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THE WALL STREET TRANSCRIPT
Connecting Market Leaders with Investors

Finding Opportunities in the Growth Areas of the Market Within a Value Portfolio

MICHELLE STEVENS, CFA, is Senior Portfolio Manager and Managing Director at Baird Equity Asset Management. Ms. Stevens has 22 years of investment industry experience, having managed mutual funds, subadvised funds and institutional separate accounts in the small, small/mid — smid — and all-cap value equity disciplines. She holds an MBA from the University of Cincinnati and received her bachelor's degree in economics from Wittenberg University.

SECTOR — GENERAL INVESTING

TWST: Could you please introduce yourself?

Ms. Stevens: Hi, this is Michelle Stevens, and I'm the Portfolio Manager for the Baird Equity small/midcap value portfolios and small-cap value portfolios.

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

Ms. Stevens: Sure. Baird is a Fortune 100 company with a long history of managing money for clients. Within the larger organization, Baird Asset Management manages about $70 billion. And under that resides Baird Equity Asset Management, which manages about $5 billion in equity assets for individuals and institutions.

TWST: On the fund that you work on, is there a unique investment philosophy, and how does that compare to maybe the investment philosophy of the entire firm?

Ms. Stevens: At Baird, we operate on the equity side as individual boutiques within a larger organization. Our team is located in Cincinnati, Ohio. We have been together since 2004, which is a long time in this industry, with no changes either to the portfolio management or among the analysts. And we do in fact have our own investment philosophy and process, which is distinct from the other teams within Baird Equity Asset Management.

TWST: Did you want to explain that a little bit?

Ms. Stevens: Sure. When we look at the market, first and foremost, we believe that value and growth investing don't have to be mutually exclusive. We like to borrow the best of both worlds. It's a bit of a mashup between Warren Buffett and Graham and Dodd.

Our process, just to go a little bit further, is to identify good companies mispriced by the market. We like businesses that have high returns on equity and a solid earnings growth profile. We believe that companies with high returns through the market cycle indicate that they have some sort of competitive advantage or high barriers to entry. So we like those types of businesses, but we're very true to our value discipline. In that regard, we're not willing to pay a premium for those businesses based upon their growth rates. So to do that, we're always seeking companies where we believe there is what we call a predictable surprise — that is, a catalyst for earnings surprise — and then ultimately p/e multiple expansion.

We run a well-diversified portfolio across all investment sectors. What we're really looking for are companies where we think the market has not yet given credit to the business for the true profitability of the business. There could be a catalyst that's either company-specific — it could be something like a balance sheet restructuring or margin expansion opportunities, M&A synergies — or a macro-related trend that we've identified that we don't think is fully priced into the business.

Just to give you an example, one of the names in the portfolio is a company called **Cypress Semiconductor** (NASDAQ:CY). This is a business that's really been transformed over the last three years. They completed three large transactions that changed the business from more commodity-related semiconductor chips to a focus on much higher growth areas of the market with better margins. They're now number one in a lot of auto categories where we're seeing double-digit growth.

They're also number one in things related to the connected car, like Wi-Fi, Bluetooth and touch screen. They're capitalizing on the trend of more chip content and more computing power within the car. Six or seven years ago, a BMW 7 series only had about $20 of **Cypress** content in it. Today, that's approaching $100 per vehicle.

They're also one of the leaders in IoT connectivity, the internet of things. They acquired **Broadcom's** (NASDAQ:AVGO) business a couple of years ago. So they provide connectivity like Wi-Fi, Bluetooth and Zigbee in devices such as your **Nest** thermostat, for example, in the home, and that market is growing north of 17% as well. The market didn't give **Cypress** full credit for these changes, and what we've seen over the last two years is earnings projections go from less than $1 to about $1.50 this year. Their earnings have grown threefold during that time period.

TWST: And so looking ahead for a few years, investors who want to invest in something where there's emerging need and an interest on the part of consumers and corporations — being equipped in cars and the internet of things are two probable growth areas — would that be a reason that investors might want to invest in Cypress?

Ms. Stevens: Yes. One of the things that we believe is unique to our strategy is this ability to find opportunities to invest in growth areas of the market, even within a value portfolio. So instead of paying a premium for growth, as you might with a growth manager, we've found ways to leverage those trends, buying at a discount to their growth rates.

Another theme in the portfolio is related to the proliferation of e-commerce, which is a disrupter within the economy. E-commerce is only 13% of retail sales right now, but it's about half of all the growth in retail. And 70% of online retail is happening through **Amazon** (NASDAQ:AMZN). We can't own **Amazon** in our portfolio, but we can own other companies that partner or help **Amazon** fulfill the needs that are exploding in e-commerce.

One of the ways we do that is through a company called **Air Transport Services Group** (NASDAQ:ATSG). They operate and lease aircraft for package delivery, and they have about 80 planes. Other large customers in e-commerce, such as **DHL**, use **Air Transport's** services, but they also have a relationship with **Amazon** where they're now running 20 planes for **Amazon** to help them meet that overnight or one-day delivery that they've expanded to within the last year or so.

Again, it's another business where the Street didn't recognize the growth potential in our opinion, and you've seen estimates move about 30% higher over the last two years. It's still only trading at about 15 times earnings, and it gives us a backdoor way to participate in e-commerce at attractive valuations. One of the neat things too about logistics is that online retail purchases are about three times more likely to be returned by the customer than traditional brick-and-mortar sales. That means you're shipping more packages, and you're leveraging those growth rates even more when it comes to moving e-commerce goods back and forth.

Highlights

Michelle Stevens discusses Baird Equity Asset Management. Ms. Stevens doesn't believe value and growth investing have to be mutually exclusive. She describes her style as a mashup of the two. Ms. Stevens looks for good companies mispriced by the market. She likes businesses with high returns on equity and a solid earnings growth profile. However, due to her value discipline, she is not willing to pay a premium for those businesses. She aims to identify a company-specific catalyst or a macro-related trend that isn't fully priced into the business. One of the current themes in the portfolio is the proliferation of e-commerce. Ms. Stevens' portfolio is well-diversified across investment sectors.

Companies discussed: Cypress Semiconductor Corporation (NASDAQ:CY); Broadcom (NASDAQ:AVGO); Amazon.com (NASDAQ:AMZN); Air Transport Services Group (NASDAQ:ATSG); Atlas Air Worldwide Holdings (NASDAQ:AAWW); Stamps.com (NASDAQ:STMP) and Ryman Hospitality Properties (NYSE:RHP).

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TWST: And where the products are flown, is that mainly in the United States right now, or is it in different countries?

Ms. Stevens: So **ATSG** mainly operates domestically, but we also own another company in the space called **Atlas Air** (NASDAQ:AAWW). They have the same relationship with **Amazon**. They are also now operating 20 planes for **Amazon**, but they have a much larger fleet, including international cargo, which they leverage through other package delivery providers to provide service internationally as well.

1-Year Daily Chart of Cypress Semiconductor Corporation

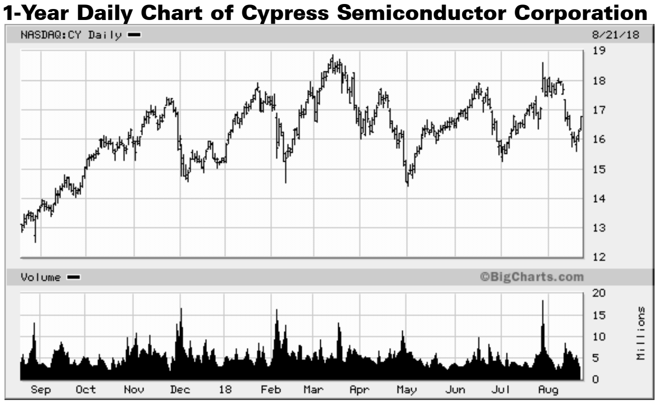

Chart provided by www.BigCharts.com

This is another example where the Street just didn't get the earnings estimates right. When we bought the stock two years ago, the earnings estimates were for less than $6 for this year, 2018. The current 2018 estimates are $10.75.

TWST: And if a major retailer, among the well-known retailers, wanted to compete with Amazon and had a strong online presence, would they have to undertake the same flight systems to be competitive with Amazon and those companies?

Ms. Stevens: Certainly, most retailers wouldn't be able to afford running their own planes. They just wouldn't have the volume, but they might use a service like **Stamps.com** to help with their mailing and fulfillment. **Stamps** provides those services as well to other retailers. So they have opportunity there.

In terms of e-commerce though, at this point, **Amazon** has roughly 70% of all e-commerce sales. So they really have become the 800-pound gorilla in the sense that they can do it cheaper in terms of providing less expensive shipping to the customer. So while other retailers will continue to migrate to having an online presence, they won't necessarily be doing that at the expense of **Amazon** in our opinion.

"We also own businesses in the portfolio that provide a nice yield to investors, such as real estate investment trusts. It's a big part of our benchmark, roughly 16%, and a lot of small-cap value managers have missed out on owning this sector to their demise because REITs have done very well in the last 10 years."

TWST: And basically, when the flight gets to the airport, then they've got to partner with another firm to get it to the person that's going to receive it or the company that is going to receive it. Is that the way it works?

Ms. Stevens: In the case of **ATSG** or **Atlas**, they're mostly providing the plane leasing. They do some package sorting as well. Here in Cincinnati, Ohio, they have a large facility that they run for **Amazon**. But from that point, **Amazon** then partners back out with other logistics providers, such as trucking companies, to move the goods to one of their distribution centers or directly to the customer.

TWST: Great. And did you want to mention another company?

Ms. Stevens: Sure. While we're on this trend, we can also talk about a little company we own called **Stamps.com** (NASDAQ:STMP). They provide mailing and shipping solutions to businesses, and five years ago, they mainly provided these services to small businesses, just allowing them to print postage. They made some transformative acquisitions within the last few years of companies, such as **Endicia** and **ShippingEasy**, that are focused on high-volume shippers. So that's really the play on e-commerce again, wholesalers and third-party resellers that are selling to companies like **Amazon**.

Stamps provides the shipping solutions, so they're levered to the growth in e-commerce without having to choose which retailer is going to necessarily win. They just announced a new acquisition of a company called **MetaPack**. And that's going to expand their services more rapidly internationally, adding another whole leg of growth.

1-Year Daily Chart of Air Transport Services Group

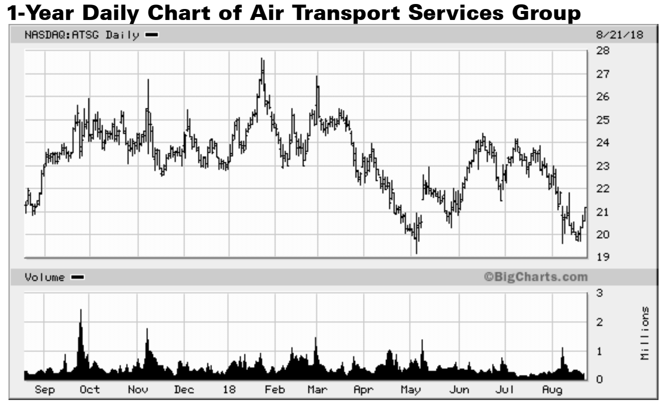

Chart provided by www.BigCharts.com

TWST: And did you want to mention one final company?

Ms. Stevens: Sure. So maybe something a little less exciting in terms of growth than e-commerce plays, we also own businesses in the portfolio that provide a nice yield to investors, such as real estate investment trusts. It's a big part of our benchmark, roughly 16%, and a lot of small-cap value managers have missed out on owning this sector to their demise because REITs have done very well in the last 10 years. We believe that you can own real estate investment trusts even in a rising interest rate environment.

This is one of those areas where we really look to our macroeconomic overlay to help us choose stocks. And given the current environment, hotel REITs are attractive to us. A name that we've bought more recently is **Ryman Hospitality** (NYSE:RHP). **Ryman** owns the Gaylord properties, which are very large conference-oriented group facilities. What gets us excited here is with recent tax reform and more money in the pockets of corporate America, there, in our estimation, will be increased business travel, and group bookings will rise.

1-Year Daily Chart of Ryman Hospitality Properties

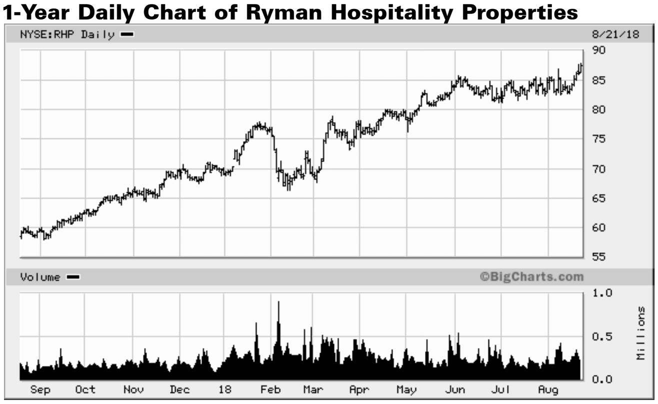

Chart provided by www.BigCharts.com

seen signs of yet. So in this environment, again, we feel that small caps look very attractive because they have the best earnings growth profile out of all of the market-cap spectrum, and in particular, value looks attractive to us relative to growth.

TWST: And have you seen the funds that you work on benefiting from the tax reform?

Ms. Stevens: Absolutely. It's been a good couple of years for small-cap returns. Again, small caps have been the largest beneficiary of tax reform, and you've seen estimates move significantly higher for our benchmarks, such as Russell 2000 or the Russell 2000 Value, during that time period.

TWST: And when you talk to some of your clients and investors, what are some of their concerns that they have looking at the rest of this year and into next year?

Ms. Stevens: Well, I think investors are concerned that because small caps and equities in general have done well that we might be overdue for a correction, especially since we're nine years into the current economic expansion. And one of the things that we talk about is being long term in focus and staying with small caps through the cycle because it's very difficult to time.

Also, with an active manager such as ourselves, you can also find some nice downside protection in that environment. A lot of investors have moved to ETFs or passive in the past several years, and we think there's definitely more risk to those index returns in a bear market. Our portfolios have done very well in down markets. We have had about 80% downside capture since inception, which is the past 18 years. So that means in a down market, we're only capturing 80% of the downside. And that really helps long-term performance not to have to dig out of as much of a hole when there is a bear market.

"Well, I think investors are concerned that because small caps and equities in general have done well that we might be overdue for a correction, especially since we're nine years into the current economic expansion. And one of the things that we talk about is being long term in focus and staying with small caps through the cycle because it's very difficult to time."

So group bookings also have leverage to all of the ancillary revenue that accompanies large conferences. Not only do you get more rooms rented out, you also have the food and the conference facility, which are much higher-margin businesses. And we think **Ryman** is poised to do well in the coming years as group bookings improve. The stock trades at about 13 times FFO with a 4% yield. And they also have a couple of new properties that should open or expand in the next 12 months.

TWST: And you mentioned interest rates, what do you see the Fed doing over the next year or two, and how might that affect some of the funds on which you work?

Ms. Stevens: So toward the end of last year, as tax reform became a reality, we anticipated that rates would move higher in the short run, and as a result, we trimmed some of our holdings that were more interest-rate-sensitive, where we had been overweight and those stocks had done very well. We're a bit more sanguine at this point on rates moving higher from here. We think that the 10-year is probably fairly priced at around 3%. And we wouldn't anticipate a large move higher from here unless we see inflation really accelerate, which in our opinion we have not

TWST: And changing gears a bit, do you think that those who are in retirement years or nearing retirement years should have a significant amount of their investments, their portfolios, in equities? I know some people like to go with fixed-income-type products, but given what they've been paying, are equities required to make sure that you have enough money to live out your retirement comfortably?

Ms. Stevens: Well, I don't do individual financial planning, but I think that depending on what your liquidity needs are, you do need to have some more fixed income investments to meet those income needs. But outside of those needs, equities are the right place to be. I'm a strong believer that most investors are meaningfully underweight small caps and that most advisers steer them away from small caps because of volatility. But that's also where you have seen the very best absolute performance over the long run. So if you have an intermediate- to long-term time horizon, I think a larger exposure to small- and mid-cap value stocks is completely appropriate.

TWST: Given that some people might be retiring in their 60s or early 70s and life expectancy has expanded, their time horizon is going to be longer than maybe it would have been 70, 80 years ago.

Ms. Stevens: That's a great point and another reason why a good portion of that portfolio, where you don't have near-term liquidity, should be invested most likely in equity products.

TWST: On the other end of the age group is the Millennials. I know many of them sort of watched as their parents and grandparents had problems with the situation around 2008, 2009, but do you think they're going to start to get more involved in the market and then maybe even look at small caps for long-term growth?

Ms. Stevens: I think so. So every generation that has experienced a meaningful bear market has also shied away from equities for some period afterward. But we as human beings tend to have short-term memories and ultimately gravitate back to where the absolute returns have been best in the long run.

TWST: So you think they'll get over their discomfort with the market that maybe their great-grandparents saw, who lived through the Depression, and they might decide that stocks may be the place to get long-term growth of their savings?

Ms. Stevens: Yes, I do.

TWST: In terms of when you're talking with clients, do you think that they're a little bit too focused on the day-to-day news that might come over a news business channel as opposed to really looking at long-term growth and that they have to focus on the bigger picture rather than just the day-to-day news?

Ms. Stevens: Absolutely. I think that's one of the most difficult things about investing — is not being short term in your focus. It's easy to fall into that trap, and I think people want to be involved and take control of their financial situation, but it's so dangerous to think short term. Even institutional investors and consultants are guilty of the same by focusing too much on managers' quarterly performance versus a benchmark. We try so hard to get our investors to focus on long-term performance and returns and just sticking with a strategy that you have confidence in over the full market cycle. On any given day, you can have a stock have a negative contribution to your portfolio that in the long run might be a big winner, and you don't want to focus too much on those short-term fluctuations.

TWST: Recently in the news, we've been reading about the possibility of more trade wars, and there's been some tension between the United States and some of its trading partners. Do you think that's going to impact the small-cap funds much, or because many of them are more domestic, will it maybe not have as much impact?

Ms. Stevens: Well, you've made a good point that small caps are more domestic. They have about half the revenue exposure overseas of their larger-cap brethren. The market has certainly keyed in on that in recent months. And we've seen large inflows into small-cap ETFs. In April, in particular, I think almost $10 billion flowed into small-cap index funds. And that really goosed returns for those benchmarks and, in particular, drove the performance of the smaller names in the benchmark, which are also some of the lower-quality companies.

So we saw some short-term outperformance of low-quality companies with high p/e ratios or companies that don't make money at all. And what we know historically is that will tend to reverse itself. Investors have caught on to small caps being more insulated from trade wars and that one needs to be careful though when buying just an ETF instead of looking more distinctively at individual names or active managers.

TWST: is there anything that you think that the government could do to encourage the growth of companies that one would find in a small-cap fund? I'm thinking about some of these companies that might largely have a domestic audience for their products and might be involved in a very specific field. Just now, we saw how the tax reform helped, and we saw some other things helping so far. Do you think that there are some other policies that the government might be able to implement that might help the companies that you find in your funds?

Ms. Stevens: Really, outside of tax reform and changes that might encourage capital spending, I think we prefer a free market system. We certainly appreciate anything that unwinds undue regulation or that alleviates uncertainty so that corporations are comfortable expanding or making capital investments.

TWST: And do you see small-cap companies as interesting targets for mergers and acquisitions? Do you see that continuing in the next year or two?

Ms. Stevens: Absolutely, and we have seen a pick up again with some of the more recent changes to the tax code. So as corporations gain confidence in a stronger economy or have opportunities to make acquisitions at a more tax-advantaged rate, we've seen that happening. Our companies tend to be targets because of their higher growth and higher return profile. So we hope to be a beneficiary of some of those trends in the coming months.

TWST: Thank you. (ES)

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Performance as of 6/30/18:

Fund Name	Expenses (Gross/Net)	1 yr	3 yr	5 yr	Since Inception	Inception Date
Baird SmallCap Value Fund Institutional Class	1.35/1.00	15.88%	8.47%	9.70%	10.98%	5/1/12
Russell 2000 Value Index		14.37%	12.92%	10.19%	12.79%	
Baird Small/Mid Cap Value Fund Institutional Class	1.92/0.95	14.68%	--	--	9.40%	11/30/15
Russell 2500 Value Total Return		12.83%	--	--	12.98%	

Performance data quoted represents past performance. Past performance does not guarantee future results. Investment return and principal value of an investment in the fund will fluctuate so that an investor's shares, when redeemed, may be worth more or less than their original cost. The funds' current performance may be lower or higher than the performance data quoted.

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The Advisor has contractually agreed to waive its fees and/or reimburse expenses at least through April 30, 2019 to the extent necessary to ensure that the total operating expenses do not exceed 1% and 0.95% of the SmallCap Value and Small/MidCap Value Fund Institutional Class's average daily net assets, respectively.

The minimum investment in Baird SmallCap Value Fund Institional Class or Baird Small/MidCap Value Fund Institutional Class is $25,000.

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Top 5 Small/Mid Value Fund Contributors			Bottom 5 Small/Mid Value Fund Contributors		
Security	Avg. Weight	Contribution	Security	Avg. Weight	Contribution
ZAGG INC	2.90	0.97	META FINANCIAL	4.00	-0.44
STAMPS.COM	3.93	0.91	BOINGO WIRELESS	5.07	-0.43
ICU MEDICAL	4.35	0.68	ORCHIDS PAPER PRODUCTS	0.50	-0.39
LAMB WESTON	2.58	0.42	LKQ CORPORATION	1.81	-0.35
ATLAS AIR WORLDWIDE	2.23	0.39	ESSENT GROUP	1.56	-0.30

Top 5 Small Cap Value Fund Contributors			Bottom 5 Small Cap Fund Portfolio Contributors		
Security	Avg. Weight	Contribution	Security	Avg. Weight	Contribution
ZAGG INC	2.92	0.99	BOINGO WIRELESS	5.51	-0.61
STAMPS.COM	3.95	0.94	META FINANCIAL	4.05	-0.45
ICU MEDICAL	5.68	0.90	ORCHIDS PAPER PRODUCTS	0.50	-0.39
MERCHANTS BANCORP	2.52	0.75	LCI INDUSTRIES	1.25	-0.34
IMMERSION CORPORATION	2.10	0.68	SOLARIS OILFIELD	2.42	-0.30

A complete listing of all fund holdings can be found on bairdfunds.com.

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