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MONEY MANAGER INTERVIEW

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Assuming a Higher Risk Profile if Tax Rates are Lowered

P E T E R H . H A V E N S , B A L D W I N M A N A G E M E N T , L L C



PETER H. HAVENS is Chairman and Founder of Baldwin Management, LLC. Earlier, he was a member of the board of directors and Executive Vice President of the Bryn Mawr Trust Company. Before, he organized and operated the family office of Kewanee Enterprises. Mr. Havens holds a bachelor's degree from Harvard and an MBA from Columbia Business School. He is also Chairman of the Lankenau Institute for Medical Research, Chairman of the board for the Independence Seaport Museum, and Vice

Chairman of Main Line Health. He is a board member of AAA Club Alliance, Main Line Health, the Lankenau Medical Center Foundation, Main Line Health Realty and Lankenau Development Inc. He is a Trustee Emeritus at Ursinus College and former Trustee of the Leukemia Society of America. He was also the Chairman of the board of Petroferm, Inc. and a board member of Nobel Learning Communities Inc.

SECTOR — GENERAL INVESTING

(AGV512) **TWST:** Could you please identify yourself?

Mr. Havens: Peter Havens.

TWST: And could you tell me your title and firm?

Mr. Havens: Sure. Chairman of Baldwin Management, LLC.

TWST: And could you tell me a little bit about the firm?

Mr. Havens: We are a multifamily office located outside of Philadelphia, Pennsylvania.

TWST: And does the firm have any unique approaches to investments?

Mr. Havens: We invest all over the world in actively traded securities. We're largely an equity shop, but we also manage some fixed income. We not only invest in actively traded securities, but we also do several private deals on an annual basis, whether that be real estate or in venture, private equity, those sorts of things. And being a family office, a little different from most family offices that I know in that we lead with our investment management work, but we also do a lot of accounting and tax work. So most family offices that I know lead with their accounting and tax efforts and provide investment services as an

accommodation to their clients, and they usually farm most of that out. We sort of reverse it. We lead with our investment management work, but we also provide accounting and tax services.

So our client base — essentially all high-net-worth families and individuals and their charitable interests if they have them. What gets interwoven into a lot of our investment work is I'd say real awareness, if you will, of tax ramifications. So we do an awful lot of work in wealth transfer, intergenerational wealth transfer, and we're very aware of the influence of the tax code and tax payments on investment results. And part of our consideration whenever we make investments includes, what are going to be the tax ramifications for this generation or for the next generation?

TWST: And given the change in administration and the fact that there might be changes to the tax code and changes to corporate tax rates, are these things that are being followed closely now by high-net-worth individuals?

Mr. Havens: Yes, unquestionably.

TWST: And what would they like to see that would benefit them and make the economy work better?

Mr. Havens: Well, I think a lower capital gains tax rate would be, I think, very

Highlights

Peter Havens says his firm invests all over the world in actively traded securities. It is essentially an equity shop with some fixed income, and a client base of high-net-worth families and individuals. Mr. Havens says his client base is very disposed to the lowering of tax rates. It would allow them to assume a higher risk profile to do things which would be more equity oriented. Mr. Havens shares several companies he finds interesting in the current environment. Companies discussed: 3M Co (NYSE:MMM); Johnson & Johnson (NYSE:JNJ); Enterprise Products Partners L.P. (NYSE:EPD); Celgene Corporation (NASDAQ:CELG) and Thermo Fisher Scientific (NYSE:TMO)..

favorably received to allow people to assume more risk in their investment profile. I think income tax rates going down also would be very favorably received. Certainly the idea of the elimination of estate taxes is very popular, at least amongst our client base. People feel as though throughout their investing lives, they've already paid taxes on all the capital that eventually passes from one generation to another generation. So the idea of now paying another tax simply because one passes away, I think that's not necessarily a proper allocation of tax resources.

“Certainly the idea of the elimination of estate taxes is very popular, at least amongst our client base. People feel as though throughout their investing lives, they’ve already paid taxes on all the capital that eventually passes from one generation to another generation.”

So generally across the board, the idea of lowering tax rates, our client base is very disposed toward that because it allows them, if you will, to assume a higher risk profile to do things, which would probably be more equity oriented — so getting away from fixed income, if you will. And if it's going to be more equity oriented, then it's going to be investing in companies and things that are going to employ more and more people. And they would be more disposed toward doing that since one of the major expenses on an annual basis, i.e. the taxes that they have to pay, are going down. So they're willing to assume more risk.

TWST: And are there any particular types of equities that might be helped by doing those kind of changes?

Mr. Havens: Yes. I think our client base would be more willing to assume risk. And so shifting of assets from say more fixed income oriented to more equity oriented, and within the equity spectrum even there to take more risk, i.e. to invest in younger companies and assume more risks simply because, again, if it looks like I'm willing to take the risk and a potential bill down the road — i.e. my taxes when I eventually sell my position — is going to go down. Puts more in my pockets. As a consequence, I'm willing to take more risk, assume a higher risk profile.

So I think just generally across the board there would be a shift in the risk spectrum, people willing to take more risks both between asset classes, i.e. fixed income, bonds, if you will, to equities. And then within equities, the equity risk spectrum from more established companies, the proverbial three **3Ms** (NYSE:MMM) of the world, the **J&Js** (NYSE:JNJ) of the world too, more venture oriented, where there is more potential for upside but a lot more risk connected with that potential for the upside.

TWST: And did you want to mention a company that you find interesting?

Mr. Havens: Well, sure. One particular company that we like **Enterprise Products** (NYSE:EPD). Now, this is a master limited partnership actively traded on the New York Stock Exchange. Its symbol is EPD. This is, if you will, an infrastructure play. **Enterprise**

Products essentially earns their money by charging a fee for transporting natural gas, natural gas liquids in particular, and refining — what they call in the business fractionating, which is essentially refining a natural gas stream. So when one produces natural gas out of a well, there is dry gas and wet gas. And it's basically the stripping out, the fractionation, stripping out of the wet gas from the dry gas stream, and then taking those wet gas components and then further refining, you know fractionating that, breaking it down into various components, butanes, propanes, ethanes, etc.

So **Enterprise Products** gets paid a fee by producers to transport these natural gas and natural gas liquids and to refine them for them, and then to get them from point A to point B. We're a big believer in natural gas and natural gas's future as a part of the energy mosaic to get us to, if you will, cleaner environmental fuel to get us into a period where we are away from dirty hydrocarbons and away from, say, coal particularly. So natural gas is occupying a greater market share of the energy spectrum to generate energy, particularly electric energy. So we think it's got a very bright future.

And **Enterprise Products** got caught up in the broad selloff, master limited partnerships beginning in late 2014 and going through 2015. It did have something of a recovery in 2016, but we think there's still quite a bit of upside potential. It's got a 6% yield, which for new owners is largely sheltered because of DD&A, which gets taken against the income stream. That's depletion, depreciation and amortization. So it's a tax-sheltered distribution of 6%, which on a tax-equivalent basis is more like around probably somewhere between 7% and 8%. So it's a very attractive income generating vehicle.



Chart provided by www.BigCharts.com

But these MLPs, they are good MLPs; master limited partnerships have had a history over quite a period of time of continuously increasing their distributions, and **Enterprise Products** is one of those. So it's not something which has never increased its distribution. In fact, on a quarterly basis it increases its distribution. So you're getting approximately a 6% tax sheltered yield currently and a yield which has done nothing but go up, or distribution which has done nothing but go up over the years and quite a few years. And as consequence, we think that the price of the equity will go up and get somewhere in the mid-30s; it's around \$27 a share today, \$27, \$28

a share. So for somebody who is looking for an increasing income stream in an environmentally friendly fuel source — than certainly coal is — we like **Enterprise Products** a great deal.

“One of the things about multiple sclerosis, or any let’s say chronic disease, is you have to depend upon the patient to be compliant. They have to follow the regimen, and they have to follow it quite closely if they want to maintain their stability or maybe even improve.”

TWST: And from the point of view of the United States, the market for natural gas looks promising, in terms of even exports, and the Trump administration looks like it’s sympathetic to natural gas production, so that should help this company too?

Mr. Havens: Absolutely. In fact, because natural gas has traded at a very severe discount on an energy-equivalent basis to oil, in the old days, it used to trade on like six-to-one basis. Take the price of natural gas, multiply it times six and you should get roughly the price of oil. That relationship then grew to like 10 to one. And now it’s sort of blown out; one period of time it was up as high as like 15 or 16 to one, so natural gas trade is cheap on an energy-equivalent basis.

And as a consequence, there are number of chemical companies which are setting up new chemical manufacturing capacity in the United States because they can get some of the most essential building blocks for the production of chemicals out of natural gas far more cheaply than getting crude oil. So I think there is something like tens of billions of dollars of new chemical manufacturing capacity. That is in process of being built in and around the Gulf Coast area to exploit the inexpensive natural gas that is here in the United States. And why natural gas so inexpensive in this country is because we’ve been so successful in drilling shales.

We’ve got surfeit of natural gas both dry and wet natural gas. And in fact, we’ve got so much, I mean, I think the Marcellus, which is up in this neck of the woods around Pennsylvania — so it stretches from West Virginia up through Western Pennsylvania and then Northern Pennsylvania and gets into Southern New York. It trades at a severe discount to natural gas in the mid-continent, and that’s because there is not enough pipeline takeaway capacity.

So we are trading natural gas in the Marcellus at \$1 something an Mcf, whereas at Henry Hub we’re trading at \$3.50 an Mcf. And that’s simply because there is just too much supply, and there is not enough takeaway capacity, pipeline capacity, to cure that situation. So natural gas is extremely cheap in this country. Chemical companies, a number of foreign chemical companies and U.S. chemical companies, are building new capacity to use that natural gas for their building blocks and building other chemicals, so it’s got a very bright future in addition to just taking more and more market share away from coal for the generation of electricity.

TWST: Did you want to mention another company?

Mr. Havens: Sure. Another company that we like, and this is sort of a bit controversial, would be **Celgene** (NASDAQ:CELG),

the biotech company. There have been a number of political tweets over the last year and a half having to do with primarily drug pricing and primarily with older drugs that for whatever reason the manufacturer has decided to increase pricing of this new innovation connected with the drug. As a sort of a broad statement, just about everything in the pharmaceutical industry, including the biotechs, have gotten pasted because the market tends to paint with a broad brush, and **Celgene** has gotten caught up in this.

So **Celgene** is a company that we like a great deal because it’s been a very successful biotech company. One of its main products is REVLIMID, and that is used primarily in the field of cancer. It generates a lot of revenues from that, about \$8 billion of revenues from this product. But I think the market focuses too much now — the company has got about \$16 billion in revenue. So probably half are from this one product line, but the market is focusing too much on that we think. And we think that the company has got a pretty broad and deep pipeline of new potentials.

They’ve got about 19 different Phase III trials that are ongoing right now. And one of their most promising is called Ozanimod, and that’s for multiple sclerosis. And this particular product has got a very clean profile, clean safety profile, and one of the things about multiple sclerosis, or any let’s say chronic disease, is you have to depend upon the patient to be compliant. They have to follow the regimen, and they have to follow it quite closely if they want to maintain their stability or maybe even improve. And so like most humans, where most humans are fairly lazy, and so as a consequence, well you know, I’m going to take my pills or not going to take my pills, or not going to take it exactly when I should take it or not going to get my injection when I should.

1-Year Daily Chart of Celgene Corporation



Chart provided by www.BigCharts.com

The key to compliance is to make it very, very easy for a patient to comply. And we think that this particular new drug — which we think will come out this year or next year because it’s got such a clean safety profile — we think it’s going to aid compliance as a consequence. We think it’s going to be a big drug. And that’s just one example. They’ve got, as I said, 19 different Phase III trials going on. They are going to have readouts this year. So we think there’s a broad and a deep pipeline which is not being appreciated

by the market, and the company's fortunes are not dependent upon all drugs and just increasing process. Their future is dependent upon new innovation and bringing new drugs to market.

And so you got a company that's selling for — somewhere around 17 times earnings, and it's growing at about 22% a year, and that's on fairly conservative earnings estimates. And so we think that there is quite a bit of potential. The stock is in the low \$100s right now. We think it could get up to somewhere around \$150 a share. So that would be another counterintuitive example in that nobody wants to be invested in this pharmaceutical industry these days because politicians are bashing drug pricing.

TWST: Did you want to mention another company?

Mr. Havens: The last one I will mention is in the health care space. It's not necessarily a drug company. It's **Thermo Fisher** (NYSE:TMO), and this is a life sciences and also a measurement company. It's also involved in food safety and environmental. And we've found them to be a very effective acquirer of technology, getting ahead of the curve. Last year they bought a company called **FEI**, and they make high-performance electron microscopes. And the reason they got involved in this is with regard to protein identification and characterization, and this is where scientific research is going.

And so here you've got a company that is getting out in front of buying tools that are necessary for this particular field of study, but they are also involved in food safety and environmental, and one of their biggest markets is China. And China has made it very clear in their most recent five-year plan that they want to improve food safety, and they want to improve their environment. And **Thermo Fisher** has got quite a big presence in China. So we think they are in a sweet spot there. And this company is growing somewhere around 12%, 13% a year. It trades at about 15 times earnings, and we think it's not as exciting on the upside as the other two that I mentioned, but we could certainly see 10% to 15% growth in the share price over a year's basis.

TWST: With all these acquisitions, are there some common things that connect each of these in terms of a strategy on what they're trying to do as they acquire all these different technology and scientific companies?

Mr. Havens: Margin improvement. So they're typically going after companies where their operating margins are like high single digit, and then they work to improve their operating margins to about 15%, and they've been very successful at doing that. It is a mantra of the management team, so that they will go in, and we've found them to be very efficient and effective operators. And we get

up to this sort of scale that **Thermo Fisher** has got, they can just use that scale to further improve operating margins of smaller companies and great cross-selling opportunities.

In fact, we are exposed to them not only from their common stock, which we've owned for quite a while and had good bit of success, but one of our venture capital investments is now in a very big relationship with them. So now we're seeing them from the other side, where they are working with this small venture company in which we have investments, and this sort of just came out of the blue. **Thermo** found this company and like the product, and it fit in very nicely with their life sciences division. And so now they're selling this venture company's product around the world.

TWST: As you interact with some of the clients that you have, are there some particular concerns that they have as 2017 continues, and how do you respond to them about those concerns?

Mr. Havens: Well, I think probably the biggest concern right now, and I don't know if you put it as concern or you just sort of say question mark, is politics. I dare to say that's probably not an unusual answer, with Mr. Trump having been elected president of the United States, and people just don't know what the immediate future holds. He is something that is out of the mold, the typical politician. And as a consequence, people are trying to figure out exactly which way the wind will be blowing.

The markets don't like uncertainties, we all know. Now certainly the things that he has talked about are music to quite a few people's ears, i.e. we're going to do away with some regulations, we've got lower taxes. We're going to make it easier for business to operate. And certainly some of the people that he has appointed to his Cabinet are impressive, but we've still got to see how he's going to work with the Congress, because he is out of the mold of a typical selfish Republican. So we got to see how all this works, because he is not going to be able to do it all on his own; he is going to have to work with people. And so we'll have to see.

TWST: Thank you. (ES)

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