Fourth Quarter Letter 2016

PERSPECTIVE

Stock market rallies and declines are usually precipitated by a dramatic change in outlook for future profits. Before November 8, Wall Street seemed comfortable with the status quo represented by the anticipated election of Hillary Clinton. On election night, the Dow futures plunged 800 points when Donald Trump's upset became apparent. The consensus was that the stock market would drop dramatically in the event of a Trump victory. However, it did not take long for the stock market to rapidly adjust to the reality of a Trump administration and economic policies, which were in some cases quite different from either party.

The post-election rally has been driven by a number of assessments (lower taxes, infrastructure spending and deregulation) on the economic front that was broadly interpreted as positive. This bellwether election represents the first time since Dwight Eisenhower was elected in 1952 that a Republican president will enter office with GOP majorities in both the House and the Senate.

As of this writing, financials have surged over 17% since the election, having benefited from the reassessment of the market, making them the S&P 500's best performing sector. Large banks have spent the last six years and hundreds of millions of dollars adapting to the post-financial crisis regulatory landscape ushered in by the 2010 Dodd Frank Act. More stringent regulations have forced banks to hold more capital, add staff to focus on compliance and exit profitable businesses such as proprietary trading, thus dampening returns. Slow economic growth and ultra-low interest rates have also crimped bank returns. These required changes left banks looking a lot more like utilities with limited, regulated growth prospects. Any moves by the incoming Trump administration to undo or lessen regulation could allow banks to return more capital to investors or invest a higher percentage of capital, which in turn would boost returns on equity.

We feel there is greater value in focusing on individual companies and their economic merit as opposed to macro factors such as monetary and or fiscal policy, which are constantly in flux and give the stock market its overall random nature.

Early cabinet picks, backed by a Republican Congress, are poised to advance labor, environmental and financial regulatory policies more favorable to many U.S. companies. For example on the environmental front, Trump's selection to head the EPA has given hope to auto makers seeking relief from stringent Obama administration regulations such as increasing fuel

economy standards to 54 miles per gallon by 2025. Energy companies could also benefit from changes to the EPA's ethanol mandate, which requires biofuels to be blended into the nation's gasoline pool.

Corporate tax cuts could potentially unleash investment in equipment, buildings, software and hiring. Deutsche Bank's chief economist predicted the range of tax cuts proposed by Trump could propel the economy's annual growth rate from 2% to a range of 3.5% to 4% by the end of 2017. During the campaign, Trump also pledged to double the $275 billion stimulus proposed by Hillary Clinton for infrastructure spending. Trump said his top priorities would include the country's highways, bridges, airports, tunnels and electrical grid.

The truth is that no one yet knows what Trump will do as president. A dose of reality could again change the direction of the market. Tax cuts and infrastructure spending could further swell the deficit and spike inflation. The threats to impose taxes on companies that move operations overseas or impose tariffs to settle trade disputes could amplify uncertainty and slow economic investment. Certain constituencies may delay the deregulatory march. Just as pro-business groups have sued to block Mr. Obama's regulations, certain advocacy groups could sue to stop their reversal.

The recurring lesson of an unpredictable market was evident during election night and in the immediate days that followed. Consensus and conventional wisdom of the market can be upended in short order, and market moves can be random. Attempts to anticipate or time the market are speculative and lead to additional risk. At Delta, we base decisions on the economic merits of individual companies. We invest in stocks when they trade at a discount to their long-term value and sell them when they trade at a premium to their long-term value or when their original value proposition changes. We feel there is greater value in focusing on individual companies and their economic merit as opposed to macro factors such as monetary and or fiscal policy, which are constantly in flux and give the stock market its overall random nature.

December 13, 2016

COMPANY COMMENTS

Comments follow regarding common stocks of interest to clients with stock portfolios managed by Delta Asset Management. This commentary is not a recommendation to purchase or sell but a summary of Delta's review during the quarter.

Apache Corporation { APA }

Apache has grown to become one of the largest independent oil and gas exploration companies in the world. The company's strategy has been balanced production between oil and natural gas and a broad global geographic approach that includes exposure to conventional,

unconventional, offshore shelf and deep water and onshore operations. Apache's asset portfolio encompasses the United States, Australia, Canada, Egypt and the United Kingdom. Approximately 60% of the company's production is from North America and 40% is international. Apache has 11.5 million gross acres across the U.S., 75% of which is undeveloped. The company's North American assets provide a good balance of hydrocarbon mix and reserve life with opportunity for continued exploration and production growth.

Historically, Apache has strived for a diverse portfolio of assets that balances oil and gas production, North American and international exposure, and short-term and long-term risk and reward profile. This strategy has given Apache the ability to deliver long-term production and reserve growth while achieving competitive returns on invested capital. Apache's management team maintains a long-term focus and believes the oil and gas industry remains cyclical. The company will not chase production growth at the expense of profitability and return on capital.

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Apache's strong historical performance is attributable to exploiting mature fields with operating efficiency and cutting-edge technology. Its efficiency has reduced drilling and rig mobilization times, while the use of horizontal drilling produces cost savings and higher yields. The net result has been moderate growth but with a higher return on capital than its peers.

Apache recently disclosed that it has discovered the equivalent of at least two billion barrels of oil in a new West Texas field that has the potential to become one of the largest energy finds of the past decade. The discovery, called Alpine High, is in an area that had been overlooked by engineers and geologists who believed it would be a poor fit for hydraulic fracturing. The position now exceeds 300,000 acres and is about 20 times the size of Manhattan. The company is planning to direct one-fourth of its capital budget this year toward the field, but it will require several years to ramp up production because of the need for pipelines and processing equipment.

The company has made strides to reduce its international exposure that have uncertain political and economic risks. Apache has been proactive in de-risking its asset portfolio. In August 2013, the company announced the sale of one-third of its Egyptian stake for $3.1 billion. The transaction also valued the company's Egyptian assets significantly more than market expectations. However, further civil unrest could hurt Apache's production and limit its energy delivery and exports. Apache operates in remote areas of Egypt's western desert with a deep backlog of both exploratory and development drilling locations.

The greatest risk facing Apache and others in its industry is low oil prices for a longer-term period than expected. In the case of Apache, revenues have declined due to both a slowdown in production as well as selling lower priced oil to its customers. We believe the current oversupply of oil is mostly cyclical, and oil supply and demand will ultimately rebalance at higher future prices. The company has a good balance sheet, flexible capital spending programs and enough liquidity to provide an attractive long-term investment return.

Apache's assets provide balance with good long-term growth prospects in North America and high free cash flow generation in its more mature fields internationally. We believe Apache should be able to grow production before acquisitions at a low-single digit range long-term. The corresponding production and personnel expenses are expected to result in profit margins in the mid-20% range. At the present stock price, our model indicates an 11% long-term average annual rate of return.

The Goldman Sachs Group, Inc. { GS }

Goldman Sachs is a global investment banking, securities and investment management firm that provides a wide range of financial services to a substantial and diversified client base, such as corporations, financial institutions, governments and high net worth individuals. Founded in 1869, the firm is headquartered in New York City and maintains offices in all of the major financial centers around the world. Goldman converted to a bank holding company in 2008 and is regulated by the Federal Reserve. As a bank holding company, it is subject to regulatory capital requirements and periodic stress tests as determined by the Federal Reserve. These capital requirements are expressed as capital ratios that compare the bank's capital to its risk-weighted assets.

A core competency of Goldman is the ability to reposition businesses to quickly adapt to rapidly changing economic and financial trends by exploiting the firm's global reach and knowledge base. The firm's nimble capital allocation is executed with an intense focus on risk management and the foresight of a long-term outlook. This strategy was key to Goldman's emergence from the financial crisis in a position of relative strength versus most competitors. Another example of Goldman adapting quickly to changing circumstances is when equity and currency trading went digital in the early 2000s; Goldman rapidly invested huge sums in technology and automated much of its trading. The resulting explosion in trading volumes more than offset the drop in the profitability of each trade.

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The firm has a deep talent pool made possible by a partnership structure. This unique model does not rely on any one individual rainmaker. Goldman imposes equity ownership requirements on its partners, which helps align management's interest with those of common shareholders. Goldman's leadership and legacy in its field attracts a high caliber, diversified group of talent each year. In 2015, more than 313,000 candidates applied for positions at Goldman while the firm's hire rate was just 3%.

Since the Great Recession of 2008, investment banks have experienced increased regulation and higher capital requirements. Trading profits, a key profit driver, have gone from extraordinary to just ordinary, rising no faster than the annual growth in capital markets activity. Some banks have had to limit or exit profitable businesses such as proprietary trading, dampening returns.

In response to the new regulatory requirements, Goldman has strengthened its balance sheet by reducing debt, building capital and raising liquidity. Goldman has also reallocated capital away from riskier, proprietary investments toward its more client-driven businesses, such as investment banking and trading.

The incoming Trump administration has pledged to undo or lessen regulations, which could allow banks to return more capital to productive uses or to investors. This revision, in turn, would boost returns on equity. The election has created pockets of uncertainty that might increase hedge fund activity. Goldman might be a beneficiary of increased trading volume as it gets about one-quarter of its trading business from hedge funds.

The firm is focused on expanding its franchise globally to participate in fast growing economic and financial market activity in developing regions. Several European banks have been reducing headcount and exiting certain businesses which should open up various opportunities for Goldman. Emerging market economies should produce plenty of capital raising and business building activity. With professionals on the ground in developing regions and financial centers, Goldman should be well positioned to compete in the global underwriting and investing business.

Goldman is exposed to a number of risks. Financial results in any given period can be materially affected by global financial markets, economic conditions and other factors. Goldman contributed to the campaign to keep the United Kingdom in the European Union (EU). Goldman has one in six of its workers in Britain, the highest exposure among non-British banks. London will continue to be an important trading city, and exiting the EU is a two-year process, which gives Goldman time to adjust.

Goldman has maintained a leadership position in most of its activities and is financially sturdier and less burdened by irrational competition than it was before the financial crisis. We believe Goldman will be able to grow revenue in the low single digits on market share gains and emerging market expansion. This growth will be somewhat mitigated by slower global growth, higher regulatory capital and reduced leverage. We expect Goldman can generate return on equity of over 9% over the next decade. Based on these assumptions, our financial model indicates that at the current stock price Goldman Sachs' stock offers a potential long-term annual return of approximately 5%.

Ecolab Inc. { ECL }

Ecolab is the largest global provider of cleaning and sanitizing products and service programs. The company pursues a "Circle the Customer – Circle the Globe" strategy by providing a comprehensive set of innovative cleaning, sanitizing and water treatment programs, products and services. Ecolab was founded in 1923 and is headquartered in St. Paul, MN. The company dwarfs its rivals in this highly-fragmented market.

Ecolab's extensive and highly-trained sales force has been a key contributor to strengthening and growing its leadership position in the industry. New customers over time are offered new products and solutions, thus expanding the relationship and adding incremental revenue.

These customer relationships also provide valuable customer insight, which often leads to product innovation. The sales force stays in close contact with customers by visiting sites to ensure that the company's products are working and being used properly. Salesmen are highly motivated with as much as 75% of compensation in the form of variable pay.

Ecolab has transformed itself with two major acquisitions. In 2011, Ecolab significantly changed its business with the acquisition of Nalco. Nalco is a leading global water technology company. It provides chemicals, services and analytics to help commercial and industrial customers manage water quality, treat boiler and cooling water, and manage and reduce waste water. Nalco serves global industries, such as food and beverage, manufacturing, pulp and paper production, mining and energy. The company's core strength of helping customers reduce, reuse and recycle water is becoming increasingly important as water potentially becomes more scarce longer-term. In 2012, Ecolab purchased Champion, a specialty chemical services firm that treats water and wastewater from oil and gas extraction.

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Nalco and Champion's oil and gas businesses have added cyclicality to Ecolab's portfolio. The company's energy segment has been in a difficult operating environment the past two years. Lower oil prices have continued to put pressure on energy sales in 2016. Longer-term, the company is positioned well in the industry with many advanced technologies and water treatment solutions required for energy sources, such as shale. From the reservoir to the refinery, the company's chemical solutions touch almost every part of the oil and gas value chain.

There continues to be good cross-sell opportunities between legacy Ecolab and Nalco. Nalco's water applications already service hotels, hospitals, commercial buildings and food and beverage customers. This customer overlap should enable Ecolab to further "Circle the Customer" by selling new products and services to established Nalco customers and vice versa.

Ecolab has struggled in Europe for years and has gone through many reorganizations and cost cutting efforts. The investment has begun to pay off with improved operating results. The company has streamlined operations by implementing one operating system to replace 15 and reducing the number of products. Ecolab also retrained its entire sales staff in Europe to focus on deeper product knowledge and incentives for cross-selling opportunities. These changes have resulted in better revenue growth and higher profitability.

Based on its business attributes as a whole, we have assumed Ecolab can grow revenue at an average annual rate of approximately 4% over the next decade. Given the consolidation of the Nalco and Champion businesses and expectations of improved European profitability, we believe cash flow margins will average just below 21% during our forecast period. Using these assumptions, our stock valuation model based on Ecolab's current stock price offers a long-term annual rate of return of approximately 5%.

Canon Inc. { CAJ }

Canon is a Japanese-domiciled worldwide developer, manufacturer and marketer of cameras, printers, copiers and semiconductor equipment. The firm also generates reliable, high margin revenue through printer supplies and service contracts whenever a Canon system is installed. The brand is noted throughout the world for quality and dependability. Canon derives about 80% of its sales outside of Japan and is one of corporate Japan's biggest beneficiaries of a weak yen.

Due to significant exposure to technologically mature products, camera disruption and lower paper and printing demand, we believe the company will experience flat top line growth over the long term.

Canon and Nikon dominate the high-end camera market, especially in single-lens reflex (SLR) cameras. SLR cameras and interchangeable lenses involve expertise that is hard to replicate, making entry barriers high. The technology and brand value of these top two companies limit the competition in upper-end markets. The success of Canon's camera segment is largely driven by its professional grade digital single-lens reflex (DSLR) camera. This product line has a captive customer base as users invest in interchangeable lenses only compatible with Canon cameras. Once a buyer picks a brand, he or she is more likely to drive incremental revenue by acquiring multiple lenses. The lenses often cost more than the camera body.

At the other end of the spectrum, competition in the middle and low end is intense. Revenue and profitability for "point and shoot" cameras have declined for several years. The threat to Canon's lower end camera business isn't coming so much from direct competitors as much as from a broad change in the way people take and share photos. Not only is the image quality of smartphones and tablets improving, these devices are very convenient in sharing photos on various social media platforms.

Canon's greatest strength is the efficiency of its operations. Canon has been improving its production efficiency through increased automation. Canon's automated manufacturing has reduced compensation expense and allowed the company to lower logistics costs by placing factories in high wage markets.

Canon supplies laser printers to Hewlett Packard on an original equipment manufacturer (OEM) basis. This relationship spans more than 25 years. The company's core advantage in printers is its large volume and automated production of laser beam printer engines for Hewlett Packard, which handles most of the marketing and branding. The scale of this production gives Canon a significant cost advantage and allows it to earn a premium return even after volume pricing to HP. However, Canon also faces increased competition from Korean manufacturers as well as reduced demand for high margin printer ink. More people are sharing documents and photos via email and social networks.

Due to significant exposure to technologically mature products, camera disruption and lower paper and printing demand, we believe the company will experience flat top line growth over the long term. The company can continue to earn premium cash flow margins due to its low cost production, but we believe competitive pressures will reduce profit margins over time.

During the quarter, Canon's market price exceeded our long-term estimate of its fair value. Given its growth and margin profile, technological product maturity and the competitive nature of the industry, we believe the stock price now fully reflects the company's long-term value. Consequently, we elected to sell our Canon position in client portfolios in October.

Dated: December 13, 2016

Specific securities were included for illustrative purposes based upon a summary of our review during the most recent quarter. Individual portfolios will vary in their holdings over time in relation to others. Information on other individual holdings is available upon request. The information contained herein has been obtained from sources believed to be reliable but cannot be guaranteed for accuracy. The opinions expressed are subject to change from time to time and do not constitute a recommendation to purchase or sell any security nor to engage in any particular investment strategy. Any projections are hypothetical in nature, do not reflect actual investment results and are not a guarantee of future results and are based upon certain assumptions subject to change as well as market conditions. Actual results may also vary to a material degree due to external factors beyond the scope and control of the projections and assumptions.