

# Green and Financial Values

*For certain funds, social and financial returns can be mutually exclusive, but that does not hold true for the Appleseed Fund. Joshua Strauss and his team look for companies that have sustainable earnings, trade significantly below their fair values, and have a low environmental impact. Through a team-oriented approach, the fund scours a limited universe of stocks to find the ones that meet its fundamental, valuation and sustainability criteria.*

## **What are the core beliefs that guide your investment philosophy?**

The Appleseed Fund integrates the disciplines of value investing and socially responsible investing, with each discipline serving to reinforce the other.

Our fund will not invest in companies that derive substantial revenues from the tobacco, alcohol, pornography, gambling or weapons industries. We will also consider a company's performance with respect to its environmental responsibility, labor standards, and recognition of human rights.

We believe that socially responsible companies present less business risk for investors and create opportunities to contribute to a more sustainable society.

## **Could you describe how your investment philosophy translates into an investment strategy?**

Our investment process is focused on a bottom-up fundamental research approach. We are value investors who seek to generate market-beating returns by investing in sustainable, undervalued companies.

Our investment strategy is based on three principles - fundamentals, valuation, and sustainability. In determining investment suitability, my team uses fundamental investing techniques to determine intrinsic value. The fund invests primarily in common stocks, searching for significant discrepancies between its own appraisal of the intrinsic value of a prospective business and the prevailing market price. In an effort to limit downside risk and maximize upside potential, we seek out companies that have strong competitive positions, solid financials, and capable, shareholder-friendly management teams. Lastly, the fund seeks to invest in companies that balance generating profits with an awareness of their impact on the environment and society.

## **Can you illustrate the significance of the term "value" with a few examples?**

We believe the best way to generate strong returns is to pursue only our best ideas, to minimize downside risk, to seek out underappreciated value, and to invest in high-quality companies where we expect value to grow over the long term.



**JOSHUA STRAUSS**

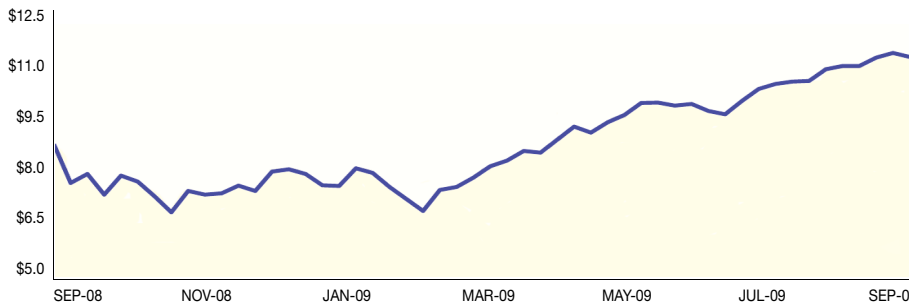
Previous to joining the adviser in 2004, Strauss served in an operational role as Director of Business Development at Color Kinetics Incorporated (2000-2004).

Strauss began his career as an Analyst at Markowitz & McNaughton (1994-1995) and, subsequent to that, at Shearman & Sterling (1995-1998). He earned a B.A. in Foreign Affairs from the University of Virginia in 1994 and an MBA from the Stephen M. Ross School of Business at the University of Michigan in 2000.

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## Performance - Price History N.A.V.

Appleseed Plus Fund (APPLX)



	2007	2008	2009*
S&P 500 Index	5.49%	-37.00%	19.26%
Appleseed Fund	-2.02%	-18.05%	46.61%

\*AS OF 09/30/09

For example, our biggest holding is John B. Sanfilippo & Son, the largest U.S. nut processor. The company boasts long-term growth potential due to the health benefits of nuts.

The stock currently trades at \$10, and we were buying the company's stock in the fourth quarter of 2008 at \$4-5 a share, which was meaningfully below tangible book value of \$14. The company's earnings power is going to increase substantially after consolidating its six manufacturing facilities into one super-efficient plant, plus they are experiencing improving raw material prices due to better growing conditions. The top line growth over the next year or two is roughly 5% with significant gross margin/operating margin expansion. In addition, no sell-side analyst covers the stock, which highlights how it represents undiscovered value.

This is a stock that was trading at \$55 a couple of years ago and commands earnings power in the next twelve months of somewhere between \$1.20 and \$1.80 per share. So, we just couldn't stop buying it during the heat of the downturn.

We do not think it is very distressed since it is a food company and demand is fairly constant. But because of the way it has traded over the last two years, investors clearly believed it to be distressed. The stock price of John B. Sanfilippo has risen 98% this year. That's the kind of value we understand.

From a social perspective, nuts are a high quality, sustainable source of vegetarian protein and the carbon footprint for nuts is much smaller than other forms of protein such as beef or chicken. So it has got the best of both worlds – a terrific investment and a healthy one as well with a lower impact on the environment.

Another example of a tremendous value investment would be Teradata Corporation, an enterprise data-management company that was spun off from NCR Corporation two years ago. The credit crisis in 2008 caused Teradata's stock price, along with that of many other stocks, to fall considerably. We were buying Teradata stock in the \$12 or \$13 range when it was trading at ten or eleven times earnings with \$4 per share in cash on the balance sheet,

which was a tremendous valuation. The stock now trades around \$27.

Companies are constantly trying to get an edge through technology; therefore, Teradata's suite of products is a necessity for managing the growing complexity of corporate data. The company does not have much competition at all in the high-end of the market, and it stands to benefit as the amount and complexity of corporate data grew. Risk management in financial services and supply chain management in retail have been big revenue tailwinds for them in 2008. As a result, revenues continued to grow throughout the credit crisis on a local currency basis.

We are comfortable buying growth stocks as long as we are paying value prices. We buy any stock at the right price as long as it meets our social criteria.

Another stock that represented good value to us was Schering-Plough, which had a big allocation in our fund as the best pipeline in the pharmaceutical industry trading at 10-11x earnings. We believed that there was a strong possibility of a takeover because of Schering-Plough's manageable size and their unique partnerships with Johnson & Johnson and Merck, and we proved to be correct.

### Could you describe your research process along with an example?

We have a team-oriented research and decision-making process. The investment team includes eight investment professionals and support personnel of five people, and we relish the professional diversity of our valued team. We will not make an investment in our portfolio unless a particular security meets the fund's social criteria and our estimate of the company's intrinsic value is at least 50% greater than our purchase price.

The research team is constantly scouring the universe of publicly traded securities for investments. We conduct both quantitative and sustainability screens upfront before our analysts start to dig into the fundamentals of a particular security.

There are four key components in our research process: fundamentals, financial analysis, management, and valuation.

From a fundamental perspective, we like to buy companies that have a “moat,” or a sustainable barrier to entry. We pay close attention to both cyclical and secular trends in our investments, and we like to buy stocks that have significant pricing power. Given our current fears about inflation, we are either buying companies that will benefit directly from inflationary forces, or we are buying companies that have demonstrated pricing power in previous inflationary environments that should help them to retain their inflation-adjusted value over time.

From a financial perspective we pay close attention to balance sheets, looking for off-balance sheet liabilities and other red flags. Free cash flow drives the valuation for all of our investments. We are less concerned with the income statement, given the ease with which companies can manipulate earnings.

From a management perspective, we want to buy companies that act as owner-operators – like us. They have a lot of skin in the game and are focused on returning cash to shareholders. We pay close attention to capital allocation choices as well as the historical performance of companies.

From a valuation perspective, we like to use multiple valuation techniques regarding our stocks. We prefer to use three different valuation metrics but two

are required. It is a necessity for each investment to offer >50% upside from our purchase price and contain little downside.

When we identify a stock with considerable value, the portfolio manager or analyst will then compile a detailed research report. That report is then presented to our investment committee, which comprises our analysts and portfolio managers. The committee scrutinizes all the assumptions involved in a particular company, whether it be the moat, the valuation assumptions, etc. That scrutinization process could take a couple of hours or a couple of years, depending on the company. At the end of that process, the portfolio managers vote on the stock idea. We need at least four out of five votes in favor of the company for a stock to be included in the portfolio.

For example, we used to own Apollo Group, a company which provides higher education to working adults through the University of Phoenix. They were a terrific growth company between 2000 and 2006. We started buying the stock after it had fallen about 60% within a year-and-a-half period. We bought the stock at about \$37, and we had an oversized position in the fund, as we thought Apollo represented tremendous value. In the next twelve months, we watched the stock double and subsequently liquidated our position. Then, three months later, Apollo had a weak quarter, investors got terrified, and the stock fell all the way back down to \$40. So, we went back in again and bought the stock around the low 40s before we liquidated for a second time in the low 70s. We identified it as a strong company with a wide moat that tripped twice, and we took advantage both times.

#### **What is your buy and sell discipline?**

When we purchase a new holding

it must meet sustainability criteria and show appreciation potential of at least 50% relative to our independent estimate of intrinsic value. Again, when selecting a stock, we follow a collaborative decision-making process where four out of five votes are required among the portfolio managers in order to make a new purchase. Lastly, our position size reflects our view of an investment’s risk-return profile.

From a selling perspective, one of four things has to occur for us to liquidate a stock.

1. The stock price reaches intrinsic value;
2. The estimate for intrinsic value has changed;
3. The sustainability performance for the company has worsened;
4. We are finding better opportunities elsewhere.

#### **Could you briefly explain your risk management strategy?**

We like to buy stocks at valuations where there is not a lot of downside in the security at the time of purchase.

The reason we have not been involved in the rebound of financials this year is because we saw too little value and too much risk. For example, a large financial institution like Bank of America has at any point 100% downside given how levered they are and the weak quality of their balance sheet. We were able to generate significant returns with much less risk by investing in other sectors of the market.

We stress test our valuation estimates by looking at worst case revenue and deteriorating profit margin scenarios. Our analysts monitor each of the portfolio holdings very intensively via SEC filings, quarterly conference calls, and meetings with management. Our investment committee and analysts constantly test the investment thesis

assumptions of existing portfolio investments. Our value-oriented investment style leads us towards investments with high dividend yields and low price-to-book values. It also leads us away from more speculative momentum-oriented investments.

Our risk management system in bear markets works pretty well. The recent credit crunch is not the first time that we have outperformed in a bear market. During 2000-2002, the S&P 500 index peak-to-trough fell 44%, the Nasdaq Composite fell 80%, and our client equity portfolios increased in value by 8% during that same time period. We clearly know how to outperform in bear markets.

### Can you explain your portfolio construction process?

We have twenty to twenty-five holdings in our portfolio. We make no attempt whatsoever to mimic the sector weightings of our benchmark, the S&P 500 index.

We are more of a go-anywhere value fund than a traditional value fund that fits in a neat style box. Preservation of capital is paramount to our investors, and they do not care how we accomplish that goal.


### What are the risks perceived in the portfolio and how do you mitigate them?

Our belief is that it is far more risky to have an overly diversified portfolio

than a concentrated portfolio that we know intimately. We invest a greater percentage of our assets in a fewer number of stocks as compared to other mutual funds that are more broadly diversified.

There are three factors that allowed us to outperform over the long term. First, we are value investors and, as value investors, we have a keen focus on obtaining a large margin of safety in all of our investments, which helps to mitigate risk.

Second, we place heavy emphasis on risk management. This is demonstrated by our historic performance during downturns. In addition to actually making money during this credit crisis, we outperformed by over 50% between 2000 and 2002 versus the S&P 500 Index at a time when markets were in decline.

Third, the portfolio managers of the fund place our personal capital behind the investments we make for our clients. When we invest in a company, we like to see insiders own a significant percentage of the company; we assume our own shareholders expect the same of us. The portfolio managers of the Appleseed Fund own more than 15% of the fund's outstanding shares as of December 31, 2008. We clearly eat our own cooking, which aligns our interests with that of our shareholders. 

## Appleseed Fund

Symbol	<b>APPLX</b>
Website	<a href="http://www.appleseedfund.com">www.appleseedfund.com</a>
Address	Pekin Singer Strauss Asset Management 21 South Clark Street Suite 3325 Chicago, IL 60603
Telephone	800-470-1029
Inception	12/08/06

PORTFOLIO	
Total Net Assets *	\$55.0
Avg Mkt Cap (\$ Weighted) *	\$4,334
Average Price/Earnings Ratio	12.6x
Average Price/Book Ratio	1.4x
Turnover Ratio	128%

INVESTMENT INFORMATION	
New Investment	Open
Min Initial Investment	\$2,000
Min Subsequent Investment	N/A
Min Initial IRA Investment	\$1,000

RETURNS VS. S&P 500 INDEX		
	APPLX	Index
Ytd (Cum.)	46.61%	19.26%
1 Year (Cum.)	25.46%	-6.91%
Since Inception (Ann.)**	6.04%	-7.69%

FEES AND EXPENSES	
Max Sales Charge - Front	0.00%
Max Sales Charge - Deferred	0.00%
Max Redemption Fee	2.00%
Gross Expense Ratio	3.13%
Net Expense Ratio	1.28%

PORTFOLIO MANAGER	
Joshua Strauss	2006

\*millions \*\*12/08/2006  
09/30/2009; Source: Company Documents; Lipper

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