



Year-End 2019 Commentary

As we enter our 45th year of service to our clients and helping them achieve their financial and life objectives, we decided to share some of the things that are important to us. Some institutions request quarterly commentaries that contain our portfolio thoughts and market thoughts. The thoughts in this year-end letter wouldn't fit in that format, but we thought this year-end letter would be an appropriate forum to communicate what type of investment firm we are and what motivates us.

Our Investment Process

We look for three core investment characteristics when researching potential portfolio companies: talented and ethical management team; best-in-class, niche-focused business; and proven business model. As pertains to the first core investment characteristic, we seek to find "Level 5 Leaders" (a term coined by Jim Collins in *Good to Great*), who are personally humble but extremely ambitious for their organizations; who, when things go wrong, take the blame themselves, and when things go right, give the credit to others; and who surround themselves with top talent without fear of being overshadowed. If we feel that a company with a great business model and impressive financials is led by a management team that doesn't meet our high standards, we just walk away. It is never worth it to us to entrust our clients' assets to a management team that we cannot trust.

Extensive due diligence is a critical component of our bottom-up investment process. The due diligence process may take months or even years and typically includes multiple meetings with the management team (including at their headquarters, where we can see them in their natural habitat), as well as review of SEC filings and past earnings calls and checks with customers, suppliers, distributors, and/or competitors. We try to involve as many people on our research team in these activities as possible, so that when it comes time to discuss a prospective investment, we have many cognitively diverse people around the table with a strong opinion (good or bad) of the management team and the business.

At D.F. Dent, we are growth-oriented investors (meaning that we try to identify companies that will grow their earnings substantially faster than the market), but we are also valuation sensitive. We do extensive financial modeling to try to determine a company's medium-term and long-term potential measured in earnings, free cash flow, and other metrics. We realize that the best companies rarely get "cheap," and if we want to own them for a long time, we might have to buy them (at least initially) at valuations that might seem expensive when viewed with a short-term lens. We try to evaluate whether the valuation is "fair" from a longer-term perspective consistent with our longer holding period. Of course, we make mistakes, both in buying companies that turn out not to be great and in buying great companies at sub-optimal times, but we work hard to learn from these mistakes and make fewer of them as time goes on.

Our People

For the first 25 years of the firm's 45 year history, there were basically two people doing the fundamental research necessary to invest our clients' assets wisely. It became obvious that if we wanted our clients to continue to prosper, we would need to increase our research and client-service capabilities. We have made significant investments in people as we have grown. Consistent with the wisdom in Jim Collins' book *Good to Great*, we have attempted to "get the right people on the bus" and then figure out how to take the firm to someplace great. Twenty years later, we have a research team of eleven people doing the fundamental research necessary to find attractive investment opportunities and avoid mistakes. We come from very diverse backgrounds - family office, venture capital, medicine, law, Wall Street research, mutual fund management, private equity and more. Age-wise we run the gamut from baby boomers to today's millennials. Geographically we come from everywhere including China, India and even New York. It is this cognitive diversity that allows us to look at potential investments from so many different perspectives and in the end decide on their suitability for your portfolios. Despite the animated discussions we have about the companies we are researching, the collegial atmosphere we have cultivated at the firm has led to little professional turnover and remarkable long-term stability of the research team. The firm has never been in a stronger position from a research team perspective, as is reflected in the quality of businesses you own. The names currently in your portfolios have been sourced and driven by many members of the research team.

Over the 45 year history of the firm, we have attempted to control the growth of the firm. The most desirable form of growth has been through the appreciation of our existing clients' portfolios. For us, the quality of assets under management is much more important than the quantity. We will continue to grow but not at the expense of our existing clients or our firm's culture. We have a saying at the firm that "The best new business is the existing business. Take care of the existing business, and the rest will take care of itself."

Socially Responsible Investing

Socially responsible investing has recently become a hot topic in the investment world, and Environmental, Social & Governance (ESG) funds have heavily marketed themselves to investors as a more sustainable and socially responsible alternative to traditional investing. At D.F. Dent, these considerations have always played a significant role in D.F. Dent's research process, helping us evaluate how a company is treating all of its stakeholders (employees, customers, suppliers, the local community, the global community, etc.).

Evaluating potential and existing investments using socially responsible criteria is core to our research – both philosophically and in a very practical sense. It is a major focus of our ongoing due diligence and face-to-face meetings with management. Our goal is to invest our clients' money in companies run by executives of high integrity without compromising investment performance. We believe that investing with a focus on ethics, integrity, employee relations, environmental stewardship, and corporate citizenship is highly correlated with the strong historical investment performance in your portfolio.

Over a year ago, we added to our research tools by subscribing to an ESG screen (called the ISS-Ethix screen) that allows us to screen all of our portfolio companies, as well as potential investments, to see if any ESG red flags come up. Currently, none of the portfolio companies in

any of our model portfolios (All Cap, Midcap, Small Cap) is flagged by the ISS screen. The ISS screen is no substitute for the extensive due diligence that we perform when conducting our research, and there might be cases where our assessment differs from that of ISS. In those instances, we would not be afraid to follow our own moral compass and to act accordingly. That said, we usually find the ISS ESG screen insightful and additive to our research process, and it is helpful for us to use the ISS ESG screen as a double check to make sure we are not missing anything. We have not officially created or marketed an “ESG” product, but we would like our clients to understand that socially responsibility and ESG principles have always been critical to our research process.

Our Values

In 2019, we decided to start to formalize our D.F. Dent and Company Core Values – to put down on paper the principles that have guided us through the years, the values that determine how we conduct ourselves at work and in life. The trick was to avoid platitudes and to get to the root of what we think distinguishes our firm from the thousands of other investment advisers in the world. We thought we would focus here on one Core Value that stands out for us: “Be grateful, kind and charitable to all.” We would like to illustrate this Core Value by expressing our gratitude for the following:

- Through our investment management, we have the opportunity to help many of our clients do important charitable works (as organizations or endowments) or generously contribute to charity (as individuals or family foundations);
- In a world of many competing investment strategies, we have clients who believe what we believe – that over the long term, stock performance is highly correlated with earnings growth;
- Our pension fund clients can achieve fully funded status through our asset allocation and appreciation and can fulfill their pension promises to their retirees. In cases of pension fund clients, we are hired with the understanding that if we do a good job over many years and achieve the client’s goals, we will be “dismissed with appreciation.” We have happily lost clients this way over time;
- We have the great pleasure to work with colleagues of different backgrounds who are very passionate about what they do and who make each of us feel (pleasantly) like we are surrounded by people smarter and wiser than we are. All of our colleagues also “empty the dishwasher” every day, sometimes literally and sometimes metaphorically – never passing up a chance to step up and do something extra to help a colleague;
- We get to spend most of our time doing what we love (building relationships with clients and researching companies and their management teams);
- We know we are all incredibly fortunate and try to give back to the community in some small way:
 - We have internship programs with Morgan State University and with Cristo Rey High School that have given us the privilege of getting to know some incredibly impressive young people and the opportunity to guide them as they enter their adult lives;
 - We have had the opportunity to perform community service at local charities, which contributed in some small way to addressing community hunger issues but contributed in a bigger way to our perspective on life;

- Our offices are in Baltimore, a city with its share of problems but a city of kindness and warmth. We all pull for each other in Baltimore; and
- Next baseball season every team starts out 0-0, tied for first place.

We are extremely grateful for the confidence you have placed in D.F. Dent and Co. and will continue to work diligently on your behalf. We never take for granted your belief in our investment process and support of our firm.