RAINIER

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The Rainier philosophy is simple. We invest in quality growth companies at prices that make sense. We believe that rewarding stock performance comes from companies with superior growth, attractive relative valuations, competitive strength, and financial integrity. Our decisions are based on fundamental analysis, which emphasizes bottom-up stock selection by sector specialists. We invest in all major market sectors because we believe that investment opportunities are found in industries that are frequently overlooked.

Sector Insights

Focus: Energy

Energy sector specialists: James R. Margard, Peter M. Musser and Carlee J. Price

Q: How does Rainier use its sector experts to manage a diversified portfolio?

A: At all times we work in sector teams, sitting in the same room, where each Portfolio Manager is immersed in industry fundamentals. Sector teams consist of two or three people, each of whom acts as both Analyst and Portfolio Manager. The sector team identifies opportunities and makes recommendations to the larger equity team for final affirmation.

Q: Can you give an overview of Rainier's approach to buying stocks in the energy sector?

A: We prefer companies with high growth potential, low costs, long reserve lives and moderate price-to-cash flow ratios. Across all sectors, we integrate quantitative tools to help us execute more efficiently and combine with our fundamental research to select stocks with growth at reasonable prices.

Q: How is the energy sector perceived in terms of being a "traditional growth" sector?

A: Energy stocks have had exceptional profit growth over the last decade. This sector is not traditionally viewed as a "growth" sector. But by looking for growth within each of the industries in the group, we have been able to identify attractive opportunities.

Q: How does Rainier find growth in this area?

A: We begin by looking at the industries within the sector. Each industry has a history of either growth or lack thereof, and when we assess the history of each industry together with its apparent prospects for future growth, we have a better idea of where to concentrate our attention.

Q: Could you describe the industries and give an idea of what you look for in your investigation?

A: One of the industries we must consider is refining and marketing. Historically, this area has produced low or no growth because few companies can add value to a commoditized product. It is hard to differentiate gasoline. Growth here typically parallels gross domestic product (GDP) growth. There is significant price pressure in the industry, constraining profitability. Hence, we see few growth opportunities in this area. We do not expend enormous energy analyzing companies here, and we typically do not own stocks in this industry.

The largest industry in the energy space is Integrated Oils. This includes Exxon Mobil, Chevron, and ConocoPhillips, each of which represents a sizeable portion of traditional large-cap market indexes. Finding growth opportunities in this industry is challenging. We are usually market-weight or lower due to the fact that sustainable growth is hard for these companies to achieve. Additionally, many of these companies have business lines that are low- or no-growth. For example, Exxon Mobil's chemical and refining and marketing businesses account for over three quarters of the company's total profits.

A third energy industry is coal. There are opportunities at certain points in the business cycle, during which supply and demand imbalances persist, but growth opportunities are scarce over a full cycle as demand is principally tied to electric utility coal consumption. Given current environmental concerns, this area faces headwinds in gaining combustion share and we are typically underweight in this industry. We currently own Walter Energy, which focuses on supplying metallurgical coal, a scarcer mineral required for processing iron ore into steel.

There are significant opportunities in the Exploration and Production (E&P) industry. These companies should be able to grow reserves and production at different rates, and differentiate themselves through either engineering expertise or by virtue of the quality of their assets. Some companies operate in more mature fields, such as the shallow Gulf of Mexico, while others operate in emerging fast growth fields, such as the Haynesville shale in Louisiana, and the Bakken shale in the Dakotas.

Companies that provide services and equipment to E&P companies are another primary area for investment opportunities. These drilling and service companies range from the more commoditized, such as drilling bits and fluids, to the more differentiated and specialized, such as deep water drill ships. The latter, which cost over $500 million per ship to manufacture, have historically yielded higher returns and margins over a longer period. We emphasize such companies (example: Transocean) as well as others that either dominate their product category (Oceaneering International—a producer of remotely operated underwater vessels) or have been gaining market share (Halliburton—taking North American on-shore business from competitors).

Q: The exploration and production industry has some interesting prospects given Rainier's investment style. How do you find growth stocks at a reasonable price in this industry?

A: There are three main themes we apply to this group. First, we seek companies with long reserve lives. Companies with robust inventories of well-defined assets and longer production lives are, all else being equal, more attractive. Another characteristic we favor is low operating costs. Companies with a low cost structure can operate profitably at lower commodity price levels. A final factor we emphasize is the ability to grow the quantity of oil or gas produced at a relatively high rate. Specifically, we favor companies with average expected production growth rates for the next few years in the double digits, excluding acquisition-based contribution. We call this organic, or "from the drill bit," growth. We also prefer more visibility and higher predictability of future growth. These are typically companies with a high level of "proved"—especially "proved developed"—reserves, which are considered "official" reserves in government filings.

Q: With so many different industries, how do you keep track of all the different companies in the energy sector?

A: There is a large opportunity set in the energy sector. There are 205 public US companies that have a market cap greater than $500 million. We seek to understand these companies from both a subjectively analytical point of view (including meeting management, having a good network of contacts, and understanding key fundamental parameters), as well as a quantitative angle. To this latter point, we have a proprietary database in which we track important characteristics of a broad range of companies. We also have another tool to track measures that are more specific to this sector, such as production growth rates, reserve lives, relative cost structures and the degree to which future production is hedged. We utilize price-to-cash flow ratios and net asset valuations as the principal tools for assessing the stock price targets. It is this blend of both qualitative and quantitative assessment, together with price evaluation, that are the key to our stock selection process.

Next edition: Financials

Rainier Investment Management, Inc.®
601 Union Street, Suite 2801
Seattle, WA 98101

Seattle/New York

Cash flow measures the cash generating capability of a company by adding non-cash charges (e.g. depreciation) and interest expense to pretax income. Price to cash flow is a stock's capitalization divided by its cash flow for the latest fiscal year.

Fund holdings and sector allocation are subject to change and should not be considered a recommendation to buy or sell any security. Diversification does not assure a profit or protect against loss in a declining market.

Mutual fund investing involves risk. Principal loss is possible.

Please follow the links below to view our holdings:

Large Cap Equity

Mid Cap Equity

Small/Mid Cap Equity

Balanced

Intermediate Fixed Income