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MONEY MANAGER INTERVIEW

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Looking for Change in the Large-Cap Universe

KENNETH CRAWFORD AND MEGHAN JAMES, ARGENT CAPITAL MANAGEMENT LLC



KENNETH CRAWFORD is a Senior Portfolio Manager at Argent Capital Management LLC. Mr. Crawford performs market research and is actively involved in portfolio management activities with a focus on the consumer discretionary, energy, financials, health care, materials and utilities sectors. Mr. Crawford has 20 years' experience in the industry. Prior to joining Argent Capital Management LLC in 2002, he was a Portfolio Manager for American Century Investment Management, where he oversaw the American

Century Select Fund. Additionally, he worked as an Analyst for Texas Commerce Bank. Mr. Crawford earned a degree in economics and a Master of Finance from the prestigious Applied Securities Analysis program at the University of Wisconsin–Madison. Mr. Crawford serves on the Corporate Givers Committee for the Missouri Botanical Garden.



MEGHAN JAMES is Director of Client Service, responsible for the daily oversight and coordination of Argent Capital Management LLC's client service activities on behalf of our institutional clients. Ms. James and her team are responsible for implementing this service initiative which includes working closely with marketing/sales, operations, compliance and the portfolio management teams within the company. This initiative begins with the integration of all new client accounts and continues with developing an

understanding of our clients' needs and objectives, serves as our clients' advocate within the firm, and communicates proactively with key contacts regarding all aspects of the client relationship. Ms. James has 10 years of client service experience within the industry. She earned a B.A. in psychology from Georgetown University and is a former board member of the Spirit of St. Louis Women's Fund.

SECTOR — GENERAL INVESTING

(AGT512) TWST: I've been reviewing some materials from your website, and so I have the current summary information. I thought maybe to begin with you could tell me a little bit about the fund.

Mr. Crawford: The large-cap strategy, we've got about \$1.7 billion in it of the \$2.6 billion AUM at Argent, so the founding product and the largest obviously. We run a relatively concentrated portfolio, 30 to 35 names. We look for a change when we invest. We have almost off-the-charts active share. That's not by design; that's

an outcome of our investment process. I think relative to other managers, we have low turnover. We hold a stock three to five years, so our turnover is in the 30% range.

Our team has been together for quite a while: Scott, John and myself. I'm the newbie, and I've been here for 14 years, so a stable group. Well, stable in terms of same team; mentally is always a question, but stable we hope. One other things that we pride ourselves on — and with me here is Meghan James, she is Head of the Client Service, is our client retention. So we've averaged 95%-plus client

retention year over year, and that's something that we are very proud of, and something that we're certainly focused on at Argent.

TWST: That's an interesting statistic. I don't know what the norm is in the industry.

Mr. Crawford: Neither do we, honestly. If you had data, that would be of interest to us, but our sense is that we're doing well and likely doing better than most of our peers.

TWST: Let's start at the beginning, and since I have this in front of me, I'll let you go over the universe you begin with, which is a market cap of \$3 billion or more U.S. companies. I'll kind of let you talk me through your screening process.

Mr. Crawford: You're right. We look for \$3 billion and above, primarily domestic companies. We own **TEVA** (NYSE:TEVA), which was our lone, solely foreign-based company. We've owned a few companies along the way that have decided primarily for tax reasons to re-domicile outside the United States, but for all intents and purposes are U.S. companies.

What we look for is change. So our belief is, especially in the large-cap world, finding a hundreds of mispriced assets is probably unlikely, and where we think we have the most likelihood for mispricing is when a company is going through some change, so credibly the next three to five years is going to be different than the last three to five years. What we are particularly keen on is change in management. So if we see CFO change, CEO change, we get very interested. We also look at product changes, so a health care company, drug pipelines, new products similarly with information technology companies, a software upgrade or hardware upgrade, something that's going to make, again, credibly the next three to five years different than the last three to five.

And then we want that change to drive betterment, so we look for revenue, earnings, profit improvement. CFROI is another tool or criterion that we look at, cash flow return on investment. So we use **HOLT**, which is owned by Credit Suisse, is one of the information sources for us there. And we like to talk to people in the real world, we call them Main Street contacts. We don't pay for research, so we're not looking for experts, but we actively reach out to people who are in the real world and ask them what they're seeing frequently. Because we invest in large-cap companies, they're familiar with the companies that we're looking at and oftentimes

have done business with the companies that we look at. So when we identify change that's going to drive improvement, we want the Main Street contacts to validate or codify that change.

TWST: Can you give me an example of that? For instance, maybe a supplier to a large company and they make a change, and so you would investigate?

Mr. Crawford: Well, I'll give you a story. A company that we own today that has been in the news of late — **CBS** (NYSE:CBS). So we're actually looking at cable companies, and we talk to someone who is involved in television broadcasting, and we said to them: Cable companies' strong cash flow looks kind of interesting. And he said: What is changing in my world is retransmission, and whereas before when you would turn on your TV or you'd have cable or satellite, you'd get the **NBC, ABC, CBS, Fox** feed for free, and then you'd pay for **Showtime, HBO, etc., ESPN**. He said that's changing.

What's going on is those networks are cutting deals with cable providers and getting paid for the first time ever. And we said: We had heard about retransmission, and it sounded like they had done their deals, and it's one and done. And he said: No, no, no, that's not the way it's going to play out. **CBS** is going to ink a contract with **Comcast** (NASDAQ:CMCSA), with **Charter** (NASDAQ:CHTR), with dot-dot-dot cable company for three years, and then they're going to go back and say, we want a little bit more money, we want a little bit more money, etc.

So we started working on **CBS** initially thinking that we're going to be interested in cable companies, and lo and behold retransmission has been a grand slam for **CBS**, and it's been a great stock for our clients. So a very good example of the — of course, you obviously knew what was going on in industry, not telling us something that was unknown but just highlighting to us the magnitude of that change, and then we're looking at

the valuation of **CBS** and coming to the conclusion that the magnitude had yet to be embedded in the valuation of the company.

TWST: OK, so that's a good example. And so let's talk a little bit more about this change aspect that you focus on. You said change in management is one thing that would trigger your interest. What are some other change triggers?

Mr. Crawford: Well, obviously outside factors. For instance, today we own **Schlumberger** (NYSE:SLB), we owned another — we owned an E&P company, an oilfield service company,

Highlights

*Kenneth Crawford discusses his firm's large-cap strategy. Mr. Crawford says the firm looks for a change when investing in \$3 billion-market-cap-and-above domestic companies. He looks for changes such as changes in management or products, and he wants that change to drive betterment. Companies discussed: Teva Pharmaceutical Industries Ltd (ADR) (NYSE:TEVA); CBS Corporation (NYSE:CBS); Comcast Corporation (NASDAQ:CMCSA); Charter Communications (NASDAQ:CHTR); Schlumberger Limited (NYSE:SLB); Lowe's Companies (NYSE:LOW); Amazon.com (NASDAQ:AMZN); Home Depot (NYSE:HD); SunTrust Banks (NYSE:STI); JPMorgan Chase & Co. (NYSE:JPM); Lincoln National Corporation (NYSE:LNC); E*TRADE Financial Corp (NASDAQ:ETFC); Wynn Resorts, Limited (NASDAQ:WYNN); Biogen (NASDAQ:BIIB); Gilead Sciences (NASDAQ:GILD); Allergan plc Ordinary Shares (NYSE:AGN); Endo International plc - Ordinary Shares (NASDAQ:ENDP); Mallinckrodt PLC (NYSE:MNK); Valeant Pharmaceuticals Intl (NYSE:VRX); Danaher Corporation (NYSE:DHR); Fortive Corp (NYSE:FTV); Alphabet (NASDAQ:GOOG); Facebook (NASDAQ:FB); Apple (NASDAQ:AAPL); Netflix (NASDAQ:NFLX); Masco Corp (NYSE:MAS); Post Holdings (NYSE:POST); Costco Wholesale Corporation (NASDAQ:COST); Conagra Brands (NYSE:CAG) and Lamb Weston Holdings (NYSE:LW).*

and when oil went from \$100 to \$30 a barrel, obviously their operating environment worsened considerably. So that would be kind of the flipside of a catalyst for a change — catalyst for bad change. So what we asked ourselves was, you've got the best E&P company in the world, but all of a sudden the value of their product has been cut by two-thirds. How able are they to realize their business strategy, and our conclusion was it's going to be a tough road to home. So even the best management in that kind of circumstance, because of the change, is we thought less able or less likely to realize that change.

“We got the sense back then that the housing market was beginning to stabilize, certainly not take off, but not worsen anymore. So we asked ourselves, who in that environment would be helped, and do-it-yourself retailers seem like a natural place to go.”

On the flip side, betterment if you will, **Lowe's** (NYSE:LOW) is a company that we will own for probably another five years, and we got the sense back then that the housing market was beginning to stabilize, certainly not take off, but not worsen anymore. So we asked ourselves, who in that environment would be helped, and do-it-yourself retailers seem like a natural place to go. We also had the insulation mode, if you will, that — well, **Amazon** (NASDAQ:AMZN) is taking over the world in retail. There aren't that many people who are going online and getting two-by-fours. They might be getting coats, they might be getting shoes, they might be getting TVs, but for whatever reason people like sheets of plywood and going to the store and grab them.

So we thought that there was a barrier to entry there that protected **Home Depot** (NYSE:HD) and **Lowe's**, and then particular to **Lowe's**, they were talking about reducing their SKUs in order to increase their margins. So we had an external change, we thought improvement in housing and then internal change in management actively reducing the number of SKUs in the store to increase their margins.

TWST: Are they able to execute on that?

Mr. Crawford: They were to a degree, I guess — I mean, to ding them and yet give them credit, it was a more difficult task for them. So instead of just going blindly for their program of reducing SKUs, they traveled it back and did it more slowly. One of the pushbacks we honestly got — I was talking to people in Wall Street — was they had never seen a company that had positive same-store sales when they were trying to execute this SKU reduction plan. So there was skepticism, and we thought that spoke to the favorable odds, the valuation that we saw, **Lowe's** especially relative to **Home Depot**; they were able to realize same-store sales. So that was a surprise, but suffice to say it was not without difficulty.

TWST: Let's move on here to sectors. I've got the pie chart in front of me. So obviously you're very, very underweight energy, no surprise.

Mr. Crawford: Relative to the S&P we are. Relative to

Russell 1000 growth, we're actually overweighted.

TWST: OK. So why don't you tell us your sector thoughts and we'll go from there?

Mr. Crawford: Well, the way we get our sector exposure is on a stock-by-stock basis. We're very much a bottom-up company. Where we have overweights today are industrials and financials primarily, and we — I would say we look more at the Russell 1000 growth for sector exposure than the S&P 500 if that tripped you up at all. And with industrials, we've actually been adding to names for the past year or so. Valuation we thought was not incorporating the continued improvement that we saw in the economy.

So that was one of the things that our investment process was lagging. From a 30,000-foot macro standpoint, we were seeing oil stabilizing, and although oil is a relatively small part of the economy, to a degree that you're an industrial company — and as I mentioned before, oil has been ripping at \$100 a barrel. That was probably a good source of business for you that went either to nearly nil or nil when oil dropped to \$30. So we were seeing some stability and improvement in the operating backdrop of those companies.

Meanwhile, as you would expect, they weren't doing nothing, so they were actively cutting their costs to try to readjust to a more difficult operating environment. So we had — we thought compelling valuation, some sense of stability which was the catalyst for change, that wasn't really incorporated in the valuation of the companies. Well, we realized that we were early, and it's certainly not going to be a unidirectional improvement if you will. We thought that worst case is, if we bump along, we're basically paying, paying for bumping along if you will with the stocks that we bought, and if there was any whiff of improvement, our stocks would benefit. And lo and behold, and certainly outside of our expectations, Donald Trump wins the presidential election and economically sensitive companies, industrials in particular, have run nicely. and our clients participated in that.

1-Year Daily Chart of Lowe's Companies, Inc.



Chart provided by www.BigCharts.com

The other substantial overweight we have is financials. We've held that overweight for a couple of years I would think. The financials we thought were interesting coming out of the Great Recession, because valuation again was quite low. We thought that we're beginning to see — I mentioned housing improving to the

degree that the housing market was Ground Zero for the financial crisis. Obviously, if people can pay their mortgages or want to pay their mortgages, that means their credit quality is going to improve.

“We like the secular change if you will of online brokerage relative to kind of the wire houses of all that probably I would do business with.”

So we looked around for companies that we felt would benefit from that change, and we added **SunTrust** (NYSE:STI), an Atlanta-based regional bank, and **JPMorgan** (NYSE:JPM), obviously a world bank to our portfolio. As interest rates rose some and the world continued to improve, we added **Lincoln National** (NYSE:LNC), a life insurance company, and then more recently we've added **E-TRADE Financial** (NASDAQ:ETFC), which is an online broker that had a banking business especially exposed to HELOCs. So they had to work through that mess, and honestly that nearly did the company in, but we were able to get through that, and we like the secular change if you will of online brokerage relative to kind of the wire houses of all that probably I would do business with, but probably not you and Meghan as younger Millennial types.

TWST: Not me, but certainly Meghan, yes. OK. And where would you be overweighted, sometimes underweighted?

Mr. Crawford: Underweight, consumer discretionary and then more recently health care. Consumer discretionary, I mentioned **Lowe's**, and I also mentioned **Amazon**. So **Amazon** continues to take over the world of retail to the degree that we focus on valuation. Well, we certainly respect Jeff Bezos and all of what he has done to retail. We have a kind of hard time stepping up to — I was going to look up the recent valuation of **Amazon**, but suffice to say it's a little bit out of our bailiwick.

So rather than own **Amazon**, forward p/e of a 161 times, right — we think that people have given them their credit and credit is due, but where they do, having missed up favorable odds would be a little bit difficult to explain to our clients. But also what they have done is changed the operating environment for a good many retailers, so for us to find consumer discretionary companies especially in the retail industries is difficult.

I mentioned **CBS** though, so we certainly do have exposure. We added **Wynn Resorts** (NASDAQ:WYNN) recently. So we are not naked, but we are underweighted. In health care, we are probably overweighted, what, a year or so ago Meghan?

Ms. James: Yes.

Mr. Crawford: And I would say that end of 2010, we were adding two biotech and drug pharma stocks, because the valuation we thought was relatively low, and we own **Biogen Idec** (NASDAQ:BIIB), and we own **Gilead** (NASDAQ:GILD). Those companies did quite well for us, and as they rose, we initially — we trim positions because even though the change catalyst that we saw

in the companies, their pipelines were coming through. They were being given credit for their successful execution.

And then more recently we owned some of the specialty pharma companies; we owned **Allergan** (NYSE:AGN), and we own that through Forest Labs. So we owned Forest, and then that was bought by a company that eventually became **Allergan**. We owned **Endo Pharmaceuticals** (NASDAQ:ENDP), and we owned **Mallinckrodt** (NYSE:MNK), a St. Louis-based Irish tax-domiciled specialty pharma company, and what was going on, Jennifer, as I'm sure you know, was **Valeant** (NYSE:VRX) was kind of writing the playbook, where they were making serial acquisitions, they were cutting costs, they were raising the price of drugs, generating free cash, buying the next company, the next company, dot-dot-dot. And **Allergan** and **Endo** and **Mallinckrodt** were participating in that change, and then when investors said, we're not interested in rollups, so we're not going to give you the multiple, and Congress said, we're not happy that you're raising prices and not generating any kind of new products or innovation, we started to sell those positions even as the Russell 1000 growth was increasing its weight in health care.

And the last health care stock we owned was **Teva**, and we sold that sometime during this year. So we have no drug stocks now. We have a couple of device companies, and we have **Danaher** (NYSE:DHR), which to a degree changed its strides with the breakup of **Fortive** (NYSE:FTV) from **Danaher**. So that's become an underweight for us.

TWST: Yes, and I see Danaher here on your top holdings.

Mr. Crawford: Correct.

TWST: So let's finish up by going through some of the issues in your top-10 holdings. Alphabet?

Mr. Crawford: Yes, aka **Google** (NASDAQ:GOOG). We bought **Google** —

Ms. James: 2009 March.

1-Year Daily Chart of CBS Corporation



Chart provided by www.BigCharts.com

Mr. Crawford: Right, March of 2009, when we were first getting a sense that kind of the skies were beginning to clear, coming out of the Great Recession. Obviously, a leader in search, both via the desktop and mobile, Google maps, etc., they're basically — I'm not

telling you anything you don't know — revolutionizing the way we gather information, and we very much like their moat. The valuation we think is low relative to **Facebook** (NASDAQ:FB), **Apple** (NASDAQ:AAPL), **Netflix** (NASDAQ:NFLX) or **Amazon**. So we're comfortable with the valuation.

We like Ruth Porat, the change in CFO and what she has brought to the company, clarity and I think a kind of a lingua franca the investment people understand well, and to the degree that they continue to grow their assets and have returns well above their costs of capital. **Google** is doing exactly what we want them to do.

TWST: Let's move on to Masco.

Mr. Crawford: OK. **Masco** (NYSE:MAS) has new management. There was something, as I mentioned, a catalyst for change that gets us very enthused. The person who ran their cabinets division is now their CEO. We had looked at **Masco** probably five years ago, as I mentioned, when we thought housing was getting better. They had a cabinet-installation business that was losing money, and we asked them then why do you have this and they said, we've got — we manufacture cabinets. We want cabinet installation. And we said to them, anybody can install cabinets, not many people make cabinets. Why don't you just make up. And they held on to that business until a couple of years ago when they got their new CEO, and he said that he was going to look at every segment of their business and look at that in a returns-based framework, and got rid of their cabinets installation.

So we like that change; we like their change in management. Obviously with an improvement in the housing sector, people buy cabinets, people buy fixtures and people buy paint, so three key products for **Masco**, and they have executed quite well. Their returns have improved nicely, which was part of our investment thesis. We are believers in Millennials eventually moving out of the basement of parents' homes and forming households, and when they do, again, they're going to buy cabinets, they're going to buy some paint and they're going to buy faucet. So we like the position from that perspective as well.

TWST: Indeed, and Post Holdings?

Mr. Crawford: **Post** (NYSE:POST) is a St. Louis-based company, and we've owned them in various forms for a long, long

time. We owned them as **Ralcorp**. I don't know if you remember that company Jennifer; they were private-label food. So if you went to **Sam's** and **Costco** (NASDAQ:COST), and you bought a Sam's muffin, you're probably buying a **Ralcorp** muffin. They were and are very good at acquisitions, and **Ralcorp** bought **Post**, and what the management realized was that private label and branded don't get along so well. So **Ralcorp** spun out **Post**.

We elected to keep both pieces. And then one day we woke up and **ConAgra** (NYSE:CAG) bought **Ralcorp** for a substantial premium. So our clients were happy, and we were left not unhappily with **Post**, and since that time they have used the same playbook. No pun intended, they've made serial acquisitions in the food business, and they're very good acquirers. And what they have shown an ability to do is acquire well and to sell well. They sold **Ralcorp** well.

So what we expect from the company is continued acquisitions. They bought **Malt-O-Meal**, **MOM**. Recently they bought **Michaels**, which is a egg producer. They were rumored to be looking at **Lamb Weston** (NYSE:LW), which was spun out of **ConAgra** recently. So to the degree that they are a relatively small food-based consumer staples company. We think that their ability to continue to make acquisitions is quite good, which is the change catalyst that we like with the company. And if and when someone were to say to **Post**, we want to buy pieces or we want to buy your company, they have shown once that they're willing to sell themselves for a substantial premium to help their shareholders. So we believe that they are a very shareholder friendly management team.

TWST: Thank you. (JM)

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