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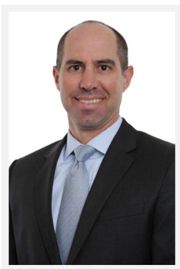

Episode 6

First Quarter 2014 Review of the Small Cap Quality Select Portfolio

Todd Beiley, CFA
Portfolio Manager & Senior Research Analyst

Hello, this is Todd Beiley, portfolio manager of the Small Cap Quality Select strategy at Kayne Anderson Rudnick. Today I will discuss the portfolio's recent performance and briefly touch on our current holdings.

Small Cap Quality Select declined about 8% in the first quarter of 2014 compared to a rise of about 1% in the Russell 2000. This decline in our portfolio was attributable to a retreat in the price of Chef's Warehouse, our largest position, primarily due to the company's announcement that earnings in 2014 will be lower than what most investors had expected due to higher spending that management believes will enhance the operating capacity and efficiency of the company as it grows. As shareholders, we appreciate and view favorably management's willingness to make investments it deems important at the expense of near-term profitability for the potential benefit to future earnings. However, it is not a certainty that these expenses will ultimately prove fruitful and investors are understandably questioning the business's inherent profitability.

We believe Chef's competitive position does remain strong. Current metrics support this view: Gross margins remain firm, which indicates pricing power is intact while business activity has continued to be healthy in regions not impacted by the winter's severe weather. By focusing on a specific customer segment in the food-service industry (that is high-end, culinary-focused restaurants), the company has established a competitive position that is difficult for others to displace. Distributors focused on high-volume customers cannot best meet the service needs of customers that place irregular, small quantity orders for a wide variety of specialty ingredients. Alternatively, competing specialty distributors lack the scale and resources that Chef's, as the largest distributor serving this customer segment, enjoys. They simply cannot match the company's ability to provide a broad array of globally-sourced ingredients in an efficient, low-cost way.

Our view is that, relative to its underlying value, the stock overshot to the upside in 2013 and has recently overshot to the downside. We cannot precisely forecast the company's ultimate margin structure, but we do have confidence that our expected range of future outcomes in profitability is reasonable. This range has not materially changed since we made our initial investment in 2012. Given our belief that the business retains a powerful competitive advantage and faces prospects for materially higher earning power in the years ahead, coupled with the current price, our investment is likely to provide an attractive return over time. The business remains our largest investment in the portfolio.

For additional perspective, consider the stock's path since its initial public offering in 2011. The shares ended 2011 priced 19% above its offering price in July, then declined 12% in 2012, rose 84% in 2013, and have declined approximately 27% thus far this year. Cumulatively, the stock has risen about 42% from its offering price in 2011 through the end of the first quarter of 2014, although you can see the path has been anything but smooth. Looking at the development of the business between 2011 and 2013, revenue increased 68%, operating income grew 32%, and earnings per share rose 79%. So, the business has been progressing (although it is a small period of time from which to draw broad conclusions) while the stock has darted around dramatically. Over time, the stock price will be governed by how the business develops and this is where our attention is focused.

By design, our strategy will experience large deviations from the market due to the relatively small number of stocks in the portfolio. This is an important element in enabling the portfolio to earn returns meaningfully above the market over time, but it also means that the portfolio will experience periods of decline. Stock prices are more erratic than underlying business values, but it is this volatility that offers us opportunity as long-term investors.

The portfolio held eight securities at the end of the first quarter. In order of position size, these were Chef's Warehouse, NVE Corporation, UFP Technologies, Primerica, MercadoLibre, Hittite Microwave, NVR, and Computer Programs & Systems. I believe each of these businesses maintains a highly durable competitive position that is likely to enable it to remain prosperous for many years. One important measure of this ability is the amount a company earns off its base of equity capital, or its return on equity. If a business can persistently earn a high rate of return on its owners' capital, then chances are good the business possesses some form of protection that enables it to keep competitors – who would like to steal those high returns – at bay. Looking at our portfolio, the companies we own earned 22% on their equity capital per year on average over the past five years. For comparison, the equivalent number for the Russell 2000 is 9%. Our portfolio companies' high and persistent return on equity is a strong signal that the businesses have effective competitive barriers and can produce sustained high profitability. Given this, coupled with the attractive prices at which we own them, we expect our portfolio's returns over time to be very healthy. Despite inevitable periods of decline, our investment approach has led to attractive returns over the long term, and we believe will continue to do so.

As always, our goal is to produce exceptional long-term investment results by owning a handful of businesses with enduring competitive protections and favorable long-term prospects, purchased at attractive prices. We employ thorough research in an attempt to understand the advantages and vulnerabilities of a business so that we can more accurately assess its value. We do not attempt to forecast the market, but instead seek to understand individual companies and their worth so that we are in a position to recognize attractive prices when they arise.

This concludes my comments. Thank you for listening.