



MID-CAP VALUE Detailed Investment Strategy

Investment Philosophy

H&W employs a research-driven, fundamental value investing approach. We invest in companies where, in our opinion, the present value of its future cash flows exceeds the market price. These opportunities often emerge because the market extrapolates current trends into the future, which leads to favoring popular investments and shunning others—regardless of valuation. Empirical evidence suggests that companies generating above average returns on capital attract competition that leads to lower levels of profitability. Conversely, capital leaves depressed areas, often allowing profitability to revert back to normal levels. The difference between a company's price based on an extrapolation of current trends and a more likely reversion to mean creates the value investment opportunity.

Traditional Wall Street research for medium sized companies is limited. This creates an opportunity for investors with fundamental research capabilities to identify attractive investment candidates or special situations. We organize our research team by industry rather than by strategy, which allows us to focus more investment resources per dollar of assets under management and identify securities that are not widely followed by Wall Street research.

To uncover these opportunities, we employ a disciplined, bottom-up investment process emphasizing rigorous, internally-generated fundamental research. We believe the consistent application and depth of our independent research can maximize the tradeoff between value and risk providing superior returns to a static benchmark over the long term.

Investment Process

H&W subscribes to a team-oriented, four-stage process. The goal is to employ a consistent, repeatable approach and create a diversified portfolio that exhibits attractive risk/return characteristics.

<u>Stage</u>	<u>Purpose</u>	<u>Responsibility</u>
1. Idea Generation	Identify investment candidates and prepare initial review	Entire Team
2. In-Depth Evaluation	Prepare detailed assessment of investment opportunity	Analysts
3. Recommendation	Review analysis, assess risk/return profile	Analysts/Sector Teams
4. Portfolio Construction	Buy, sell, and monitor	Portfolio Coordinators

1. Idea Generation

We source investment ideas from screens of financial databases and from our investment team.

Financial Database Screens

We use dynamic and flexible quantitative screens designed to filter a large universe of securities to identify those that appear to have attractive risk/reward characteristics. These screens evaluate similar risk and valuation criteria, but can be tailored for specific sectors/industries to emphasize the most relevant factors.

Investment Team

We augment our quantitative screens with ideas sourced from our Analysts and Portfolio Coordinators. Based on their industry knowledge, contacts, experience, and discussions within the Sector Teams, our investment team identifies opportunities that automated screens can miss due to data issues or other limitations inherent with screens.

Once investment ideas are generated, an initial review is conducted to highlight the key investment merits and risks, verify the validity of the characteristics that attracted us to the security in the first place, identify any obvious issues/warning signs that need to be addressed, and provide a rough estimate of the risk/return profile.

2. In-Depth Evaluation

The in-depth evaluation stage of the process is by far, the most rigorous and time-consuming. This stage involves detailed research at the industry, company, and security level.

Industry

Analysts conduct industry research concentrated on determining long-run margins and returns on capital. We seek to understand the factors that influence changes in supply and demand in order to determine normal industry profitability. Competitive analysis, akin to a Porter's Five Forces approach, is also evaluated to obtain a better understanding of industry risks. Our analysts accumulate a body of knowledge over years that enable them to respond to dynamic markets quickly.

Company

Using the industry research as a backdrop, the Analyst conducts detailed fundamental research at the company level. We focus on the company's long-run normal earnings power, which is the sustainable cash earnings of a company under equilibrium economic and competitive market conditions. Company analysis focuses on full cycle profitability, capital intensity, free cash flow and financial leverage. Analysts meet with company management to better understand the company's business model by its various divisions, capital allocation policy, return potential of current capital programs, shareholder orientation, and overall competence.

Next we do a risk assessment, which entails a variety of both financial and non-financial factors. We assess the company's ability to survive temporary, short-term distress without impairing the long-term value of its franchise. This includes a review of its financial leverage, historical cash flow volatility, available liquidity, access to capital, exposure to extreme events, and unusual profit concentrations. To augment the risk evaluation process we have developed a red flags analysis,

which is a list of questions that helps identify subtle but potentially meaningful risks. The ultimate goal is to identify attractively valued companies with acceptable risk profiles.

Security

To quantify return potential, we use one or more of several valuation techniques such as dividend discount model, multiple of normal earnings, or price to replacement costs depending on a variety of individual circumstances. The analyst also provides a risk assessment highlighting critical issues that could affect the company and its stock price. Finally, the analyst summarizes the recommendation with an investment thesis and recommended weight.

3. Recommendation

Each step of the in-depth evaluation is subject to peer review by the Portfolio Coordinators. In addition to reviewing financial models and ensuring integrity/consistency, the reviewers play a devil's advocate role to challenge the thesis and modeling assumptions. The primary objective is to solidify our belief in valuation and security risk. Sector Teams also consider macroeconomic trends and the potential effect on the portfolio. Once ideas are thoroughly vetted, the Analyst and Portfolio Coordinators jointly decide on a target weight.

4. Portfolio Construction

We employ a bottom-up, risk-controlled portfolio construction process with the primary goal of generating attractive risk-adjusted returns. Portfolio Coordinators assess recommendations within the context of the overall portfolio. They consider the relative attractiveness of opportunities and assess the complementary nature of new ideas with the existing portfolio. Portfolio Coordinators have responsibility for creating and maintaining a target portfolio for the investment strategy, generating trades and assuring compliance with client guidelines—buy, sell, and monitor.

Financial Definitions

Porter's Five Forces: 1) barriers to entry, 2) bargaining power of customers, 3) bargaining power of suppliers, 4) threat of substitute products, 5) competitive industry rivalry.

Cash flow: Measures the cash generating capability of a company by adding non-cash charges (e.g. depreciation) and interest expense to pretax income.

Free cash flow: The amount of cash that a company has left over after it has paid all of its expenses.

Return on capital: Measures how effectively a company uses the money (borrowed or owned) invested in its operations.