Fourth Quarter Letter 2013

PERSPECTIVE

What a difference a quarter makes. Over the summer, there were fears that the Fed would taper its stimulus program in the autumn and, in response, the financial markets turned volatile. A lackluster economy and policy turmoil in Washington persuaded the Fed to delay cuts to its stimulus program. For the past several years, one of the main drivers of the stock market has been the Federal Reserve's willingness to provide various forms of financial boosts. The current program, Quantitative Easing IV, is comprised of $85 billion a month in bond purchases. In mid-December, the Fed finally announced a small reduction in monthly bond purchases to $75 billion a month. Most pundits believe incoming Fed Chairwoman, Janet Yellen, will allow the pace of bond purchases to continue. With inflation low and economic indicators uncertain, the expectation is that the Fed could extend the stimulus, which in the market's eyes makes riskier investments, such as stocks, more attractive.

The accommodative Fed policy has been fuel for the markets. At the end of December, the Dow Jones Industrial Average total return was up 29.6% for the year, while the S&P 500 index was up more than 32%. At some juncture, the Fed will end its stimulus program to pre-empt inflation. Some believe increased volatility will occur whenever significant stimulus cuts come, particularly if the economy is still in the early stages of a recovery. Others feel that such cuts will be well telegraphed and would occur only when Ms. Yellen is established in her new role and the economy is strong enough to grow independently of Fed action.

How does this market speculation and the current level of market valuation affect Delta's portfolio decisions? We do not pursue a market-timing strategy, nor are we a macroeconomic-driven firm. We are a bottom-up value firm and make our investment decisions based on the current price of a company's stock relative to what we believe the long-term value of the company to be. Attempting to predict the nuances of the economy and how the markets will perceive data and policy are beyond the scope of even some of the best minds in finance. Our goal is to focus on assembling a collection of high quality, strong cash flow companies with managements whose interests are aligned with shareholders. We look for companies with strong competitive positions and sustainable advantages over their peers. Using a broad array of information, we create a long-term free cash flow model for every company we invest in to arrive at an estimate of the company's value per share. We make our buy and sell decisions based on this value relative to the current stock price.

We view opportunity at both ends of the valuation spectrum. If market prices exceed our estimated long-term intrinsic value, we will begin to sell or scale out of our positions over time. If market prices fall appreciably below our intrinsic value, we will add to our existing positions or add new positions to our portfolio. Investors tend to overemphasize the short term, even to the point of focusing on opaque signals and esoteric hints from the Fed. In so doing, sometimes the psychology of the market ignores very valuable, long-term information, which opportunistically we find important to our investment process.

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.

Wells Fargo & Company { WFC }

Wells Fargo is the world's largest bank by market capitalization and the second largest U.S. bank by deposits. Wells is a combination of four super regional banks: Wells, Norwest, Wachovia and First Union. While each merger added to the bank's footprint across the country, the bank has been able to maintain a strong corporate character and culture, thanks in large part to the stewardship of longtime CEO Dick Kovacevich who was replaced by John Stumpf in 2007.

Based in San Francisco, the bank is largely a conventional lender and is known for cross selling multiple products through its extensive branch system. The idea of cross selling is to expand the relationship from simply opening a checking account to financing auto loans, and providing wealth management services and retirement planning from the bank. The average Wells client household now utilizes six products from the bank, up from just one or two in the 1980s.

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The banking industry is generally commodity-oriented with little product differentiation and modest growth prospects. Banks experience definite, but unpredictable, business cycles determined by the changing credit environment. Wells stands out because of its strong sales culture combined with stringent risk management. An additional strength is the diversification of revenue. Wells' revenue remains almost evenly split between net interest and fee income.

Wells Fargo's acquisition of Wachovia in 2008 doubled its branch count and gave Wells exposure to the eastern half of the country. A Wells branch or ATM is now within two miles of half of America's homes and half of its businesses. The Wachovia acquisition also gave Wells the third largest network of stockbrokers in America, trailing only Merrill Lynch and Morgan Stanley.

Wells boasts strong market-share positions in many of the largest, fastest-growing and wealthiest markets in the country. The forecasted five-year population and income-growth rates for its markets are more than 4% and 18%, respectively, compared with national averages of 3.4% and 14.6%. We believe these characteristics should help Wells grow organically faster than the banking industry on average.

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Wells has become the dominant U.S. mortgage lender. It originates over a quarter of all home loans issued nationwide and generates roughly half of its mortgage volume in its retail branches. Direct retail origination provides higher profit margins, and the credit quality tends to be better. The big question now for Wells and other mortgage lenders is what will happen when the refinancing boom wanes. The bank has reduced expenses recently by cutting at least 20% of the back office staff who process mortgage applications.

Wells is likely to experience some net interest margin pressure for the next few years, due largely to the fact that its relatively high loan and securities portfolio yields will roll over to lower rates. There is also the possibility of higher funding costs going forward. Although an aggressive regulatory environment will add to costs, it will also create additional barriers to entry.

Global regulators are working to finalize new, more stringent capital requirements for banks. We have assumed the higher level of expectations so far announced will be the required norm. Based on our assumptions, our financial model indicates that at the present stock price, Wells Fargo's stock offers a potential long-term annual return of greater than 7.5%.

ECOLAB®

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, Minnesota. The company dwarfs its rivals in this highly fragmented market. It is estimated that Ecolab has a 14% global market share.

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Ecolab's extensive and highly trained sales force has been a key contributor to strengthening and growing its leadership position in the industry. 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 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.

In 2011, Ecolab significantly changed its business with the acquisition of Nalco, a leading global water technology company. Nalco 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. It serves global industries, such as food and beverage, manufacturing, pulp and paper production, mining and energy.

The increased demand for energy has created significant growth opportunities for Nalco. Many of the new energy sources, such as deep water, shale and oil sand, require more technology and water treatment solutions. Global Energy has become Nalco's fastest growing segment. In addition, Nalco has a number of technologies for the difficult-to-reach reserves. From the reservoir to the refinery, the company's chemical solutions segment touches almost every part of the oil and gas value chain.

Management believes there are 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.

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Ecolab has struggled in Europe for years. Reorganizations and cost-cutting efforts have begun to pay off with improved operating results. The company has streamlined operations by replacing fifteen operating systems with one and by reducing the number of product offerings. Ecolab also retrained its entire sales staff in Europe to focus on deeper product knowledge and occasions for cross-sell opportunities.

Based on its business attributes as a whole, we estimate Ecolab can grow revenue at an average annual rate of approximately 6.5% over the next decade. Given the consolidation of the Nalco business and expectations of moderately improved European profitability, we believe cash flow margins will average just below 18% 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 5.5%.

The Walt Disney Company { DIS }

The Walt Disney Company is a global, diversified entertainment company with operations spanning theme parks, broadcast and cable television, movie production and consumer products. The company owns some of the world's most valuable media brands, including Disney, ESPN, ABC, Pixar, Marvel and Lucasfilm (Star Wars). Disney's broad media and entertainment reach provides diversified distribution channels for the company's creative content. The management team, headed by Roger Iger, has proven adept at using this reach to create value for its brands by generating revenue and profits from multiple consumer outlets.

Disney's core strategy is to further develop characters and storylines by spinning them into multiple and enduring products. In addition to revered legacy brands, such as Mickey Mouse and Disney Princesses, the company has many new flourishing franchises, ranging from *CARS* and *Toy Story* to the Marvel characters, such as the Avengers. Disney showcases these brands through multiple platforms of the company, from films to theme park rides to DVDs and video games to toys and other consumer products. Based on merchandise and consumer sales, Disney estimates that it owns five of the top six character franchises.

Disney's competitive position is strongest in its theme parks and media offerings (cable channels), which generate the majority of the company's profitability. Disney's majority-owned ESPN networks are the dominant sports broadcasters in the U.S. Benefitting from the dual revenue stream of cable company surcharges and advertising, ESPN has grown to include ESPN2, ESPN News, ESPNU, ESPN Classic, ESPN Deportes, ESPNRadio, ESPN.com, and a $100 million ESPN theme park in Florida. ESPNRadio is the largest radio network in America, and ESPN.com clocks more than 50 million visitors a month.

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Sports are Disney's major content edge. As consumer-viewing options (Internet and mobile media) grow and become more fragmented and as viewing preferences change, "must see" live sports provide ESPN with a significant advantage over its traditional cable distributors and advertisers. ESPN networks monetize this advantage with the highest cable affiliate fees in the industry. These recurring, high-margin cable affiliate fees provide revenue and profit stability in most economic backdrops. In addition, sports programming is the most valuable advertising inventory on television, which helps cushion advertising volatility.

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Disney's theme parks and cruise lines contribute approximately 20% of operating income. In addition to the wholly owned domestic parks, Disneyland and Disney World, the company has partial ownership and management contracts to operate several international parks, including France, Hong Kong and Tokyo. Disney is nearing the end of a major expansion phase, which included adding new cruise ships and expanding existing theme parks and will culminate with the opening of a new Disney park and resort in Shanghai. Disney theme parks are unique in nature and continue to be popular destinations for families. Though economic cycles persist, there is sustainable demand for Disney's theme park experience which lacks a competitive substitute.

Disney does face long-term challenges. The cost of sports programming rights continues to rise sharply, and ESPN pays handsomely to acquire major sports contracts. ESPN has been able to defray some of these costs by charging ever increasing affiliate fees to cable operators. With such high fees, angst is growing among viewers, cable operators and program competitors. If

ESPN cannot continue to pass along sports rights' costs to cable operators, its profit margins will erode; however, profit erosion would be gradual due to ESPN's long-term contracts with both major sports leagues and cable operators. The high value of sports also has created additional competition for ESPN. All major broadcasters, such as FOX and NBC, and the major sports leagues themselves have increased their investments in sports programming. More competition for viewers is likely to drive up the overall operating costs to broadcast sporting events.

Disney's proven ability to develop entertainment icons with increased consumer opportunities from merchandising royalties, positive cable pricing and theme park expansion internationally should allow the company to continue its good revenue growth with solid operating profit margins. Our valuation model suggests that the company's stock is priced to generate a long-term average annual rate of return of 7%.

LOWE'S

Lowe's Companies, Inc. { LOW }

Lowe's is a leading home improvement retailer with more than 1,700 stores located primarily in the United States. The company's stores offer a wide selection of home improvement products and services aimed at do-it-yourself and do-it-for-me customers, as well as commercial business clients.

Lowe's has proven to be an especially efficient retail operator with a culture built on exceptional customer service. Over many years, the company has developed a highly automated distribution system that links its suppliers, distribution centers and company stores on a single network, driving operating efficiency. Lowe's significant scale combined with its efficient distribution system creates a cost advantage. The company also has been especially proficient at using this cost advantage for maintaining low prices to generate higher sales volumes while producing solid free cash flow.

The U.S. home improvement retail market is mature and has become fully saturated with stores. After years of rapid expansion, Lowe's new store growth has slowed as quality locations have become increasingly limited. To help drive incremental growth and improve profit margins, the company is redoubling efforts to improve in-store execution and operating efficiency. Lowe's is adding customer-facing employees, improving inventory management and significantly shrinking its cost structure. The company also plans to increase its proprietary products and further penetrate the professional market.

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With Lowe's and Home Depot together controlling approximately 40% of industry market share, the retail home improvement industry remains fairly fragmented. Lowe's competitive strengths and new products and services should drive further market share gains from smaller competitors.

The operating environment has been extremely difficult for Lowe's since the beginning of the housing collapse in 2007. After struggling through three years of negative same store sales and lower profit margins, the company's performance has begun to improve. Lowe's transformation efforts, such as increasing its high-turnover inventory and adding customer-facing employees during peak hours, are bearing fruit. Tighter consumer credit availability and a more subdued housing market going forward will make it difficult to reach the level of sales and profit margins achieved during the housing boom; however, we expect Lowe's sales and profit margins to continue to gain strength as the economy recovers.

> **Thus far, competition between Lowe's and Home Depot has been rational, and their increased industry dominance has come mainly at the expense of smaller competitors.**

Rival Home Depot has completed a company-wide revamp that has improved its operating efficiency and customer service. Home Depot's investments in its distribution network and information technology systems target one of Lowe's key competitive advantages. Thus far, competition between the two rivals has been rational, and their increased industry dominance has come mainly at the expense of smaller competitors. Competition between Lowe's and Home Depot could intensify over time as growth and market share gains become increasingly difficult.

Given minimal expected store expansion, we have assumed Lowe's can grow revenues approximately 2% over the next decade. At this pace of growth and given improving in-store execution, we believe average cash flow margins will improve gradually to just above 11% over this period. Based on these assumptions, our stock valuation model indicates Lowe's current stock price offers a long-term average annual rate of return of over 7%.

AVERY DENNISON

Avery Denison Corporation { AVY }

Avery Dennison is the leading manufacturer of pressure-sensitive labeling materials. The company is also a manufacturer of retail apparel ticketing and branding systems, radio frequency identification (RFID) inlays, office products and specialty tapes. Avery is an early-cycle company as its customers have become sensitive to consumer trends. When end-market demand changes, Avery is impacted immediately.

Avery has a significant global presence with approximately 200 manufacturing and distribution facilities in 50 countries and product sales in 89 countries. Nearly 75% of revenue is derived from international markets, including emerging-market exposure.

The company maintains a dominant market share position in its two main businesses: pressure-sensitive materials and retail information services. Avery's specialization, superior product offerings and effective customer services should continue to strengthen its relationships in these businesses. Although both business segments have reached maturity in developed markets, Avery continues to expand its already significant international presence, especially in markets such as Asia and Latin America. As these economies continue to expand, the demand for packaged goods and apparel should also increase.

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Avery's size gives it a narrow competitive advantage. The firm's extensive global distribution network and customer relationships further strengthen its advantages over its competition, particularly with large consumer products manufacturers such as P&G. These relationships can be "sticky" due to the tailored servicing involved. Meeting specific customer specifications and formats increases switching costs.

Pressure-sensitive materials are Avery's most important business segment and contribute nearly 75% of company profits. Avery is more than twice the size of its nearest competitor. Its technical and engineering expertise have led to innovative new products, such as clear film labels and thinner, more flexible labels that conform to oddly-shaped consumer packages and bottles. This proprietary technology is important to consumer products manufacturers for brand awareness and product appeal on the shelf. We expect the company will continue to benefit from the growing shift from glue-applied paper labels to flexible clear film labels on consumer products packaging and bottles.

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Given Avery's concentration in mature markets and its increasing market share in faster-growing emerging markets, we have assumed the company can grow revenue approximately 2.8% annually over the next decade. At this pace, given the company's operating efficiencies, we believe cash flow margins can average close to 9% during this period. Based on these assumptions, our stock valuation model indicates Avery's current stock price offers a long-term average annual rate return of over 7.6%.

BED BATH & BEYOND

Bed Bath & Beyond Inc. { BBBY }

Bed Bath & Beyond is the largest specialty retailer in domestics and home furnishings. Domestics include bedding, bath products and kitchen textiles. In addition to the Bed Bath & Beyond stores, the company owns several smaller retail concepts, including buy, buy Baby, a baby merchandise and accessories store, and the Christmas Tree Shops, a discount variety store with a focus on inexpensive home décor and accessories. Bed Bath recently acquired a chain of 260 World Market stores, which offers home decorating items, furniture and specialty food and beverage items.

Bed Bath & Beyond has proven to be the best retailer in the home furnishings industry. The company has dominated the home furnishings niche by offering an unmatched depth and breadth of products with a relentless focus on the store experience and exceptional customer service. The company also has a unique, decentralized operating culture, which encourages store managers to act as independent owners. Managers make merchandising decisions and tailor the assortments for their specific store, which instills accountability and a strong "promote from within" culture, thereby attracting and retaining talented employees. Merchandise is well laid out with logical placements, making the search for products easy for customers. The in-store presentation is very simple, keeping costs down and allowing for easy reconfiguration as categories expand or contract.

Bed Bath has a unique, decentralized operating culture, which encourages store managers to act as independent owners. Managers make merchandising decisions and tailor the assortments for their specific store.

Bed Bath stores operate almost exclusively in the mature, domestic U.S. market. At year end, it had 1,000 stores in all 50 states, the District of Columbia, Puerto Rico and Canada. New store expansion should moderate as quality locations become increasingly hard to find. The liquidation of weaker competitors has provided additional opportunities for market share gains and expansion into vacated retail space with more favorable lease agreements. Although we expect growth to slow, Bed Bath should continue to generate strong free cash flow and maintain among the highest profit margins in the retail industry.

Bed Bath has acquired or developed several concepts which are currently small contributors to the bottom line but could serve as catalysts for growth in the future. buy, buy Baby stores generally have 20,000 items of merchandise for infants, babies and toddlers in a broad array of categories. Bed Bath's latest acquisition, World Market stores, provides a potential opportunity to grow a new concept as well as cross merchandise between its various store concepts. Cross merchandising between stores helps drive traffic by offering a broad and differentiated product offering.

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Bed Bath faces an array of competition from specialty stores, such as Williams Sonoma and Pier 1; traditional department stores, such as Penny's and Kohl's; and discount chains, such as Target and Walmart. Some of these retailers have increased their focus on home furnishings, but we believe they are not likely to match Bed Bath's full line of product offerings or merchandising. The challenge from online competition is growing with the launch of casa.com, an Amazon subsidiary. The online store has more than 35,000 items for the home with large product overlap to Bed Bath. To combat this threat, Bed Bath is enhancing its website experience and building an e-commerce sales platform, including a new fulfillment / distribution center. The threat of online competition, however, may be exaggerated as many of Bed Bath's products are items that consumers want to see in person in order to match colors and décor.

We believe store expansion and same store sales can grow at an average annual rate of approximately 4%. At this pace of growth and given the increasingly competitive environment, we project the company can maintain its cash flow margins at 15% on average. Based on these assumptions, our stock valuation model indicates the current stock price for Bed Bath & Beyond offers a long-term annual rate of return of approximately 9%.

Dated: December 31, 2013

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.