THE WALL STREET TRANSCRIPT
Connecting Market Leaders with Investors

Looking Beneath the Surface to Find Unique ESG Prospects

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SECTOR — GENERAL INVESTING

TWST: I know you've spoken with the publication in the past, but if you wouldn't mind, refresh our memories with a snapshot of Fairpointe Capital's business and your overall investment approach and philosophy.

Ms. Tuite: I joined Fairpointe in 2017. We are headed up by Thyra Zerhusen, CEO and CIO, who's been leading the strategy since 1999; she has focused on the midcap space for a long time. She and I worked together in 1999 for four years, and then went separate ways, so rejoining her has been pretty straightforward since we have had a history together. The bulk of the assets in the firm have always been in the Mid-Cap strategy with a core approach. I joined Fairpointe to assist in running an ESG strategy that we incepted at the beginning of 2018, something that we talked about last time and that I've always been very passionate about. I also brought with me a small, long/short U.S. equity hedge fund.

My roots are in value investing, but value not in the sense of book value but in the sense of looking at intrinsic value — I was at Harris Associates for many years — and just thinking about businesses and what they're really worth and also looking for a very attractive risk versus reward. So trying to protect the downside and yet look for interesting upside. I think what has differentiated us, and my career, has really been our long-term focus and low turnover approach, with a concentrated portfolio of companies that are either misunderstood or undiscovered by the market for various reasons.

TWST: I hope you don't mind talking a little bit about both the Mid-Cap strategy and the ESG strategy. Let's start with the flagship of the firm, the Mid-Cap Equity strategy. What would you note in terms of the investment process and approach to choosing stocks and portfolio management?

Ms. Tuite: Our analysts are generalists, and our process is a bottom-up approach, so really not coming at it from a thematic perspective, but looking for interesting situations, versus a macro, top-down approach. Again, the strategy is really looking for turnaround situations, or maybe a company that is spinning off a segment, or where the market hasn't fully appreciated a restructuring or a change that a company is going through, or where we believe the market has a different view on the outlook for the company's products or services — that's always been our approach.

Both portfolios are concentrated. The Mid-Cap strategy generally has 40 to 50 names. The ESG strategy has around 40 names, so that's more concentrated even than Mid-Cap. We generally overlap in the two strategies in terms of names, and we've always been involved in governance as a firm and voting proxies, so the G part of the analysis has been with us a long time. I brought more process to the due diligence on both environmental and social issues. So we do apply ESG principles to both strategies, but the ESG has more constraints than the Mid-Cap.

> **Highlights**
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> *Frances E. Tuite discusses Mid-Cap and ESG strategies at Fairpointe Capital, LLC. Fairpointe employs a long-term focus and low turnover approach, seeking to assemble a portfolio of companies that are either misunderstood or undiscovered by the market for various reasons. Both portfolios are concentrated; the Mid-Cap strategy generally has 40 to 50 names and the ESG strategy has around 40 names. Rather than overpay for companies that rank high for ESG factors in databases, Ms. Tuite looks for companies that are not necessarily classified as ESG companies or are not well understood regarding their ESG principles. She believes ESG factors can affect a company's long-term valuation and are important to all investors, not just specific to ESG strategies.*
> *Companies discussed: Agilent Technologies (NYSE:A); Commercial Metals Company (NYSE:CMC); CONMED Corp. (NYSE:CNMD); Quest Diagnostics (NYSE:DGX); Ecolab (NYSE:ECL); Adtalem Global Education (NYSE:ATGE); Corning (NYSE:GLW); Nokia Oyj (NYSE:NOK); Qualcomm (NASDAQ:QCOM); Akamai Technologies (NASDAQ:AKAM); Check Point Software Technologies Ltd. (NASDAQ:CHKP); Magna International (NYSE:MGA); Methode Electronics (NYSE:MEI); Nikola Corporation (NASDAQ:NKLA) and Facebook (NASDAQ:FB).*

TWST: Tell us more about what those constraints are, and anything else you'd want to add about the ESG strategy.

Ms. Tuite: The ESG strategy is pretty unique from a lot of other ESG strategies. Obviously, a lot of money has flowed into the category. It's been very popular with investors, and enormous dollars have looked at ESG funds and ETFs. A fair amount is passive money. What I found is that many ESG strategies base their investments on database rankings for companies, and there begins to be what is considered a "great ESG company." As a result, stocks and funds have gotten a lot of flows into the name and potentially get overvalued.

At Fairpointe, we want to find a great ESG company, but do not want to overpay. For us, return is a very important part of our ESG strategy, so we like to look at names that are not assumed to be classified as ESG companies or are not well understood regarding their ESG principles. Some of the smaller Mid-Cap names do not have the same resources to greenwash or play the ESG game. I believe we have a unique approach and a unique portfolio of names that other funds would not identify as good ESG characters just on the surface.

Last year I talked about **Agilent** (NYSE:A), which was a name we bought in both strategies and was a huge success for us. It is a great ESG company, but it's run up and performed very well. The company is held in a lot of ESG strategies and it's a name that we still love. However, we wouldn't be buying here. **Agilent** is more of a "hold" than a "buy" at this point.

We do our own ESG rating of each company. We evaluate a company by doing independent work, by talking to management teams, looking at filings and doing fundamental research — and that takes time, so it makes more sense to manage a concentrated portfolio.

A company we bought that you might not think of as an ESG name is **Commercial Metals** (NYSE:CMC), which is a steel company. While it does have a carbon footprint, it produces steel from 99% recycled inputs. The company takes scrap metal and melts it, but uses an electric arc furnace versus a coal, iron ore or blast furnace, so it is a lot more energy efficient. They are also ahead of the curve in terms of recycling their water. **Commercial Metals** is led by a female CEO, which is unusual in the steel industry. When we initiated the position, they actually had a female CFO, but she has since retired. The company's board is also well diversified.

Re-bar is the majority of their products, so it's a necessary item to be used in this economy. Rebar is used in highways, bridges and construction of buildings. Certainly, our bridges need repair, as do our highways. So here you have a company that you might, on the surface, say, OK, steel, metal company, how can that be a good ESG name? But we took a more pragmatic approach to our assessment of the company and what it was doing and how it was conducting its business. We consider ESG factors as risk issues, and we didn't see significant risks to their business from their management or operations.

TWST: Great example. Are you willing to give us one more?

Ms. Tuite: Sure. It's a really interesting health care name called **CONMED** (NYSE:CNMD), and it's a $3 billion market cap company, so pretty small for most funds. We bought the stock in July when it was $2 billion in market cap. **CONMED** makes instruments for orthopedic and general surgery. Because of COVID, the stock got knocked down as hospitals were not doing any surgeries for a period of time. Their earnings were under pressure, but the stock looked very attractive to us. The company had done an acquisition at the end of 2018, so the balance sheet had some leverage on it and the market this year hasn't liked levered companies for the most part.

1-Year Daily Chart of Commercial Metals Company

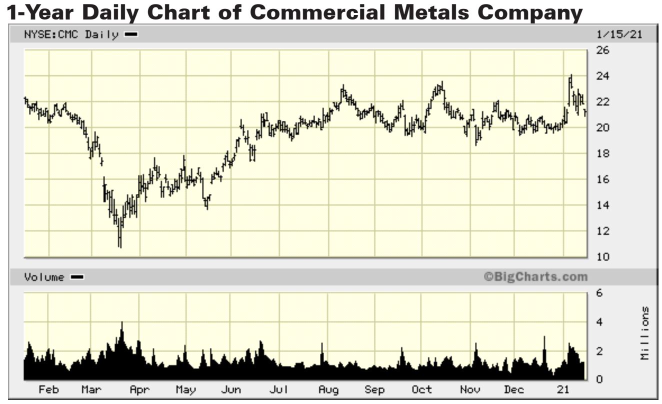

Chart provided by www.BigCharts.com

The acquisition they made in 2018 was very interesting. The company was **Buffalo Filter** and it manufactures a tool that is used in surgery, especially minimally invasive surgeries. For example, when you cut the skin you use a laser, and during that process smoke is generated.

That smoke can be the equivalent of 30 cigarettes for the health care workers in the operating room if they are not doing anything to control it. This tool evacuates the smoke, protects the health care workers, and is now being regulated and mandated in some states. **Buffalo Filter** has 80% market share and it's growing over 20%. **CONMED** is not a household name and **Buffalo Filter** products are a small niche market that is growing rapidly.

The smoke that is given off can be carbon monoxide, it can have carcinogens and it can have contaminants from the body of the person being lasered. From an environmental perspective and also health care worker, these products play an important role. We were able to buy this company during this period of COVID concern and it's been a huge win for the portfolio.

TWST: You mentioned that Agilent has done well and run up in price, and that if anything you might trim back on that holding. How would you describe your exit strategy and sell discipline overall?

Ms. Tuite: That's always tough. Again, we look at stocks on a risk/reward basis. While I do not see a huge upside with **Agilent** at this point, I also don't see a huge downside. They continue to have very high margins and good predictable growth. And so for me, I look at where is it on fair value, and its downside risk.

I think the last time we spoke I talked about **Agilent** and I also talked about **Quest** (NYSE:DGX); both companies have done well, and both are closer to fair value. And so it is one that I'm closer to trimming, but I haven't done that at this point.

This market has rewarded consistent growers, and valuations have moved higher than expected in a short timeframe, in my opinion. I also look at what I'm going to replace it with, and I am working on a couple of new names that would be potential replacements.

So they've both been extraordinary names in the portfolio. **Quest** has benefited from the testing that is taking place currently and will continue to take place over the end of our lifetime, just because testing is such an effective means for diagnosis for doctors, whether it's COVID or flu or a number of other disease states that we have. Both are great businesses. **Ecolab** (NYSE:ECL) is another name that I owned in the ESG strategy previously, and I sold it completely because it performed so well and exceeded my target. It's a great ESG company, but it was overvalued in my opinion. I am afraid to sell, but I look at that risk/reward and replacement stocks that I can put in the portfolio.

TWST: You mentioned earlier that you take a real bottom-up approach. That said, what macro factors do you pay most attention to, given all the various economic, political, public health, market trends in the backdrop?

Ms. Tuite: It is a time of a lot of uncertainty. I guess it always is to some extent. But what I do is have a longer-term time horizon. Most of our stocks are not necessarily cyclical plays, but they need something that's going to continue to generate cash flow, and that cash flow may be predicated on some economic upturn. So I pay attention to those factors and, obviously, the news on unemployment, and consumer confidence. However, I don't pretend that I can predict those factors. I am just trying to account for those factors in my valuation assessment of the business and what I think it's worth based on the cash flows on a three- to five-year time horizon.

TWST: As companies have their Q4 calls and release their year-end earnings and guidance for the new year, what will you be looking for in terms of trends or management tone and comments and outlook?

Ms. Tuite: Well, obviously COVID's affected how the consumer has acted as well as the technology stories that have dominated the market. Trying to assess the health of the economy and what the bookings look like for companies and management's tone are obviously things we pay a lot of attention to. Management is a very important part of our investment process. Partnering with managers that think as owners and have that long-term perspective is crucial. So yes, we are busy listening to company calls of stocks we own and stocks that we just think have good information content, whether they're competitors or just bellwether companies.

A name that we've owned for a while, but it's been hit because of concerns over a Biden presidency, is **Adtalem** (NYSE:ATGE). **Adtalem** is a Chicago-based company focused on education. The company is led by an African-American woman CEO, Lisa Wardell, which is pretty unusual still. Ms. Wardell brought greater diversity to her C-suite as well as her board. We love to find local companies and we love to see diversity on boards. Fairpointe Capital is part of the Thirty Percent Coalition, so we're actively trying to support companies diversifying at the C-suite level and the board level. This stock was knocked down because of the concern about free education. Education stocks, in general, have been hit hard with the outlook of Biden coming into play, what's going to happen with Title IV funding and regulation.

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The industry is not well covered by Wall Street, so it suffers from a lack of efficient flow of information. However, **Adtalem** is unique in that they've really changed their portfolio of brands and they're highly focused on health care now. The company has a nursing school, a medical school, and a veterinarian school, and all are obviously important. Many people got pets this year, plus we currently have a shortage of nurses and doctors, and **Adtalem** plays a very important role in that space. The other part of their business is testing, whether it's CPA testing or issues with banking. The company also has some compliance software as well. Last, **Adtalem** is in the midst of acquiring **Walden University**, which is an online university.

I believe the trend of education is going to be radically different in the future. Obviously, we've seen that there is a lot more that can be done online or virtually for education than there has been in the past. Companies that have been on the forefront of this trend are really going to do well with this new technology. It's an interesting name and we currently own it in both our strategies.

TWST: Are there any other trends that you would note?

Ms. Tuite: We've been focused on the 5G rollout but play it in interesting ways. We think that that's going to be an important trend that's coming. Companies that are involved and have products around 5G will benefit in the future. **Corning** (NYSE:GLW) does a lot of technology related to fiber, phone screens and laptops. We have a position in **Nokia** (NYSE:NOK). We also have a position in **Qualcomm** (NASDAQ:QCOM). Qualcomm, with their semiconductor business, has been a big winner for us this year. So we're thinking about 5G as a broader trend. We have some technology companies that have benefited from Internet usage and breaches. **Akamai** (NASDAQ:AKAM) and **Check Point** (NASDAQ:CHKP) are examples. So things that are more like the pick and the axe, that can benefit from some of these bigger trends that are ongoing.

We have some exposure to electric vehicles in **Magna** (NYSE:MGA), which is an auto assembler, and **Methode Electronics** (NYSE:MEI), which is an auto part manufacturer based in Chicago. **Methode** has some new EV business that is not well appreciated by the Street and we think that's a hidden asset that hopefully will get discovered in the next couple of years. We wouldn't invest in something like a **Nikola** (NASDAQ:NKLA) or a highflier. We like predictable and growing cash flows and proven business models of focused companies, so we tend to not chase some of the highflier stocks that are out there.

TWST: For both of the strategies we talked about, what do you use as a benchmark? How have you been performing against the benchmark, and in particular how did 2020 treat you?

Ms. Tuite: For our Mid-Cap strategy we've been put in the value bucket just by the mix of our stocks, although many of our positions that we added this year — in fact seven out of eight — were core or growth, not value stocks. However, we are categorized as value, and value investing has been really tough.

In terms of the overall market, value has underperformed for the last five years. As a result, our performance has not been great, just because we do tend to be looking at more value-type stocks. We like growth, we just are not willing to pay crazy multiples for it. We have lagged the market, but we have seen a rotation in the market and there has been some pickup in value stocks in the last month. We are hopeful that this rotation will continue into more value-oriented stocks in the near future.

TWST: Would you wrap up with some final thoughts or advice or your outlook for the coming year?

Ms. Tuite: There has been a lot of talk about ESG, and as we talked about earlier, I do think that investors are interested in climate change, carbon footprints, and social equity, and I do see these trends continuing. I am also hopeful that investors will appreciate the nuances of ESG investing and will look for companies that aren't just greenwashing or passive investors, but will look for managers that are actively researching ESG issues.

I believe that active investing in ESG is essential. As I mentioned earlier, many ETFs and passive ESG strategies own **Facebook** (NASDAQ:FB) and other large tech companies. What we are finding out today is these companies have real ESG issues, whether it's privacy of data, or breakup and regulatory constraints that may come about. ESG factors can affect a company's long-term valuation, in my opinion. ESG factors are important to all investors and not just specific to ESG strategies.

More and more investors will pay attention to these criteria and look at them when they're investing in companies. As we get greater disclosure and maybe more standardized disclosure, it will help investors in the future to separate companies out and make decisions that are more holistic in their approach.

TWST: Thank you. (MN)

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