First Quarter Letter 2014

PERSPECTIVE

Should a company issue or increase dividends or buyback stock? Should a company build a new plant to increase capacity, make an acquisition or pay down debt? These are some of the capital allocation dilemmas facing executives of today's publicly traded companies. Higher quality companies not only achieve success through generating net income but also by properly allocating capital in a way that is most beneficial to shareholders. Increased regulation across a number of sectors and continued uncertainty about the economy have required a more informed and efficient use of capital. At Delta, we are assessing continually how management allocates capital and financial resources, especially given that cash on the balance sheets of U.S. public companies is near an all-time high. Management's ability to effectively allocate that cash is one of its most important responsibilities and is one of the primary determinants of value.

Generally, early in a company's lifecycle, the greater its growth from existing products and services, the greater the likelihood that the company will allocate cash flows to capital expenditures and research and development (R&D) to increase capacity and / or increase its product differentiation. Later in its lifecycle, these opportunities may diminish, and a company can return some of its capital to shareholders in the form of stock buybacks and dividends. Management's increasing a dividend can indicate confidence in continued profitability and performance. A buyback can telegraph management's assessment that the stock is undervalued relative to its market price. This move will increase the percentage ownership of all the other shareholders and is generally seen as a positive signal that the management believes in the future of the company.

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Collectively, over the past year, companies in Delta's model portfolio invested $63.3 billion dollars in capital expenditures and spent approximately 4.8% of sales in R&D (of those that reported R&D separately). Our group of companies also paid out $52 billion in dividends and bought back over $51 billion in stock. It is worthwhile noting that these values have increased markedly over the past five years and reflect the shareholder value that these companies have generated.

At Delta, we look for companies that dispense with a myopic view of near-term earnings management and instead focus on making long-term, value-enhancing investments and returning cash to shareholders when appropriate. We evaluate our management teams' ability

to have the strategic flexibility to change course as new information is gleaned about the competitive environment and not be bound by a fixed budgeting cycle or aversion to change.

Investors tend to overemphasize the short-term, especially recent earnings information and earnings guidance, both positive and negative. If a company is making sound investment decisions and has a strong competitive position, Delta will look for opportunities to initiate or add to existing positions during emotive price pullbacks. How a company allocates its hard-earned cash flows is a critical determinant of value creation. It is the reason why we spend a considerable amount of time on monitoring and analyzing capital allocation decisions.

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.

Honeywell

Honeywell International Inc. { HON }

Honeywell, one the world's largest industrial and manufacturing conglomerates, is organized into four diverse segments: Aerospace, Automation and Control Systems, Transportation and Specialty Materials. The broad range of products enables the company to offset risk in any market or region with strength in another. More than 40% of its products are manufactured overseas, and approximately 55% of sales are outside the U.S. Honeywell's main themes are energy efficiency, power generation and industrial safety.

Much of the positive shift in Honeywell's fortunes can be attributed to its CEO. David Cote arrived in 2002 while the company was struggling with two conflicting cultures as a result of the merger with Allied Signal. The company also was dealing with a highly-cyclical and commoditized product portfolio. As the new CEO, Cote quickly meshed the cultures and shifted Honeywell's portfolio toward technologically sophisticated offerings with bigger competitive moats and higher margins. The company focused on core growth themes of energy conservation, power generation and industrial safety. In the subsequent decade, Cote diligently transformed Honeywell, making 70 acquisitions and jettisoning 40 slower growing, cyclical businesses.

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Honeywell allocates a high percentage of cash resources to R&D spending. R&D spending is 4.9% of revenues (roughly twice the industry peer average) and is targeted at high growth areas to enhance product attributes and differentiation. Turbochargers represent one of Honeywell's

technologically sophisticated growth offerings. Currently, only 5% of gasoline engines in the U.S. are turbocharged, compared to more than 50% in Europe. It is estimated that tighter emission regulations and higher gasoline prices will drive double-digit growth for turbochargers in the years to come. Honeywell is one of only a handful of companies that have deep experience and scale in mass producing high output turbochargers. They form the bulk of Honeywell's Transportation Systems Division, which last year experienced 16% year-over-year revenue growth and 37% operating profit growth.

Honeywell has been a very cautious buyer of new businesses. It focuses on small, easy to integrate small businesses that have the potential to deliver immediate and significant cost savings.

In addition to new product offerings, Honeywell has become a much more efficient manufacturer over the past 10 years. A number of operating initiatives (Six Sigma, Honeywell Operating System, Functional Transformation, etc.) implemented since 2003 have pushed the company's key operating metrics toward the upper end of the peer group. The rewards have been transformative. Since 2002, Honeywell has increased sales by 72% while increasing headcount just 21%. By keeping costs like labor relatively flat, the company generates operating leverage that magnifies returns.

Honeywell has been a very cautious buyer of new businesses. It focuses on small, easy to integrate small businesses that have the potential to deliver immediate and significant cost savings. Every acquisition must meet a highly specific checklist with an emphasis on integrating the business. On average, Honeywell has paid around 12x earnings for 70 acquired companies and tripled profits.

Based on the financial characteristics outlined, we have assumed that Honeywell can grow its revenue at an average annual rate of more than 3% over the next decade. At this pace of growth and given improved operating efficiency, we believe cash flow margins can average nearly 17% during this period. Accordingly, our stock valuation model indicates a long-term annual rate of return of approximately 8%.

Baxter

Baxter International { BAX }

Baxter is a global biotech and medical supply manufacturer and distributor focused on the treatment of chronic diseases. The company's products treat blood disorders (hemophilia) and immune deficiency disorders as well as provide medication delivery products and treatments for late-stage kidney disease. Baxter operates a diversified healthcare model with a broad portfolio of products that treat life-threatening conditions. These treatments are largely non-discretionary, providing ongoing demand.

The BioScience division, which generates 60% of the company profits, is the company's fastest growing and most profitable business. Baxter is currently the market leader in the manufacture and distribution of blood plasma-based proteins and recombinant factors (non-plasma proteins) used to treat hemophilia, immune deficiency disorders and other acute blood-related conditions. The complex and capital intensive nature of the business has reduced Baxter's competitors to a few global manufacturers; however, in the recombinant market, there is impending competition.

Baxter maintains large global market shares in mature but stable products, such as IV-administered therapies and nutritional solutions.

The recombinant market is heading into a period of significant disruption as several competitors intend to introduce longer-acting products. Baxter is countering by introducing its own long-acting therapy, extending overseas supply contracts and stressing the safety record of existing products.

Baxter's medical delivery and dialysis businesses consist of a diversified mix of both basic and innovative products. The company maintains large global market shares in mature, but stable products, such as IV-administered therapies and nutritional solutions. Baxter offers the broadest selection of pre-mixed drugs in the industry and continues to expand revenue from innovative drugs, such as inhaled anesthesia.

Baxter places a significant emphasis on its R&D program to drive innovation. R&D spending is close to $1 billion annually, or 7% of sales. The company currently has 18 products in its pipeline, the largest at any time in its history.

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The new U.S. healthcare law will impact Baxter. The company will face lower Medicaid reimbursements and new taxes on its pharmaceutical and medical supply products. Efforts toward cost containment in the healthcare industry ultimately will exert pricing pressure on Baxter's products. Healthcare cost containment is a global issue, particularly in developed markets such as Europe and North America.

We believe Baxter can generate long-term revenue growth in the 3-4% range with cash flow margins over 25%. Based on these assumptions, our valuation model indicates Baxter's current stock price offers a long-term average annualized rate of return approaching 8%.

Wal-Mart Stores, Inc. { WMT }

Wal-Mart began as a single store in Rogers, Arkansas, in 1962. Today, Wal-Mart operates more than 10,700 stores under 60 different brands in 27 countries. There are 2.2 million employees who serve 200 million customers a week. With over $470 billion in sales, the retailer possesses tremendous scale and leverage to extract the most favorable terms possible from suppliers and

vendors. Wal-Mart pioneered the hub-and-spoke distribution network, which uses warehouses to service stores less than a day's truck drive away so it could remove the middlemen, quickly replenish shelves and reduce costs.

The retail environment is rapidly changing and competitive advantages are hard to come by. Amazon created a distribution channel in general merchandise with a direct-to-consumer model. Another competitor, Costco, derives nearly all of its profits from membership fees, so it sells food at essentially break-even. "Dollar" stores have proliferated with convenient accessibility and improved product offerings. Squeezed by higher gasoline prices, consumers are forgoing longer drives to big-box stores far from their neighborhoods.

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Wal-Mart's initial response to these secular changes has been slow and tepid. Only recently have they initiated or increased their competitive response in a number of areas. Wal-Mart plans on spending approximately $430 million this year on e-commerce investments, including a logistics system tailored for Web orders. Wal-Mart is building a pair of dedicated fulfillment centers to handle Internet orders and speed up shipments. In 2013, Web orders came in at $10 billion, a 30% increase over the prior year.

Even though Wal-Mart's small store concepts have been around since 1998, they have been in perpetual test mode ever since. This year, however, the company intends to open 270-300 small format stores, with half representing the 40,000 square foot format and half representing the 20,000 square foot format. Wal-Mart is targeting the 15 largest metro markets and less populated rural locations for its Wal-Mart Express stores.

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International stores remain Wal-Mart's growth engine. The company's strategy is centered on increasing penetration in its existing markets and entering new, emerging markets. Wal-Mart executes this strategy by acquiring local retail chains and then improving operating efficiency to reduce pricing and drive sales volumes. The International division's limited scale in each country results in less efficiency with lower profitability than its U.S. operations. Operating internationally can be more challenging than domestically, as the company adjusts to different cultures, laws and varying degrees of economic development; however, we believe strategic international expansion remains a growth opportunity for Wal-Mart.

Overall, we expect Wal-Mart's growth to moderate due to the large size of its store base, its full penetration of the domestic market and the changing competitive environment. We expect Wal-Mart's improved distribution and better inventory management to generate average cash flow margins of over 7%. Based on these and other assumptions, our stock valuation model indicates Wal-Mart's current stock price offers a long-term average annual rate of return of approximately 8%.

Comcast Corporation { CMCSK }

Comcast is the nation's largest cable provider offering a range of information, entertainment and communication services to residential and commercial customers. The cable segment's network is complete with video, high speed Internet and voice services that can be accessed by more than 54 million homes and businesses in 39 states representing more than 40% of all U.S. households. The company's NBC Universal business is a leading entertainment and media company that develops, produces and distributes news, sports and entertainment for global audiences.

The cable segment is mature with subscriptions for video and high speed Internet access slowing. With the cable footprint essentially built, capital expenditures have fallen and cash flows have increased. New competitive forces are emerging with Netflix, Amazon, Google and other technology companies offering online and mobile platforms to watch video. Comcast leads the cable industry in innovations and has aggressively responded to these new entrants by launching its own online offerings, Streampix and X1. Another important Comcast defense is its industry-leading Internet speeds. With the growth of online and mobile video, data usage-based pricing could become another driver of Comcast's revenue growth in the future, especially as data usage increases exponentially.

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In 2013, the company completed the full acquisition of NBC Universal (NBCU). The NBCU segment has several popular cable channels, such as USA Network, CNBC, Golf Channel, E! and Bravo. Comcast believes it can transform the entertainment unit into a compelling multi-media juggernaut with the parent company's ample capital, scale and digital know-how. Its central focus will be sports. The NBC Sports group has a new $100 million production facility. With investments in the Olympics and NFL Football, it is betting it can boost fees and advertising. Sports are "must-see" live events. Comcast is using sports to promote its interactive services, such as TV Everywhere, so customers never have to miss any action and to help prevent cord cutting – that is, sourcing their TV programming elsewhere.

Comcast has many positive attributes, including recurring and predictable cash flows, and competitive advantages, such as substantial scale and a fully built-out network. The significant capital investment needed for a new entrant to build a competing network serves as a barrier to entry and limits the ability to compete on price. With its network complete, Comcast can add new subscribers with only modest additional costs while increasing overall return on investment and efficiency.

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Comcast has a number of good responses to the various competitive threats it faces; however, we believe it is prudent to expect modest revenue growth and a gradual reduction in operating margins over our forecast horizon. Our stock valuation model estimates a long-term annual return for Comcast of approximately 9.5% based on its current stock price.

LEGG MASON
GLOBAL ASSET MANAGEMENT

Legg Mason, Inc. { LM }

Based in Baltimore, Legg Mason is the parent company to several highly regarded asset management firms. Its brands include Western Asset Management, one of the largest institutional fixed income firms with an international presence. Legg also owns Royce Funds, which is particularly well-known for its value approach to investing. Legg's Permal is one of the oldest and largest fund of hedge funds. Its corporate structure gives the parent company responsibility for back office, marketing and distribution, allowing the investment affiliates to focus on investment performance and growing client relationships.

The asset management business was severely affected by the recent financial crisis, and Legg was no exception. Western Asset, Legg's largest affiliate, had several challenges, including an overexposure to mortgage-backed securities and debt issued by financial companies. Western fell out of favor with bond investors in search of safety due to its low exposure to Treasury bonds. These and other missteps led to underperformance and fund outflows. Despite better performance and a lengthy bull market in both stocks and bonds, Legg's assets under management (AUM) have not meaningfully improved, unlike many other asset managers. We believe the company's reputation was damaged during the financial crisis. Institutional clients lost are hard to win back.

Recent performance has markedly improved as 80% of assets under management have beaten their respective benchmarks on a three-year basis, which is the best three-year performance for Legg's affiliates since the beginning of the financial crisis. Western Asset added risk management professionals and quantitative tools. The firm is more vigilant in dialing down risk at the first signs of market trouble. Western is positioned to do better when riskier assets do well. As pensions and other institutions desire more yield, Western is well-positioned with specialized higher yield products.

Legg has been proactive in meeting the challenges at the corporate level. Its recent actions to lower costs by moving operational and support functions to the affiliates have resulted in $140 million of annual savings. These actions also will make it easier for the company to sell individual affiliates if Legg determines these affiliates are worth more as independents.

Legg still faces several challenges, including the reputational damage previously mentioned. With 70% of its AUM in fixed income and cash management products, Legg faces a high level of interest rate risk. After a few decades of gradually decreasing interest rates (with Federal Reserve help in recent years), they have reached historic lows. In addition, the most favored investment vehicles today are index- based exchange-traded funds (ETFs). This shift has placed active mutual fund managers at a relative disadvantage.

During the quarter, Legg's market price exceeded our long-term estimate of its fair value. Following its poor performance during the financial crisis, Legg's stock price has performed well recently, up nearly 70% in 2013. Nevertheless, given our concerns about its reputational damage, elevated interest rate exposure 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 Legg Mason position in client portfolios in early February.

Spectra Energy Corp { SE }

Spectra Energy is a leading natural gas infrastructure company operating in the United States and Canada. The company provides transportation and storage of natural gas to customers in the northeast U.S. and Canada. Spectra also has an extensive pipeline system in western Canada and a natural gas distribution utility in Ontario. Spectra has an 84% limited partner stake and a 100% general partner interest in its master limited partnership (MLP), Spectra Energy Partners (SEP). In addition, Spectra owns a 50% interest in a large natural gas field services company in partnership with Phillips 66.

Price competition is limited for the regulated pipelines and will continue to be as long as growth in natural gas demand remains robust.

Spectra's regulated natural gas pipeline operations are relatively stable and produce approximately 80% of Spectra's cash flow. Field services produce the remaining 20%, which is more volatile than the regulated operations due to the impact of natural gas pricing. Price competition is limited for the regulated pipelines and will continue to be as long as growth in natural gas demand remains robust. Regulation of Spectra's pipelines in the U.S. and Canada is primarily at the federal level versus the often heavy-handed state authorities. Federal regulatory agencies have not historically interfered in pricing decisions, which are determined by individual long-term contracts.

The natural gas industry has changed dramatically in recent years due to significant supply increases from underground shale rock formations. With the addition of new, more economic drilling techniques, such as horizontal drilling and hydraulic fracturing of shale rock, natural gas has become an abundant and relatively inexpensive energy resource. Since natural gas is relatively clean-burning, it also has positive environmental characteristics.

Demand for low cost natural gas and natural gas liquids (NGL) is growing relative to other major energy sources, including coal and fuel oil. The excess supply-driven demand has been a boon for infrastructure companies as the nation's infrastructure is currently inadequate. Growth opportunities for Spectra, both near-term and long-term, include conversion of coal-fired power plants to natural gas, natural gas based electricity by industrial/manufacturing companies, shale infrastructure build-out, new liquids pipelines and potential liquefied natural gas (LNG) export facilities.

Spectra's pipeline systems extend from virtually every major natural gas producing basin and shale formation to some of the highest growth distribution regions in the United States. For the next few years, the company has a stream of projects amounting to at least $2 billion of growth capital spending per year, supported by contracted supply and customer agreements. Beyond that, Spectra's management believes that a similar level of capital investment for expansion projects will be needed. These projects are expected to deliver an 8% to 10% pretax cash return on equity for the life of the contracts. This incremental expansion of Spectra's asset base will increase its profitability and cash flow. Spectra recently sold all its transmission pipelines and storage facilities to SEP (84% owned by Spectra) to help free up capital and raise cash to fund its deep set of project opportunities.

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Spectra's ability to effectively execute on its capital expansion projects is critical. The growth in shale gas production and resulting infrastructure build-out has led to increased competition in bidding for projects, rising construction costs and skilled labor shortages, which has resulted in a slightly lower expected return on invested capital versus earlier projects. The environmental impact from the production of shale gas is under tight scrutiny from federal, state and local authorities. Tougher environmental laws and regulations may delay projects, increase construction costs and reduce profitability on new infrastructure projects.

We believe Spectra should be able to grow annual revenues at approximately 4% long-term, while averaging a 5.5% return on invested capital. Spectra's balance sheet contains a fair amount of debt, which reflects the capital intensity of the pipeline business. Based on our growth and return assumptions, our model indicates that Spectra's current share price offers a long-term annual return of approximately 7%.

Emerson { EMR }

Emerson, formed in 1890, has grown from a regional manufacturer of electric motors and fans into a diversified global technology company with operations in over 30 countries. The company operates in a wide variety of businesses, including diagnostic controls and measurement products for industrial processes, data network power, manufacturing automation and climate technologies. Headquartered in St. Louis, Missouri, Emerson has more than 235 manufacturing locations worldwide with 55% of sales outside North America.

Although Emerson generated over $24 billion in global sales in 2013, it has the flexibility of a smaller, more nimble player due to its regional operating structure. Emerson innovates, engineers, sources, manufactures and sells within each region of the world. What is made in Asia is sold in Asia, what is made in Europe is sold in Europe and what is made in the U.S. is

sold in the U.S. Sales in emerging markets account for 37% of the total sales. Emerson's overall strategy is to provide differentiated products with leading technology, volume leverage and pricing, which results in higher profit margins than competitors and most industrial companies.

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The company positioned itself in a number of secular growth sectors early, building a lead in reputation, distribution and innovation. An example is cooling and uninterrupted power supply products for data centers. With the advent of virtualization software and cloud networking, data centers need large amounts of power and equipment to cool the servers. Emerson has one of the most comprehensive data center product offerings. Its products range from power to cooling and provide a solution for almost every aspect of the data center. Though global IT spending is currently weak, we believe this state to be a relatively short-term trend.

In process management (43% of total company profitability), Emerson offers leading technology and a complete system solution that allows the company to earn profit margins comfortably above peer levels. Customers from various industries, including power, oil and gas, chemical, and pharmaceuticals, pay a premium for Emerson's complete front-to-back automation solutions. Although others have subsequently developed competitive products, Emerson's strategy is to develop a unique technology, implement it at the beginning of the cycle, establish a lead and expand market share. This strategy developed a significant global installed base that requires software updates every few years.

Emerson's next phase of growth will involve a broader push into higher margin solutions and services sales, somewhat similar to IBM's transformation over the past 20 years. Its strategy is to move from being a high quality supplier of engineered products and components to collaborating with customers to better understand their operations and what they value. This information is valuable for Emerson as it leads to innovative technology. The company is increasing its engineering and development spending by 6% per year to $1 billion, or 3.5% of overall sales. In addition, Emerson is adding 3,000 employees in sales, marketing, customer service and project management globally to enhance its relationship with customers, support product development and increase market penetration.

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Emerson is still a cyclical company and faces challenges and risks within its portfolio of businesses. The company's network power segment has been in a challenging operating environment with cutbacks in key end markets and increasing competition. Telecom and IT

customers have cut back on investment spending, and the sector has experienced higher manufacturing and labor costs, particularly in China. Additional risks include falling oil prices and a sharp decline in developing markets. Growth in process management is dependent on oil and gas production, and Emerson generates 37% (and growing) of its overall revenue in developing markets.

We believe the company's extensive installed base and long-term customer relationships should provide support for its stated transition to a services and solutions strategy. We expect Emerson will grow revenues 3% on average with cash flow margins of 17% over our 10-year modeling period. Based on these assumptions, our stock valuation model indicates Emerson's current stock price offers an average annual long-term rate of return of 8%.

Dated: March 31, 2014

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.