DELTA ASSET MANAGEMENT, LLC

A WEALTHTRUST Company

Third Quarter Letter 2015

PERSPECTIVE

The Federal Reserve continues to struggle with when to raise interest rates. After months of feeding the market with expectations, the Fed opted to take another pass in raising rates at its September 17 rate policy meeting. Probably influencing its decision, the Fed lowered its GDP forecasts for 2016-2017 and provided a low 2% forecast for real growth for 2018 and beyond. It has been nine years (June 2006) since the Fed last raised its benchmark interest rate. The Fed cited recent “global economic and financial developments” driven in large part by China’s stock market volatility and low inflation for delaying the increase.

Although persistent low interest rates have helped fund large government deficits and large private sector borrowers, it has also hurt lenders, savers and distorted the price of risk. Japan has followed a similar program since its bubble economy burst in the early 1990s and has experienced poor results. The Bank of Japan has maintained near-zero rates since the 90s and bought bonds equal to 70% of its GDP, more than double what the Fed has done. The end result is that after decades of near-zero rates, growth and inflation haven’t budged, and Standard and Poor’s has just downgraded the ratings on Japan’s substantial debt.

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It is hard to see the Fed following Japan’s example long-term in the face of an improving U.S. economy. The U.S. economy grew at an annualized 3.7% pace in the second quarter of 2015. Consumers have been spending again, and firms have been hiring workers. In August, the unemployment rate fell to 5.1%.

It is difficult for the Fed, or anyone for that matter, to accurately assess China’s black box economy. The country’s true growth is a guessing game given the lack of transparency in the statistics. Several bullish factors could swing sentiment on China back into positive territory. The collapse of crude oil prices has decreased manufacturing and transportation costs and boosted consumers’ real incomes. China’s share of global exports has risen from 11.5% in 2011 to 14.2% in June, 2015. GDP growth may be sagging but, even if real growth were only 5%, that represents more economic output than the double digit growth seen in 2007 because the economy is so much larger.

All of this points to the fact that the economic pendulum can swing from positive to negative sentiment and back again fairly quickly. Even the volatility of the past few weeks is well within the long-term norm. Nonetheless, the stock market reacted to the Fed's decision and the continual uncertainty with a sharp sell-off.

At Delta, we believe the best way to withstand market turbulence is to embrace a long-term investment horizon, have a well-diversified portfolio and invest in companies with competitive advantages, strong balance sheets and capable management teams. We try to take advantage of inefficiencies in the market over time, adding or initiating positions when the stock is trading well below our appraised value.

Fixating on fluctuations in the short-term will make it harder to remain focused on long-term investing goals. Perceptions of the economy and predictions of the Fed's actions can be kaleidoscopic with varying scenarios and outcomes depending on the focus of the day. The one thing about which you can be fairly sure is that no one knows what the market will do next. The best approach to this certainty is a long-term focus, diversification and the application of a consistent investment discipline.

September 28, 2015

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 { HON }

Honeywell, one the world's largest industrial and manufacturing conglomerates, is organized into three diverse segments: Aerospace; Automation and Control Systems; and Performance Materials and Technology. The broad range of products enables the company to offset risk in any market or region with strength in another. Over 40% of its products are manufactured overseas, and approximately 55% of sales are outside the U.S. Honeywell's main themes are power generation, energy efficiency 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. In the subsequent decade, Cote diligently transformed Honeywell, making more than 70 acquisitions and jettisoning 40 slower growth, cyclical businesses.

Cote also focused on internal operations by implementing a number of operating initiatives (Six Sigma, Honeywell Operating System, Functional Transformation, etc.). Implemented in 2003, these programs have pushed the company's key operating metrics towards the upper end of the peer group. The rewards have been transformative. Since 2002, Honeywell has increased sales by 80% while limiting increased headcount to just over 20%. The new operating system streamlined manufacturing processes, identified opportunities for purchasing scale and integrated back office systems to yield efficiencies. Honeywell Operating System Gold is the next generation efficiency initiative that should help extract additional operating efficiency, particularly from newly acquired businesses.

Honeywell's R&D spending is 4.7% of revenues (roughly twice the industry peer average) and targets high growth areas to enhance product attributes and differentiation.

Honeywell allocates a high percentage of cash resources to research and development (R&D). R&D spending is 4.7% of revenues (roughly twice the industry peer average) and targets high growth areas to enhance product attributes and differentiation. Turbochargers represent one of Honeywell's technologically sophisticated growth offerings. Currently, approximately 7% 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.

Honeywell announced in July an agreement to acquire the German utility metering company, Elster Group, for approximately $5.2 billion. The deal increases Honeywell's expertise in natural gas combustion, flow control and smart-metering applications for gas, electricity and water. Regulatory support can be a major catalyst for sales, as certain regions mandate smart-meter adoption within specific time frames.

Based on the financial characteristics outlined, we have assumed that Honeywell can grow its revenue at an average annual rate of around 3% over the next decade. At this pace of growth and given improved operating efficiency, we believe return on invested capital can average over 19% during this period. Accordingly, our stock valuation model indicates a long-term annual rate of return of approximately 9%.

Baxter *Baxter International Inc. { BAX }*

On July 1, 2015, Baxter International completed the spin-off of its former BioSciences division, which specializes in the treatment of rare and acute bleeding and immune-deficiency disorders. Baxter retained a 19.5% stake in the new company, Baxalta, and received a $4 billion cash dividend payment from Baxalta to complete the sale. Baxter plans to use the cash proceeds to strengthen its balance sheet.

The "new" Baxter operates two divisions: Renal and Hospital Products. Baxter's Renal business consists of devices that treat chronic kidney failure or end stage renal disease (ESRD). The Hospital Products division manufactures a number of premixed solutions and drugs as well intravenous (IV) administration sets; products sold include IV solutions, pre-filled vials and syringes of injectable drugs, infusion pumps and inhalation anesthetics, among others. Baxter is truly a global company with 60% of sales in international markets with a large footprint in emerging markets at approximately 25% of total revenue.

Baxter is typically a leading competitor in its product lines, often taking the number one or two spot in many markets in which it competes, such as dialysis equipment, parenteral nutrition, biosurgery and anesthetics. Baxter has good manufacturing scale with worldwide distribution capabilities offering depth and breadth of consumable products and systems to treat illnesses, which generate ongoing sustainable demand. The company also maintains sufficient exposure to a variety of oligopolistic markets with fairly high barriers to entry such as switching costs to patients, large up-front capital costs to achieve sufficient scale and stringent regulatory requirements.

The company's Hospital Products division offers mostly mature medical products in fully penetrated developed market hospital settings. Baxter's critical products support reasonably good, long-term demand. The Renal division is expected to drive most of the company's growth due to an aging population and a growing prevalence of risk factors for kidney failure, such as diabetes. Favorable market dynamics such as a rising number of patients, nursing shortages and overcrowded clinics are driving patients toward treatments at home or away from clinics where Baxter has a dominant market share.

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Baxter faces challenges after the spin-off of Baxalta. The major challenge for the company is to rightsize its business and improve its profit margin. The company must improve operating efficiencies and strengthen the portfolio mix through new product launches. Long-term challenges for Baxter will be defending its sizable market shares from competitors and new products as well as maintaining strong quality control measures to prevent costly recalls.

The Affordable Care Act 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 will ultimately exert pricing pressure on Baxter's products. Healthcare cost containment is a global issue, particularly in developed markets such as Europe and North America. On the positive side, a rising number of insured patients could increase demand for Baxter products. In addition, the company has been operating in government controlled healthcare markets for many years due to its international presence. Baxter is very familiar with regulations and procedures used to administer care and control costs.

We believe Baxter can generate long-term revenue growth in the low single-digits with cash flow margins approaching 20%. Based on these assumptions, our valuation model indicates Baxter's current stock price offers a long-term average annualized rate of return of approximately 7%.

Baxalta Baxalta Inc. { BXLT }

Baxalta is a newly formed company recently created in the spin-off from Baxter International. The spin-off of Baxalta was completed on July 1, 2015, creating a $6 billion biopharmaceutical company. Baxalta develops, manufactures and markets a portfolio of differentiated therapies that seek to address unmet medical needs across several disease areas.

The company's strategy is aimed at improving diagnosis, treatment and standards of care across a wide range of bleeding disorders. This approach will be done through current treatment offerings, developing an innovative pipeline, increasing awareness and diagnosis of disease and further penetrating global and emerging markets where treatment of such blood disorders is low.

We believe the barriers to entry have declined. It seems increasingly likely the risks to its recombinant franchise are not temporary but long-term in nature; therefore, we elected to sell our shares in Baxalta.

Baxalta is currently the global market leader in the manufacture and distribution of blood plasma-based proteins and plasma-derivative blood clotters (recombinants) used to treat hemophilia, immune deficiency disorders and other acute blood-related conditions. The company has good manufacturing scale with worldwide distribution capabilities offering niche products to treat chronic illnesses providing recurring, sustainable demand. The complex and capital intensive nature of the business has reduced Baxalta's competitors to just a handful of global manufacturers; however, in the recombinant market, there is impending competition.

Baxalta's hemophilia business is heading into a period of disruption as new companies enter the recombinant treatment market over the next few years. More concerning, current competitors have beaten Baxalta to market with the introduction of longer-acting products, which provide longer dosing intervals and improved patient quality of life. There is a potential doubling of competition from four industry players to eight within three years, together with the overhang of even more disruptive agents making their way to market in the years ahead.

Baxalta is countering by introducing its own long-acting therapy, developing a broader drug pipeline, extending overseas supply contracts and stressing the safety record of existing products. Historically, hemophilia treatment has been a sticky market, one in which patients switched products only after developing inhibitors or other issues with a particular product. Baxalta's long track record of patient efficacy and safety will be an early defense against new product competition.

After the spin-off from Baxter, Baxalta has become a much more concentrated company with 65% of profits coming from its Recombinant Factor VIII franchise with well over 50% of profits concentrated in a single drug. With the recent addition of new competitors and more effective drug treatments, we believe the barriers to entry have declined. It seems increasingly likely the risks to its recombinant franchise are not temporary but long-term in nature. Therefore, we elected to sell our shares in Baxalta received from the Baxter spin-off.

McGRAW HILL FINANCIAL

McGraw Hill Financial { MHFI }

McGraw Hill Financial is a global leader in credit ratings, benchmarks and analytics that provides essential information and data content to the commercial, capital and commodity markets. Its brands include Standard & Poor's, Capital IQ, Dow Jones Indices, S&P Indices, Platts and J.D. Power and Associates. These businesses have a large footprint, good market penetration, are highly scalable, require little capital investment and generate high profit margins and strong free cash flow.

In May 2015, the company completed its second year as McGraw Hill Financial, which marked the conclusion of its reorganization plan. The centerpiece of this plan was the sale of McGraw-Hill Education and divestiture of smaller, non-core businesses. McGraw Hill used the proceeds from the sale to reduce debt and repurchase shares. Along with a new name, McGraw Hill Financial, the company is now singularly focused on business-to-business financial services.

McGraw Hill's businesses have a large global footprint, good market penetration, are highly scalable, require little capital investment and generate high profit margins and strong free cash flow.

Standard and Poor's (S&P) Ratings is one of the three dominant firms that rates securities and assesses credit risk; the other two are Moody's and Fitch. Barriers to entry – such as market acceptance and reputation, scale, world-wide distribution, network effects and complex regulations – are high. Credit ratings are used by investors, issuers, investment banks and governments; they provide the marketplace with a benchmark to help gauge borrowers' credit worthiness. Most bonds that are issued must have at least one rating from a respected Credit Rating Agency (CRA) for the issuance to be successful. S&P and other credit rating firms benefit from a unique market structure that favors an oligopoly. Customers want two or three ratings so as to minimize the time management must spend with analysts, to diversify their risk that one analyst gets it wrong and to lower their financing costs.

CRAs continue to be subject to criticism and lawsuits as a result of missteps made during the credit crisis. In 2014, S&P settled major lawsuits with the Department of Justice (DOJ), several states and California's public employee pension for a total of $1.6 billion. The DOJ suit alone was originally seeking $5 billion. Though McGraw Hill continues to be successful in the courtroom, legal and regulatory uncertainty may continue to be a challenge. The Dodd-Frank law includes a provision that makes it somewhat easier to sue CRAs for securities fraud. The global regulatory framework has become more difficult with greater scrutiny and oversight. Although we anticipate a reduction in margins from additional regulations and constraints, we believe the major CRAs, such as S&P, have the international presence, resources and reputation to remain highly profitable.

Separate from S&P Ratings, the company's S&P Indices and Capital IQ are large and highly profitable businesses with good growth prospects. S&P's Indices provide investors with wellknown market benchmarks, including the Dow Jones Industrial Average and S&P 500. The S&P 500 is the world's most followed stock market index with over $7 trillion in benchmarked assets. Growing investor demand for index-based passive investments has boosted the share of exchange traded funds (ETF) and index mutual funds, increasing the fees paid to McGraw Hill for the use of its benchmarks.

Capital IQ is a leading provider of financial research and analytical tools for asset managers, investment banks, brokers and analysts. The global capital markets have become more integrated, driving increased demand for data and analytics. Capital IQ continues to gain market share as it acquires, develops and integrates additional mission critical content.

Additional data and information brands include Platts and J.D. Power and Associates. These subsidiaries provide energy, marketing, research and information to a broad range of individual and institutional clients. These subscriptions-based recurring revenue models fit well with McGraw Hill's business of providing value-added data and reputational insights.

Though McGraw Hill's businesses are cyclical, we believe its strong position in each of its businesses and completion of its reorganization plan has created a better long-term growth profile. We assume mid-single digit revenue growth with operating margins averaging in the mid-30 percent range over the long-term. Based on these assumptions, our valuation model indicates approximately 8% annualized long-term rate of return given the current stock price.

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, window treatments 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's last acquisition was a chain of 260 World Market stores, which offers home decorating items, furniture and specialty food and beverage items.

Bed Bath & Beyond stores have a unique layout that groups related product lines into separate areas, creating the appearance and feel of a collection of individual specialty stores. The in-store presentation is very simple, keeping costs down and allowing for easy reconfiguration as categories expand or contract.

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. This instills accountability and a strong "promote from within" culture and attracts and retains talented employees. Stores have a unique layout that groups related product lines into separate areas, creating the appearance and feel of a collection of individual specialty stores.

The in-store presentation is very simple, keeping costs down and allowing for easy reconfiguration as categories expand or contract.

The company operates almost exclusively in the mature, domestic U.S. market. At year end, it had 1,513 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 sales growth is slowing, 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. World Market stores provide the potential opportunity to grow a new concept as well as cross merchandise between various store concepts. Cross merchandising between stores helps drive traffic by offering a broad and differentiated product offering.

Recent trends signal increased competition from specialty stores, such as Williams-Sonoma and Pier 1, traditional department stores such as JCPenny and Kohl's, and discount chains like Target and Walmart. An increased competitive and promotional environment is evidenced by a mix shift to lower-margin products, increases in the frequency and size of coupon redemptions and costly free shipping. 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 offers free shipping and has over 100,000 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 the slower pace of growth and the increasingly competitive environment are somewhat mitigated by cross-selling opportunities as well as online and mobile site enhancements, and the increased use of data analytics to fine-tune marketing. With these efforts, we anticipate the company can maintain its return on invested capital at 13% over our forecast period. Based on these assumptions, our stock valuation model indicates Bed Bath's current stock price offers a long-term annual rate of return of approximately 12%.

Spectra Energy Corp. { SE }

Spectra Energy is a leading natural gas infrastructure company operating in the United States and Canada. Based in Houston, the company operates with 22,000 miles of interstate transmission pipelines, along with related infrastructure assets. For many years, Spectra Energy and its predecessor companies have been involved in critical pipelines connecting natural gas supplies to high-volume markets. It delivers 20% of North America's natural gas. Spectra has an 84% limited partner stake and a 100% general partner interest in its master limited partnership (MLP), Spectra Energy Partners, LP (SEP). In addition, Spectra owns a 50% interest in a large natural gas field services company in partnership with Phillips 66.

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 its greater sensitivity to 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 United States 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.

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 natural gas liquids export facilities.

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 NGL 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. Spectra's growth is driven ultimately by the demand for natural gas. Capital expenses this year are expected to be $2.7 billion directed toward expansion of new natural gas supply in western Canada, Appalachia and the southeast U.S. The company has identified approximately $35 billion in expansion opportunities through the end of the decade, which should support above average dividend growth.

Spectra's ability to effectively execute on its capital expansion projects is critical. The growth in shale gas production and subsequent 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 3.5% long-term, while averaging a 5.2% 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 12%.

Dated: September 28, 2015