



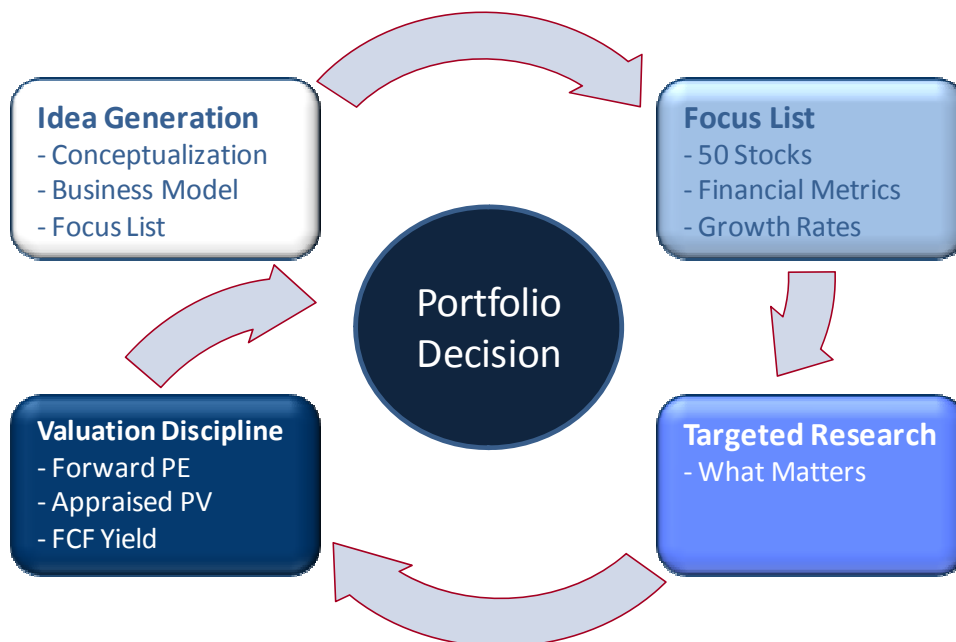
*investment styles ebb and flow . . . fundamentals never go out of favor*

**Investment Approach**



*investment styles ebb and flow...fundamentals never go out of favor*

### Fundamentals First Approach



HSMP's investment process begins with **Idea Generation**. We capitalize on the broad experience and knowledge base of our senior investment team. The members comprising this group have analyzed a vast range of companies and industries over four decades, and have lived through and gained experience from a variety of economic and markets cycles over the course of their investment careers.

In our quest for suitable investment candidates, we seek to identify quality business franchises with criteria that include: strong management teams; superior business models; sound balance sheets; high free cash flow characteristics; recurring revenue streams; pricing power; global platforms; new market opportunities; wide and defensible moats; and strong, albeit reasonably attainable, earnings prospects.

The businesses with sustainable competitive advantages vital to the attainment of our core objective – the delivery of superior returns by attaching client assets to a growing stream of high-quality earnings while employing discipline with targeted research and proven valuation tools – is a finite universe. Indeed, we believe our investable universe consists of no more than several hundred companies that exhibit the characteristics we prize. Investment candidates tend to reside in the Consumer Discretionary/Staples, Consumer/Business Services, Technology, Media, Healthcare, and Specialty Industrial sectors.

In addition to established, leading companies that we have known for many years, we constantly seek to identify “up and coming” new candidates that meet our quality criteria largely within these sectors. Examples would include businesses possessing great assets and new leadership, companies that have been freed of legacy issues, franchises moving from niche markets to mainstream, and/or companies with exciting new products/services. Ideas with attractive investment potential are placed on our **Focus List**.

The HS Management Partners Focus List consists of 50 stocks, and is the next phase in our replicable investment process whereby an idea is formally integrated into a comparative valuation analysis. This analysis among our 50-stock Focus List allows us to compare candidates on an apples-to-apples basis with respect to anticipated growth rates, appropriate discount rates, and reasoned valuation assumptions as measured in relative multiples to the market, free cash flow yields, and appraised present values.

Following the addition of a stock to our Focus List, we conduct more intensive **Targeted Research** with a single goal: Proof of Concept. We analyze business models and evaluate long-term potential. We utilize technology to access publicly available information such as conference calls, SEC filings and Street research. Our experienced senior investment team members identify the key determinants unique to each company required for us to gain a more comprehensive understanding of the factors critical to the attainment of projected earnings growth. Our work addressing what matters varies by company and/or industry and can include the following:

- Accessing industry contacts (customers/suppliers/vendors)
- Visiting companies and/or stores
- Attending trade shows and industry conferences
- Modeling specific profit enhancement initiatives

The next step in the investment process is our **Valuation Discipline**, in which we evaluate relevant and proven metrics. We analyze a company’s absolute and relative price/earnings ratio in the context of the level and duration of its organic growth rate. The P/E ratio is also

examined relative to where the stock has sold in the past and to where it may sell in the future based on fundamental prospects. The quality of earnings is determined by focusing on free cash flow yields. We also conduct an appraised present value analysis on each of the stocks on our Focus List.

**Portfolio Decision:** Should a company's fundamentals appear strong and validated by our proof of concept work, and we find the valuation of its shares attractive, we will initiate a position in a stock. The portfolio consists of 20 to 25 stocks. Individual position sizes typically range from 2% to 8% and we typically invest incrementally, building positions over time with sensitivity to conviction and market conditions.

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