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THE WALL STREET TRANSCRIPT

Connecting Market Leaders with Investors

Managing Risk While Striving for High Returns

JAY JACKLEY, CIMA, joined Compass Capital Management, Inc., as a Senior Portfolio Manager in 2009. He has been in the financial investment industry for over 18 years. He began his career at Merrill Lynch where he was a Vice President and attained the unique qualification of being a Certified Investment Management Analyst — CIMA — and trained as an advanced financial consultant for institutions, nonprofits and private clients. Mr. Jackley completed his B.A. in economics and philosophy from Macalester College. He is a member of the Investment Management Consultants Association, IMCA; and a member of the Chartered Financial Analyst Society of America, CFA. He currently sits on the Minneapolis College of Art and Design — MCAD — board and finance committee.

MARK VITELLI, CFA, is a Senior Portfolio Manager at Compass Capital Management, Inc. Prior to joining Compass in 2011, he managed high net worth and institutional client portfolios for Wells Fargo Private Bank. From 1998 until joining Wells Fargo in 2004, he managed portfolios for a Forbes 100 family at Tonkawa, Inc., a Minneapolis-area family office. Mr. Vitelli began his career in the fixed income group at Sit Investment Associates in 1992. He completed his MBA in finance at the University of St. Thomas, holds the Chartered Financial Analyst designation and earned his undergraduate degree in finance from the Carlson School of Management at the University of Minnesota.

SECTOR — GENERAL INVESTING

TWST: Please tell us a bit of the history of Compass Capital Management.

Mr. Jackley: Charlie Kelley and David Carlson founded Compass Capital in August 1988. They were Portfolio Managers at a large national financial firm, and it occurred to them that they could do their best work for clients if they could focus primarily on the investment style they preferred and had used successfully for many years. They also wanted to structure and align their firm around the interests and needs of their clients. After 26 years – this remains our main focus today.

TWST: Tell us a little bit about the investment philosophy.

Mr. Jackley: As in medicine, our governing principle at Compass is “first, do no harm”. What this means is that managing risk is at least as important to us as striving for high returns. This is why we focus on high-quality stock companies and high-quality bond issuers we can understand and follow closely over time. Risk and return are really two sides of the same coin. Simple math reminds us that if we lose 50% of the money, we then must generate a return of 100% just to get back to even. It’s best not to lose money in the first place, if possible. We clearly don’t control the markets and obviously cannot promise we will never lose money. Nevertheless, over the past 26 years this Compass philosophy has served our clients very well especially during periods of economic stress.

TWST: Are there certain trends impacting your investing decisions right now, either in terms of sectors or market cap size?

Mr. Vitelli: Mid to Large cap growth has always been the investment style at Compass and remains the focus today. Regardless of market cycles, when you look closely at individual high-quality companies, you almost always are able to find good well-managed companies with a high-quality balance sheet trading at attractive levels. We do not spend time trying to figure out if in the next six months small caps are going to outperform large-caps or should we be in gold or any of those things. At times the market will present a large number of bargains in your space, and then there are other times where you have to be more patient. But regardless, we like the Mid to Large cap growth space.

Mr. Jackley: Our strategy is to buy growth companies but we are also valuation sensitive. As to certain trends impacting our investment decisions today, we use a very opportunistic investment approach. Let me explain, we believe in investing in superior businesses led by responsible and dedicated managers at reasonable prices – regardless of market size but we stay in the $2 billion and above market capitalization range. Many other Money Managers invest only in a certain style i.e. Large Cap or Mid-Cap, and must remain invested in their style even when there are few or no compelling values in that segment of the investing universe. Our ability to preserve capital during the challenging years (2000-2001) was a direct result of our flexibility to invest where it made sense to do so. In the late nineties the S&P 500 Index (market-cap weighted and dominated by large cap companies) was trading at 30x times earnings, compared to the Value Line index of 1500 equally weighted companies (more representative of mid-cap companies) which was trading at 13x times earnings. Clearly, the opportunities were in Mid-Cap sized companies, and we made the switch.

TWST: How many stocks do you like to have in a portfolio?

Mr. Vitelli: We always have 25 stocks in a portfolio. For us, that's simply the right number. Most studies done over time prove that the number of holdings needed for an appropriate diversification is around 15, maybe 20. Twenty-five is the right number for us because it gives us diversification and it also allows us to display conviction in an idea. I have worked at other firms before I came to Compass where you held so many holdings that if company ABC tripled, it would barely impact the portfolio performance. At the same time, the discipline in having 25 companies, benefits the clients on the positive side because we have a really thorough understanding of the company before we put it in the portfolio.

Highlights

Jay Jackley and Mark Vitelli discuss their investment strategy; the governing principle of which is: "First, do no harm." At Compass Capital Management, they believe that managing risk is equal in importance to aiming for high returns. Mr. Jackley and Mr. Vitelli focus on large-to-midcap growth and attractive valuations. Their portfolios consist of 25 diversified stocks and showcase high-quality, well-managed companies with flexible balance sheets. Mr. Vitelli advises investors to orient themselves toward the long term, and Mr. Jackley recommends that investors and portfolio managers maintain clarity and transparency with regard to what they're invested in.

Companies discussed: The Procter & Gamble Company (PG); Johnson & Johnson (JNJ); QUALCOMM (QCOM); Visa (V); Accenture plc (ACN); Novartis AG (NVS); Thermo Fisher Scientific (TMO) and Ecolab (ECL).

Mr. Jackley: We also equally weight and rebalance the portfolio which is a very unique and defining discipline unlike other money management firms. We want to make sure that when we buy 25 stocks – a 4% commitment to each name in the equity segment of the portfolio – each one will have meaningful impact. If a stock runs up to 5% weighting we'll trim it back to 4%. If it drifts down to 3% we'll add to it, bringing it back up to 4%. This forces us to be objective, buy low/sell high and lessens risk to some extent.

TWST: What are some of the characteristics you look for in addition to valuation when you are evaluating stocks for a portfolio?

Mr. Vitelli: There are unique defining characteristics of "Compass Stock." We look for a proven management team that has been through market cycles. And as you probably could figure, the last ten years have made it easier to find management teams who have been through some tough times. In 1999, it was hard to find teams who had been through any difficult cycles because it hadn't been challenging for a long time. We look at the last two recessions and evaluate whether the management teams have maintained or even grown profitability and revenue in spite of the economic downturn.

The key to us is having a debt to total capital maximum ratio of 40%. We want companies to have flexibility with the balance sheet. So if we like a business but their debt to capital ratio is significantly above 40%, we won't buy the stock. We really value that flexibility. We also look for diversification both in the geographic location of the revenue streams and diversification of the products or services provided. We want them to not just be a single product line company because your products might be hot now, but may not be later.

Nokia used to be the "hot" cell phone. Then **Apple** came along with the smart phone, and **Nokia** had missed that trend coming. So we try to stay away from the single product company. We want diversification on what they sell or what service they provide. Those are some of the big things. We don't require dividends but we prefer a dividend that has been growing over time which is a reflection of strong cash flow from the business.

Mr. Jackley: Really what we are doing for clients is building an earnings stream for them. We want businesses that are generating and growing cash flow. We spend a lot of time researching and talking to the management of these companies making certain that they have been good stewards of the cash they are generating within their businesses and that they are allocating the cash appropriately to enhance shareholder value. We fully monitor that process. I look at our businesses as companies that are building an earnings stream that's consistent and stable.

"There are certain sectors that, because of the nature of them, we tend to shy away from. Sometimes it's the typical composition of the balance sheet of a company. For example, with a 40% total debt to capital maximum, the banking sector is eliminated from our portfolios."

Mr. Vitelli: Also, we don't target sector weightings but we do have diversification, and the mix of the companies we have is important. Some of them are higher growth companies which have more volatility and others are much bigger and grow at a slower rate, but are less volatile. These are the **Procter & Gambles** of the world. No one expects **Procter & Gamble** (PG) and **Johnson & Johnson** (JNJ) to grow as fast as **Qualcomm** (QCOM) or **Visa** (V), but all of those companies have a role in our portfolio and when you blend them together, you participate in the upside of the market and you do a good job of protecting the downside.

TWST: You mentioned that you don't have sector weightings. Do you actively strive to diversify, or do you primarily evaluate each individual stock based completely on its own characteristics?

Mr. Vitelli: It's pretty much stock specific. There are certain sectors that, because of the nature of them, we tend to shy away from.

Sometimes it's the typical composition of the balance sheet of a company. For example, with a 40% total debt to capital maximum, the banking sector is eliminated from our portfolios. Companies must have a reasonable handle on the pricing of the products they're providing and we must be able to reasonably project that price going forward. So, we tend to avoid companies that produce and extract commodities because it's very difficult to model their revenue with any sort of certainty.

1-Year Daily Chart of Thermo Fisher Scientific

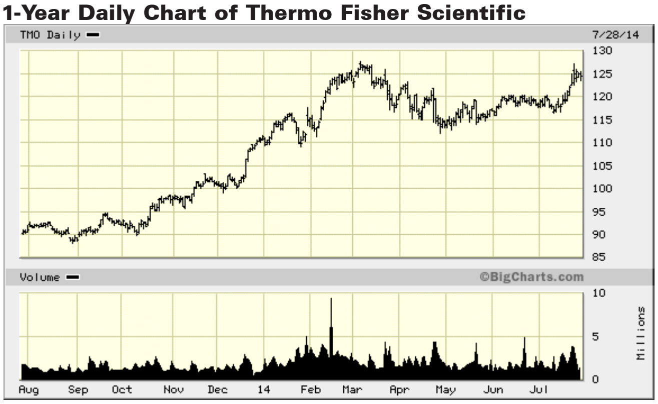

Chart provided by www.BigCharts.com

Utilities are another example, because they are so highly regulated. They don't really have any pricing power because they must go to a government appointed panel to get permission to increase prices. Typically utilities also have a lot of debt on the balance sheet so we only find a small number of them which would even meet our debt to capital ratio irrespective of their business.

After these considerations, we go where we find value in the market. For example, we have been over-weighted in healthcare for several years, and it has served us quite well. At the time we bought these companies, they were very attractively priced, with globally diversified revenue streams and the market was shying away from them because of the uncertainty around the Affordable Care Act.

TWST: What about international companies? Do you invest internationally as well?

Mr. Vitelli: We invest in any company that has shares which trade on a US based exchange. Right now we have two international companies in our portfolio, **Accenture** (ACN)and **Novartis** (NVS).

TWST: What is it about Accenture that is attractive to you?

Mr. Vitelli: We bought the stock five years ago when a lot of companies, especially technology-related companies, were really beat up price wise. We purchased **Accenture** in 2009 at about $32. And what we really like about **Accenture** is that the business is fairly evenly split between their consulting practice and their information technology outsourcing business.

The company has grown earnings over time in the low-teens. They initiated a dividend about six years ago and have increased it nearly 30% annually. They have zero debt on the balance sheet and the dividend yield is 2.5%. Their net profit margin, even after taxes, is in the double-digits and foreign revenue is 52% of total.

If you look back in 2008-2009, the business held fairly steady. They were able to maintain their margins on a very modest drop in revenue with steady profitability in dollars and then came out the other side of the recession and continued to grow nicely. **Accenture** met all our criteria and the stock right now trades at around $80. So over five years, we have earned a nice return on that stock.

TWST: You mentioned health care and that you have been overweight there. Can you give us an idea in the health care area that you like?

Mr. Jackley: Another company we own is **Thermo Fisher Scientific** (TMO). They are a manufacturer of analytical technologies, diagnostic equipment, and laboratory products and services for both research and practice. **Thermo Fisher** is the combination of **Thermo Electron** and **Fisher Scientific**, which merged in 2006. The merger blended the strengths of the two companies really well. Over the last five years, they have grown sales and profits at a double-digit percentage rate annually. Over time, they have improved their operating margin, net profit margin, and initiated a dividend. In 2009, the company made $5.00 a share and they are projected to make $9.50 this year.

We were able to buy the stock in 2012 at $51 and it currently is trading at about $118. This was also a case where we bought the stock at the right valuation relative to where it normally trades. We had several phone calls with management and we happened to purchase the stock about three weeks prior to the earnings release which surpassed expectations and the stock started moving back up. But that's just an example of a company whose stock was down due to the uncertainty around the Affordable Care Act.

1-Year Daily Chart of Ecolab

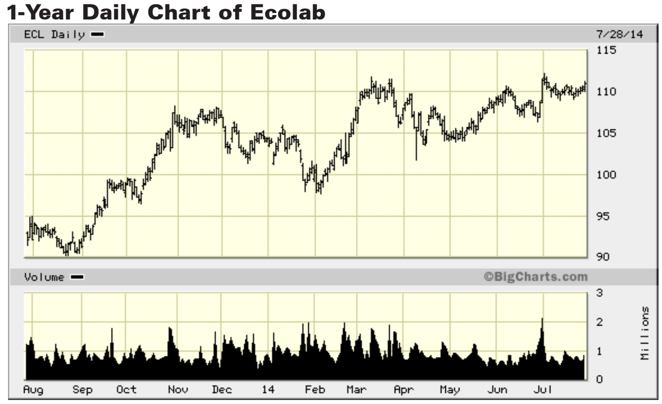

Chart provided by www.BigCharts.com

At the end of the day, away from those headlines, there are companies like **Thermo Fisher** who are developing technologies, products, and diagnostic tools to help the researchers find cures for various diseases. No matter what's going on politically around healthcare, there remains a lot of human and financial capital devoted to trying to cure diseases. That will continue, regardless of what's happening in Washington.

TWST: Can you give us one more example?

Mr. Vitelli: The last one I'll give you is a local company, **Ecolab** (ECL). Many may not be aware of some of the things they've done in the last few years to position their business. Most people know **Ecolab** from the hand sanitizer pump or soap dispenser in a restaurant or store. If you have worked in a restaurant or a deli the soap for the big dishwasher is from **Ecolab** as are the cleaning products used to mop the floor. This has been **Ecolab's** business for quite a long time and they are good at it.

In 2011, they acquired a water company called **Nalco**. **Nalco** specializes in both water filtration and cleaning the water used in the process of hydraulic fracking in the energy sector. This transformed **Ecolab** and enabled them to move into a much higher growth sector. In addition to **Nalco**, they acquired a privately-held, smaller company called **Champion Industries** in 2012. Now **Ecolab** has diversified their revenue stream quite a bit. The global institutional cleaning supplies and hand sanitizer business has dropped from around half of their revenue stream to about 31%, and the water and energy services business from the two acquisitions is now 26% of their revenue. So, this transformation in the company will be beneficial going forward.

Ecolab is headquartered in St. Paul, right across the river from us in Minneapolis. We talk to the management team on a fairly regular basis and they described to us why they made these acquisitions to move into the water business and the reasons they articulated are proving to be true. Their earnings per share have gone from $2.54 in 2011 to a projection of $4.15 this year. So, it's been a substantial positive for the company and when a lot of people think of **Ecolab**, they may not be aware of what's going on in the industrial space and how this company adjusted to make sure they can provide what customers need.

TWST: Are you fully invested all the time or do you keep cash?

Mr. Vitelli: There are two answers to this question. Typically, we remain fully invested. Some clients might have a need to have a portion of their portfolio in cash for specific reasons. Typically, there will be a just couple percent in cash in the portfolio, often due to collecting dividends. We're not a manager who's going to say we think the market's over-valued, and go to 15% or more in cash in all portfolios, that's not something we do.

Mr. Vitelli: To be long-term in orientation; I think that's really, really important and something learned over 20+ years in the industry. What has changed over this time period is the investor's time horizon. When I started in the early 90s, the more seasoned portfolio managers would lament that peoples' time frame and holding periods were measured in months. As we all know with the internet, Twitter, 24/7 news and high frequency trading now it's measured in seconds. Investors should buy a good quality company and watch closely how they manage their business.

We bought **Qualcomm** a couple of years ago and they surpassed earnings expectations modestly the first few quarters and the stock didn't move while the market was rising. And then all of a sudden people started paying attention to the stock and it started to have its price catch back up with the earnings stream that they've been producing. Sometime people feel like they always need to do something. Our investment committee meets weekly. Every week in that meeting we make a conscious decision to keep what we have because we still like what's in the portfolio.

Mr. Jackley: I believe that investors should understand what they own in their portfolio, it should be clear and transparent. Often times investors have a portfolio with a vast array of money managers, using as many as 8-12 different firms. During the financial downturn of 2008, this over-diversification actually added more risk and volatility to portfolios. As Warren Buffet said "diversification is a hedge for ignorance".

"We have protected the downside substantially relative to the market in all of these declines, and a lot of that is due to the quality of the companies we own. The asset allocation is also an important part. Most of our accounts hold bonds as well as stocks. Our bonds are high-quality, intermediate maturities, all A-rated or better and truly act as a risk mitigator."

We believe that to succeed in market timing, you have to get two decisions right. To do that, you have get out of the market at the right time and get back in at the right time. History has shown very few managers are able to get both of those decisions right. That isn't how we work.

TWST: What is your sell discipline? What makes you sell something?

Mr. Vitelli: Number one, if the debt-to-total capital increases much over 40%, we would sell the stock. Another reason would be if there was a major change in the management team and someone unproven or unfamiliar with the company is placed in a leading role. That too would get us to sell the stock. Or if the company makes a big acquisition which makes no sense relative to their core competency. But the most common reason is we simply find another company that appears to have better growth prospects and we can buy it at a price we are comfortable with. The last couple of times we have sold a company, it was because we were able to find companies we believe have strong growth prospects and buy them at fairly attractive prices.

TWST: What are the most important methods you use to manage risk in a portfolio?

Mr. Vitelli: First of all, owning quality companies helps. There have been four or five down years in the 25 plus year history at Compass. We have protected the downside substantially relative to the market in all of these declines and a lot of that is due to the quality of the companies we own. The asset allocation is also an important part. Most of our accounts hold bonds as well as stocks. Our bonds are high quality, intermediate maturities, all A-rated or better, and truly act as a risk mitigator. This limits interest rate risk and duration risk, and we minimize the credit risk in the portfolio. Equally weighting the stocks also helps. By trimming back your winners, you reduce concentration risk in the portfolio.

TWST: With all your experience and looking at the markets, for each of you, what is the best advice you would give an investor?

At Compass we move in the opposite direction. We want clarity, transparency and greater control over our holdings. We and our clients want to know what we're invested in and why are we holding these securities. We view stocks for what they are: an ownership interest in a business led by managers who view us as co-owners and our clients as shareholders. Because of this we feel that we have a better likelihood of achieving our clients' goals with a limited number of carefully selected individual stocks and bonds. I guess what it comes down to, is that you have to have conviction in your investment process, which works, and a fervent commitment to the disciplined execution of that process.

The other piece of advice that I would give clients is to have direct access to their portfolio manager. Having the transparency to better understand the process, only empowers them to be able to make better decisions. For us at Compass, having that connection aligns the managers' interests with those of the investors so that performance success provides rewards to all.

TWST: Thank you. (LMR)

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