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THE WALL STREET TRANSCRIPT

Connecting Market Leaders with Investors

Applying Bottom-Up Fundamental Research in the Large-Cap Space

OWEN FITZPATRICK, CFA, is the Lead Portfolio Manager and a Senior Research Analyst at Aristotle Atlantic Partners, LLC. He has over 30 years of experience in trust and investment management. Earlier, he worked for Deutsche Asset Management, including as Managing Director and Head of the U.S. Equity Platform. As Head of U.S. Equities, he oversaw all active U.S. equity strategies, and as a portfolio manager, he managed the Large Cap Growth and Large Cap Core portfolios. Prior to Deutsche Asset Management, he managed equity portfolios for Chemical Bank, where he was also responsible for research coverage of the consumer cyclical sector. Additionally, he was a portfolio manager at Manufacturers Hanover Trust. He received both an undergraduate degree in finance and an MBA from Fordham University.

SECTOR — GENERAL INVESTING

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

Mr. Fitzpatrick: Aristotle manages just over $13 billion across our affiliates. We are part of a shared-service structure where we have different investment teams that are independent of one another. However, when it comes to trading, operations and all the shared services that are utilized by different teams, it is centralized under one group. The independent investment teams include Aristotle Capital, which includes large-cap value, global and international teams spearheaded by Howard Gleicher out in Los Angeles; Aristotle Boston, a small-cap- and smid-cap-focused team in Boston; Aristotle Credit Partners, a value-added credit strategies team also located out on the West Coast; and then my team, Aristotle Atlantic Partners, here in New York.

TWST: Does the firm have any unique investment philosophies?

Mr. Fitzpatrick: We are really focused on bottom-up fundamental research.

TWST: Do you work on one main fund, or do you work on several different ones?

Mr. Fitzpatrick: I work on two different strategies: Large Cap Growth and Large Cap Core.

TWST: Do those have a unique approach?

Mr. Fitzpatrick: We believe they do. The approach really is bottom-up fundamental research. We basically put companies into three different buckets: one being product-driven companies, second being more secular-driven and the third being cyclical-driven.

TWST: From what's going on at a macro level now, some people are saying that this might be the time for small-cap funds and maybe even midcap funds. Why do you think large cap would be a good investment now?

Mr. Fitzpatrick: From a valuation standpoint, I believe there is not a big gap between small, large and mid. In addition, when you look at the potential for the economy to improve domestically and globally, I think large-cap companies will take advantage of both. The potential changes that we may see around taxes down the road could benefit large-cap companies depending on how it's structured. Then, there is the leverage aspect. When you look at large-cap companies, they benefit from increased volume just given the cost structure of the entities and the ability to drive down costs, which is an ongoing trend that's been in place now for quite a while.

TWST: Did you want to highlight a company you find interesting?

Mr. Fitzpatrick: There are several companies we find interesting. One would be **Pinnacle Foods** (NYSE:PF). They operate in a category where there is a lot of competition and the inability for many companies to drive topline growth. This is one company that has been eking out some decent topline growth. It's in the packaged food business with very well-known brands like Birds Eye, Duncan Hines and Wish-Bone. These are obviously brands that have been around for a long period of time.

What **Pinnacle Foods** has been able to do is move in the direction of healthier types of offerings. They've done that largely through the Birds Eye division, but they have also gone out and made acquisitions like **Boulder Brands**, which is well-positioned in the gluten-free category. They are not only doing it from a healthy-eating perspective but also for people who have certain types of food needs. They have been able to fill those gaps.

And in addition to growing their top line in a category that's very difficult to find companies that are growing their top lines, they were also looking at taking down the cost structure of the company and expanding margins. So you can be getting the added benefit of topline growth combined with margin expansion. The company has been able, therefore, to produce midteens type of earnings growth year over year, and that's what they are targeting for 2017. In an environment where that type of growth is very difficult to find, we think this is a company that's really been able to do it by being very innovative in terms of what they are delivering to the consumer and really trying to meet those needs that the consumer is looking for.

TWST: Pinnacle has acquired different companies such as Boulder Brands. Does it look like that they might be looking at some more acquisitions down the road?

Mr. Fitzpatrick: I wouldn't be surprised, and frankly, I think I wouldn't be surprised too, if at some point in time, they become a takeout target. They have been in the past. It could go in either direction where they continue to acquire additional brands or they themselves could be acquired. However, I think, for now, they are really focused on folding in the **Boulder Brands** acquisition and also cleaning up a lot of the older brands while also being more innovative.

Some examples would be Wish-Bone, where they are coming out with healthier types of oils within their salad dressings or a focus on improving the Duncan Hines brand where they have had some issues in terms of volumes. They have a lot on their table today in relation to the current brands they have in place. And with the recent acquisition, I think they are more focused on that. But I wouldn't be surprised if they have bolt-on acquisitions, the ability to go out and acquire within the categories where they view good niche growth markets — I think they would definitely do that.

TWST: Consumers today, they respond very well to well-known brands and may not think about the holding company that much. But when they are in a grocery store, if they look through the different brands, they are going to see Pinnacle's, and do they recognize them?

Mr. Fitzpatrick: Yes, absolutely. I think Birds Eye in particular is one where they have really done a great job innovating and coming up with new products within the frozen segment of the markets. Not a lot of people think of the frozen section of the market as a growth area, but it has been, and they have done a really good job taking advantage of that, really through innovation — combining vegetables with really prepared type of meals — but in the frozen section of the aisle. I think Birds Eye is a pretty well-known developed brand and the same thing, I would say, with Hungry-Man and Wish-Bone. These are pretty well-known brands that have been around a long time but probably just need a little bit of a facelift, and the facelift being moving more toward and gravitating toward that healthier-eating category, where consumers want to see that in terms of the packaging of the food, and that's definitely a move that they have made.

They don't want to be considered just purely moving in that one direction; they just want to improve upon other brands. Like Duncan Hines is probably not going to be considered healthy eating, but they do want to improve the scope of what the product offers today and be a little bit more upscale in terms of what they are offering in the baking category. They really want to execute across the board, whether it's healthy eating or gluten-free, but also, in the dessert category with Duncan Hines, improve upon what they are offering there.

TWST: Did you want to mention a second company?

Mr. Fitzpatrick: The second company would be **Envision Healthcare** (NYSE:EVHC). What's interesting in terms of what's going on in health care is this concept toward lowering the overall cost structure of the business. We think **Envision** is kind of in the sweet spot of that trend. They have three different divisions. I would say two out of the three really are ones that the whole health care system is likely going to benefit from, one being these ambulatory surgery centers.

For example, my wife recently went in to have her knee done, and it wasn't done in the hospital, it was done in this outpatient facility where you go in, and it looks like a hospital, smells like a hospital, but in reality, it's not a hospital. You're seeing more and more of those types

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Highlights

Owen Fitzpatrick discusses Aristotle Atlantic Partners, LLC. Mr. Fitzpatrick works on the Large Cap Growth and Large Cap Core strategies. He uses bottom-up fundamental research to divide companies into three buckets: product-driven, secular-driven and cyclical-driven. While some investors are focusing on small caps and midcaps based on the current macro environment, Mr. Fitzpatrick believes there isn't a big gap between those market caps and the large caps. He also thinks large-cap companies will take advantage of potential improvements in the domestic and global economies.

Companies discussed: Pinnacle Foods (NYSE:PF); Envision Healthcare Corp. (NYSE:EVHC); Celgene Corporation (NASDAQ:CELG); bluebird bio (NASDAQ:BLUE); Roper Technologies (NYSE:ROP); Danaher Corporation (NYSE:DHR); Advanced Micro Devices (NASDAQ:AMD); NVIDIA Corporation (NASDAQ:NVDA); QUALCOMM (NASDAQ:QCOM); Motorola Solutions (NYSE:MSI); Nokia Corp. (NYSE:NOK); BlackBerry Ltd. (NASDAQ:BBRY); Apple (NASDAQ:AAPL); Samsung Electronics Co. Ltd. (KRX:005930) and Facebook (NASDAQ:FB).

of centers pop up, and **Envision** owns a good many of those. They have a total of 260 centers. That's kind of the direction the health care industry is headed. Rather than going into a hospital where the cost structure is quite high, you are able to go into these specialized surgery centers.

1-Year Daily Chart of Pinnacle Foods

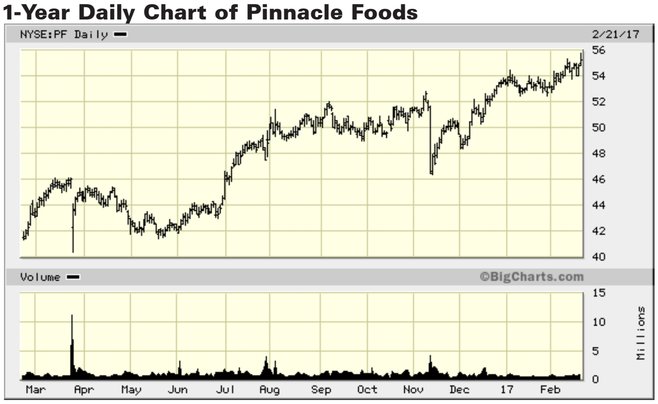

Chart provided by www.BigCharts.com

Mr. Fitzpatrick: Yes, absolutely. I think when you look at health spending in general, by far the biggest category is hospitals, a lot larger than pharmaceuticals, but they get very little attention. Here's a case in point, where that old model of the hospital hiring all the people that function within the hospital is maybe an outdated model, and what **Envision's** offering today is one where they control that physician group that then goes into the hospital and provides that service. Whether it's anesthesiology, radiology, the emergency room, all those physicians functioning within those different segments of the hospital are working for **Envision** and can be driving down the overall cost of the health care system because of the efficiency in terms of how they run that model.

It's the same thing with these surgery centers, where you are going away from the hospital for noncritical type of surgery and lowering the overall cost structure. You really have a specialized group sitting within these surgery centers that are doing, for example, orthopedics in the case of my wife getting her knee done. They literally are almost like a factory in terms of how they have people lined up coming through because that's their main focus, where hospitals really gear toward handling whoever walks in that day in terms of a function that they may or may not have to ramp-up on. In this case, everything is scheduled out and enabled to be delivered very efficiently. This is a more specialized way of delivering health care, and I think in any case where you are ramping volumes and increasing that specialized aspect of what a physician can do, the physician can benefit from it, but also the whole health care system can benefit from it, too.

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The second kind you are seeing is this outsourced physician service, and that's by far the biggest component of **Envision**. What they are looking to do there is, within a hospital, take over the trauma centers or the emergency room or radiology, so they are the ones that the doctors are working for, but they're being supplied to a hospital or a group of hospitals — so different departments in the hospital where it's conducive to having a group-run function. And that decision being supplied by a company like **Envision** is where you are seeing a lot of the hospitals move toward.

It can save them money, it can save the whole industry money, and you are seeing a ramp-up of hospitals being very open to that type of structure. I think that's probably going to gain traction where you are seeing more and more services outsourced to a company like **Envision** and additional hospitals signing on. They have quite a few already today, and it's over 60% of their revenue base and still growing.

The last component of the company is the transportation side of it. They run a whole bunch of 911-type of contracts, where they fill in the ambulatory services to different municipalities, and they also transport people who need to go to the hospital to see the doctor, not necessarily on an emergency basis but need some type of transportation associated with a medical need. What I like about **Envision** is that it's in that area where it can drive down costs and really not in the crosshairs of the biggest debate that's going on in health care today, which is all about pricing.

TWST: So as the Trump administration and Congress work out maybe an alternative to Obamacare or refine it a bit — or whatever they're going to do — finding solutions for affordable care costs and then encouraging insurance companies to want to be in the health care sector, these are all things that this company could provide?

1-Year Daily Chart of Envision Healthcare Corp.

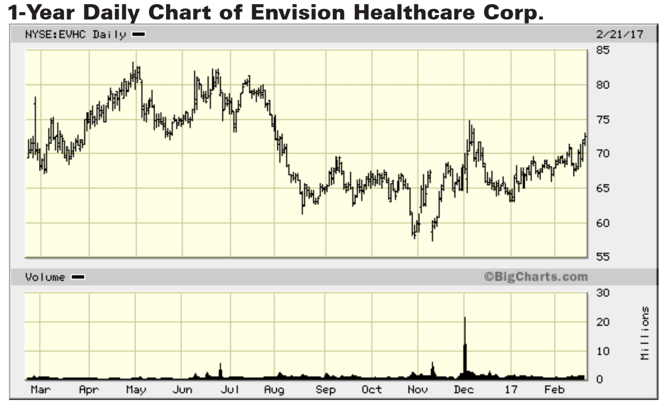

Chart provided by www.BigCharts.com

TWST: And they focus too on making sure that their healthcare providers are well trained and they have a lot of clinical skills?

Mr. Fitzpatrick: Absolutely – we don't think there is any doubt. Physicians are attracted to the business model, too, especially when you are thinking about the surgery centers because they're able to, from a volume standpoint, handle higher volume. And in many cases the physicians also have part ownership in the centers. They're participating in the benefit of driving patients through that type of facility.

TWST: Do you think that as the country irons out what it wants to do with health care this business model is going to get attention from both policymakers and investors?

Mr. Fitzpatrick: I think as you look at the health care system and you look at where we have inefficiencies — it's always kind of easiest to highlight the EpiPen, the one-off situation, because everyone is aware of it, knows what it is, can understand it and grasp it. But in reality, when you look at pharmaceuticals in general, they're not the biggest piece of the pie in terms of health care spending. It's really facilities and hospitals in general that are by far the biggest component, and it's really not the most efficient way of delivering health care because you don't have best practices delivered across the board. One hospital does something a certain way; another hospital does something a little bit different. All of a sudden, if you are training people where you have multiple groups that work for one organization in a specialized area like radiology, and you have best practices executed across the board, you can really be improving the overall health care system and likely saving quite a bit of money in relation to outcomes.

Really, when you look at, what the concept that the government wants to move toward is outcomes, and a good portion of the Affordable Care Act was pushed toward ensuring that you don't have the people coming back in because they weren't treated properly and the penalties associated with that. I think this kind of specialized medicine is a positive, where you literally have the data around how to best treat people in various categories and you really save the system quite a bit of money because you're delivering best practices across a much broader section of the economy. This company operates in over 40 states, so you can imagine how that can help drive a pretty efficient health care system.

TWST: Did you want to mention another company?

Mr. Fitzpatrick: Health care, in my opinion, is one of the cheapest sectors out there for the exact reason we're commenting on before — because it becomes such a hot topic. A company that we've owned for years is **Celgene** (NASDAQ:CELG). **Celgene's** biggest drug by far is REVLIMID, to treat blood cancers and multiple myeloma. The run rate in terms of revenue base for this drug is over $7 billion.

What I really like about **Celgene** in general is just the fact that here you have a company that's trading at a little over 16 times earnings, and it's growing earnings north of 20%. They have a target for 2020 in terms of what their revenue base should grow to and what their earnings base should grow to. It's trading where it is largely because of this whole debate around pricing.

And what's nice about **Celgene**, too, is that it's no longer just driven off of that one product, REVLIMID. They have OTEZLA, which I don't know if you have seen any commercials on TV, but they advertise it quite a bit for psoriasis, and they are looking to expand out in that whole category of diseases associated with the immune system. When you look at psoriatic arthritis, they're looking at Crohn's disease and so on in terms of having potentially this drug treat that. They have a lot of different trials going on, even though it's already approved today for psoriasis.

They have ABRAXANE for pancreatic cancer. They're looking at expanding that out into much broader solid-tumor type of issues within the cancer setting, and then, they have POMALYST, which is another derivate of REVLIMID that they're using within the multiple myeloma category. In addition to having these four main drugs already sitting out there, they have 19 Phase II readouts that they'll get in the next two years — in some cases the drugs that I've mentioned here being used in different settings but also additional drugs. They've done a whole bunch of partnering up with different companies and different categories to find new drugs out there.

They're really looking at treating various types of blood cancers beyond just multiple myeloma, getting into non-Hodgkin lymphoma, CLL, all these different areas within blood cancers that they think they can make money and have potentially very life-changing types of products. Solid tumors, as I mentioned also, they're looking to expand out there and also Crohn's disease. These are all different areas where they have drugs today that they have in some shape or form in Phase I, Phase II or Phase III that they're looking to potentially monetize down the road and get approval through the whole process.

They have a pretty good track record, obviously, when you look at the size of the company today in terms of the pipeline and being able to take stuff through the entire process of getting it approved to the market and making it a profitable business for them. When you look at outside of REVLIMID, the other three drugs that I mentioned are also approaching or over $1 billion in revenues on an annual basis.

TWST: Celgene is pretty well-known by a lot of investors. Are there one or two things that you would like them to know about it that they may not realize?

Mr. Fitzpatrick: I think it's the pipeline. What they've done probably better than any of the competing companies is their willingness to go out and do joint ventures and partner with other companies. When you look at KEYTRUDA, for example, which is **Merck's** drug to treat various types of cancer, the big one, non-small cell lung cancer, they're more than willing to partner up with **Merck** and do tests with their drug in combination with KEYTRUDA. The same thing with **bluebird** (NASDAQ:BLUE), which is kind of a new type of approach in terms of gene therapy, in terms of going after various types of diseases, partnering up with them. They have a whole bunch of different partnerships in place.

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In addition to taking their own drugs and testing them in various other types of cancers and other types of diseases, they've also gone out and partnered up with many other companies. And in some cases, you're giving up a little bit of the revenue stream, but you're also increasing the probability of being approved. I had mentioned solid tumors. They're looking at doing combo drugs with their drug with Avastin, which has been around a long time, which is not a **Celgene** drug. I think people miss that to some extent. They look at it and think of **Celgene** as just a REVLIMID story. However, I think when you look at the other drugs and the other areas, they're really doing a great job today, but also looking to improve upon that going forward, and fairly well-positioned.

Because the biggest concern is post REVLIMID coming off patent in the middle of the next decade, where does this company go? And I think they've done a really good job outlining that, in the next couple of years, with all the different studies they have going on, that's all going to be filled in, in relation to drugs being approved and just from a probability standpoint when you look at how many are in Phase III, how many are in Phase II and so on. The likelihood that a good many of these have is pretty high. You're probably going to be able to fill in that gap and then some in relation to continuing that nice growth phase that they've been able to achieve.

I can remember when they came out several years ago and put out the 2020 guidance, and everyone thought it was quite aggressive, but they've done a really good job of beating the numbers almost every single year in relation to posting higher not only revenue numbers but earnings numbers. I think now the 2020 numbers are very believable numbers, and it's only three years away from kind of achieving that and now filling in the back end of that. They were just at the J.P. Morgan Conference in January and really did a really good job highlighting how they were going to fill in the beyond-2020 type of landscape in relation to all the different diseases that they're targeting with all the different compounds that they have in place today in various different phases and then all the different joint ventures they have going on. I think they're smart about it just in terms of how they're looking to develop, either internally or in combination with other companies, a pretty strong pipeline. I think people miss that. They get overly concerned about what's life going to look like post-REVLIMID.

TWST: Did you want to mention one final company?

Mr. Fitzpatrick: The other company I want to talk about, also one that's kind of gone through a transition and probably will continue to do so, is **Roper** (NYSE:ROP). It was **Roper Industries**, and today it's **Roper Technologies**. I wouldn't be surprised if at some point in time down the road it gets just like **Danaher** (NYSE:DHR) did in terms of breaking the company up into two, got moved out of the industrial sector into the health care sector. I won't be surprised if **Roper** — even with the name change, you can see the direction that they want to go — at some point in time is moved over to the technology sector.

I think they've done a really good job in terms of the four different divisions that they operate in. Two of them are definitely tech-oriented, one is medical, and scientific imaging. They have a whole bunch of different companies they've purchased over the years that fit that category.

RF technology is a very big component of the company today. They do a lot of the barcode readings on cars. If you are going through E-ZPass up here in New York — that is the one that's widely used — and if you go down to Florida, for example, they dominate that market as the barcode. It is the little barcode thing that sits on the windshield of the car; that's them. The same thing with the traffic signals here in New York. They operate the whole traffic system here in the city within that division.

And then, they have kind of the two older divisions on the industrial side of the business. The industrial technology business, which has a lot of pumps, they do meter reading, and then, they also have an energy systems business, again, where its pumps and valves within the energy sector. We had the big issue around the energy sector last year, but you are starting to see that it's definitely bottomed out, so that is nice. Now, it hasn't really improved yet year over year, but we think there's a clear path just given where we are in terms of the rig count today that that segment of the company is going to improve.

"But it's interesting; it's in the industrial sector but yet has two high growth segments of the company that really aren't industrial-related. In fact, on the latest earnings call, they highlighted how much of their revenue today is deferred revenue because of all the software that they sell within the RF technology and the medical-imaging side of the business — its software-related type of sales."

But it's interesting; it's in the industrial sector but yet has two high growth segments of the company that really aren't industrial-related. In fact, on the latest earnings call, they highlighted how much of their revenue today is deferred revenue because of all the software that they sell within the RF technology and the medical-imaging side of the business — its software-related type of sales. It's really changing its stripes to a large extent, and I think they've also done a great job going out acquiring other entities and rolling them up into each one of these different divisions that they run today, probably with a bigger emphasis going forward on the first two: the medical imaging and the RF technology.

However, I think if they find attractive opportunities like they have in the past in the other two segments they would look to acquire, too. You're getting the benefits of really running these businesses fairly effectively, but in addition to that, when you look at the overall growth rate of the company, I think they've done a good job of acquiring at very attractive prices other entities and rolling them up into the overall **Roper** umbrella.

TWST: If you look toward what the popular new technologies might be, especially over the next few years, are they well-situated to take advantage of those, be it something like machine-to-machine communication or internet of things?

Mr. Fitzpatrick: I think they are. I think there are other areas kind of playing that, that are probably more attractive than **Roper**. I believe it's going to play out a lot like the cellphone business did, where initially it was not so much of the end device that really counts. You look back when the initial cellphone came out, it was pretty clunky, and I don't think any of us can even recall who made it, but really, the component portion of the business did quite well. I think that's probably how artificial intelligence is going to play out.

You can see it already in relation to the semiconductor companies that have performed quite well in the last year — both **Advanced Micro Devices** (NASDAQ:AMD) and **NVIDIA** (NASDAQ:NVDA) being the two that really performed the best. We're not quite there yet in relation to the second stage that typically occurs when you go through this process of seeing a nascent industry. You start to grow and then the device really matters, just like it did in the cellphone market, where you went from **QUALCOMM** being a great investment in the 1990s because they made the chipsets that went into the cellphones, and they also made the CDMA technology that allowed cellphones to really be pretty efficient and collected royalties off of that.

Then, it basically moved over to the actual device, where **Motorola** (NYSE:MSI), **Nokia** (NYSE:NOK) and then **BlackBerry** (NASDAQ:BBRY), and then eventually **Apple** (NASDAQ:AAPL) and **Samsung** (KRX:005930) became the big players within that market. I think the same thing here. When you look at **Oculus**, which is owned by **Facebook** (NASDAQ:FB), you don't know if that's going to be the device that wins out in terms of virtual reality, but it requires high computing power and relation to graphics, and that's where we see **NVIDIA** and **Advanced Micro** are fairly well-positioned.

I think when you look at **Roper** today, it's really not going to benefit from that until we really see what the end products are going to look like because they really don't make the components that go into these systems. I think they're fairly well-positioned today with the movement toward and the types of technology they offer, and whether its traffic control systems that they have in place both domestically, and frankly, they're growing that nice globally. The same thing with the RF technology, where this movement toward getting rid of toll systems as the antiquated way of kind of collecting fees on highways to the one that's been around for a while, but they also can probably have the best technology out there within that category.

They're always on the leading edge in terms of technology, but I wouldn't say they're quite varied in terms of benefiting from what's going to really be a pretty dramatic change in my opinion in the technology sector in terms of artificial intelligence and the data collection that we're going to see around that. Now, definitely given the fact that they're collecting data, whether it's within the medical division, the metering division, as I mentioned, within the industrial portion of the technology in terms of water metering and so on, and the same thing with RF technology, so they have the ability to analyze that data, provide that data to the customer base, but they're doing it today. I think we'll see a lot more of that down the road in a very different format than probably what we're looking at today.

TWST: I have one final question. As you talk to investors, what are some of their concerns about 2017 as the year unfolds, and what would you say in response to those?

Mr. Fitzpatrick: I think the two things are valuation and the length. The valuation level of the equity market — we're looking at a multiple on the equity market that from a historical perspective is at the top end of the range. The second thing I would say, it's just the length of time that we've seen here in relation to economic expansion post the last correction in the economy. Both are very long in the tooth.

One thing I would say is that we really haven't had that last leg that you typically see in relation to economic growth. That is where interest rates start to rise, you start to see multiple compression in the market, but earnings start to grow. I think we had a couple of years of stagnation where you did not see any type of earnings growth, and frankly, the economy in general stagnated, and now, we're starting to see some of those end markets that caused the problem — with the biggest by far with the energy sector — emerge out of that. We basically went through an industrial recession caused by the energy sector recession over the last 12 to 18 months, and now, we're coming out of that.

Then, the second thing was really the strength in the dollar really threw a lot of cold water on any company that had revenues outside the U.S. I think, when you look at 2017, both of those things can be tailwinds to some extent. Now, the strength in the dollar is probably going to be neutral to maybe slightly negative but not negative to the degree it was the last couple of years. And the second thing, I think there is no doubt that the energy sector is going to be a big positive to earnings growth on the S&P 500 when you look at how much of a decline we had in the last 12 to 18 months in relation to the energy sector.

The last thing I'd note — I think if we do get any type of tax reform, that would definitely be a big positive from an earnings perspective. If we see a corporate tax rate that's lowered, there is no doubt that that will also help, and that's typically what happens at the tail end of these economic expansions. If you look at 2006 and 2007, you had earnings growth that outstripped the return in the equity markets in those years, and you had multiple compression occur. That's really what we've been waiting for, kind of that exclamation point on this since 2008, a pretty prolonged period of economic growth and a positive equity market. But that last stage is typically interest rates start moving up, and you start to see the Fed tighten, and you get that last boost of earnings like we saw in 2005 and 2006 and 2007.

TWST: Thank you. (ES)

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Footnote for AUM:
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