ValueInvestor INSIGHT

The Leading Authority on Value Investing

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Nuanced Approach

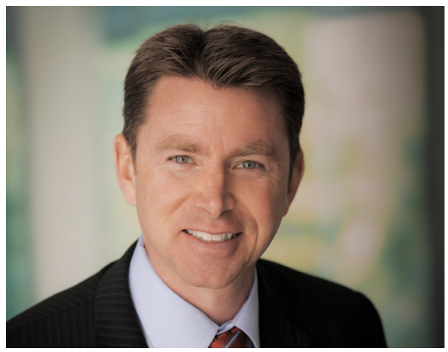
Distinguishing between transitory and permanent challenges facing a company is often job one for value investors. Scott Moore has proven well up to the task.

He started his firm in the absolute middle of 2008's financial crisis, so Nuance Investments' Scott Moore has considerable experience in preaching patience to his investors – something he's again doing today. "The good news is the vast majority of our clients have clear eyes and a long-term view," he says.

They have also been well rewarded by Moore's stewardship. Nuance now manages $2.2 billion and its all-cap Concentrated Value strategy since November 2008 has earned a net annualized 15.7%, vs. 12.9% for the Russell 3000 Value Index.

While finding table-pounding ideas relatively scarce, Moore in today's market is seeing unrecognized value in such industries as insurance, poultry processing, dental supplies and healthcare equipment.

INVESTOR INSIGHT



Scott Moore
Nuance Investments

Investment Focus: Seeks to buy what he considers leading business franchises when negative transitory problems are inappropriately built into their share prices.

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Investor Insight: Scott Moore

Scott Moore of Kansas City's Nuance Investments describes what "competitive transitions" he's avidly avoiding today, why he considers mid-caps to be particularly fertile ground for his types of ideas, why he dislikes late-cycle investing, and why he believes Sanderson Farms, Dentsply Sirona, Travelers and Reinsurance Group of America are undervalued.

Every investor needs to be able to winnow the broad opportunity set down to ideas with the highest likelihood of success. What's your first step in that process?

Scott Moore: Our big-picture philosophy is that we believe in investing in leading business franchises when they face transitory negative events. If we're right about the transitory part, we can typically buy when we believe there's both much less downside and much more upside than the market opportunity as a whole. Put those together and you end up with a much better risk/reward profile for leading companies we can own for the long term.

To winnow down the opportunity set, we group public companies – mostly, but not exclusively, based in the U.S. – into 68 sub-industries, and within the resulting niches we're looking for the #1 or #2 player with specific traits. Most important are returns on capital that have been higher for a longer time in the sub-industry, and that have also been less variable. Higher-than-average returns with less standard deviation of returns is a heavy indicator of a potential leading business franchise.

The second screen is to assess balance-sheet strength. For the vast majority of non-finance businesses, we're focusing on net-debt-to-EBITDA ratios that over long periods are better than average. This also is a very common trait of leading business franchises. In many sub-industries we see medians of 2.5x or so, while we're looking for the ones that are 2.0x, 1.5x or better.

The third primary data item we study is capital spending relative to depreciation for the companies in the peer group. We've found over time that leading businesses have capital spending to depreciation in the range of 1.05x to 1.35x, while the #3, #4 or #5 players are having to spend more in trying to catch up. Given the advantages attendant to being #1 or #2, playing catch up is difficult and success is rare.

This screening process has been in place a long time, and generally identifies about 250 leading business franchises that we track, follow, understand, have great relationships with, and really know, in my opinion, about as well as you would ever need to know a company to invest in it. Of course, we're adding and subtracting names as companies and industries evolve, but a significant number of the names have been on the list for more than 20 years.

ON MISTAKES:

My biggest mistakes have clearly been when I got the strength and durability of the competitive position wrong.

How about a typical example?

SM: A good one would be Aptargroup [ATR], which is the world's dominant and largest supplier of specialty lids. These are not the little screw-top lids on a water bottle, but things like a no-spill lid for Tide detergent, a flip-top lid for Gatorade, or a lid that manages dosage on an asthma inhaler. The company has had over 50% market share since I started following it in the 1990s, has had an excellent balance sheet through cycles, and benefits from important barriers to entry, in particular the fact that it has so many co-located production facilities with customers around the world.

Describe some ways in which you filter the transitory from the more-permanent problems facing a company.

SM: That's one of the most difficult things we do, and without doubt the biggest mistakes I've made in my career have been when I got the strength and durability of the competitive position wrong. Here we're looking at all the evidence and data we can on the relevant industry dynamics and evolution of market shares over time. We really want to avoid market-share-losing companies and incumbent firms whose industries are going through a competitive transition.

Transitory problems in general cause companies to underearn relative to their mid-cycle or more-normal earnings power. One common example we've seen over time is when a company is spending heavily on technology or other investments that are expensive today but will pay off tomorrow. A couple years ago we bought Sysco Foods, the food distributor, when it was going through a large SAP-software transition. The stock had fallen significantly as near-term earnings fell to maybe $1.80 per share, against a more-normal level we estimated to be closer to $2.40 per share. On our normalized estimate, we were paying maybe an 11x P/E when we thought the stock should trade at around 17x. To us, that was clearly transitory.

The transitory problem is often also cyclical. An economic recession is the broadest transitory issue we can have, but it can also be related to things like weather, commodity prices or just recurring industry supply/demand dynamics. We'll talk in more detail later about Sanderson Farms [SAFM], the big poultry producer. Depending on chicken, pork and beef prices, as well as feed costs, the company over time can go from returns on capital – we use EBITDA to tangible assets for this sub-industry – of 0% to 50%. At the peaks and troughs, capital moves either in or out to chase or flee the returns, which results in a self-regulating mechanism that drives, in Sanderson's case, what we consider to be a roughly 25% normal return on capital. If on the resulting mid-cycle earnings at that return level we believe the shares provide an attractive enough risk/reward, that's the type of thing that interests us.

You've been fairly active in healthcare. What are the transitory issues you see in a portfolio holding like medical-equipment company Smith & Nephew [SNN]?

SM: There are two things. The company is earning today at a rate of $1.90 to $2 per share against what we consider a normal level of $2.50 to 2.60. Roughly half of that difference has to do with the current British pound/U.S. dollar exchange rate, and the other half has to do with the fact that the company's selling, general and administrative expenses are significantly higher than they should be. The currency issue we don't consider permanent, and new management appears to be highly attuned to addressing the cost issue. At today's share price [of around $37], we're paying less than 15x normal earnings, when our Nuance master list on a comparable basis is trading at 24-25x. We think there's a compelling takeover case to be made as well. In any event, we expect the stock to have a very different return pattern versus the market going forward.

Let's talk about "competitive transitions" and the ones you're avoiding today.

SM: Competitive disruptions render historical financial statements and historical valuation metrics largely irrelevant and useless as a guide to the future. If that's the case, calculating fair value isn't much different than playing the slots in Las Vegas.

I'll talk about one historical transition and a couple that are more current. We for some time appreciated the automated-teller-machine [ATM] business, which had a solid oligopolistic structure led by Diebold and NCR. In the financial crisis when banks slashed spending on everything, we saw that as an opportunity to take a position in Diebold, which we considered a leading business franchise. What we didn't adequately anticipate, however, was the extent of the structural change impacting the ATM business as foot traffic at banks fell and electronic and credit-card payments continued to take share. We recognized it soon enough that we were able to get out of the stock with a 5-10% loss – terrible versus the rest of the market, by the way – which turned out to be quite fortunate. Shares in the company today, now called Diebold Nixdorf [DBD], trade at less than $5.

As an aside, some very accomplished investors own Diebold shares today and can make a case for it as a market-leading company with an inappropriately beaten-down stock. For us, the prospective sustainability of the business just isn't sufficient – it's no longer on our list of 250 stocks we'd consider.

ON ENERGY:

We're not predicting imminent demise [but] we're setting such companies aside until the business stabilizes.

In today's world, we've also taken off our list a number of distributors, of a variety of things. Amazon is a distribution machine with scale and technology advantages that distributors that come into its sights may find difficult to compete with. In dental-product distribution, for example, Henry Schein [HSIC] and Patterson [PDCO] have long been leading franchises, but we would no longer invest in them due to market-share losses and an Amazon-driven structural shift in that market.

You've spoken a lot about energy, a sector on which you've said you went quiet as of the middle of last year. Why?

SM: After a complete review of the sector, we now believe that crude oil and the companies that search for it, drill it, refine it and make equipment related to all of the above are likely facing a multi-year period of competitive transition, driven by our belief that electric vehicles will take significant market share from combustion engines and that renewable sources of energy will generate an increasing share of electricity. The cost of alternatives is coming down, the performance of alternatives is going up, and government mandates in favor of alternative energy are likely to expand as a response to climate issues.

We're not predicting imminent demise for anyone, we're just saying that the level of certainty around most fossil-fuel-related companies has declined enough that we can no longer use historical financial statements to judge the future. As such, we're setting those companies to the side at least until the business stabilizes, which could be a very long way off. To give one example, we sold the stock of oil-services leader Schlumberger [SLB] at between $65 and $70 a little over a year ago, and while oil prices are up 30-40% since then, the shares trade now at around $61. Our experience has been similar in other names, which gives us some confidence that the environment has in fact changed.

Are you looking at potential winners from this transition as well?

SM: We are. We're spending more time in a variety of areas, including electrical-equipment companies, auto-parts manufacturers with content independent of the power source, fuse and electronic-component manufacturers, and semiconductor and semiconductor-capital-equipment firms. We expect to find leading franchises in a number of places where the wind from the energy transition is at their backs.

While you invest across the capital structure, you've long staked a successful claim investing in mid-cap companies. Why do you find that area fertile ground?

SM: These are companies that are mature and big enough that you can identify sustainable franchises, but they also can still have interesting organic-growth prospects that your average large- or mega-cap doesn't have. And while I wouldn't say mid-caps are not well followed, you have a better chance of having an information advantage than exists with bigger companies. Roll that all together – competitive advantages, more interesting growth prospects and better potential of an informational edge – and we've just found mid-caps to be an attractive space for producing strong risk-adjusted returns.

You mentioned valuing both Sanderson Farms and Smith & Nephew on normal, mid-cycle earnings. Is there a valuation hurdle of some kind a stock has to clear to make it into the portfolio?

SM: The hurdle for us is that the stock has a better risk/reward than the opportunity in the market, which we define as the 250 market leaders we follow. Right now that group is overvalued relative to our estimation of fair by about 25%, and the downside to trough is closer to 60%. That's obviously not a tough bogey to beat, but we also consider holding cash as an option, with its 1-2% upside and zero downside. That brings more of an absolute bent to what we do, rather than just relative. Cash now is about 22% in our concentrated portfolio and 8% in mid-cap.

We take a conservative view of normal in arriving at fair values, but I'm always surprised when people say they have 30-40% upside in their portfolio today. Maybe they're looking further out than we do, but while we can certainly find that kind of upside in individual cases, we're nowhere near that on our overall portfolios.

Describe in more detail your investment case for Sanderson Farms.

SM: Sanderson Farms is a fully integrated poultry company that processes, markets and distributes fresh, frozen and prepared chicken products. It's #3 in the overall U.S. market behind Tyson Foods and Pilgrim's Pride, but on a regional basis – which is relevant here due to transportation costs and spoilage – it has #1 or #2 share in nearly all of the southeastern and south-central states.

There are only so many places to grow chickens and it's difficult to obtain licenses for new locations. Combined with the company's scale and low costs, that helps insulate the business. At the same time, chicken is one of the healthiest proteins, with low levels of fat and calories, so it's well positioned to benefit from the trend toward healthier eating habits. Most packaged-foods companies today have a hard time saying that.

As I mentioned earlier, even though the company's through-the-cycle returns on capital are quite healthy, the business is certainly cyclical. Last year due mostly to historically low feed costs, Sanderson earned an unsustainably high $12.30 per share. With feed costs returning to normal and a trade-war-related glut developing in the U.S. protein supply, earnings this year have swung wildly the other way and are expected to come in at $2.50 or so per share. The share price has fallen from $175 to just over $100 today, giving us what we think is a solid opportunity.

How do you arrive at what you believe the shares are more reasonably worth?

SM: Applying our normalized 25% return on capital estimate to the current tangible asset base and assuming boneless-chicken-breast prices of $1.40 per pound – up from the current level of around $1 per

INVESTMENT SNAPSHOT

Sanderson Farms
(Nasdaq: SAFM)

Business: Production, processing, marketing and distribution of fresh, frozen and pre-packaged chicken products mostly in the southeastern and south-central United States.

Share Information (@9/28/18):

Price	**103.37**
52-Week Range	95.97 – 176.43
Dividend Yield	1.3%
Market Cap	$2.36 billion

Financials (TTM):

Revenue	$3.36 billion
Operating Profit Margin	5.8%
Net Profit Margin	5.3%

Valuation Metrics
(@9/28/18):

	SAFM	S&P 500
P/E (TTM)	13.3	24.4
Forward P/E (Est.)	31.5	18.1

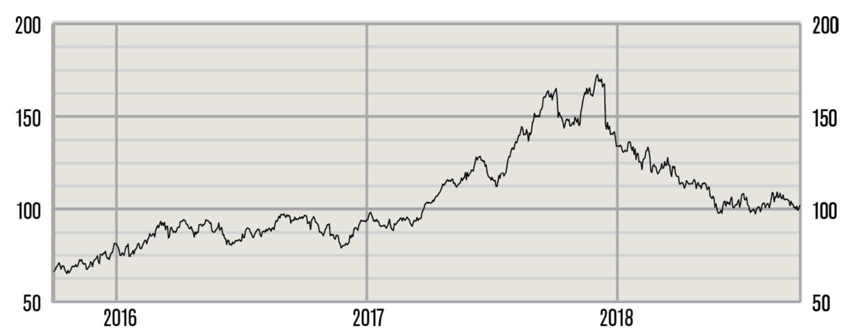
Largest Institutional Owners
(@6/30/18 or latest filing):

Company	% Owned
BlackRock	9.3%
Vanguard Group	9.3%
Renaissance Technologies	7.8%
Dimensional Fund Adv	6.3%
LSV Asset Mgmt	4.9%

Short Interest (as of 9/14/18):

Shares Short/Float	20.5%

SAFM PRICE HISTORY



THE BOTTOM LINE

The company's earnings have veered sharply from the normalized level Scott Moore expects, due to rising feed costs and trade-war impacts that he believes are transitory. Applying a historical average 14x P/E to his $11 per share estimate of mid-cycle earnings – which includes the impact of share buybacks – the stock would trade at more than $150.

Sources: Company reports, other publicly available information

pound, but down from the $1.75 level of a year ago – we estimate the company's normalized earnings at $9 per share. We add another $2 per share to that to reflect share repurchases the company should make using its net cash balance. At the historical average P/E of 14x, we arrive at a price target of better than $150.

The company was affected by Hurricane Florence earlier this month. How are you reacting to that, if at all?

SM: Sanderson has a fairly significant footprint in North Carolina, so it lost inventory and had some facilities damaged in the hurricane. It has plenty of redundant capacity in other states unaffected by the storm, but Florence will likely affect this quarter's earnings and management says it may take 90 days for operations to return fully to normal. If it turns out that the impact is greater than anticipated and causes a further decline in the shares, we would very likely add to our position because that would pretty clearly be a transitory issue.

You mentioned earlier that dental-product distributors are facing a changing competitive landscape. What upside do you see today in dental-product supplier Dentsply Sirona [XRAY]?

SM: Dentsply is the leading global manufacturer of dental equipment and supplies, generating 35% of its revenue in the U.S., 40% in Europe and 25% in the rest of the world. The 2016 merger with Sirona Dental Systems broadened the scope of its business, adding things like chairside milling equipment, imaging, and chairs to Dentsply's traditional strength in areas such as implants, endodontic supplies and restoratives.

The competitive set is more or less an oligopoly consisting of Dentsply and divisions of 3M and Danaher. Except for incursions into the orthodontics market by Invisalign maker Align Technology, market shares among the three main players have been stable for many years. We think the business long-term is attractive, benefitting from the aging population in developed markets and an increased incidence of dental care in emerging markets.

The opportunity in the stock actually stems from the disruption I spoke of earlier. As Amazon has taken share from Patterson and Henry Schein, Dentsply has had to increase its internal sales efforts to service dentists who don't have the depth of relationship with Amazon that they had with the two incumbents. That's modestly increased Dentsply's operating costs, but the far bigger issue has been upheaval in the distribution market leading to inventory destocking that will take a material chunk out of Dentsply's 2018 revenue. From earnings of nearly $2.80 per share in 2016, this year's number is expected to be closer to $2.10. From a high of nearly $70 in October of last year, the stock today is just below $38.

How inexpensive do you consider the shares?

SM: We expect the company to acclimate to the changes in the distribution system relatively quickly, and based on a more mid-cycle 34% EBITDA-to-tangible-asset ratio, we put normalized earnings power

INVESTMENT SNAPSHOT

Dentsply Sirona
(Nasdaq: XRAY)

Business: Global design, manufacture and sale of professional dental equipment and products, including milling and imaging machines, implants, restoratives and chairs.

Share Information (@9/28/18):

Price	**37.74**
52-Week Range	37.18 – 68.98
Dividend Yield	0.9%
Market Cap	$8.39 billion

Financials (TTM):

Revenue	$4.10 billion
Operating Profit Margin	12.0%
Net Profit Margin	(-39.0%)

Valuation Metrics
(@9/28/18):

	XRAY	S&P 500
P/E (TTM)	n/a	24.4
Forward P/E (Est.)	16.2	18.1

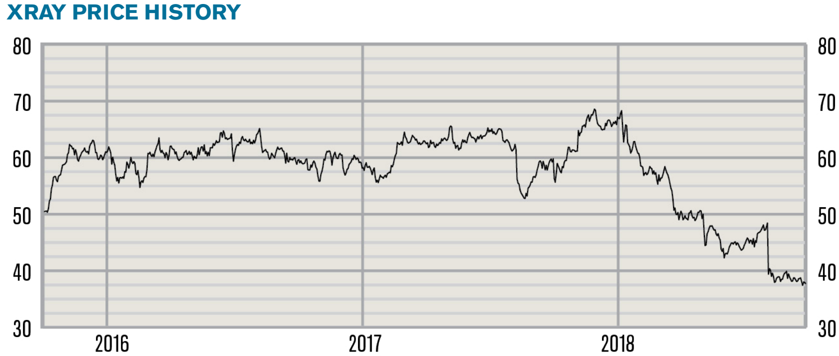
Largest Institutional Owners
(@6/30/18 or latest filing):

Company	% Owned
Vanguard Group	10.1%
Generation Inv Mgmt	7.7%
Veritas Asset Mgmt	4.4%
BlackRock	4.4%
State Street	3.9%

Short Interest (as of 9/14/18):

Shares Short/Float	4.2%

XRAY PRICE HISTORY



THE BOTTOM LINE

Amazon-induced upheaval in the distribution market for the company's products will significantly impact its earnings this year, says Scott Moore. He expects the company to acclimate quickly to the changes and by applying an 18.5x normalized multiple to his $2.70 estimate of normalized EPS, he arrives at a fair value for the shares of around $50.

Sources: Company reports, other publicly available information

at around $2.70 per share. At that level of earnings the stock trades at only a 14x P/E, but using a more normal historical multiple of 18.5x, our fair value estimate is around $50.

Does the management turnover at the company in the past year concern you?

SM: The board a year ago terminated the company's top three executives who orchestrated the Sirona deal, after expected synergies of $125 million were not realized. We've spoken with the new team three times since they started, and we're comfortable that they're focused on better integrating Sirona, while favoring organic growth and share repurchases over big acquisitions. While we're not counting on additional synergies from the merger, we have a free option on the new team's potential to achieve what their predecessors could not.

What attracted your interest in insurer Travelers [TRV]?

SM: We have long admired Travelers as a global leader in property and casualty insurance, especially in commercial lines for small and medium-sized businesses. It consistently generates higher returns on equity and lower claims losses than its industry, and it benefits from scale efficiency in both underwriting and claims management. It's one of the best capitalized companies in the industry, with an A+ credit rating from A.M. Best, vs. a peer median of BBB+. Per-share book value hasn't declined in over 15 years, which we attribute to management's willingness to walk away from business when the pricing isn't there.

The opportunity to invest arose after a heavy period of natural catastrophes in 2017 pulled earnings per share down to around $7.30, from $10.30 the previous year. There was a clear reason, but it was somewhat unusual to find a market leader operating at below-mid-cycle earnings so late in an economic cycle.

Do you worry about competitive transition in this business?

SM: We do believe certain personal insurance lines, most notably auto insurance, are in the early stages of being disrupted. Web-based comparison shopping is squeezing rates and it's hard to see positives for auto insurers from increased reliance over time on ride sharing or self-driving cars. We're avoiding companies such as Allstate [ALL] that are heavily focused on personal auto and home insurance. Travelers is exposed to disruption in roughly 20% of its business – which we take into account when normalizing earnings – but we think most of its commercial business lines will be harder to disrupt and should be especially durable because of the company's scale.

How are you looking at fair value versus the current share price of $129.70?

SM: High-quality companies rarely get wildly mispriced, so we think our upside here is somewhat more modest than usual. Our estimate of the company's mid-cycle earnings is $11 per share, derived from applying average returns on equity of about 15% to the most recently reported net asset value. For a normal multiple we use 13.5x, which is a bit above the historical

INVESTMENT SNAPSHOT

Travelers
(NYSE: TRV)

Business: Provider of commercial and individual property and casualty insurance, including workers' compensation, home, auto and speciality-lines products and services.

Share Information (@9/28/18):

Price	**129.71**
52-Week Range	120.74 – 150.55
Dividend Yield	2.4%
Market Cap	$34.72 billion

Financials (TTM):

Revenue	$29.54 billion
Operating Profit Margin	10.0%
Net Profit Margin	6.9%

Valuation Metrics
(@9/28/18):

	TRV	S&P 500
P/E (TTM)	17.6	24.4
Forward P/E (Est.)	11.5	18.1

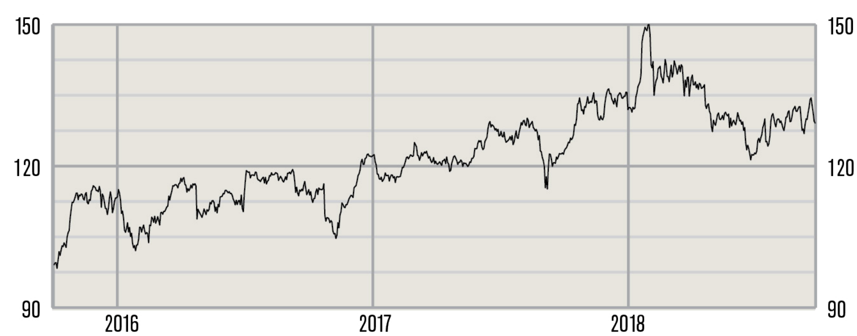
Largest Institutional Owners
(@6/30/18 or latest filing):

Company	% Owned
Vanguard Group	8.1%
State Street	6.7%
Massachusetts Fin Serv	4.8%
BlackRock	4.5%
Fidelity Mgmt & Research	4.1%

Short Interest (as of 9/14/18):

Shares Short/Float	1.5%

TRV PRICE HISTORY



THE BOTTOM LINE

Its shares have recovered somewhat after being hit by a bad catastrophe-loss year in 2017, but Scott Moore still doesn't believe the company's stock reflects the strength of its competitive profile and its proven ability to generate above-norm returns. At 13.5x his $11-plus per share estimate of normalized earnings, the stock would trade at $150.

Sources: Company reports, other publicly available information

median, but we think is deserved given the strength of the competitive profile and the demonstrated ability to generate above-norm returns. That works out to a price target today of around $150. As a check, that price equates to 1.8x tangible book value, right in the middle of the historical range of 0.9x to 2.7x.

Again, are you building in any impact from Hurricane Florence?

SM: Early estimates are that the impact for insurers like Travelers from Florence will be less than feared. If 2018 does turn out to be a bad catastrophe year, that would most likely just result in somewhat of an extension of our holding period for the stock.

Turning to another insurer, why are you high on the prospects for Reinsurance Group of America [RGA].

SM: This is the third-largest global life and health reinsurer behind Swiss Re and Munich Re. With 80% of the global market controlled by the top five competitors, pricing in the business tends to be fairly rational and RGA's market share across its various lines of business has been quite stable over time. Like Travelers, it has an A+ credit rating from A.M. Best and a long history of sound underwriting.

The company's returns on capital are below trend for two primary reasons, low but increasing interest rates and a recent bump up in mortality rates. We don't ascribe to the view that historically low interest rates are permanent, and while rising rates can lead to mark-to-market charges on a bond portfolio, we think the market will see that higher rates are essential for matching assets and liabilities and that they should ultimately fuel earnings.

As for mortality rates, quarterly aberrations happen from time to time, and even small differentials can lead to earnings that fall short of estimates. I'm always surprised when the market responds to that, but it happened in this year's first quarter with RGA when earnings came in low relative to potential.

Confidence in management is of particular importance when investing in a company like this. Is your confidence here high?

SM: It's true that management is especially important with insurance because there is always a temptation to grow revenues by sacrificing underwriting standards. The revenue growth hits right away, but the underwriting laxity may not surface as a problem for many years. In general, when we meet with management teams we want to make sure that there are no major changes in strategy or major capital-allocation decisions on the way that would reduce the usefulness of historical financial statements in estimating mid-cycle earnings. In RGA's case, the chief executive, chief financial officer, chief operating officer and chief risk officer have all been with the company for a decade or more. We're confident they will do what they say, and they have the track record to support that.

Aging populations generally aren't positive for life insurers. Is that a concern here?

SM: While aging populations do tend to demand less life insurance, longer life spans delay claims payments and allow

INVESTMENT SNAPSHOT

Reinsurance Group of America
(NYSE: RGA)

Business: Global provider of traditional and non-traditional life and health reinsurance products, including those related to employee retirement benefits and annuity coinsurance.

Share Information (@9/28/18):

Price	**144.56**
52-Week Range	131.72 – 165.12
Dividend Yield	1.7%
Market Cap	$9.20 billion

Financials (TTM):

Revenue	$12.75 billion
Operating Profit Margin	9.3%
Net Profit Margin	13.7%

Valuation Metrics
(@9/28/18):

	RGA	S&P 500
P/E (TTM)	5.4	24.4
Forward P/E (Est.)	10.8	18.1

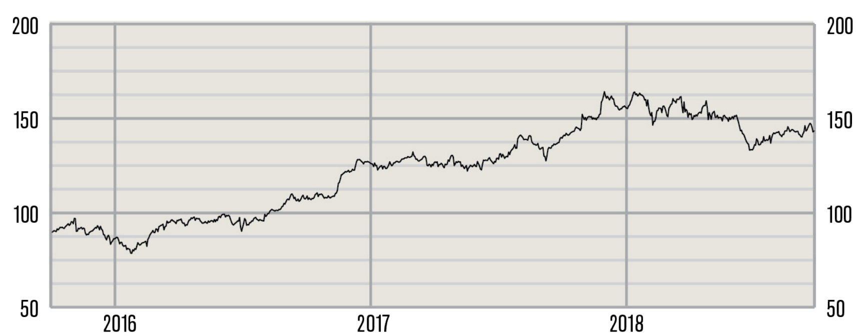
Largest Institutional Owners
(@6/30/18 or latest filing):

Company	% Owned
Vanguard Group	8.9%
BlackRock	7.9%
Fidelity Mgmt & Research	3.7%
Boston Partners	3.5%
State Street	3.4%

Short Interest (as of 9/14/18):

Shares Short/Float	2.6%

RGA PRICE HISTORY



THE BOTTOM LINE

Scott Moore believes the company is underearning its potential primarily due to short-term impacts of low but rising interest rates and perceived rising mortality rates. Basing his mid-cycle earnings estimate on the company's historical-average returns on capital and applying a cycle-median multiple of 13x, he pegs the stock's fair share value at $175.

Sources: Company reports, other publicly available information

insurers to earn investment income on the float for longer periods. I'd also point out that aging populations are unique to the developed world. In the Asia-Pacific region, which now accounts for 60% of the global population, the median age of 31 is far less than it is in the U.S. and Europe, and insurance penetration rates overall are exceedingly low. Importantly, RGA has a particularly strong franchise in the Asia-Pacific region, where it generates 20% of its revenues.

At today's share price of $144.50, what upside do you see in the shares?

SM: Consensus earnings estimates for this year are around $11.40 per share. That's nearly 20% below our mid-cycle EPS estimate – based on historical-average returns on capital – of $13.50. Using a cycle median multiple of 13x, we peg fair value at $175 per share.

I should have mentioned this earlier, but while I'm using earnings multiples to simplify our discussion, we also value our companies in a similar fashion using other measures like enterprise value to EBITDA, unlevered free cash flow yield, and dividend yield with normal payout ratios. Using multiple methods can help surface gaps in your understanding if there are material differences in the results.

You wrote recently to your investors about the travails of "late-cycle investing." Why does that describe for you the period we're in today?

SM: All market cycles are different, but we believe the current market has important traits in common with late-cycle periods in the late 1990's and from 2005 to 2007. Valuations in general are not being emphasized by the broad market. Narrowness of performance proliferates, and people start to think investing is pretty easy if you own a select few stocks or sectors. Leverage is increasing and people seem to forget that it can work both ways, to the detriment of personal, company or governmental balance sheets when the good times end.

Late-cycle investing, as you can imagine, is not our preferred period. The traits in the market during these times just aren't in sync with our style of looking for the best risk-adjusted returns that can be achieved over the long-term.

You changed you firm's name in 2010 to Nuance. Why that?

SM: We saw the potential for confusion with a company owned by my financial partner in the firm, so we looked for a new name. My children and I Googled "100 interesting words," and out of that we identified three that weren't already taken and we thought had something to do with investing and what we do every day. Why choose Nuance? One answer is that I do believe in this business that it's the nuances of how we do things, even subtle ones, that make the difference in performance. So there's a nice connection between the name and what we do. Truthfully, though, the main reason we chose Nuance was that it was my kids' favorite. VII

Note A: Nuance Investments, LLC is a Registered Investment Advisor. Commencement of the Nuance Concentrated Value Composite was 11/13/08. Commencement of the Nuance Mid Cap Value composite is 11/03/08. Return figures for the Composites are provided by Clearwater Analytics. The Primary benchmark for the Nuance Concentrated Value Composite is the Russell 3000 Value Index. The secondary benchmark is the S&P 500 Index. The Primary benchmark for the Nuance Mid Cap Value Composite is the Russell Midcap Value Index. The secondary benchmarks are the S&P MidCap 400 Index and S&P 500 Index. Return figures for all Indices are provided by Bloomberg. Investors cannot invest directly in any index. Annualized Standard Deviation & Annualized Sharpe Ratio figures are provided by Zephyr Style Advisor. The Sharpe Ratio is a calculation of a product's risk-adjusted performance over time. The ratio is calculated by taking a product's annualized excess return over a risk-free rate (we use the Citi 3-month Treasury Bill as the risk-free rate) and dividing by its annualized standard deviation calculated using monthly return data.

Portfolio holdings and sector allocations are subjected to change and are not a recommendation to buy or sell any security. Holdings identified do not represent all of the securities purchased, sold or recommended by the adviser.

As of 9/30/2018 portfolio weights in Nuance Concentrated Value of the names discussed are as follows: Dentsply Sirona Co. (XRAY) 6.36%, Sanderson Farms Inc. (SAFM) 5.21%, Smith & Nephew PLC Sp ADR (SNN) 4.54%, Reinsurance Group of America Inc. (RGA) 3.96%, Travelers Companies Inc. (TRV) 3.91%, 3M Co. (MMM) 1.05%, AptarGroup Inc. (ATR) 0.50%, Sysco Corp. (SYY) 0.00%, Diebold Nixdorf Inc. (DBD) 0.00%, NCR Corp. (NCR) 0.00%, Amazon.com Inc. (AMZN) 0.00%, Henry Schein Inc. (HSIC) 0.00%, Patterson Companies Inc. (PDCO) 0.00%, Schlumberger Ltd. (SLB) 0.00%, Tyson Foods Inc. (TSN) 0.00%, Pilgrim's Pride Corp. (PPC) 0.00%, Danaher Corp. (DHR) 0.00%, Align Technology Inc. (ALGN) 0.00%, Allstate Corp. (ALL) 0.00%, Swiss Re AG (SREN) 0.00% and Munich Re Group (MUV2) 0.00%.

As of 9/30/2018 portfolio weights in Nuance Mid Cap Value of the names discussed are as follows: Dentsply Sirona Co. (XRAY) 5.84%, Sanderson Farms Inc. (SAFM) 5.18%, Smith & Nephew PLC Sp ADR (SNN) 5.03%, Travelers Companies Inc. (TRV) 3.90%, Reinsurance Group of America Inc. (RGA) 3.54%, Sysco Corp. (SYY) 1.04%, AptarGroup Inc. (ATR) 1.00%, Diebold Nixdorf Inc. (DBD) 0.00%, NCR Corp. (NCR) 0.00%, Amazon.com Inc. (AMZN) 0.00%, Henry Schein Inc. (HSIC) 0.00%, Patterson Companies Inc. (PDCO) 0.00%, Schlumberger Ltd. (SLB) 0.00%, Tyson Foods Inc. (TSN) 0.00%, Pilgrim's Pride Corp. (PPC) 0.00%, 3M Co. (MMM) 0.00%, Danaher Corp. (DHR) 0.00%, Align Technology Inc. (ALGN) 0.00%, Allstate Corp. (ALL) 0.00%, Swiss Re AG (SREN) 0.00% and Munich Re Group (MUV2) 0.00%.

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