

Small and Mid-Cap (SMID) List

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Small and Mid-Cap (SMID) List overview

The Small and Mid-Cap List (SMID List) includes stocks representing companies with market capitalizations ranging from \$1.0 billion to \$20 billion at the time of addition. The objective is to exceed the total return of the S&P 1000 Index over a minimum one-year time horizon.

All financial data as of January 13, 2023 and sourced from FactSet and Wells Fargo Investment Institute.

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**Please see pages 38-40 of this report for Important Disclosures (including disclosures on conflicts of interest),
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Communication Services

Liberty Global Plc Class A (LBTYA-\$21.26)

Summary: Liberty Global plc (Liberty) is a provider of video, broadband internet, fixed-line telephony, and mobile services to residential and commercial customers in select European countries. Company operations are conducted through wholly owned subsidiaries, and joint ventures. The company also has equity investments in other media assets. Liberty is domiciled in the United Kingdom.

Company Highlights: Liberty's investment appeal builds upon a combination of an inexpensive valuation, a strong management team, and business optionality.

We note multiples for media assets have been described as moving along a pendulum, often past equilibrium and favoring one, or the other, of two perceived extremes: distribution or content. Liberty is no stranger to this phenomenon, having a long history of transacting in both categories of media assets.

We believe management is a critical feature to the investment appeal of Liberty, with its executives equally skilled at both operating expanding telecommunications services businesses, as well as navigating dynamic capital markets. Company activities for the past several years have been directed by Chief Executive Officer (CEO) Mike Fries and Chairman John Malone, with Malone the long-serving executive, Board member, and arguably chief capital allocator for many years for several different Liberty properties, with shareholders generally being the long-term beneficiaries of his decision-making. Management is a keen user of leverage and creative in their deal-making and financing, some of which may be complex in structure and usually tax-efficient. The company's rich tradition of deal-making has continued.

Among the recent significant moves, in July 2019, Liberty completed the sale of assets in Germany, Romania, Hungary, and the Czech Republic to Vodafone Group plc, which brought in more than \$11 billion in net cash proceeds. In May 2020, it announced the formation of a joint venture, merging the UK operations of Virgin Media, and its broadband network, with Telefonica's O2 UK, the country's largest mobile platform. Liberty also has refinanced more than \$10 billion of long-term debt, extending maturities, and lowering its financing cost. In April 2021, it completed the acquisition of Sunrise Communications Group AG, creating a fixed-mobile player in Switzerland.

We think the company preserves much optionality, as it pursues communication service opportunities that have favorable outlooks for growth. In their words, the strategy is about creating "converged, national champions across core European markets." As it executes the strategy, tactics could take multiple forms, including additional mergers and acquisitions (M&A), joint ventures, or investments. The company may find other ways to surface, or highlight the value of its assets, such as through the use of tracking stock. And as mentioned before, the balance sheet has added flexibility too, which enhances the options available to the company. The overall goal seems the same: deliver durable free cash flow (net cash from operating activities less capital expenditures) and create value for equity holders.

Valuation: Shares of LBTYA trade at a forward EV/EBITDA (enterprise value divided by earnings before interest, taxes, depreciation, and amortization) ratio of 8.2x, compared to its five-year historical average of 7.8x.

Risks: Liberty has a levered balance sheet. Competition in its markets is often quite aggressive. Given its history of corporate actions the company may make a misstep with an acquisition. The loss of key management personnel would potentially be damaging to the company. John Malone has a large voting interest which is higher than his economic interest in the company, gives him significant influence on matters submitted to shareholders for approval. Valuations for Liberty may not improve. The company is subject to extensive regulation in its core markets. Subscriptions may decline. The company may not provide satisfactory customer service in its areas of operation or operate its network effectively. The company may not be able to maintain subscriber rates. Technology is evolving for broadband and mobile usage. Unfavorable economic conditions may affect collection rates from customers.

Consumer Discretionary

Burlington Stores, Inc. (BURL-\$225.25)

Summary: Burlington Stores, Inc. (Burlington) is a leading retailer of off-price branded apparel, accessories, footwear, and home goods that operates with an “everyday low price” model.

Company Highlights: A solid operator with a good history of sales and earnings growth, Burlington still sees opportunities to add to its fleet of stores, improve the productivity of the existing store base, and raise operating profit margins to be more in-line with its off-price competitors. Burlington is widely viewed as capable of closing much of the operating gap with peers, and that potential has not gone unnoticed by investors.

After several successful years, which included revenue and profit growth, improving margin, and better inventory management, management introduced a slightly more conservative growth algorithm, including a lower rate of same-store sales growth, but with a greater desire to chase the sales trend, make opportunistic buys, while smartly controlling inventory and liquidity. Management also closed their small e-commerce business, which was viewed as difficult to operate economically at their typical transaction values.

Burlington’s leaders are experienced managers, and have been given a strong hand to play, considering the company’s store-level economics, runway for unit growth, and ability to generate free cash flow. Management sees the potential for 2,000 stores. New store development for the fleet features a smaller prototype footprint, a tactic underway for a few years now, which should help raise the productivity and the profitability of the store base, which we believe is a strong feature of investment appeal. Operating margins at Burlington though are still below peers. As well, inventory turnover, while much improved over the past several years, is still more than a full-turn lower than peers.

Lastly, the pandemic has accelerated the decline of some specialty and department store retailers, reinforcing a trend owed to a combination of changed shopping patterns (more online) and, in some cases, unsupportable capital structures. With many specialty and department store chains losing business or closing, there is presumably an opportunity for Burlington to capture some of that business as it looks to return to, and eventually exceed, prior levels of peak profitability.

Valuation: Shares of BURL trade at a price-to-earnings ratio of approximately 41.1x the next-twelve-months consensus earnings per share estimate of \$5.48, compared to its five-year historical average of 33.7x. On a relative basis (to the S&P 500), the shares trade at 2.0x the market versus 1.7x five-year historical average.

Risks: Competition is fierce from well-established competitors. Spending habits may change. Growth rates may decline and may not meet market expectations. Visibility into business trends is often limited. Annual profitability is heavily seasonal and skews to the fourth fiscal quarter. The company’s financial results could come in shy of market expectations. The retailer may be in the latter-growth stage of its lifecycle, which may reduce the investment appeal. Traffic-driving initiatives may not have the desired effect. Macroeconomic variables, such as income and employment, could change adversely for the company’s core middle-income consumer. The company may not be able to improve its margins or other operating metrics. The company faces wage pressure from competitors and minimum wage initiatives of state governments. The broader migration of sales to online alternatives is a threat to much of physical retail.

Chewy, Inc. (CHWY-\$43.76)

Summary: Chewy, Inc. (Chewy) is a pure-play, online retailer of pet food, supplies, and pet health products.

Company Highlights: Chewy operates in a very attractive category - pet food, supplies, and services - which is a large market (estimated at more than \$90 billion annually), with decent growth (typically a mid-single-digit percentage annually). Pet food and products also offer some of the most resilient demand characteristics in consumer goods and is a category receptive to brand building and premiumization strategies for its products. It is also a category seeing purchasing patterns shift from traditional in-store, brick and mortar retail channels to online retail, given online retail's potential for wider assortments, price points, package sizes, and the convenience and flexibility of reordering and delivery.

Chewy, as the largest pure-play online retailer of pet food and supplies in the United States, offers 2,500 brands and more than 75,000 products through its website and mobile applications. The business has several attractive features including a strong brand, superior customer service, a wide product assortment, and a recurring revenue model.

Key components of the company's strategy include increasing its base of active customers, increasing its sales per active customer and realizing a greater share of wallet, and generating recurring revenue. Demand for its products is durable, and importantly, for the company, relatively predictable. The majority total revenue comes from sales to customers on the company's Autoship subscription program, which offers automatic ordering, payment, and delivery of products to customers. The revenue mix is heavily skewed to consumables. When combined – durable demand, subscription-based purchasing, and a consumables product mix - should create a sticky revenue stream. As for expanding wallet share, Chewy customers typically, by their third year, spend 3-4x their first-year spending with the company, and the spending levels may go up the longer the customer stays with Chewy.

The company is known for exceptional 24x7 customer service and an easy shopping experience - among the critical factors to building brand value for ecommerce companies, in our view. Fulfillment capabilities are also vital, with the company's fulfillment centers capable of reaching 80% of the US population overnight, and nearly 100% of the US in two days. The success of these efforts has translated into strong net promoter scores (NPS) for the company. (NPS is a metric measuring the likelihood to recommend the product or service.) All of these features help foster strong customer retention.

Valuation: CHWY is trading for 1.8x EV to consensus estimated fiscal 2022 revenue and 1.7x EV to consensus estimated fiscal 2023 revenue, below the median one-year and two-year forward EV to sales multiples of 2.9x and 2.3x, respectively

Risks: Competition in retail is intense. Chewy's competitors have strong fulfillment infrastructures and distribution capabilities. The company may not be able to retain, or increase its customer base. Execution and fulfillment may disappoint. Customer churn could increase. Supply chains could be pressured. Incidents may occur which could damage the company's reputation and status in the market. The company could lose key suppliers. Financial results may fall short of market expectations. The company is subject to extensive regulation. International expansion may not be successful. Consumer purchasing habits may change. Valuations could contract.

MGM Resorts International. (MGM-\$39.54)

Summary: MGM Resorts International (MGM) owns and operates casino and hotel resorts, which offer lodging, gaming, dining, entertainment, meeting and conference facilities, and retail experiences for patrons. Casino resorts are located on the Las Vegas strip, in regional U.S. markets, and in Macau.

Company Highlights: MGM possesses several appealing features including: a leading portfolio of casino resorts in key domestic and select international gaming markets; an "asset-light" operating model; a Board of Directors that is a significant owner of the common stock; and a valuation that we think is attractive. MGM also has a U.S. sports betting and online gaming venture, which offers added optionality for the company. Importantly too, the company has reasonable on-balance sheet liquidity.

MGM has a number of casino resorts on the Las Vegas strip as well as in regional markets in the U.S., and in Macau. Among the company's properties in Las Vegas are the Bellagio, MGM Grand Las Vegas, Mandalay Bay, and Luxor. Regional operations include the MGM Grand Detroit, Beau Rivage, Gold Strike, and Borgata, among others. Internationally, the company has an ownership interest in a company that holds a subconcession to operate casino games in Macau.

The company's domestic properties cater to gaming patrons, as well as group, business, and leisure travelers, with an assortment of casino gaming operations including slots and table games, as well as racing and sports book wagering. MGM's properties feature lodging, dining, entertainment, and other amenities. MGM's leisure appeal is broader than gaming, as more than half of the company revenue from domestic resorts comes from non-gaming operations, such as hotel accommodations, food and beverage, and non-gaming entertainment.

MGM has pursued an "asset-light" model, moving many of its properties to a real estate investment trust (REIT) (either a consolidated subsidiary or a third party) and leases them back under long-term lease agreements. The sale and lease-back of properties separates the underlying real estate from the operating company, and has generated considerable cash proceeds for MGM, boosting company liquidity.

MGM's casino operations were disrupted by the COVID-19 pandemic. Key markets of Las Vegas and Macau saw lower volumes with reduced domestic and international air travel, and government-directed temporary suspensions of gaming operations. While we expect revenues and profits for MGM to recover as travel and leisure activity returns, the timing of that recovery is uncertain. When demand does return, we think the company is well-positioned to exceed the prior peak in profits, helped by savings in operating and administrative expenses.

Additionally, we think the company has plenty of business optionality. It is pursuing online gaming, mobile betting, and retail sports betting opportunities that are developing in the U.S. MGM's sports betting and iGaming franchises have promise as more states look to legalize sports betting. The company is live in several states and seeking licenses in other states. The company's loyalty program with more than 34 million members (M life Rewards), is a potentially valuable resource as it expands its online gaming presence. Lastly, partial ownership of MGM China (operates the MGM Macau and MGM Cotai casino resorts), gives the company exposure to the largest gaming market in the world, Macau, without being totally dependent upon it.

Valuation is appealing too. On a consolidated basis, the company is trading for 12.9x EV to EBITDA. Over time, we believe the company can surpass the prior peak in adjusted EBITDA, as demand returns and expense and efficiency program savings are realized, resulting in an even lower prospective valuation. The company also looks attractively valued on a sum-of-the-parts basis.

Lastly, with the appointment of Barry Diller and Joey Levin to the Board of Directors of MGM, management and insiders own approximately 17% of the company's common stock, aligning their interests with those of outside shareholders.

Valuation: MGM is trading for 12.9x EBITDA. In comparison, MGM's historical five year average EV to EBITDA is 13.8x

Risks: Valuations could contract. Competition is fierce from well-established competitors in gaming and other hospitality industries. New capacity may enter its current or surrounding markets. Travel and entertainment habits may be changed by the pandemic in ways not favorable to destination casino resort operations. Financial results may not meet market expectations. Macroeconomic variables, such as income and employment, could change adversely for the company's consumer. Regional or national economic conditions could deteriorate. The company and gaming operations are extensively regulated. The sub-concession under which the company operates in Macau may be pulled by the government or may not be renewed. The company operates with a leveraged balance sheet. The company takes on development risk.

Vail Resorts, Inc. (MTN-\$251.84)

Summary: Vail Resorts, Inc. (Vail Resorts) is the leading operator of global mountain resorts, including well-known ski venues of Vail, Beaver Creek, Breckenridge, Keystone, and Crested Butte in Colorado; Park City in Utah; Heavenly, Northstar and Kirkwood in the Lake Tahoe area of California and Nevada; Whistler Blackcomb in British Columbia, Canada; Stowe in Vermont; and Perisher in New South Wales, Australia. The company also operates other ski venues in Wisconsin, Minnesota, and Michigan. Vail Resorts owns or manages several luxury hotels as well as operates a real estate development company.

Company Highlights: Several features we think make Vail Resorts attractive include barriers to entry, a relative scarcity of leading, destination skiing resorts in iconic locations, a limited threat of new entrants, and high capital requirements.

Vail Resorts boasts a portfolio of leading mountain resorts, with several of the top locations in the U.S., which have fairly stable annual visitorship and high customer loyalty. With Vail Resorts' Epic pass, vacationers can substitute visitation, and access a number of attractive venues. The pass creates a network effect with Vail Resorts' resorts, building customer loyalty, and allowing the company to record a large percentage of annual revenue prior to the season, adding predictability to the revenue model. The low cost of lift tickets relative to the total cost of a destination trip (lodging, travel expense, etc.) also allows for modest annual pricing. Favorable demographics are supportive too, as the majority of visitors have income levels typically permitting discretionary expenditures such as destination ski trips.

As a vertically integrated operator, Vail Resorts benefits from spending opportunities across the resort experience, not merely lift ticket revenues, although that represents most of the revenue. The company is an active user of technology, with data-driven consumer marketing to further customer loyalty and interaction.

Vail Resorts remains in a strong position to lead consolidation, as ski areas are still quite fragmented. Private equity has been involved in this industry for many years, and current participants may seek monetization of these investments in the future, providing Vail Resorts with potential acquisition opportunities. While the number of iconic, destination options is fairly limited in North America, acquisition opportunities outside of North America look promising. Adding to the acquisition appeal, the company is reasonably well-capitalized. We think the company's longer-term trajectory is promising, particularly when backed by long-lived, iconic, difficult-to-replicate assets.

Valuation: Shares of MTN trade at a price-to-next-twelve-months earnings ratio of approximately 28.5x. On a relative basis (to the S&P 500), the shares trade at 1.5x the market versus the 2.1x five-year historical average.

Risks: Although destination vacations are usually planned well in advance, vacation spending remains a highly discretionary expenditure. Vail's business is highly seasonal with most revenues generated in the fiscal second and third quarters of the year. Given the seasonal nature to the business, the equity value and trading action of Vail can be very volatile too. The company faces weather risk, with potential snowfall below expectations, inhibiting the appeal of destination skiing resorts. The company faces competition from other skiing and destination resorts, as well as other entertainment venues and experiences. The model has a relatively high fixed cost component which needs to be covered to drive profitability. Consumer travel / vacation preferences may change. The company has made several acquisitions in its history and could have a misstep with another acquisition. It could also encounter competition in the acquisition of properties.

Consumer Staples

BellRing Brands, Inc. (BRBR-\$27.00)

Summary: BellRing Brands, Inc. (BellRing) is a marketer of branded ready-to-drink (RTD) protein shakes, nutrition bars, powders, and other convenient nutrition products. Brands include Premier Protein, Dymatize, and PowerBar.

Company Highlights: BellRing was formed from the Active Nutrition business of Post Holdings, Inc. In 2019, Post Holdings completed an initial public offering (IPO) of approximately 29% of BellRing Brands, Inc. Class A stock. In March 2022, through a series of transactions, including a plan of merger, BellRing Brands, Inc. became the successor organization, with the Class A shares ultimately converting to BellRing Brands, Inc. stock.

BellRing has had attractive rates of unit and revenue growth, decent profit margins, requires relatively limited amounts of incremental capital, and management believes most years should generate free cash flow. We believe the company has the potential to expand channel distribution and household penetration, which are appealing characteristics for center-of-the-store product categories, which can often be growth-challenged. In our view, BellRing also has optionality in the form of M&A. Under some scenarios, the company may even be an acquisition candidate itself.

The Premier Protein and Dymatize brands represent the majority of company revenue and profit. While club store operators are the primary sales channel, the company is actively looking to expand distribution. Greater household penetration also looks possible, with the company's focus on convenient nutrition indexing well-below other center-of-the-store categories in grocery.

RTD shakes remain the dominant nutritional form for the company. BellRing has added flavors to the Premier Protein lineup, which has more line-extension potential, in flavors as well as form, with shakes and now bars. With its shakes, the appeal for consumers is the combination of high protein with low-sugar content. It has also created larger count package sizes of its Premier Protein shake for food, drug, mass merchant, and club stores. We think the company may have single-serve options, which might offer both revenue and margin-enhancing potential, as well as foodservice distribution revenue opportunities. Dymatize and to a lesser extent, we think, PowerBar, have opportunities to expand distribution and household penetration as well. Management expects the company to have long-term annual organic net sales growth of 10-12%. BellRing has good profitability, with adjusted EBITDA margins likely in the 18-20% range on an annual basis.

The company relies on third party contract manufacturing for its shake production, which limits the capital intensity of the business, but can present challenges too. At times, demand has outstripped the company's ability to supply product. The company announced an agreement with Post Holdings to add co-manufacturing capacity to help position it for future demand. As it becomes a larger, and fully stand-alone company, BellRing may decide to internalize some production, adding manufacturing capacity, which would require incremental capital. Nonetheless, we think the company should be able to generate free cash flow on an annual basis.

We believe BellRing has optionality in the form of M&A. Under Post Holdings' leadership, the foundation of BellRing was built with the original acquisition of Premier Nutrition. Over time, Post Holdings management added other active nutrition brands, acquiring Dymatize and PowerBar. With Post Holdings CEO Rob Vitale as Executive Chairman of BellRing, we believe there is M&A potential for BellRing (as well as for Post Holdings.) We are fans of Chairman Vitale and note his long-time association with packaged goods veteran and Post Holdings Chairman Bill Stirtz. Over their careers, they have blended both brand management savvy, with a keen understanding of capital markets, using a variety of techniques (M&A, share repurchase, spin-offs) to create value for shareholders in multiple packaged goods companies. Given BellRing's size, positioning in active nutrition, and growth profile, under some scenarios the company may be an acquisition candidate. Strategic interest may come from other packaged goods companies, even as private equity sponsors are often active participants in this market capitalization range and in this industry.

Valuation: BellRing recently traded for 11.1x EV to consensus estimated fiscal 2022 EBITDA and 10.0x EV to consensus estimated fiscal 2023 EBITDA. The low to mid-teens EV multiples reflect the company's higher growth potential in the packaged goods industry.

Risks: Competition in packaged goods is fierce, from established players and challenger brands. Established packaged goods companies may have greater financial, marketing, and operating resources than BellRing. Consumer tastes and preferences in nutrition may change. Company financial results or guidance could fall short of market expectations. Valuations could contract. Customer or channel concentration may present challenges, such as in the club channel. The company faces execution and other risks in expanding its distribution. The company could lose a major customer or experience fulfillment issues. With its production managed by third parties, the company has experienced disruptions in supply due to manufacturing constraints, or labor. The company also faces potentially higher input costs for certain commodities like milk protein, or higher packaging and transportation costs, which could negatively affect margins. The majority of revenue originates from one brand, Premier Protein, and one product type, shakes and other RTD products. The company has a leveraged balance sheet. The company could make a mistake with an acquisition. As a provider of food products, the company is subject to extensive regulation. The loss of key executive or management personnel would likely detract from the company's investment appeal.

Lamb Weston Holdings, Inc. (LW-\$98.16)

Summary: Lamb Weston Holdings Inc. (Lamb Weston) is a leading provider of value-added frozen potato products (the majority of which are french fries) to a variety of channels including quick service and casual dining restaurants, foodservice distributors, grocery, mass merchants, and club stores. The company, which was spun off from ConAgra Brands, Inc. during 2016, is headquartered in Eagle, Idaho.

Company Highlights: Lamb Weston has several business features which we like, among them: leading market positions, reasonably predictable revenue streams, good profit margins, sensible incremental capital additions, a strong brand name in the industry, and the ability to generate free cash flow. Industry market share is also heavily concentrated in the top few players, which usually means competition is rational and capacity additions are too, and as a result, there is the opportunity to increase prices.

Lamb Weston holds the #1 market share position in the U.S. and #2 globally in frozen potatoes. French fries are among the most widely available products in restaurants and are the second most profitable product for a restaurant (behind fountain soft drinks). Growing product demand, often paired with multi-year contracts to supply customers, and strong customer relationships lead to reasonably predictable revenues, which build from a blend of modest volume gains and price increases. The good demand environment and high manufacturing capacity utilization have created very favorable conditions for the company and the industry in the past few years.

Anticipated capacity additions in the industry, planned over the next few years, have had some market observers concerned that the attractive supply/demand dynamics of the industry may be eroding. We believe there is little to be gained by irrational additions to capacity or excessive competition by producers, given the consolidated nature of the industry. To our way of thinking, the capacity additions likely prove necessary over time, given the current demand environment, and the need for processors to take appropriate downtime of machinery for required maintenance. Such additions of capacity may also relieve some of the overtime labor expense associated with production.

Valuation: Shares of LW trade at a price-to-next-twelve-months earnings ratio of approximately 23.4x, compared to its five-year historical average of 25.6x. On a relative basis (to the S&P 500), the shares trade at 1.3x the market versus the 1.3x five-year historical average.

Risks: Food suppliers are subject to a number of risks including the potential for food spoilage or other supply chain disruptions which would affect the company's ability to meet the demand of customers. There is competition from other food service suppliers. As a producer and marketer of agricultural products, the company is subject to adverse growing conditions, pests, and diseases. The company and industry have benefitted from favorable supply / demand dynamics, leading to high levels of plant utilization and pricing power. Should utilization rates fall, or too much capacity come on the market, the favorable pricing and profitability features could be negatively affected. Consumer tastes and preferences may change. The company may also experience disruptions caused by tariffs or trade disputes between and among countries where it has operations. The company is subject to extensive regulation. Valuations for the company may contract in the absolute and relative to other consumer products companies.

Post Holdings, Inc. (POST-\$93.97)

Summary: Post Holdings, Inc. (Post) is a consumer packaged goods holding company headquartered in St. Louis Missouri, operating in center-of-the-store brands, refrigerated, private label, and food service. In 2008, Post was split-off from Kraft Foods Inc. and merged with Ralcorp Holdings. In 2012, Post was spun-off from Ralcorp Holdings. Since then, the company has executed a number of complementary acquisitions, entered new markets, or strengthened current market positions.

Company Highlights: Post creatively and aggressively uses M&A strategies to pursue select growth verticals in packaged foods. We are fans of the management team of Chairman Bill Stiritz and Chief Executive Officer Rob Vitale, who have demonstrated over their careers a rare pairing of the ability to manufacture and market products, with a strong understanding of the dynamics of capital markets.

Valuation: Shares of POST trade at a price-to-next-twelve-months earnings ratio of approximately 30.5x, compared to its five-year historical average of 23.1x. On a relative basis (to the S&P 500), the shares trade at 1.7x the market versus the 1.2x five-year historical average.

Risks: Post operates in the consumer packaged foods industry and faces potentially changing consumer preferences. The company also faces strong, well-capitalized competitors in center-of-the-store categories, as well as from food service operators. The company has generally operated with greater financial leverage than peers, and given their preference for M&A could face both increased competition for deals as well as potential integration challenges from successful transactions. The company's ability to execute on acquisitions may be stalled by regulatory reviews as well.

Financials

Brown & Brown Inc. (BRO-\$61.27)

Summary: Brown & Brown Inc. (Brown) is a provider of insurance brokerage and related services for retail, wholesale, and national account programs. Founded in 1939, the company is headquartered in Daytona Beach, Florida.

Company Highlights: Brown has a number of business features which we like, including reasonably predictable rates of revenue growth, attractive profit margins, and a limited need for incremental capital expenditures. Management operates the company conservatively, maintaining a well-capitalized balance sheet, with an eye toward producing free cash flow on a consistent basis. Brown also has optionality through M&A, a characteristic we particularly like in SMID List companies, and the company has successfully used M&A to grow revenue.

Insurance brokers help clients place an insurance program with an insurance carrier, for a fee or a commission, which is a percentage of the insurance premiums, from the carrier. The company may also receive fees paid directly by customers. Some of the larger brokers also offer consulting services. The four largest brokers are estimated to have the majority of industry revenue, which should lead to a competitive, but rational, operating environment. While the industry is dependent on stable macroeconomic conditions, organic revenue growth rates for Brown are relatively consistent, in the low-to-mid-single-digits on an annual basis.

Brown boasts an attractive margin profile, with operating margin generally topping 25% annually for most of the past two decades. Brokers do not take underwriting risk, and as such, they have lower capital requirements than insurance companies, enabling companies like Brown to produce free cash flow. Free cash flow is routinely more than 20% of annual revenues.

Despite its seemingly top-heavy nature, the insurance brokerage industry is quite fragmented, with many small insurance intermediary operations creating potential acquisition opportunities for players like Brown, to supplement the organic rate of growth. The company has successfully made dozens of acquisitions, which have added meaningfully to its revenue. Management continues to pursue potential tie-ups. Private equity has also been an active, aggressive participant in the broker space, and is partly responsible for driving-up acquisition multiples.

Cultural and financial fits are of paramount importance to management. The company tends to cultivate long-term relationships with key decision makers at smaller insurance intermediaries, such that when the potential seller is looking toward a transfer of ownership, Brown is in position to act on the opportunity, having already established the relationship, and can ensure a smooth ownership transition. Importantly, in an environment of elevated transaction multiples and aggressive bidders, management has remained disciplined in its acquisition criteria. The company tends to be conservatively leveraged, which leaves it in good position to close on acquisitions, the timing of which is often difficult to predict.

While acquisitions generate a lot of the headlines and spending, management thoughtfully deploys capital in the business to expand, and Brown can still produce excess cash flow, which they deploy to share repurchase and to dividends. Dividends are a priority and the company has raised the dividend for 26 consecutive years.

Lastly, members of the management team are significant shareholders of the company, aligning their economic interest with that of outside shareholders. The company has also shared that nearly one-quarter of the company is owned by management and employees.

Valuation: Shares of BRO trade at an EV/EBITDA ratio of 14.9x, compared to its five-year historical average of 14.9x.

Risks: The majority of company revenue is from commissions. Weaker economic conditions may develop, which could cause revenue growth rates to slow if premium volume slows. The company faces competition from other brokers, which may be larger, possess greater financial resources, and may offer a wider variety of services than does the company. The company also faces competition for acquisitions from these players, as well as more recently from private equity (PE) sponsors which are actively pursuing acquisition targets in the industry. Such aggressive bidding activity by PE firms may price Brown out of potential deals, limiting its growth via acquisition. The company may encounter difficulty with integrating an acquisition too. Valuations for the company and other brokers have expanded in recent years, and could contract should financial results fall short of market expectations. The company's small and middle-market customers may face operating difficulties. Organic growth rates may also diminish or decline.

First Financial Bankshares, Inc. (FFIN-\$35.07)

Summary: First Financial Bankshares, Inc. (First Financial) is a financial holding company, headquartered in Abilene Texas, which provides consumer and commercial customers with banking, trust, brokerage, and wealth management services.

Company Highlights: First Financial has an attractive home market, a differentiated bank operating model, experienced management, a high-quality financial profile, and a decent record on credit. The company also has optionality (a quality we like in SMID List companies) in the form of M&A, having executed several transactions over its history. The company could have strategic potential as an acquisition candidate itself.

First Financial operates exclusively in the state of Texas - principally in the areas of North Central, Southeastern, and West Texas. The state has a large, diverse economy, and is generally regarded as being pro-business / pro-consumer. Three of the ten most populated cities in the US are located in Texas, and the population growth rate for the state is expected to exceed the national average. Texas is also one of the few remaining states with no state income tax. Growth markets for the bank are communities within a 50-mile radius of the large metropolitan areas of Dallas/Fort Worth, Houston, Austin, and San Antonio.

The company labels its operating model, the “One Bank, Twelve Regions Concept.” Under the “One Bank” part, the company consolidates its back-office functions including check processing, credit administration, call center, human resources, risk management, and compliance, which it believes leads to a lower efficiency ratio. The “Twelve Regions” component allows local management in the various regions to meet the banking needs of their communities, which are typically smaller markets outside of large metropolitan areas, with each region managed by its own president.

Seasoned banking industry executives populate the executive management, senior management, line of business roles, as well as the company’s regional leadership. Many of the company’s regional CEOs and Presidents have spent the majority of their career with First Financial, although some have joined through acquisition. The regional bank CEOs and Presidents have, on average, more than 25 years of banking industry experience.

As a holding company, the subsidiary bank is considered well-capitalized by regulators, with equity capital well-above regulatory minimums. In its core markets, the company has top-tier deposit shares, and improving shares in its expansion markets. Deposit growth, in dollars and accounts, has occurred for several years, and includes organic as well as acquired growth. Double-digit percentage growth in loans is the company’s annual target, and it has enjoyed many consecutive years of loan growth. As for margins and returns, net interest margin, return on average assets, and return on average equity are generally above peers. For the past several years, returns on tangible equity have been at very attractive levels, in the mid-to-high-teens. The efficiency ratio is consistently less than 50% annually, and usually several percentage points better than peer banks. First Financial has an impressive record of profitability, increasing earnings for more than 30 consecutive years.

The company looks like a reasonable lender, with decent underwriting. The average loan to deposit ratio is usually in the low-to-mid 60% percentage range. Non-performing assets as a percentage of loans and foreclosed assets have been modest. The loan portfolio is modestly diversified, in consumer and commercial loans, agriculture, 1-to-4-family real estate, and commercial real estate. Given its geography, there is a natural inclination to energy lending, although energy is a small percentage of the total loans held for investment. The investment portfolio has a heavy emphasis on mortgage-backed securities, which are backed by Ginnie Mae, Fannie Mae, and Freddie Mac, or are collateralized by securities backed by these agencies. The majority of the available-for-sale securities that are obligations of states and political subdivisions were issued within the State of Texas, more than half of which are guaranteed by the Texas Permanent School Fund.

Expansion into new markets takes the form of new branches as well as acquisitions, with the company making several acquisitions in its history. The expansion strategy is focused on profitable institutions, in smaller markets, with outstanding customer service. The company has a strong currency to pursue acquisitions. We expect management would be quite selective when pursuing community bank deals.

Lastly, management’s economic interest is directionally aligned with outside shareholders, as executive officers and directors own roughly 4% of shares outstanding.

Valuation: Shares of FFIN trade at 21.5x the next twelve months consensus earnings per share estimate of \$1.63 compared to its 5-year average of 26.9x. On a relative price-to-earnings basis (relative to the S&P 500), FFIN shares trade at 1.2x compared to the 5-year average of 1.3x. Additionally, the company recently traded for 6.0x tangible book value per share versus its 10-year median multiple of 3.7x.

Risks: The company could be affected by factors outside of its control, such as the general level of interest rates, economic, or credit conditions. Moves in the level of interest rates could crimp company profits. Loan growth could slow, expenses could rise, and non-interest sources of income may decline. The company faces competition from local and regional banking competitors. Competitors may be much larger, more aggressive, with access to greater resources. While Texas has been an area of population and economic growth, those conditions could change. Smaller communities where the firm operates may be less economically diverse or may experience population declines. Lending to mostly small and medium-sized businesses in these markets presents risks. Credit conditions could deteriorate. Collateral values could decline. The company could make a mistake with an acquisition. Expansions in new and existing markets may not be successful. Valuations could contract. Traditional banking companies like First Financial also face competition from new technologies and approaches to consumer and commercial credit. The company may not be able to adapt to these new competitors. The company faces extensive state and federal regulation.

Markel Corp. (MKL-\$1,439.96)

Summary: Markel is a diverse financial holding company that underwrites specialty insurance products. Principal operations are in the excess and surplus (E&S), London insurance, and specialty admitted markets. Markel has a non-insurance operation, Markel Ventures, a wholly-owned private equity business that makes strategic, control investments in profitable companies in select industries.

Company Highlights: Markel has a number of attractive business features which make it appealing. First, the company targets specialty insurance markets. Its E&S lines focus on hard-to-place risks, tend to have flexible policy forms and unregulated premium rates, resulting in coverages that are more restrictive and more expensive than found in the standard market. Specialty admitted markets focus on hard-to-place risks in the standard markets that must remain with an admitted insurance company for regulatory reasons. Competition in these areas is less about price and more about other features such as service and expertise. Its target markets which include niches as varied as commercial equine facilities, museums, summer and youth recreational camps, and yachts, are often overlooked by standard carriers, given the specialized expertise required to understand their risks, and the relatively small premium value.

Regarded as a conservative underwriter, Markel operates with a standard that its reserve levels are more likely to prove redundant than deficient. It seeks to earn a consistent underwriting profit in all of its products and in all insurance market conditions, and for most of the past two decades the company has been successful, producing an annual combined ratio (CR) less than 100%. Importantly too, if market conditions do not support an underwriting profit, they will not write the business. Management is content to walk away from premium volume in business that is not appropriately priced. To reinforce the point, no underwriter at Markel receives incentive compensation unless the book of business produces a multi-year underwriting profit.

Markel operates differently as an investor too. In contrast to some other insurance companies, Markel pursues a total return investment philosophy for the investment portfolio. The company invests policy holder funds mostly in corporate, government, and municipal securities, with the vast majority of the fixed income portfolio rated “AAA” or “AA”, with an average rating of “AA” from at least one nationally recognized statistical rating organization (NRSRO). The balance of investable assets are invested for equity holders.

Markel’s equity investment philosophy consists of four parts: (1) common equity positions in profitable businesses with good returns on capital, (2) led by honest and talented management, (3) with reinvestment opportunities and capital discipline, and lastly (4) acquired for fair prices. Money is managed internally, with low turnover, low costs, and in a tax efficient manner, with a holding period longer than that of most institutional managers. Since the company has the majority of its shareholder equity invested in equities, the growth in book value per share each year can be volatile. That said, book value per share has compounded at an attractive annualized rate for the past 20 years.

Also different than most other insurance companies is the company's Markel Ventures subsidiary, which seeks to acquire majority control of companies using "permanent capital", employing little debt financing, with the intent to hold the businesses indefinitely. It looks for profitable companies, with strong market positions and capable management seeking a permanent ownership partner, in contrast to a traditional private equity owner, which usually looks to purchase with the intent of eventually exiting the position. As Markel describes it, they seek to "buy, build, and hold" businesses in manufacturing, consumer and industrial products, capital equipment, and healthcare.

The company is considered well-managed and focused on building long-term shareholder value, utilizing a 5-year measurement period for determining incentive compensation. Incentive structures are designed to reward achievement of superior results in underwriting profits or growth in book value. The company does not issue stock options, but instead offers restricted stock. For some senior executives, part of the bonus is paid in restricted stock. The company also has a loan program for employees, enabling them to purchase Markel stock, and helping foster a long-term ownership mentality among employees.

Valuation: Shares of MKL trade at a price-to-next-twelve-months earnings ratio of approximately 18.4x, compared to its five-year historical average of 24.3x. On a relative basis (to the S&P 500), the shares trade at 1.0x the market versus the 1.4x five-year historical average.

Risks: Markel faces competition in its chosen risk markets. The company's underwriting record could deteriorate. Markel faces catastrophic and non-catastrophic event risk. Specialty markets may have higher insurance risks than standard markets. Valuations for the company could contract. Its markets can be cyclical. The company could experience soft market conditions. The company could face declines in the equity or fixed income portfolios. Markel's investment approach can lead to greater quarter to quarter volatility in results. Market losses with the investment portfolio could hinder the growth in book value. The company has made acquisitions in the past in the insurance industry, as well as in other industries as part of Markel Ventures. The company could face risks with integration, overpay in an acquisition, or see the underlying business performance drift from the acquisition scenario. As an insurance company, Markel is subject to extensive regulation and supervision by state, federal, and international entities. Given the importance of management to the company's operations, the loss of key management personnel, in underwriting or investing functions, would be negative for equity appeal.

M&T Bank Corporation (MTB-\$149.55)

Summary: M&T Bank Corporation (M&T) is a bank holding company, which through its subsidiary organizations, offers a variety of community-focused banking and financial services including retail and commercial banking, trust and wealth management. M&T is headquartered in Buffalo, New York.

Company Highlights: M&T has a history characterized by strong underwriting, sensible expense management, and a conservative style to managing its balance sheet - appealing traits for lenders generally, but particularly during economic periods which are characterized by so much uncertainty.

Credit is always top of mind when discussing M&T, given its heritage of solid underwriting, and inclination to quickly address problem loans. We expect management to maintain its underwriting standards and resist the urge to dip down in credit quality or loosen structure in their lending activities, even if competitors do. To illustrate the point, for nearly 4 decades, (1983-2021) the company's average net charge off (NCO) percentage has been about 0.34% of average loans. For several quarters, management has discussed their expectations for credit to normalize at some point, with an attendant increase in credit costs. Their approach to underwriting provides some comfort for investors, although admittedly future credit losses are not easily estimated given uncertainty created by the pandemic, which has challenged the capabilities of nearly all underwriters of credit.

Management's conservative style extends to expenses too, with targeted levels of spending chosen irrespective of the revenue growth outlook for the industry. As a general matter, it adds to the base when necessary, with increases usually in compensation and benefits.

Management takes a conservative approach with managing the balance sheet. Bank capital is managed to levels appropriate for operating in a safe and sound manner, and remains above regulatory minimums. That said, they do not intend to warehouse capital awaiting an acquisition.

We think the company has some optionality with M&A. It has made acquisitions in the past, although it seems to prefer more distressed conditions for undertaking deals. The company is very selective in its deal making.

Ending where we started, we appreciate M&T's legacy on credit, noting that they remain "paranoid", to use management's wording, and put up reserves expecting the credit environment to be choppy again. That approach looks very sensible to us, since what banks do prior to the onset of a credit crisis matters more than what they do during a credit crisis. We also appreciate management's fondness for a conservative outlook and generally being guardedly optimistic, an attitude we welcome. When it does offer guidance, specific forecasted elements are usually limited.

Valuation: Shares of MTB trade at a price-to-next-twelve-months earnings ratio of approximately 8.4x, compared to its five-year historical average of 12.1x. On a relative basis (to the S&P 500), the shares trade at 0.5x the market versus the 0.7x five-year historical average.

Risks: Credit could deteriorate within the company's loan portfolio. Interest rates could remain low, and spreads may remain tight, putting pressure on net interest income. Competition is fierce, from traditional banking sources, as well as non-bank lenders. Valuations could remain lower than historical levels. The company is subject to extensive state or federal regulation, which could change. The company could make a mistake with or have difficulty integrating an acquisition.

RLI Corp. (RLI-\$139.64)

Summary: RLI Corp. (RLI) is a specialty insurance company, targeting niche property, casualty, and surety markets. The company is based in Peoria, Illinois.

Company Highlights: RLI's specialty, niche property & casualty (P&C) and surety markets require deep, specialized underwriting expertise, which we think helps insulate the company from some of the competitive pressures found in the standard property and casualty insurance markets. For the past two decades, RLI has produced a CR of less than 100 (i.e. an underwriting profit), with a CR well-ahead of the industry over the past decade.

The company's incentive structure ties underwriter compensation directly to generating an underwriting profit, thus creating a strong motivation for consistent, enduring profitability for the insurance company. The model encourages underwriters to withdraw when market conditions are less favorable.

Management is decentralized, allowing the various products to be operated as stand-alone businesses, and fostering a strong entrepreneurial culture, with accountability. Additionally, an ownership culture also characterizes the company, with RLI insiders and employees collectively owning approximately 10% of the company, aligning their interest with that of outside shareholders.

The company's investment portfolio is high-quality and liquid, well-diversified by asset class, and emphasizes a long-term investment approach with large capitalization, dividend-paying equity positions, and a "AA"-rated bond portfolio.

The combination of the underwriting and investment approaches has created a strong capital base for the company. Surplus is more than \$1 billion, with a modest amount of funded debt on the balance sheet. Book value per share has grown at an annual rate of 17% for the past decade and RLI has increased the dividend for 44 consecutive years. As well, the company has issued multiple special cash dividends over the years, reflecting the financial strength and desire to return capital to shareholders. Over the past 10 years, the company has returned more than \$1.2 billion to shareholders in the form of dividends and share repurchase.

Lastly, we also think the company has optionality. Over its 50 year history the company has made the occasional acquisition or alliance, and has interest in doing more of the same, focusing on niche P&C opportunities. Finally, we also note that in today's dynamic capital markets, the company could perhaps become an acquisition candidate itself.

Valuation: Shares of RLI trade at a price-to-next-twelve-months earnings ratio of approximately 31.7x, compared to its five-year historical average of 33.1x. On a relative basis (to the S&P 500), the shares trade at 1.8x the market versus the 1.8x five-year historical average.

Risks: RLI faces catastrophic and non-catastrophic events, competition, and the potential for adverse prior year development. Specialty markets may have higher insurance risks than standard markets. Its markets can be cyclical. The company's underwriting record could deteriorate. The company's investment portfolio could be negatively affected by market action. Given the premium valuation, acquisition scenarios of the company may be difficult. Valuations for the company could contract. Given the importance of management to the company's operations, the loss of key management personnel would be negative for equity appeal. The company is extensively regulated.

SVB Financial Group (SIVB-\$252.73)

Summary: SVB Financial Group (SVB) is a regional bank offering commercial banking, investment banking, private banking and wealth management, and venture capital and credit investing services principally to individuals and companies in the venture capital and private equity communities.

Company Highlights: Quarterly results for the company have been mixed recently, given changed market conditions, which likely do not improve in the near-term. More generally, market conditions for venture capital, private equity and private credit have investors concerned. To our way of thinking, for longer-term investors, these same market conditions speak to low expectations for SVB results in the near term but have also created reasonable value in the stock. SVB is trading at comparatively low multiples of book value and tangible book value, and discounts to the company's median multiples on both measures for the past two decades.

Venture capital and private equity activity is key to the investment appeal of SVB. Recent public market pressures have restrained exits and realizations, and likely also contributed to slower deployments of capital into companies. Venture capital deployment is expected to decline for the balance of this year. Reduced activity from private equity and venture capital prompted SVB management to lower its loan growth outlook for the year, and reduced client funds inflows also likely pressures SVB balance sheet growth.

With public market valuations down, private valuations are expected to adjust as well. Private equity investors also likely hold their "dry powder" (i.e. funds available for investment) and wait to deploy capital to try to time their involvement to vintages nearing the trough in valuations. Even as this develops, SVB is seeing firms add capital call lines of credit.

SVB has often produced attractive rates of growth in loans and deposits, with financial results enhanced by equity opportunities from warrants and investments, given its presence in one of the key geographies for venture capital and private equity investing, Silicon Valley. More than half of the company's Global Fund Banking loans are short-term lines of credit utilized by private equity and venture capital funds to support investments prior to the capital contributions of limited partners. In management's view, this is low-risk lending, and has a very good, long-term record of performance, with very few credit losses. Also, loans to early-stage companies are a much lower percentage of the loan book than in past years, totaling only about 2% of the loan portfolio, and for which the company believes it is also well-reserved. Even so, given new non-performing loans, and recent market conditions, some investors are cautious.

Sensible growth and underwriting strategies should be the focus for the company, particularly given the volatility in capital markets. We expect management to be vigilant in monitoring credit. In the long term, management is optimistic about its participation in innovation industries, and the potential of the capital currently available for investment by the venture capital and private equity communities.

Valuation: The shares are trading for 1.22x book value and 1.27x tangible book value. These valuations compare to the company's median price-to-book and price-to-tangible-book value multiples for the past twenty years of 2.3x and 2.3x, respectively.

Risks: Valuations could contract. Activity in venture capital and private equity markets could remain restrained. Revenue and earnings may decline. Credit could deteriorate. Loan and deposit growth may disappoint expectations. Competition in SVB's markets is fierce. The company could make a mistake with an acquisition. Regulation is extensive, can change over time or as the company grows, and may restrict company activities.

W.R. Berkley Corporation (WRB-\$73.36)

Summary: W.R. Berkley Corporation (Berkley) is an insurance holding company with operations primarily in select P&C insurance markets, and in reinsurance. The company headquarters is located in Greenwich, CT.

Company Highlights: Berkley is known for prudent underwriting and a sensible approach to managing the portfolio of investment assets. It is well-managed, with a good track record of building specialty insurance businesses, as well as allocating shareholder capital. The company has a decent balance sheet with reasonable liquidity.

Berkley focuses primarily on commercial lines of insurance, excess and surplus (E&S) and admitted lines and specialty personal lines. The focus on specialty lines is a positive, we think, since it tends to have less competition given the nature of the risks.

Berkley has a decentralized management structure that operates 53 independently managed units focused on niche insurance businesses. These individual businesses serve markets which may be defined by geography, industry, product, or type of customer. These niche insurance businesses require specialized underwriting expertise and deal with complex risks, or industries which have specialized risk exposures that fall outside the underwriting guidelines of the standard insurance market. The decentralized structure also allows the company to respond quickly to customer needs and developments in the market.

As a provider of specialty P&C coverage, Berkley employs an underwriting philosophy we deeply appreciate: it looks to price products to make an underwriting profit, and is willing to forgo volume growth for profitability. Management prides itself on managing the insurance cycle - when capacity and competition create unfavorable conditions, Berkley slows its underwriting. When capacity is reduced, or price adequacy returns, the company looks to accelerate its growth into those conditions, expanding P&C coverage selectively, or creating new businesses to capitalize on opportunities. The company is seeing attractive rate increases in most lines, and exceeding loss cost trend, which bodes well for future profitability. Returns on equity (ROE) have been solid, again for more than a decade, with management targeting a long-term ROE of 15%.

The company's differentiated approach extends to the other side of an insurance company operation - the investment portfolio. Assets are managed for the long-term, and the portfolio for total return, with most investments managed in-house. The company has a high-quality fixed income portfolio, with heavy allocations to corporate bonds, state and municipal obligations, and asset-backed securities. The current fixed income positioning is called defensive, with a relatively short duration (a measure of interest-rate sensitivity) and good credit quality. Management actively manages duration and looks to match asset and liability duration within approximately 1 year to minimize interest rate risk.

The combination of prudent underwriting and investing has generated favorable results for shareholders. Book value per share has grown at a solid pace, and since 2006, the company has returned nearly \$5 billion to shareholders in the form of dividends and share repurchase. Berkley has paid cash dividends without interruption since 1976. During 2021, the company announced two special cash dividends, and raised its share repurchase authorization back to 10 million shares. We think there is informational value in management repurchasing stock.

Lastly, directors and executive officers as a group are among the largest shareholders. William Berkley Sr., the founder, is the largest shareholder with more than a 20% ownership stake.

Valuation: Shares of WRB trade at a price-to-next-twelve-months earnings ratio of approximately 15.7x, compared to its five-year historical average of 19.9x. On a relative basis (to the S&P 500), the shares trade at 0.9x the market versus the 1.1x five-year historical average.

Risks: The P&C markets can move in cycles. As an insurance carrier, the company underwrites many risks, which have the potential for adverse, catastrophic, or non-catastrophic outcomes. There is uncertainty with claims development and around the estimation of reserves. Market conditions for insurance may deteriorate. Pricing in its markets could decline. Competition is fierce from existing insurers and new entrants. There may be legislative or regulatory actions related to the pandemic that are detrimental to the company. The company's investment portfolio may be negatively affected by moves in asset prices and interest rates. Management is an important feature of the company, and the loss of key personnel may detract from investment appeal. Valuations for the company could contract.

Health Care

Chemed Corporation (CHE-\$497.45)

Summary: Chemed Corporation (Chemed) has two wholly owned subsidiaries: VITAS Healthcare Corporation (VITAS), which is one of the nation's largest providers of hospice and palliative care services, and Roto-Rooter Plumbing and Water Cleanup (Roto-Rooter), a leading provider of plumbing, drain cleaning, clean-up, and water restoration services, mostly for residential customers. The company is based in Cincinnati, Ohio.

Company Highlights: Chemed's two subsidiaries have complementary features which sum to an attractive financial profile, with consistent and fairly predictable revenue growth, good profit margins, limited capital expenditure requirements, and an ability to produce free cash flow. Chemed is also well-capitalized, and its subsidiaries have optionality in the form of M&A.

VITAS offers a range of hospice services, employing healthcare professionals including physicians, registered nurses, home health aides, and social workers among others, to assist patients, and their families, with palliative care. Hospice services are provided on a daily basis, with most of company revenue consisting of amounts due from third-party payors, such as government programs Medicare and Medicaid. Annual revenue growth is likely a high-single-digit percentage, in more normal periods, with admissions growth, growth in length of stay, and pricing. Recently, VITAS has faced a few headwinds. Senior housing occupancy has been weaker, and admissions are slowly recovering. Also, labor is a key challenge, with both wage pressure, and in recruiting licensed health care workers, as turnover is elevated. Even as VITAS faces labor and other pressures in the near-term, management is optimistic that high teens adjusted EBITDA margins are sustainable. VITAS also looks to acquire businesses in hospice care, a highly fragmented market with many small operators. Chemed's longer-term interest in owning VITAS may be decided by future developments in the industry and with the payment structure, largely reimbursement by government programs.

Roto-Rooter is a leading provider of plumbing, sewer and drain cleaning, clean-up, and water restoration services mostly for residential customers, through a branch network of company-owned locations, franchisees, and independent contractors, which together reach most of the US population, and portions of Canada. Revenues typically grow year to year, with an annualized growth rate of high single-digits for nearly the past two decades. In the near-term, the company is also facing labor-related cost pressures, as it looks for qualified technicians and sales staff. Part of the Roto-Rooter strategy is to consolidate franchises, at fairly modest multiples of adjusted EBITDA, and improve profitability and raise market share. Capital expenditures for this business are limited, with this subsidiary run more for profits and cash flow. Cash flow is deployed to franchise acquisitions but could be used to acquire hospices.

While acquisitions are a strategic and financial outlet for the company's cash flow, Chemed continues to return cash to shareholders, repurchasing nearly \$2.0 billion of stock since initiating its share repurchase program in 2007. The company has paid dividends for more than 200 consecutive quarters. Lastly, the company has optionality beyond the M&A possibilities for each subsidiary. If Chemed's capital structure and cash flow would support VITAS's growth opportunities, management has said it would consider separating Roto-Rooter - if the spin-off would create long-term shareholder value, and the company could invest the proceeds in higher risk-adjusted return opportunities.

Valuation: Shares of CHE trade for 17.1x EV to consensus estimated 2022 EBITDA and 16.6x EV to consensus estimated 2023 EBITDA. These multiples reflect the company's strong financial model and optionality.

Risks: Competition is intense, including the competition for skilled, licensed employees. Financial forecasts for the company's two operating subsidiaries, or for the company overall, may not be met. Valuations could contract. Regulation is extensive for both subsidiaries, and particularly in hospice services, and may be at the federal, state, and local level. If the company is not in compliance with regulatory requirements, it could face fines, penalties, or other adverse actions, including removal from participation in Medicare and Medicaid programs. Reimbursement under government programs for hospice services could be reduced. The company could make a mistake with an acquisition, or have difficulty integrating an acquisition. The company may also find it challenging to add qualified labor. Expenses for labor likely also increase, which could pressure margins. Roto-Rooter revenues can be affected by weather and precipitation in its chosen geographies. The loss of key management personnel could reduce the investment appeal of Chemed.

Neogen Corp. (NEOG-\$17.86)

Summary: Neogen provides food and animal safety solutions at each step of the food supply chain. Products within its Food Safety segment include diagnostic testing kits to detect foodborne pathogens, spoilage organisms, natural toxins, food allergens, drug or pesticide residues, and other potentially dangerous substances in human food or animal feed. Its testing products help food companies protect against the inadvertent contamination of products for customers with food allergies to peanuts, gluten, or coconut residues, among others. Tests may also detect the presence of veterinary antibiotics in milk, or foodborne bacteria such as Salmonella or Listeria, or spoilage organisms such as mold, or other contaminants. Products may test for sanitation in facilities for food and beverage production, foodservice, and healthcare. Most test kits are single-use, disposable, detection products that produce rapid and accurate test results for customers. The company's Animal Safety segment manufactures, markets, and distributes products including vaccines, pharmaceuticals, veterinary instruments, parasiticides, rodenticides, cleaners, and disinfectants for livestock and pets. Neogen also provides genomics testing services.

Company Highlights: We think Neogen has several appealing features including a resilient business model; reasonable rates of annual revenue growth; large, addressable markets; a business mix which features a high percentage of consumable sales; strong profit margins; and an ability to generate free cash flow. The company also has a reasonably capitalized balance sheet, as well as optionality in the form of M&A which Neogen has used over many years to supplement organic growth.

Fiscal 2022 (May), represented the company's 31st consecutive year of revenue growth. Its target markets of food safety and animal safety have long-term annual revenue growth rates projected in the ranges of 6-8% and 4-6%, respectively. The company's genomics business has a projected annual revenue growth rate of 10-15%. Approximately 95% of Neogen revenues are considered consumables, which should create a nice recurring revenue stream.

We think switching costs for the business may be relatively high. Neogen products offer a compelling value proposition for customers in the food supply chain, with simple, easy-to-use testing products which help prevent the breakout of a foodborne illness, or disease transmission with animals, with the upfront cost of such testing, we believe, likely much lower than the cost of dealing with an outbreak itself.

Historically, Neogen has had decent profitability with gross margins typically in the mid-to-high 40% range and EBITDA margins typically in the low 20% range. In addition, we think the company enjoys pricing power, which it is using to help recover raw material cost inflation, and for 2023, management thinks a mid-single-digit price increase is possible. Capital expenditures look fairly limited as a percentage of annual revenue, and when paired with consistent profitability, Neogen should be able to generate free cash flow on an annual basis.

In September 2022, Neogen closed on the merger with the Food Safety Division of 3M Company (MMM - \$129.51) funding the deal with both debt and new Neogen equity. With the deal, Neogen significantly increased its revenue base, strengthened its position as a global leader in food security, and expects the combination to enhance both the company's overall growth rate and profitability. For the combined company, revenues are mostly from consumables, with approximately 70% of revenues now coming from food safety, a category which should have higher growth and a richer profit mix. Between legacy Neogen and the 3M business, there should be cross selling opportunities. Neogen management seems particularly interested in expanding the 3M business's leading Indicator Testing brand, PetriFilm, beyond usage in food safety testing. Neogen management believes it can bring focus to the acquired business and we expect will give it a growth agenda. To that point, the company is investing capital to expand manufacturing capacity for future production of PetriFilm, which may also help lift profit margins. Management also seems keen on pursuing business opportunities in other verticals.

We think Neogen still retains optionality in the form of bolt-on M&A activity. Over many years, the company has successfully executed on small acquisitions to add complementary products, improve its competitive advantage, and supplement the attractive rates of organic growth in its chosen markets.

Valuation: Shares of NEOG trade for 21.5x EV to consensus estimated 2023 EBITDA and 17.2x EV to consensus estimated 2024 EBITDA. The multiples are discounts to similar companies serving the same or similar markets and Neogen's own history and reflect the strengths of the business model as well as the recent integration challenges, which in time we think are resolvable.

Risks: Valuations are generally high for the company. Growth could slow which may make sustaining the current multiple difficult. The 3M Food Safety business integration may not yield the expected sales and profit synergies. The company may lose customer relationships because of supply issues from the integration. Financial guidance for the combined company has been pushed out from the initial timeline. The integration may not go according to plan. The company does not have much sell side research coverage. Management does not often provide formal guidance, which tends to lead to information vacuums and volatility from time to time in the stock. There may be changes in key management personnel. The company faces competition from existing and emerging companies, which may have greater financial resources than Neogen. The company could make a mistake with M&A. Many of the company's products are subject to regulation by various government agencies.

West Pharmaceutical Services, Inc. (WST-\$250.70)

Summary: West Pharmaceutical Services, Inc. (West) is a global manufacturer of integrated containment and delivery systems for injectable drugs and other healthcare products.

Company Highlights: West is one of the world leaders in integrated containment and delivery of injectable medicines. West's business has defensive growth qualities, and a financial model with a number of appealing features, including durable revenues, good rates of organic annual revenue growth, a revenue mix that skews toward proprietary products, and attractive profit margins. The company has a reasonably capitalized balance sheet. While capital expenditures are higher recently, owed to capacity expansion for high-value products (HVP), the company should produce free cash flow on an annual basis.

West operates in 50 global locations and has 25 manufacturing sites, which in 2021 produced nearly 45 billion components. The company operates through two segments: proprietary products and contract-manufactured products. The proprietary products segment includes proprietary packaging, containment, and drug delivery products, as well as analytical lab and other services. Products include stoppers and seals for injectable packaging systems, syringe and cartridge components for injectable drugs in customized solutions, as well as coatings, vision inspection, and sterilization processes and services to help mitigate contamination risk. The contract-manufactured products segment manufactures products for customer-owned components for surgical, diagnostic, injectable and other drug delivery systems and other products, for pharmaceutical, diagnostic, and medical device companies.

West revenues are expected to grow at a high-single-digit percentage annually built upon usage growth in developed and faster growing economies, which are opting for more sophisticated healthcare solutions, a greater use of injectable products, and higher usage of biologics delivered via injection. The revenue mix is intentionally moving toward proprietary products and away from contract manufacturing. With proprietary products, the intellectual property (IP) resides with West. Proprietary products also offer a greater rate of revenue growth and meaningfully higher gross margins than contract manufactured products.

Importantly, we think the company has meaningful barriers to entry and high switching costs. Medical devices or new drugs from manufacturers may require several years for product development, validation, and commercialization. Also, a supplier must be able to offer a reliable supply of components which is critical to the delivery of drugs to patients. Smaller drug companies may not have the resources to manufacture delivery devices in-house. Given its expertise, companies often include West in the early phases of drug development. The company's injectable products are heavily regulated, with tightly controlled manufacturing processes to ensure the sterile delivery of the medication. The regulatory approval process for drugs and medical devices is also lengthy and expensive. For example, when a drug manufacturer submits a drug for

approval by the Food and Drug Administration (FDA), the packaging and delivery device is part of that application. When a drug is approved, the approval includes the packaging and delivery application. That makes it difficult for drug companies to change suppliers for the injectable solution. The package and delivery mechanism is usually employed for the life of that drug, leading to durable revenue streams for West. While drug companies may opt to have a secondary supplier, if a company wishes to change suppliers for components or devices, regulations make that difficult and the refiling process can be lengthy. These features, we think, raise both the barriers to entry for competition, and the switching costs for customers.

Finally, the cash generating ability of the company is one of its more appealing characteristics. West is investing in the business, raising capital expenditures as it looks to expand capacity ahead of anticipated demand. For the past two years, capital investments have included \$300 million for expansion and new equipment. Even as it invests, West has and should continue to produce free cash flow on a fairly consistent basis. The company has a share repurchase program in place, and while dividends are not a requirement for inclusion on the SMID List, West has paid a dividend every quarter since 1970 and has raised its annual dividend for 29 consecutive years.

Valuation: The shares are trading for 20.4x EV to consensus 2022 EBITDA and 23.2x EV to consensus 2023 EBITDA. Valuations are above recent historical median multiples, but in-line with some peers, reflecting the attractiveness of the company's business within the life sciences tools and services industry.

Risks: Valuations could contract. Regulation is extensive. Safety concerns or a production issue may idle facilities. Supply chains could be disrupted. The company may rely on single source suppliers for some critical raw materials. Input costs, particularly petroleum-based, may increase. Drug products may be configured to be delivered in ways other than by injection. Customer consolidation may produce additional pricing pressure. Customers could decide to insource activity or change suppliers. Funding for drug development may be curtailed. Financial guidance may be reduced. Margins may not expand as they have historically. Revenue mix could shift to lower margin contract manufactured products. The growth rates of revenue and earnings could be reduced. Competition in life sciences and tools can be aggressive. The company could make a mistake with an acquisition.

Industrials

GXO Logistics, Inc. (GXO-\$53.26)

Summary: GXO Logistics Inc. (GXO Logistics) is a global logistics company. GXO Logistics separated from XPO Logistics, Inc. (XPO-\$37.39) via a spin-off, with XPO shareholders receiving one share of GXO for each share of XPO held on the record date of distribution. The company headquarters is in Greenwich, CT.

Company Highlights: Spin-offs often provide companies the chance to pursue market opportunities, capital structures, and capital deployment strategies that fit their new independent status, without the forced compromise of resources that often comes when they are a subsidiary or division of a larger corporate entity. Management teams of these newly independent companies can then look to surface value for shareholders, with executives often incentivized by equity ownership that more directly aligns their interests with those of the reconstituted base of shareholders. We think such conditions could be in place for GXO Logistics, now a stand-alone, pure-play, contract logistics company.

GXO Logistics is a scaled operator (885 facilities encompassing 210 million square feet of logistics warehouse space) in the \$130 billion market for contract logistics in North America and Europe. The company provides supply-chain services including warehousing and distribution, order fulfillment, ecommerce and reverse logistics. GXO Logistics manages the flow of goods through the customer's supply chain, from arrival at the logistics site, to fulfillment and distribution, and perhaps even through the handling of returned items, a capability which the company regards as a key advantage versus its peers.

Management sees the company benefitting from three large, secular trends in the logistics industry: the growing demand from ecommerce (as well as omnichannel retail and direct-to-consumer), warehouse automation, and a shift toward outsourcing. Within the ecommerce channel, increased volumes, changing consumer demand patterns, and the desire for compressed fulfillment times requires increased automation and technology, and frequently customized solutions, and has moved industry toward outsourcing logistics. Given its exposure to (and good organic growth in) ecommerce, and its scale, GXO Logistics has the potential to grow above the industry rate and take market share. (Management also sees an additional \$300 billion of market opportunity in North America and Europe, from companies that currently insource logistics.)

The company's customer base includes leading, often multinational operators from the consumer, chemical, industrial and manufacturing, life sciences, and technology industries, among others. Most of its revenue relationships are long-term and contractual, with high retention rates. The majority of company revenue originates from non-cyclical consumer end markets, such as ecommerce, consumer technology, food and beverage, and consumer packaged goods. We think switching costs for customers are relatively high, which adds to the durability of revenue for the company. Although a relatively small part of the expense base of its customers, logistics is highly valued spending, as it can have an outsized effect on the experience of end consumers. Multinational customers likely want to partner with proven operators that offer scale, which we think should only increase the company's competitive advantage. We note too that top customers have been with the company for an average of 15 years. Also, company operations generate an enormous amount of valuable data, which the company processes and analyzes to improve its own forecasting as well as provide its customers with greater insights and visibility into flows.

GXO Logistics has a reasonable capital structure, with an investment grade-rated balance sheet (BBB- from Standard & Poor's), and management expects to maintain net debt to EBITDA in a range of 1.0x-1.5x. Maintenance capital expenditures on an annual basis are comparatively limited, at around 1% of sales, with most capital expenditures directed toward growth initiatives. All of this sums to a business model, which management terms "asset-light", that should offer reasonable revenue growth, stable to improving margins, with a limited need for maintenance capital expenditures, which should enable the company to generate free cash flow. Not to be neglected when discussing the model, is management, as top executives have many years of experience in various parts of the logistics industry.

Finally, we think the company has M&A potential. The logistics market is still highly fragmented, with the top 5 players holding less than 25% of the market, by management's reckoning. GXO Logistics likely looks to M&A in the future to complement their organic revenue growth.

Valuation: Shares of GXO trade at approximately 22.2x the next twelve months consensus earnings per share estimate of \$2.40. The company also recently traded for 12.4x EV to consensus estimated 2022 EBITDA and 11.2x EV to consensus estimated 2023 EBITDA.

Risks: Valuations could contract. Financial results may not meet consensus expectations. Competition is fierce. The company is exposed to changing economic conditions and potentially reduced consumer spending. GXO Logistics could make a mistake with an acquisition or have difficulty integrating the acquired business. GXO's customers often experience seasonality in their business or could experience operational difficulty themselves. The company may have difficulty recruiting and retaining qualified employees. GXO Logistics may not be able to pursue certain strategic transactions for a time in order to preserve the tax-free status of the spin-off. The company faces extensive regulation in multiple jurisdictions. As a newly public company, GXO Logistics must also bear additional public company costs.

RBC Bearings, Inc. (ROLL – \$223.83)

Summary: RBC Bearings Inc. (RBC) is a leading manufacturer of highly engineered precision bearings, gearings, and other components for multiple industries including commercial aerospace and space, defense aerospace, construction and agricultural machinery, energy, packaging, and industrial equipment. The company headquarters is in Oxford, CT.

Company Highlights: We think the business model of RBC has a number of attractive features, among them large and diverse end markets, products which are often proprietary and single-sourced, relatively high barriers to entry, a revenue mix which includes a growing percentage of aftermarket sales, and multi-year supply agreements with customers. The company can often pass along higher raw material costs to customers too. While the company believes it has a small share of the total market for bearings, gearings, and other engineered products, in its chosen markets for specialized products, RBC believes it has leading market positions. Capital expenditure needs for the business are relatively limited, and the company has historically had a strong ability to convert income to cash flow.

RBC products include multiple types of bearings, gearings, and other engineered components. The company's bearing products are usually integral to machine operations, such as in aircraft controls, helicopter rotors, or construction equipment, and are designed with a high degree of fault tolerance and to handle load, stress, heat, and other demands. The products are often proprietary, constructed of special materials, and made to unique design specifications. Depending on the market or application, the development process can be lengthy from concept design to product development. Given the specialized nature of bearings, RBC employees may be included by customers at the machine design stage to help tailor these products to the application.

The company reports its operations in two segments – aerospace and defense, and industrial, with industrial the larger of the two segments by revenue. Revenues are from a mix of original equipment manufacturer (OEM) and replacement sales, both of which contribute to predictable revenues, with new products for existing platforms, and increasing aftermarket sales for replacement parts. RBC looks to mitigate some of the natural cyclicity in its business by having long term purchase agreements, and single and sole source relationships with its customers. The company's go-to-market strategy has been successful, with revenue growing at a compounded annual rate of 10% for the past 25 years.

Within industrial markets, RBC manufactures bearings and other engineered components for a variety of industries including construction and mining, trucking, rail, marine, food and beverage, packaging, semiconductor machinery, and others. Following the Dodge acquisition, industrial markets now represent about 70% of the company's annual revenue. Additionally, with Dodge, the company looks to introduce new products and expects a better aftermarket mix of revenue, with distributor and aftermarket revenue increasing as a percentage. Replacement sales feature prominently in the revenue mix for the company, given the installed base of equipment. The product qualification process for applications is a significant competitive barrier, we think, and may run several years in length. Also, much of RBC's product sets are proprietary and single-sourced, meaning the company is the only approved supplier of a bearing or product. The durability of revenue is further enhanced by multi-year contracts. Such features reinforce the company's defensible market position and increase the switching costs for customers.

Within aerospace and defense, the company supplies bearings and other components for use in commercial and military aircraft, guided weaponry, and military marine and ground applications, as well as to other systems. In commercial aerospace, revenues develop from build rates for new aircraft, raising the level of content on existing platforms, and from new products. In defense markets, new program spending and support of deployed equipment generates new and replacement part demand for bearings, gearing, and other engineered products.

For many of its aerospace and defense products, the company receives a product approval or certification from the OEM customer, the Department of Defense (DOD), or the Federal Aviation Administration (FAA), or some combination of them. Once the company gets that credential, it is often the only approved supplier for a bearing or engineered component. When these products are designed into and certified for specific aircraft, RBC often becomes the primary supplier of bearings for the life of that aircraft. The company is the primary bearing supplier for many aircraft OEM product lines, including aftermarket for replacement parts used in the repair and overhaul of engines and aircraft.

Defense markets represent about 39% of the aerospace and defense segment revenues. Products manufactured for U.S. DOD applications may be standardized products that are used in multiple military applications, as well as customized products for unique applications. When RBC products are used in specific U.S. military applications, they are often custom designed for these specific applications at the product design phase, which means that the company may be the sole or primary supplier for the life of the product. RBC products for military usage in areas such as marine and ground markets are mission-critical, often high tolerance products for harsh climates, and are essential to the operation of products like airframes. These products may have long and expensive development cycles, and military applications can have a lengthy approval process too, which adds a barrier to competition.

The majority of revenue is under long term supply agreements, with a significant portion of sales from products where the company is the sole or single-source producer for customers. Management also has a track record of raising both gross and EBITDA margins, with EBITDA the preferred measure of management for judging the performance of the company. Many of its customer contracts have escalation features, which allows it to manage market price increases in steel, a key raw material. The company may pass along price increases when possible, use steel surcharges, or have agreements with escalators tied to the invoiced price of steel. RBC also looks to manage moves in steel prices through buying patterns and expanding its vendor network.

The ability of the company to generate free cash flow is one of its more enduring features. (Free cash flow is cash from operations less purchases of property, plant, and equipment.) Management has even stated that cash generation is their primary focus. Capital expenditures for RBC are relatively limited and projected to be 2.5%-3% of annual sales. Also, cash conversion (cash from operations / net income) has been more than 100% of net income for the last few years. The cash generating ability of the company should lead to meaningful deleveraging of the balance sheet, with debt to EBITDA reaching 2x in three years' time, with the company targeting the elimination of funded debt within 5 years.

The company has used M&A to grow the company, having executed more than 25 acquisitions since 1992. (The recent deal to acquire Dodge effectively doubled the revenue base of RBC.) Management intends to pursue other strategic acquisitions, which complement the company's organic growth strategy. We think the optionality offered by M&A is another appealing feature of the company.

Lastly, management and insiders hold nearly 2% of the stock, directionally aligning insider interests with those of outside shareholders.

Valuation: Shares of ROLL trade at a price-to-next-twelve-months earnings ratio of approximately 29.7x, compared to its five-year historical average of 35.1x. On a relative basis (to the S&P 500), the shares trade at 1.6x the market versus the 1.7x five-year historical average.

Risks: The company operates in markets which are cyclical and highly competitive. Competitors may be larger, with greater financial resources than the company. The company's end markets are heavily regulated, particularly aerospace. Build schedules may be changed, which could negatively affect company revenues. Customers may face production delays. Within its defense industry business, contracts with the U.S. Government are not an insignificant percentage of revenue. Changes in government policy may negatively affect the company. Contracts with the U.S. Government may be renegotiated, or terminated, and are subject to audit. The company may face raw material shortages. The company has made acquisitions in the past, and future integrations could be problematic. Synergies or other benefits from the acquisition of Dodge may not be realized as planned, or at all. The company has a leveraged balance sheet. The departure of key management personnel would detract from the company's investment appeal. Valuations could contract. The company has been subject to a cyberattack. Consolidation by key customers may reduce company revenue.

Waste Connections, Inc. (WCN-\$130.59)

Summary: Waste Connections is a solid waste services company that collects and disposes of non-hazardous, municipal waste for residential and commercial customers in the United States and Canada. It also treats and disposes of non-hazardous oilfield waste products. Waste Connections is domiciled in Canada.

Company Highlights: Waste Connections has several business features that we find appealing, among them: the defensive qualities of the industry, which includes reasonably consistent rates of revenue growth owed to modest volume gains and, importantly, positive pricing, a focus on exclusive service arrangements, attractive profit margins, and an ability to produce excess cash flow. The company also has a reasonably well-capitalized balance sheet.

Generally speaking, the solid waste management industry has fairly stable underlying volume trends often thought to be similar to gross domestic product (GDP) growth. This growth rate can be enhanced during economic expansions, or with population growth, as well as during strong residential housing construction markets. While the industry may be thought of as a “late cycle” industrial, we find the industry and specifically Waste Connections business features appealing across a full market cycle.

The company intentionally focuses on secondary and rural markets, rather than major metropolitan markets, which helps limit competitive incursions and offers the company the chance at realizing a high market share of collection. As it pursues these market opportunities, the company typically targets franchise agreements, or municipal or government certificates which make the company the exclusive provider of waste management services in a specific market, creating multi-year, sticky contracts for the service area. The strategy of pursuing select markets and exclusive opportunities has the potential to yield annual pricing realization, another appealing feature of the business model.

Much of company’s absolute revenue total over the past several years has come via acquisition, and we believe the company should still have “tuck-in” M&A opportunities which can complement internal growth. The tuck-in acquisitions could be in the existing service area or in near proximity, which have the double benefit of boosting revenue while also allowing for increased efficiencies, including driving route density in existing or near markets. While it adds to the absolute revenue balance with acquisitions, the company actively looks to enrich the profit mix, divesting potential lower-margin business as it does. The company’s decentralized management approach also makes them a more appealing buyer for smaller waste operators looking to sell, since the local management of the seller often can remain in place and enjoy a high degree of decision-making authority.

Valuation: Shares of WCN trade at a price-to-next-twelve-months earnings ratio of approximately 32.5x, compared to its five-year historical average of 33.7x. On a relative basis (to the S&P 500), the shares trade at 1.8x the market versus the 1.8x five-year historical average.

Risks: The majority of the company’s absolute revenue growth has come from acquisitions, which could present challenges including overpaying and integration difficulty. Multiples for potential acquisition targets may exceed what the company is willing to pay. There are widely held expectations that the company will continue to make smaller, tuck-in acquisitions. Should the company choose not to pursue acquisition-related growth at the pace some market observers expect, the shares may underperform. Residential construction activity could moderate, or possibly decline, perhaps limiting volumes once considered in the base business. The company faces environmental and other regulation. Costs to remediate sites and possible penalties for failure to adhere to regulations could be considerable. Broader adoption of community movements to reduce the waste to be collected or sent to landfills may detract from industry volumes. Competition for municipal waste services contracts can be aggressive and periodically comes up for bid. New entrants to the industry may not be as disciplined in their bidding as other traditional operators. The loss or departure of key executives may also cause the shares to underperform. As to this last risk factor, we note too that the company’s senior executives in key roles have been working together at the company for several years.

Information Technology

Guidewire Software, Inc. (GWRE-\$75.55)

Summary: Guidewire Software, Inc. (Guidewire) is a vertical software company focused on providing solutions to the property and casualty insurance industry. The company's flagship Guidewire InsurancePlatform™ is increasingly recognized as the industry standard.

Company Highlights: Guidewire uses its highly specialized software expertise to drive modernization in the slow-moving property and casualty insurance industry. Guidewire has relatively low penetration among property and casualty companies of all sizes, with significant opportunity with carriers below \$1 billion in annual written premiums. Guidewire can expand its share of wallet among existing clients with sales of add-on solutions beyond core transaction processing, including data and analytics.

Valuation: Shares of GWRE trade at an EV-to-next-twelve-months sales ratio of approximately 6.1x, compared to its five-year historical average of 9.6x.

Risks: The vertical software market in insurance is competitive. Each market in which Guidewire competes around the world hosts several local, often entrenched, competitors. Guidewire sales depend on technology spending commitments by property and casualty insurance companies, which may opt to delay or cancel technology enhancements during periods of heavy underwriting losses. The insurance industry is also heavily regulated, and like many software firms, Guidewire is leading clients toward cloud-based solutions, which may expose Guidewire to higher liability in the event of a data breach or regulatory issue. Similarly, privacy regulations around the world are varied and highly complex. Guidewire must allocate significant resources to ensure the compliance of its solutions with privacy regulations along with meeting the requirements of its primary regulators.

Keysight Technologies, Inc. (KEYS-\$180.61)

Summary: Keysight Technologies, Inc. (Keysight) is a designer and provider of test and measurement solutions for the communications, industrial, government and defense, and electronics industries. The company was spun out of Agilent Technologies (Agilent) in 2014.

Company Highlights: Keysight is one of a select few high-quality providers of combined hardware and software services – with focus end markets including automotive, aerospace and defense, internet-of-things, networking and cloud infrastructure, and wireless infrastructure. Keysight's market niche is testing and measurement solutions, such as the provision of custom chips, modules and high-performance interconnects. The company bundles this hardware with internally developed software, with software carrying the benefit of rapid testing and deployment cycles to enhance the performance and longevity of hardware.

Valuation: Shares of KEYS trade at a price-to-next-twelve-months earnings ratio of approximately 22.7x, compared to its five-year historical average of 21.2x. On a relative basis (to the S&P 500), the shares trade at 1.3x the market versus the 1.1x five-year historical average.

Risks: As a provider of hardware and software solutions to various industry verticals, a major risk to Keysight is a macro-economic downturn which would reduce demand for the company's products. Keysight's technologies face competition from a wide variety of well capitalized competitors. The company provides critical technology solutions, and errors in hardware can be highly costly to correct, while potentially having negative consequences for customers.

Tyler Technologies, Inc. (TYL-\$316.76)

Summary: Tyler Technologies, Inc. (Tyler) is a vertical software company exclusively focused on providing technology solutions to the public sector, including state and local government organizations. Tyler is the largest U.S. pure-play vertical software provider focused exclusively on the needs of local government entities.

Company Highlights: Tyler has been a highly effective acquirer, with acquisitions significantly expanding its public safety enterprise resource planning (ERP) presence and providing cross-selling opportunities particularly in the court and justice market segment. Given the highly fragmented nature of local government institutions, we believe Tyler has opportunity to gain market share. The company's increasing scale, research and development budget, and core footprint of existing clients in the government sector, allow it to distance itself from both diversified software majors, as well as more specialized niche software providers.

Valuation: Shares of TYL trade at a price-to-next-twelve-months earnings ratio of approximately 41.9x, compared to its five-year historical average of 53.7x. On a relative basis (to the S&P 500), the shares trade at 2.3x the market versus the 2.8x five-year historical average.

Risks: Tyler provides mission-critical software solutions to highly sensitive customers such as courts and local governments. Bugs or other issues with software can cause reputational damage to Tyler, damaging the company's competitive position. Moreover, a data breach of the company's systems could negatively affect the company's financial performance or win rate. Finally, financial weakness at customers, could negatively impact demand for Tyler's products.

Materials

Axalta Coating Systems Ltd. (AXTA-\$27.27)

Summary: Axalta Coating Systems Ltd. (Axalta) was formerly the performance coatings business of DuPont. The business was acquired by private equity firm The Carlyle Group L.P. in 2013, eventually coming public in 2014. Axalta is a manufacturer, marketer, and distributor of coatings to transportation and industrial markets, holding the leading market position in automotive refinish. Axalta is a Bermuda-based company.

Company Highlights: Axalta participates in the consolidating oligopoly that is the global coatings industry, serving multiple transportation and industrial end markets. It is the leading provider of coatings to the automotive refinish industry, i.e. it supplies paints and coatings to body shops for automotive repairs, which we think is one of the more interesting businesses within the company's portfolio.

There are a number of business features that we think make Axalta attractive, among them: Favorable market structure: Coatings is a consolidating oligopoly, with the top 10 players holding approximately a 60% market share. Good barriers to entry: Refinish work is technical and complex, and often a multi-coat process. Axalta boasts a library of more than 4 million colors, and their specific formulations help body shops accurately match potentially thousands of colors regardless of make, model, or age of the vehicle. Switching costs are high: An inexact match adversely affects vehicle appearance, and repainting because of a poor match negatively affects a repair shop's volumes. Once a coatings / color system is installed at a body shop, operators almost exclusively use that supplier's products, given the proprietary nature of the system's colors and the substantial inventory required. When an original equipment manufacturer (OEM) endorses a refinisher for warranty work, switching costs are raised further. We believe these characteristics help Axalta foster high levels of customer retention. Pricing power: Historically, the industry has enjoyed pricing power on a pass-through basis. While coatings are a highly-valued product, they represent a small percentage of the build cost for light vehicle production or refinish work in a vehicle repair. Axalta makes use of four thousand independent distributors to meet the needs of repair shops, and those distributors are incented to pass along price increases. Most refinish work in developed markets is usually covered by insurance.

We believe Axalta should be able to grow revenue and EBITDA organically at modest rates; it could continue to acquire smaller, niche players, or it could become an acquisition target itself. As we noted at the outset, coatings is a consolidating oligopoly. More to the point, the company was approached by two other coatings players in 2017 with takeover/merger offers which the company ultimately rejected.

Valuation: Valuations of approximately 10.9x EV/EBITDA estimates look interesting for scarce assets in a consolidating industry, and in comparison to acquisition multiples of recently proposed and completed M&A transactions which were nearer 14X-16X EBITDA.

Risks: Features and risks which detract from Axalta's investment appeal include operating in cyclical end markets, price pressure from OEM customers, raw material inflation (particularly in crude oil), well-established competitors, environmental regulation, and the rise of automatic driver assist technologies (ADAS) which may reduce collisions and thus the need for refinish work. The company also has a leveraged balance sheet.

RPM International, Inc. (RPM-\$87.06)

Summary: RPM International is a provider of specialty paints, protective coatings, adhesives, sealants, and related products to multiple markets, including construction, consumer, specialty, as well as in industrial applications.

Company Highlights: RPM International has a number of appealing features including participation in large and growing markets, reasonable revenue growth, good profit margins, and a comparatively limited need for large, incremental capital expenditures. The company has a reasonably capitalized balance sheet and produces free cash flow. RPM International also has optionality in the form of M&A and has executed several transactions in its long history.

RPM International competes mostly in global coatings, an attractive market, we think, within the Industrials and Materials sectors. The industry usually posts annual revenue growth in the low-to-mid-single-digit range. The industry structure is also favorable, as no one competitor operates in all segments of the market.

Barriers to entry are considerable and include transportation, manufacturing, distribution, and qualification. More specifically, the value-to-weight ratio of coatings makes transportation expense a notable competitive hurdle. (Manufacturers typically do not want to ship containers of coatings and sealers long distances.) Consequently, manufacturing capacity is often located near end markets. Distribution capabilities can also serve as an obstacle for potential competitors. Some customers will also want to qualify a product, given the essential nature of some coatings products for protection and preservation, which lengthens the time to market acceptance. The industry also favors brands, and building a brand and a market reputation takes time and resources.

RPM International's annual revenue growth rate, on an organic basis, likely mirrors the industry. We believe the company's revenue mix is also attractive, with the majority of revenue in maintenance and repair categories, which tends to lead to fairly predictable growth year to year. Roughly 30% of revenue is tied to new construction.

The coatings industry is fragmented, with a well-developed consolidation theme, offering acquisition opportunities for RPM International, and others. RPM International expects to continue supplementing its organic rate of revenue growth with acquisitions. In the early years of ownership, the company utilizes its distribution model to quickly scale up the revenue of small, "bolt-on" businesses. Acquisitions are usually niche businesses, with leading brands, and good gross margins that can be integrated, or with entrepreneurial management teams already in-place to lead them. In more aggressive M&A scenarios, RPM International could perhaps become an acquisition candidate itself.

Company consolidated and segment EBITDA margins are typically in the low-to-mid teens. The company also has an efficiency program designed to richen the profit mix and leverage revenue growth into higher levels of profitability. Among other items, it has led to the rationalization of some plant capacity and certain low margin product lines, improvements in procurement costs, and reduced administrative expenses. Even so, the company is not immune to the occasional cost challenge. Disruption to supply chains and increased transportation expense have created a difficult cost environment. Raw material inflation has also occurred and supplies may be constrained too.

Management's capital allocation remains sensible, in our view, and for now, excess cash flow is targeted toward reducing the level of funded debt. Management has committed to retaining its well-capitalized balance sheet, leaving some capacity to pursue niche acquisitions. Capital expenditures are comparatively limited, and mostly covered by depreciation and amortization. Good profitability and limited capital expenditures helps the company produce free cash flow. Finally, while dividends are not a prerequisite for inclusion on the SMID List, the company's long track record of paying and raising the dividend affirms the cash generating-ability of the business.

Valuation: RPM recently traded for 14.0x EV to consensus fiscal 2021 EBITDA and 12.9x the consensus fiscal 2022 EBITDA estimate. While RPM's valuations are higher than the company's recent trading history, they are below deal multiples implied in recently proposed M&A transactions in the coatings industry. Given the scarcity of large acquisition candidates, takeovers could be struck at still higher multiples.

Risks: Valuations could contract. Competitors in its markets are strong operators, with some possessing greater resources than the company. End market conditions, particularly in housing or construction, may soften. The majority of revenue is in North America. RPM International does have some exposure to the energy (oil and gas) industry which are often volatile markets. Many raw materials are petroleum-based products, and higher prices for certain raw materials can increase the cost of manufacturing for the company. Price / cost may be unfavorable. Competition for acquisitions can be fierce. RPM International could make a misstep with an acquisition. The company is subject to potential environmental liability, litigation, and remediation expense.

Real Estate

Agree Realty Corporation (ADC-\$74.82)

Summary: Agree Realty Corporation (Agree Realty) is a real estate investment trust (REIT) headquartered in Michigan, which focuses on owning, developing, acquiring and managing a portfolio of net lease properties to industry leading tenants. Agree Realty's portfolio consists of more than 350 properties located in 43 states, totaling roughly 7 million leasable square feet. Net lease properties represent over 98% of annualized base rent, while the company's portfolio is nearly 100% leased with an average remaining term of over 10 years.

Company Highlights: Agree Realty executed a major portfolio transition over the past few years, focusing the portfolio on internet-resistant assets such as car washes, grocers, convenience stores, pharmacies, and dollar stores. We believe the portfolio transition was highly strategic, and potentially positions the company well for the future. Moreover, the company engages in property development and in-process joint ventures to grow the portfolio organically. Such development opportunities carry higher risk, but generally drive cap-rates, effectively the annual cash yield on a property, that are much higher than would be available through a simple sale-leaseback opportunity with no development involved. Agree Realty's status as the only provider in certain markets capable of providing end-to-end development to lease solutions to customers should bolster the company's growth. We expect the company to compete regularly for more standard net lease opportunities across its geographic footprint in assets fitting the company's core competency.

Valuation: Shares of ADC trade at a price-to-next-twelve-months earnings ratio of approximately 19.2x, compared to its five-year historical average of 19.5x.

Risks: As a net lease REIT, Agree Realty has assets that are among the most interest rate sensitive of all REIT types. Net lease terms are typically long in duration, providing stability to income, but subsequently re-price very infrequently, allowing for only indexed escalators over the lease life. Rapid increases in lease rates or interest rates across the company's footprint could leave it with below market earning assets, or debt costs that increase more rapidly than income. Agree Realty's clients, while often leading retailers in their respective sub-industries, are nonetheless exposed to economic changes. As a REIT, Agree Realty must pay out a significant portion of income as dividends or risk losing its REIT tax status. This in turn leaves Agree Realty beholden to the capital markets for funding, which can expose the company to liquidity risk.

Douglas Emmett Inc. (DEI-\$15.77)

Summary: Douglas Emmett Inc. (Douglas Emmett) is organized as a REIT and operates office and multi-family properties in the Los Angeles County, California (L.A.) and Honolulu, Hawaii markets. The company is based in Santa Monica, California.

Company Highlights: We appreciate several features of this REIT, among them: a focus on high barrier-to-entry markets, an affluent target tenant base, high market share in its key submarkets, and the potential for annual rental price increases. With more than 18 million square feet of office space, Douglas Emmett is one of the largest office landlords in both L.A. and Honolulu. The office portfolio is responsible for approximately 86% of total annual rental revenue. The company also has more than 4,000 multi-family apartment units, and a reasonable development pipeline.

The company's key geographies, L.A. and Honolulu, are high barrier-to-entry markets. New development for Class A office space is essentially capped by zoning laws and high land costs in its L.A. submarkets, which limits incremental supply growth. Within these submarkets, the company has built a high weighted average market share and targets small, affluent tenants. For these markets, the proximity of the office space to the tenant's personal residence, often in premier residential communities, is a key factor in the tenant's leasing decision. Neighborhoods including Brentwood, Bel Air, and Beverly Hills, offer relatively shorter commutes versus submarkets outside of the Douglas Emmett footprint, making it less likely the tenant moves. The heavy automotive traffic in Los Angeles also helps limit competition from other submarkets. Companies in the finance, technology, and entertainment industries, looking to improve their own recruitment and retention of employees, likely find the shorter commutes of these high-end residential neighborhoods appealing too.

Nearly all of the company's rental agreements have contractual annual increases of approximately 3-5%. For more than two decades, Douglas Emmett rents have grown at an annual pace within that range. As well, given the strength of their chosen submarkets, we believe the rental income is durable, with rents able to grow during periods of market expansion, with less downside volatility during a general real estate market decline. Rent is typically a small portion of the tenant revenues and is not the key factor in their leasing decision. Tenants are willing to pay a premium for the proximity of the office space to the tenant's personal residence, which again, is often in one of the affluent neighborhoods of West Los Angeles.

Office tenants for Douglas Emmett are diversified, with legal, financial services, and entertainment industries accounting for nearly half of the tenant mix. Occupancy with the company's office portfolio remains consistently high. The median tenant square footage is a relatively small, roughly 2500 sq. ft., which we believe reduces tenant concentration risks while enhancing tenant diversification. With nearly half of the office leases for 2,500 sq. ft. or less, the company does have greater operational complexity in its leasing model than perhaps is found in other office companies. Lease expirations are fairly controlled too, with 11-15% of leases up for renewal in a given year.

From a cost and capital point of view, the company sees its integrated in-house leasing, planning, legal, and design capabilities as a competitive advantage. In their view, the integrated model lowers the overhead cost of the company (General and Administrative expenses) by several hundred basis points (a basis point is 1/100th of a percent) versus its peers. While on the capital side, they standardize build-outs and have comparatively lower recurring tenant improvements or need for incremental capital expenditures. In some cases, the company improves rental opportunities on a small incremental investment, such as upgrades to the lobby or building exteriors.

On the multi-family side of the portfolio, the company's pursuit of premium properties yields a higher rental revenue per unit, with a higher associated operating margin. Occupancy with the residential properties is above 95%. The company is sensitive to the housing shortage in some of its communities, noting that in addition to apartments with luxury amenities, it is also developing projects with attractive workforce housing. In Honolulu, the company has converted office space to residential housing, helping address this critical need for rental housing within that community.

We think Douglas Emmett is reasonably-capitalized at present, with property-level, non-recourse debt, and flexibility in financing. Importantly too for equity holders, management interests are directionally aligned with shareholders, as directors and officers are significant shareholders (mostly through operating partnership units which are convertible into common stock on a one-for-one basis.)

Another feature we like in the company is its potential optionality. Douglas Emmett could acquire assets, as it has done in the past, or pursue other transactions which might surface value for the office or multi-family portfolios. In today's dynamic capital markets, the company may even have strategic value as an acquisition target. Importantly, certain aspects of the company's Operating Partnership may make a takeover of the company difficult, even if desired by shareholders.

Valuation: Douglas Emmett recently traded for 7.9x the 2020 consensus forecast for funds from operations (FFO) per share versus the 5-year median multiple of 16.3x. The modest premium to historical levels looks attractive given the company's business model, its strong competitive position, ability to produce consistent growth in Adjusted Funds from Operations (AFFO), with good common dividend coverage (based upon estimated AFFO per share) in the absolute and relative to peers. Prices also look attractive in comparison to net asset value per share (NAV).

Risks: Douglas Emmett's properties are subject to extensive regulation, particularly in California. There may be changes to the laws affecting rental real estate that may be adverse to the company's interests. For instance, Proposition 13 is a California state law which holds that properties are reassessed, for the purpose of determining property tax, when there is a change in ownership of the property. If Proposition 13 were modified in a way that would reassess commercial properties regularly ("a split tax roll") the company's property taxes would rise significantly. The company's properties are concentrated in specific submarkets. Business conditions in those markets could deteriorate. The company is subject to competition from a number of developers and operators of office and multi-family properties in its markets and markets similar to its own. An excess of supply may develop in the company's key submarkets or in other competing markets. The company has a levered balance sheet. The company could make a mistake with an acquisition. Occupancy at the company's properties may decline. Many of the company's tenants operate in cyclical industries. The economic health of its tenants could decline, or they could default. Rapid changes in the level of interest rates might reduce the investment appeal of income-oriented companies such as REITs. As a REIT, Douglas Emmett must pay out a significant portion of its income as dividends, or risk losing its REIT tax status. And since it must pay out most of its income as dividends, the company requires access to the capital markets to fund growth. The company may not be able to access the debt or equity markets on attractive terms. A loss of key management personnel would detract from the appeal of Douglas Emmett. The company's presence on the west coast may increase its exposure to environmental or natural catastrophes, including earthquakes. Certain features of the company's Operating Partnership may make a takeover of the company difficult.

FirstService Corporation. (FSV-\$120.13)

Summary: FirstService Corporation (FirstService) provides property related services through two segments: FirstService Residential which provides property management services, and FirstService Brands which offers a variety of property and home improvement services to residential and commercial property customers through company-owned and franchised locations under various brand names. FirstService is domiciled in Canada, and the company is dual-listed on the Toronto Stock Exchange and Nasdaq.

Company Highlights: FirstService Residential is North America's largest provider of property management and other services to residential communities in markets which represent the majority of the North American population. Properties are diversified by type, geography, and type of service. Homeowners in these communities are typically required to pay monthly or quarterly fees for the maintenance of common areas of their residential community, with homeowners also serving in a voluntary capacity on the board of directors of the community association. Revenue for the segment comes from property management fees, ancillary on-site services, pool and amenity management, and transaction services.

FirstService Residential fees for its property management services are based on a fixed monthly fee and are contractual. Revenues may come from ancillary services including on-site staffing with building engineering and maintenance, security, and front desk management. More than half of segment revenue is from these ancillary services. FirstService believes it is one of the few operators of scale in the industry, and usually holds the #1 or #2 market share position in its markets.

Growth for this business is thought to be low to mid-single digits annually on an organic basis, with revenue retention rates in the mid 90%+ range. FirstService grows organically by using its scale to win contracts for new residential developments, convert self-managed properties to outsourced, professional management, expand service lines and geographies, cross sell services like banking and insurance, and with tuck-in acquisitions. The contractual nature of the fees and high retention rates leads to a strong recurring revenue model for the company. This business requires limited incremental capital expenditures.

The company's FirstService Brands segment provides property-related services to residential and commercial customers through a mix of company-owned and franchised operators. Brands include Pillar to Post Home Inspectors, Paul Davis Restoration, California Closets, CertaPro Painters, Floor Coverings International, First Onsite, and Century Fire Protection. Paul Davis Restoration services include water, fire, and mold-cleanup services. CertaPro Painters offers residential and commercial painting services. California Closets provides custom designed closet and home storage installations. Pillar to Post offers home inspections. Century Fire Protection is one of the largest providers of fire protection services in the U.S., and First Onsite provides property restoration services to commercial properties.

The markets for these real estate services are large and depending on the type of service, FirstService Brands typically has the #1 or #2 market position in these markets. Its markets are also highly fragmented, with competition provided by local players, other franchise businesses, or other operators, which may present the company with additional acquisition opportunities. Some of the businesses in this segment are more closely tied to the housing cycle, while others like fire protection, have more recurring sales streams. The company continues to expand in markets that frequently experience weather events and may require restoration services.

With both segments, management also pursues acquired growth. Acquisitions are typically made at relatively low multiples of adjusted EBITDA. Transactions are structured with earn-outs, with local management retaining a significant ownership stake, ensuring alignment of interests.

On a consolidated basis, annual revenue growth is thought to approach 10%, with an even mix of organic and acquired revenue growth from tuck-in acquisitions. Adjusted EBITDA margins are usually high-single digits and may approach 10%. Taken together, the company's contractual revenue streams, consistent profitability, and a limited need for incremental capital, enables it to produce strong free cash flow. The company also has a well-capitalized balance sheet.

Lastly, directors and key officers are significant owners of the company, aligning their interests with those of outside shareholders.

Valuation: FirstService trades for 18.3x EV to the consensus 2022 EBITDA estimate and 18.4x EV to the consensus 2023 EBITDA estimate. While slightly higher than recent historical median valuations for the company, we think the multiple reflects the strong characteristics of the financial model and optionality for M&A to expand its leadership in its markets. We think the company can sustain a mid-teens EV / EBITDA multiple, in-line with other leading commercial services businesses with similar dynamics to property services (i.e. operating in markets that are often fragmented, with good annual organic growth, decent profitability, limited capital needs, and can generate free cash flow.)

Risks: Competition in its markets is fierce and from a variety of players. Much of the company's organic growth is expected to come from winning new contracts, conversions, or taking share from other players. Geographic expansion may not prove successful. Valuations could contract. The company may face wage pressure or an inability to fill open positions. Revenue for FirstService Brands could be episodic and dependent on events requiring remediation, such as from storm activity. Economic contractions may also negatively affect the revenues of FirstService Brands businesses. Lower home prices or lower home equity values may reduce spending on home improvements. Pandemics or other wide-spread disruptions could negatively affect the company's FirstService Residential business, as some ancillary service revenues are reduced with reduced consumer activity. These may also affect employees as well as the hiring and retention of labor. The company has made several acquisitions, often in a single year. It could make a mistake with an acquisition, or not successfully integrate an acquisition. Changes in regulations could negatively affect the business. Insurance coverage for its businesses may be inadequate for natural disasters, other business or system failures, or actions of its employees. The departure of key personnel may detract significantly from the company's investment appeal.

STAG Industrial, Inc. (STAG-\$34.99)

Summary: STAG Industrial, Inc. (STAG) is organized as a REIT, and is focused on the ownership and operation of mostly single-tenant industrial properties in the U.S. The company has more than 540 properties in its portfolio, representing more than 108 million square feet, across 40 states. The company has a monthly-pay dividend structure.

Company Highlights: STAG is one of the largest owners and operators of industrial properties. Management's view of the industrial property market dynamics in the U.S. includes the following observations:

- The industrial property market is large, judged by some estimates to represent more than \$1 trillion in value, and is fragmented;
- While most institutional operators focus on a few select markets, STAG operates in many different markets and submarkets;
- In its chosen geographies, STAG competes mostly with local operators of this property type;
- STAG can access debt and equity markets at an institutional-level, likely in contrast to local players;
- Most tenants have triple net leases, meaning the tenant is responsible for nearly all costs related to building operations.

Recent operating conditions for the industry have been strong, with ecommerce fulfillment seen as a secular driver of warehouse demand, which is solidly-aligned with STAG's portfolio. STAG is a beneficiary of growth in ecommerce, logistics, reverse logistics, and reshoring. Industry conditions may stay strong, as the supply chain disruptions of the past couple of years have some commercial customers looking to create more resilient supply chain networks for themselves, and build safety stock.

The company's portfolio is diversified across tenant, geography, industry, and lease maturity, and leans toward large, sophisticated tenants. More than half of its tenants are companies with greater than \$1 billion in annual revenue.

The company has a presence in more than 60 markets, with tenants that come from more than 45 industries. Leases are typically 4-5 years in duration, with in-place rent escalators, which likely proves helpful during periods of rising inflation. At 2021 year-end, portfolio occupancy was high with a weighted average lease term of about 5 years, and a manageable schedule of lease expirations.

Management believes it has a good acquisition pipeline. Over time, we think the company can develop expertise in repositioning under-leased assets to create value as well. STAG has an investment-grade rated balance sheet (rated by a nationally recognized statistical rating organization), and reasonable access to liquidity. The company has a decent maturity profile, with most funded debt maturing after 2024.

Lastly, the company is currently implementing its succession plan, with Chairman and CEO Ben Butcher becoming Executive Chairman, and William Crooker, the current President, becoming CEO. A new Chief Financial Officer was also named, replacing Mr. Crooker in that role. Mr. Butcher has been very influential, serving in multiple roles during the company's most successful period. While a planned succession of management is a natural development for a maturing company, we expect Mr. Butcher to remain actively involved with strategy and management of the company as Executive Chairman.

Valuation: Shares of STAG trade at a price-to-next-twelve-months earnings ratio of approximately 15.6x, compared to its five-year historical average of 16.1x. These valuations are several turns lower than some peer multiples. STAG's dividend yield of 4.2% compares to the company's median yield for the past 10 years of 5.7%.

Risks: Valuations could contract. Economic and industrial property conditions could weaken. Vacancy could increase. Rental rates may decline. Tenants may experience operational or financial difficulty. Tenants may not renew. Competition for industrial assets and tenants is fierce. The company could make a mistake with an acquisition. STAG's earnings growth is more dependent on acquisitions than its peers, which may affect valuation. Larger deal sizes may invite greater competition. Management is undergoing a transition, with the company's Chairman and CEO moving to an Executive Chairman role. The loss of key executives would detract from the investment appeal of STAG. The company is subject to extensive regulation, at the federal, state, and local levels, not only in the operation and management of properties, but also in the company's form of organization as a REIT. The company requires third-party capital in order to grow. Dividend expectations may not be met. STAG must also meet distribution requirements to maintain its status as a REIT. Provisions in the company's governing documents may impede a takeover of the company.

Sun Communities, Inc. (SUI-\$148.91)

Summary: Sun Communities, Inc. (Sun) is a REIT based in Michigan, which owns, operates and/or has an interest in a portfolio of manufactured housing and recreational vehicle communities in the United States, as well as Ontario, Canada. The company's portfolio includes manufactured housing communities and recreational vehicle communities, as well as properties featuring sites for both asset types. The company properties contain more than 100,000 combined manufactured housing and recreational vehicle sites that are already developed, along with sites that are suitable for development.

Company Highlights: Sun is the second largest of the so-called U.S. manufactured housing (MH) and recreational vehicle (RV) REITs, which provides the company unique scale in a set of on-trend, niche, real estate assets for many vacationers and persons seeking low cost, low maintenance housing solutions. Advances in technology have greatly enhanced the attractiveness and feature set of MH and RV homes. Sun has a long history of profitable growth organically and through M&A. In June 2016, the company executed the acquisition of Carefree Communities, which added significant prime coastal MH/RV sites to its portfolio, and also increased the company's exposure to age-restricted assets. The company's ability to acquire high grade assets, improve properties, convert transient occupancy to full time, and increase occupancy, translates to strong returns, and should support organic pricing increases over a long-term time horizon.

Valuation: Shares of SUI trade at a price-to-next-twelve-months earnings ratio of approximately 20.0x, compared to its five-year historical average of 25.0x.

Risks: Risks to Sun include general weakness in U.S. and United Kingdom economic growth that might negatively affect demand for manufactured housing and recreational vehicle properties, oversupply of new manufactured housing communities in key markets, lack of access to attractively priced capital for external growth, an unanticipated common dividend reduction, movements in foreign currency exchange rates given Sun's international property investments, and significant increases in interest rates, which would make other yield-oriented investments relatively more attractive.

Utilities

Brookfield Renewable Corporation Class A (BEPC-\$30.63)

Summary: Brookfield Renewable Corporation Class A (Brookfield Renewable) is a pure-play, renewable power platform company producing electricity from multiple technologies including hydroelectric, wind, solar and energy transition (distributed generation, pumped storage, cogeneration, and biomass) in North and South America, Europe, and Asia. Brookfield Renewable is incorporated in British Columbia, Canada. The ultimate parent of Brookfield Renewable is Brookfield Asset Management Inc. (BAM-\$31.89).

The Class A shares are a minority share class in a corporate structure and are designed to be economically equivalent to Brookfield Renewable Partners LP (BEP-\$28.48) units through payment of identical dividends / distributions. The Class A shares are for those who cannot invest in, or prefer not to invest in, the limited partnership structure of Brookfield Renewable Partners LP. The Class A shares are exchangeable into Brookfield Renewable Partners LP units on a 1:1 basis, or its cash equivalent, at any time. The Class A shares are entitled to one vote per share.

Through its partnership, and ownership of the Class B stock (with super-voting rights), Brookfield Asset Management has an 81.5% voting interest in Brookfield Renewable. Brookfield Asset Management owns 26% of the Brookfield Renewable Class A shares.

Company Highlights: Brookfield Renewable has a number of attractive investment features, including its portfolio of renewable energy assets, a reasonable approach to risk management and capitalizing assets, a growing annual distribution, and, through its affiliation with Brookfield Asset Management, a history of managing and developing long-lived power infrastructure assets.

Brookfield Renewable is diversified across technologies in renewable power, including hydroelectric, wind, and solar and has nearly 21,000 megawatts of renewable capacity. The majority of revenue is from hydroelectric assets, followed by wind, solar, and energy transition.

Brookfield Renewable builds an economic case for investment, as they build an environmental one. It is believed that the transition away from fossil-fuel based electricity will require an enormous amount of capital, which is likely measured in the trillions of dollars. The company thinks it is the partner of choice for governments and businesses that want to “decarbonize”, and works to be a welcomed part of the communities where they operate. The company stays away from projects which require government subsidies or incentives to make the economics work. They look for large-scale, complex projects that have been significantly de-risked (rather than those in development or a predevelopment stage), require meaningful capital investments, and are therefore less likely to see competition based on price. With a long-term, operational focus, management looks to reduce the risks of their platforms, and improve margins and cash flows. The company targets deploying \$800 million to \$1 billion of capital on an annual basis.

The company is reasonably-capitalized, with an investment grade-rated balance sheet (BBB+), access to external liquidity, and sponsorship by one of the preeminent managers of infrastructure assets, Brookfield Asset Management. Brookfield Renewable has a common-sense approach to financing projects, applying capital structures in an effort to maximize the long-term returns of the assets. Long-lived assets are financed with long-duration, project-specific debt that is non-recourse to the company. Brookfield Renewable's debt is mostly fixed-rate, with a decent maturity profile (relatively little matures prior to 2025.)

The company's renewable power assets operate under long-term power purchase agreements (PPA), with a diversified customer base consisting mostly of investment-grade public power authorities and utilities. The PPA agreements have an average term of 13 years, with built-in inflation-adjusted pricing. About half of company revenues have annual 1-2% inflation escalators. These long-term renewable power generation agreements yield contracted, durable cash flows, which have enabled Brookfield Renewable to produce 10-year annualized growth in funds from operations (FFO) per unit of more than 10%.

Management describes its investment approach as deep-value and contrarian, with a preference for proven technologies. With a long-term view, management deploys capital targeting 12-15% returns on the assets that it owns and looks for FFO per unit growth of 6-11% annually. When management acquires an asset it is with a plan that the company would own it forever. That said, management does recycle capital when the opportunities for improving the operations and cash flows are largely realized. They are opportunistic as sellers, divesting mature, non-core assets to buyers with a lower-cost-of-capital, and then redeploy the proceeds into higher-yielding investment opportunities.

The governance of Brookfield Renewable is unusual, but acceptable, as the ownership interests of ultimate parent, Brookfield Asset Management are reasonably aligned with the interests of Brookfield Renewable shareholders. Brookfield Asset Management is one of the largest alternative asset managers in the world, with more than \$600 billion in assets under management (AUM) and a strong history as an investor in, and operator of infrastructure assets, real estate, renewable power, private equity, and credit, investing both the company's own capital, as well as capital for investors. We believe investors in Brookfield Renewable should benefit from the global scale of Brookfield Asset Management as it pursues a long-term opportunity in transitioning electricity generation to renewable sources. Under a Master Services Agreement, Brookfield Asset Management provides management and administrative services, including sourcing acquisitions, to Brookfield Renewable in exchange for an annual base management fee, which is inflation-adjusted, and an equity enhancement fee on the increase in Brookfield Renewable's capitalization. Brookfield Asset Management also has incentive distribution rights, and benefits from increases in distributions paid to Brookfield Renewable unitholders once certain thresholds are exceeded.

Valuation: BEPC trades for 15.9x EV to consensus 2021 estimated EBITDA and 14.3x EV to consensus 2022 estimated EBITDA.

Risks: There may be seasonal changes in climate conditions which can affect the company's ability to generate electricity. Longer-term changes in weather conditions may disrupt the operation of their generation facilities. Valuations for the company could contract. Regulation is extensive. Some PPAs for the company are subject to re-contracting, which may not be in the company's favor. Economic activity could soften, negatively affecting the company's results. Operating results of the various assets may not improve, despite the efforts of management. Competition may limit the company's opportunities to earn the attractive returns it has historically. There is increasing competition to acquire renewable assets. The company could make a mistake with an acquisition. Brookfield Renewable may need access to the capital markets. Those terms may not be agreeable to the company. There are conflicts of interest between Brookfield Asset Management and Brookfield Renewable.

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An index is unmanaged and not available for direct investment.

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Sector investing can be more volatile than investments that are broadly diversified over numerous sectors of the economy and will increase a portfolio's vulnerability to any single economic, political, or regulatory development affecting the sector. This can result in greater price volatility. **Communication services** companies are vulnerable to their products and services becoming outdated because of technological advancement and the innovation of competitors. Companies in the communication services sector may also be affected by rapid technology changes; pricing competition, large equipment upgrades, substantial capital requirements and government regulation and approval of products and services. In addition, companies within the industry may invest heavily in research and development which is not guaranteed to lead to successful implementation of the proposed product. Risks associated with the **Consumer Discretionary** sector include, among others, apparel price deflation due to low-cost entries, high inventory levels and pressure from e-commerce players; reduction in traditional advertising dollars, increasing household debt levels that could limit consumer appetite for discretionary purchases, declining consumer acceptance of new product introductions, and geopolitical uncertainty that could affect consumer sentiment. **Consumer Staples** industries can be significantly affected by competitive pricing particularly with respect to the growth of low-cost emerging market production, government regulation, the performance of the overall economy, interest rates, and consumer confidence. The **Energy** sector may be adversely affected by changes in worldwide energy prices, exploration, production spending, government regulation, and changes in exchange rates, depletion of natural resources, and risks that arise from extreme weather conditions. Investing in the **Financial** services companies will subject an investment to adverse economic or regulatory occurrences affecting the sector. Some of the risks associated with investment in the **Health Care** sector include competition on branded products, sales erosion due to cheaper alternatives, research and development risk, government regulations and government approval of products anticipated to enter the market. There is increased risk investing in the **Industrials** sector. The industries within the sector can be significantly affected by general market and economic conditions, competition, technological innovation, legislation and government regulations, among other things, all of which can significantly affect a portfolio's performance. **Materials** industries can be significantly affected by the volatility of commodity prices, the exchange rate between foreign currency and the dollar, export/import concerns, worldwide competition, procurement and manufacturing and cost containment issues. **Real estate** investments have special risks, including possible illiquidity of the underlying properties, credit risk, interest rate fluctuations, and the impact of varied economic conditions. Risks associated with the **Technology** sector include increased competition from domestic and international companies, unexpected changes in demand, regulatory actions, technical problems with key products, and the departure of key members of management. Technology and Internet-related stocks, especially smaller, less-seasoned companies, tend to be more volatile than the overall market. **Utilities** are sensitive to changes in interest rates, and the securities within the sector can be volatile and may underperform in a slow economy.

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