams. Our goal is to pick off these companies at opportune price points.

We make a concerted effort to manage higher-quality portfolios. We measure quality in all of our strategies by two metrics, return on invested capital and balance sheet strength. Typically, our target median return on capital, ex-financials, is several hundred basis points higher than what we view as the appropriate benchmark. And our companies' level of indebtedness, whether you look at enterprise value to EBITDA or debt as a percentage of capitalization, is apt to be somewhat lower than the respective benchmark.

Our higher-quality mandate typically manifests itself in our portfolios, which usually have modestly lower volatility than our benchmarks and we believe oftentimes less than our peers. Our Focused Value strategy tends to be the exception, as its limit of just 20 stocks tends to increase its volatility.

As of the end of the most recent quarter, all of our strategies have performed ahead of what we view as their appropriate benchmarks since inception, illustrating that our quality value approach has worked well for us. We are prone to have stronger relative performance when the market is weak, as investors tend to rotate back toward the higher-quality stocks that we own. We sometimes will struggle during periods of market exuberance, since we are unlikely to own the "story" stocks that often come into investor favor during strong bull markets.

**TWST: What is your view on the current strength of the stock market and of the economy, and how do those views inform your approach to investing at this point?**

**Mr. Vogel:** While Silvercrest has access to internal and external macroeconomic strategists who opine on the world view, my team and I are not terribly macro-driven. We think of ourselves as bottom-up stock pickers, and frankly we don't try to parse every utterance that comes out of the Federal Reserve or every last snippet of GDP data. Instead, we seek to have our ear to the ground listening to what company managements are saying.

One of the nice advantages of being in New York is we have the ability to meet with many management teams. We probably average at least one company a week that meets with us directly. Between our meetings here at Silvercrest, we also visit companies, attend investor conferences and listen to conference calls. This gives us an opportunity to try to formulate where we think the global economies are and how they may impact the stocks we own or that we're looking at. We believe we can find winning stocks in virtually any market or economic environment.

Certainly, if we experience a great recession like we had in 2008-2009 and a broad-based stock market decline, it may be hard for us as a long-only manager to show a positive return. We don't like to run much cash in our strategies. We leave the cash decisions to Silvercrest's relationship managers or institutional consultants who have the ultimate responsibility for the client's asset allocation. My team's mandate is to manage an equity portfolio, so we keep these portfolios pretty fully invested.

As for the current environment, we think valuations are within a band of fair value right now. Having managed portfolios for almost 30 years, I certainly have seen stock markets both more expensive and less expensive. But the current multiple in our portfolios is roughly 17 times our estimates of forward 12-month earnings, which strikes us as reasonable given the current levels of inflation and interest rates.

We are encouraged by the recent uptick we've seen in merger and acquisition activity. It appears that many companies are feeling increasing pressure, in part from activist investors, to do something with excess cash on their balance sheets, whether that is M&A or share repurchase or increasing dividends to their shareholders. With all the cash on corporate balance sheets right now, you could argue that valuation multiples are even a little bit lower than they look. We believe you can back out at least some of that cash and there would be no relevant hit to earnings, because the cash isn't really earning anything at this point.

**Highlights**

*Rogel W. Vogel discusses his firm's value-oriented, low-volatility investment strategy. Mr. Vogel looks for better operating companies run by capable management teams, and measures quality by return on invested capital and balance sheet strength. Mr. Vogel is encouraged by the recent uptick in merger and acquisition activity, and believes the global economies seem to be improving. He gives examples of stocks that are representative of his firm's investment approach. Companies discussed: Ross Stores (ROST); The TJX Companies (TJX); BancorpSouth (BXS); Prosperity Bancshares (PB); US Ecology (ECOL) and Protective Life Corporation (PL).*

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What we're hearing from companies gives us a feeling that the global economies are improving. Most companies seem to be reasonably happy with the tone of their U.S. business, suggesting modest improvement. Many companies indicate that their European business is stabilizing if not improving. Asia, which is really China, elicits more of a mixed response. But in the aggregate, we think global GDP is strong enough to support the estimates that are out there, and we're still finding interesting opportunities to deploy our clients' capital.

**TWST: I know you said that you think of yourselves as bottom-up stock pickers, but are there any sectors that have emerged as being more likely than others to include the kinds of stocks you're looking for, and if so, what characteristics make those sectors attractive to you right now?**

**Mr. Vogel:** We're not terribly sector-driven. When we look at our performance attribution from our sector exposures — relative to our benchmarks versus our stock performance — we rarely add or detract much value through our relative sector exposure. Our sector exposures can look very different from our benchmarks, but that's not how we try to add value. We don't rotate in and out of sectors very aggressively, and with the exception of our Focused Value strategy, we will typically have exposure across all the major sectors. If you took a sector snapshot of any of our non-Focused Value strategies today versus a year ago or five years ago, you really wouldn't see substantive changes. So it's a hard question for me to address.

I'd say we're finding opportunities today across the spectrum. We've had some recent success in financial services companies, including a number of regional bank stocks. We're still finding more industrial-oriented companies that look attractive. Where perhaps we struggle a bit is in some of the more consumer-facing areas, but historically we have tended to have trouble finding palatable ideas in that sector.

**TWST: Can you give us three examples of stocks that you believe are representative of your approach and tell us what attracted you to each name?**

**Mr. Vogel:** One way to think about our portfolios is that we break them down into four buckets. We have what we call a "steady-eddy" bucket, comprised of companies that we think should be able to generate high-single-digit to low-double-digit earnings and cash flow growth over time, without very much volatility. This tends to be the lion's share of our portfolio and includes the companies that we're most excited to find. Hopefully, we can own them for a multiyear time period and not have to turn them over particularly aggressively.

Then we have a "catalyst-driven" bucket, which includes perhaps more value-oriented companies where we think something has changed that may lead to better results. It could be an acquisition, it could be a change in management, it could be a portfolio rationalization, but there is some type of catalyst that will hopefully lead toward more improved results.

Third, we have a "franchise value" bucket, which consists of companies that we think have the highest likelihood of being acquired at some point because of significant franchise value. These companies may be operating suboptimally at present, but offer limited downside due to their acquisition prospects.

And then lastly, our traditionally smallest bucket is mostly cyclical companies that may not look terribly attractive today because their end markets are somewhat depressed. However, in a normalized environment we believe they will have an opportunity to show significantly higher earnings and cash flow and perhaps be rewarded with a more generous valuation.

We can discuss a few names we think are interesting and that we own. One of these is a company called **Ross Stores** (ROST), which is a discount retailer. **Ross** has two concepts, Ross Stores and dd's DISCOUNTS, with Ross as the larger nameplate of the two. **Ross** has, effectively, only one other large competitor, **TJ Maxx** (TJX), another wonderful company. When we look at **Ross**, we think it should be able to continue to grow the store base perhaps in the mid-high single digits over time. Hopefully, **Ross** will also have some same-store sales growth to enable an earnings CAGR in the low-mid double digits over our forecasted time period, four years from now.

With an approximate 12% earnings CAGR and targeting a valuation at the current market multiple, we think **Ross'** stock is deeply undervalued with about 30% upside to our estimate of current fair value. There will be times, like now, when the retailing environment is not particularly robust, so **Ross'** last couple of recently reported quarters have been somewhat mediocre. But as longer-term investors, we realize that those kinds of metrics ebb and flow. As long as we think the basic model is intact, we believe there will be periods where **Ross** will show stronger same-store sales growth, and investors will become more excited with the name. We think it's a well-managed company in an attractive niche. Consequently, we continue to own **Ross** and continue to like it.

This is one holding I would characterize as a catalyst-driven story on the management change. It will hopefully morph into a steady-eddy. If I didn't make this clear earlier, our four buckets are certainly not rigid. For example, a company with franchise value can be a catalyst-driven story that eventually becomes a steady-eddy as well. We believe **BancorpSouth** is a good example of a company that started off as catalyst-driven, certainly had some franchise value and may now be moving more into our steady-eddy compartment.

**TWST: And a third example?**

**Mr. Vogel: US Ecology** (ECOL), one of the largest hazardous waste landfill companies in the United States, is a very interesting company. As you might expect, this is a business that has significant barriers to entry. It's hard to get landfill capacity permits, so there is a lot of franchise value at **US Ecology**.

What's most intriguing about the company now is it just recently closed a large acquisition of one of its competitors, a company called **EQ — The Environmental Quality Co**. This greatly enhances **US Ecology's**

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**1-Year Daily Chart of Ross Stores**

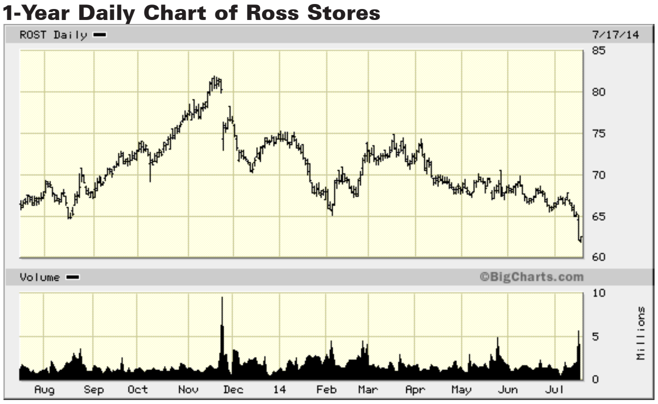


**Chart provided by www.BigCharts.com**

geographic footprint and expands the company's service offerings. It should prove to be quite accretive in the next couple of years.

We think of it as a steady-eddy with significant franchise value. This is a hard asset to replicate, and we think **US Ecology** is certainly quite valuable from that standpoint, as well as being a solid company on an operating basis.

**TWST: How would you describe the client who you think would be an ideal match for the equity strategies that you oversee?**

**Mr. Vogel:** Our clients are diverse. We have a substantial ultra-high-net-worth client base and a fair amount of institutional assets from pension funds, foundations and endowments. Almost three years ago we partnered with Aston Funds to launch a mutual fund vehicle for our small-cap strategy as well.

**1-Year Daily Chart of US Ecology**


**Chart provided by www.BigCharts.com**

**TWST: In what bucket would that one be?**

**Mr. Vogel:** That would be in a steady-eddy bucket. There is no particular catalyst there. It's certainly not a normalized earnings story, and while there is franchise value, there is really no natural acquirer.

**TWST: Can you give us more examples?**

**Mr. Vogel:** Let's shift industries and consider a name in the catalyst-driven bucket. There's a small bank we own called **BancorpSouth** (BXS), which is a Mississippi-based regional bank. We purchased **BancorpSouth,** initially on the promise that a new CEO, Dan Rollins, brought to the situation. We knew Dan very well from his previous employer, **Prosperity Bank** (PB), which is one of the highest-performing banks in the country. Dan left **Prosperity** and resurfaced at **BancorpSouth**, which arguably needed a bit of a jolt, as its expense ratio seemed to be too high. We had a lot of respect for Dan and thought he had a significant opportunity at **BancorpSouth** to rationalize the expense base, rejuvenate loan growth and to emulate the successful template **Prosperity** has. And so far that's played out.

We still believe Dan will continue to work on the expense structure of the bank and probably pursue some acquisitions as well. As a result, we think there is still at least 20% upside.

The typical Silvercrest client tends to agree with our value orientation and likes the risk/return metrics that we've historically been able to provide. Preservation of capital is something we worry about, and I like to think that historically we've done a reasonably good job on this score. As I mentioned before, all six of our strategies through June of this year have outperformed what we believe to be their relevant benchmarks since inception. If an individual or institution is looking for a very high return and a high-risk or high-volatility strategy, that's not us. But for a prospective investor who seeks a solid risk-adjusted return with lower volatility, we believe we have an attractive offering.

**TWST: What's your sell discipline, and can you share an example of a stock that you recently sold and tell us what triggered that sale?**

**Mr. Vogel:** Our sell discipline is really the flip side of the modeling we do for all of our companies. We seek to establish a four-year price objective for each company and then obtain a current net present value using various discount metrics. We buy companies selling below our appraisal of their net present value, typically with the goal of our selling them 10% to 15% above this appraisal. That's our primary sell discipline.

We also will sell companies if we feel our original premise for buying has drifted into something less favorable. For example, this may be a management change we don't like, or if a company makes a capital allocation decision we don't agree with. Finally, when clients hire us to obtain exposure to our small-cap or mid strategy, we will actively prune holdings that have become too large for their benchmark.

Our most recent sale is a company that is being acquired. **Protective Life** (PL) has been purchased by a Japanese insurance company and is selling at a very modest discount to the offered value. This has become an arbitrage situation, and we tend not to play the arbitrage game. The acquisition of **Protective Life** came at a nice premium.

**TWST: What are the investment risks that are at the top of your mind at this point, and how does your investing strategy seek to avoid and manage those risks?**

**Mr. Vogel:** In one sense this is a hard question for me to answer because we focus on running risk-averse portfolios. We don't like to take balance sheet risk, so there are very few of our companies that will be more than, let's say, four times net debt to EBITDA. As I mentioned earlier, our leverage ratios are prone to be at or below our benchmark. Earnings risk is something we always have to face. But again, we tend to gravitate toward lower-volatility business models that dampen this risk.

We also seek to avoid binary outcome situations. For example, we have no emerging biotech exposure where we would live or die depending on whether a compound successfully gets through clinical trials. That's not the kind of situation we would get our clients involved in.

The companies we identify have reasonable prospects for growth over a multiyear time horizon, and we've been able to generate favorable returns keeping to that longer-term orientation. We try not to let the wiggles in the markets get us too excited, and that has tended to work pretty well for our portfolios. From what we can see, nothing on the horizon right now suggests a "cliff"-type environment, even though there are always geopolitical and economic issues to worry about. I wouldn't characterize the current "wall of worry" as being appreciably better or worse than is typical.

**TWST: Thank you. (MES)**

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**Equity Strategy Descriptions:**

Silvercrest Large Cap Equity is an actively managed, value-oriented investment strategy which focuses on companies with market capitalizations in excess of $2 billion. The benchmark used for this strategy is the S&P 500 Index. Silvercrest Small Cap Equity is an actively managed, value-oriented investment strategy which focuses on companies with market capitalizations between $200 million and $2 billion. The benchmark used for this strategy is the Russell 2000 Index. Silvercrest Multi Cap is an actively managed, bottom-up investment strategy that invests across the market cap spectrum. The managers, therefore, are allowed to comb a broad universe of stocks to build their portfolio. The benchmark used for this strategy is the S&P 500 Index. Silvercrest SMID Cap Equity is an actively managed, value-oriented investment strategy which focuses on companies with market capitalizations between $200 million and $10 billion. The benchmark used for this strategy is the Russell 2500 Index. Silvercrest Equity Income is an actively managed, bottom-up investment strategy with a focus on higher yielding companies. The benchmarks used for this strategy are the Russell 3000 Value Index and the S&P 500 Index. Silvercrest Focused Value Equity is an actively managed, value-oriented investment strategy which seeks to enhance capital through the ownership of a concentrated portfolio of the investment team's best potential investments, regardless of market cap. The benchmark used for this strategy is the S&P 500 Index. The Silvercrest Core International Equity strategy seeks to achieve long-term, tax-efficient capital growth by investing in dominant, well-managed companies domiciled outside the United States. The benchmark used for this strategy is the MSCI EAFE Index. Silvercrest Master Limited Partnership (MLP) is an actively managed, income-oriented investment strategy which focuses on publicly traded limited partnerships with market capitalizations in excess of $1 billion. The benchmark used for this strategy is the Alerian MLP Index.

**Benchmark Descriptions:**

The S&P 500 Index is a capitalization-weighted, unmanaged index that measures 500 widely held US common stocks of leading companies in leading industries, representative of the broad US equity Market. The Russell 2000 Index is a capitalization-weighted, unmanaged index that measures the 2000 smallest companies in the Russell 3000. The Russell 2500 Index is a capitalization-weighted, unmanaged index that measures the 2500 smallest companies in the Russell 3000 Index. The Russell 3000 Value Index is a capitalization-weighted, unmanaged index that measures the 3000 largest US companies based on market capitalization. The MSCI EAFE Index is a free float adjusted market capitalization-weighted, unmanaged index that measures equity market performance of developed markets, excluding the US & Canada. The Index consists of the following 22 developed market country indices: Australia, Austria, Belgium, Denmark, Finland, France, Germany, Greece, Hong Kong, Ireland, Israel, Italy, Japan, the Netherlands, New Zealand, Norway, Portugal, Singapore, Spain, Sweden, Switzerland, and the United Kingdom. The Alerian MLP Index is a composite of the 50 most prominent energy Master Limited Partnerships. The index is calculated using a float-adjusted, capitalization-weighted methodology.