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THE WALL STREET TRANSCRIPT
Connecting Market Leaders with Investors

# Looking to Dividend-Paying Stocks for Good Risk-Adjusted Returns

**THOMAS E. BROWNE, JR., CFA,** is a Portfolio Manager at the Keeley Teton Small and Mid Cap Dividend Value strategies. Mr. Browne previously was a Portfolio Manager at Keeley Asset Management Corp. He was also a Portfolio Manager for Oppenheimer Capital, SEB Asset Management and Palisade Capital Management. Prior to that he was a sell-side technology services analyst and was twice recognized in *The Wall Street Journal's* Best on the Street survey. Mr. Browne received a B.B.A. from Notre Dame and an MBA from New York University.

**SECTOR — GENERAL INVESTING**

**TWST: Could you tell me about the firm?**

**Mr. Browne:** Sure. Keeley has been around for almost 50 years and was started by John Keeley in the early 1970s. He started originally selling research, and then started managing other people's money in the early 1980s. After John Keeley passed away in 2015, we merged with Gabelli affiliate Teton Advisors in 2017. This broadened research coverage and increased our resources.

At Keeley Teton, we manage small- and mid-cap value strategies with a focus on what we believe are misunderstood or underappreciated areas of that market. Our overall view is that in order to outperform over time, you have to do something different than what other people are doing. And so, we found a couple of different niches that we focus on.

We have two distinct strategies. One focuses on companies undergoing significant corporate change, so events like emerging from bankruptcy or companies being spun off from larger companies or sometimes companies dividing themselves into two relatively similar parts. Other areas in that genre are companies that are undergoing conversions to REITs.

We've invested in companies that have a franchise business model and sell their company-owned stores to use the proceeds to buy back stock and shrink the capital base. A lot of different things with the common theme that they're difficult to understand. By putting a bit of effort into it, you can create a very differentiated opinion about the future of the firm. That's one group of strategies that we manage.

The other group of strategies we manage is dividend strategies. We focus on these in the Keeley Small Cap Dividend Value Fund and the Keeley Mid Cap Dividend Value Fund. Both focus on small- and mid-cap companies that pay dividends. This is an area we got into about 12, 13 years ago because, one, it was a bit different from our restructuring strategies. Secondly, it was very much aligned with what we're already doing — i.e., focusing on small- and mid-cap companies. And thirdly, and most importantly, dividend-paying stocks have historically produced good risk-adjusted returns. They tend to produce better-than-average returns over time with less-than-average risk. And that's kind of the holy grail in the investment business.

**TWST: Are there any sectors that you favor, or are you looking more at the individual company?**

**Mr. Browne:** It's really looking at the individual company. It's very much bottom up instead of top down. In the restructuring strategies, we focus on companies that are undergoing significant corporate change. You find change in all industries, whether it's financial services or health care or technology or industrials. There are different amounts of change going on at any given time in all of these.

In the dividend strategies, we tend to be relatively sector neutral. That means we will control how much we want to be overweight or underweight because we want to invest in the best companies we can find in each sector which pay dividends and which offer a good combination of quality, timeliness and value.

**TWST: Did you want to highlight a company that investors might find interesting?**

**Mr. Browne:** We have 70 stocks in each fund or thereabouts. And all the funds are very diverse. One of the industrial companies is **Crane Holdings** (NYSE:CR). It's a small conglomerate with three main lines of business. They're in the aerospace and electronics business. They're in a business they call process flow, which includes pumps and valves. And they have a payment and merchandising business, which produces currency as well as vending solutions. What's interesting about **Crane** is that all three businesses are doing pretty well. We're optimistic about the aerospace business and a turnaround there. They're also in the process of spinning off the payments and merchandising business, which we think could unlock value. That's scheduled for early 2023.

Along the same lines, we think that aerospace is an interesting area to invest in these days. The air carriers seem to be doing better. People want to get out and see other people either for business or personal reasons after being locked down for the last couple of years due to

COVID-19. **Airbus** (OTCMKTS:EADSY) and **Boeing** (NYSE:BA) have had difficulty delivering planes over the last several years for a variety of reasons. And so it seems like we're getting into a shortage of airplanes. With fuel prices where they are, and newer aircraft being much more fuel efficient, this creates demand for new planes.

**Air Lease** (NYSE:AL) is one way we're investing in this trend. They are one of the largest aircraft lessors in the world. They will double their fleet over the next five to seven years. They're well managed and the stock trades well below the value of the aircraft. We think that one offers a lot of potential as well.

**TWST: Do you want to mention another one?**

**Mr. Browne:** Sure. One of the areas that we invest in is banks and other financial services companies. One of the banks we own is a company called **Columbia Banking** (NASDAQ:COLB). They're headquartered in Tacoma, Washington. They are in the process of merging with a company called **Umpqua Holdings** (NASDAQ:UMPQ), which is a bank headquartered in Oregon. The combination will create one of the largest community banks in the Northwest, which is a healthy economic market. The transaction has been delayed and delayed and delayed, but we think it will ultimately close.

When you run some of the numbers behind it, it's not too hard to see **Columbia** with more than $4 of earnings power a year or so out. The stock is in the low-$30s. So, single-digit multiple on what's historically been a very well-managed company.

**TWST: You mentioned that some of the companies that you buy are emerging from bankruptcy or reorganization. Did you want to explain how you review a company to see if it's a solid investment even if it is going through that kind of reorganization?**

**Mr. Browne:** In the restructuring area, it really is a case-by-case analysis because different types of restructuring events will have different information available to you. So with a spinoff, you can look at the old information about the segments that are being spun off. Companies also have to file a Form 10 in order to help you figure out how to adjust the historical financials. You can then compare what the new company looks like to other companies that are already in the business that are already public.

With a bankruptcy, they have to file their plan of reorganization. Part of that filing are company projections of what they'll earn because they have to rationalize to the bankruptcy judge how the company should be divided up between the former bondholders and the former equity holders and the different classes. So there tends to be a fair number of projections available in those kinds of situations.

With bankruptcies, we find it important to understand why the company went bankrupt. We prefer that the company went bankrupt because it was over-levered, because there was too much debt, as opposed to that it was a tragically broken business. Quite frankly, most of our bankruptcy investments are in energy companies which went bankrupt in the early stages of the COVID pandemic because commodity prices plunged. They came out of bankruptcy later in 2020 and have benefited from a pretty strong rally in energy prices.

**TWST: And I understand too that some of the stocks that you find are simply misunderstood by the market.**

**Mr. Browne:** With spinoffs in particular, you'll have companies that become public via spinoffs that were previously parts of much larger companies. For example, one of our longtime investments that we still have is a company called **Marriott Vacations Worldwide** (NYSE:VAC). **Marriott Vacations Worldwide** is the timeshare business which was within **Marriott International** (NASDAQ:MAR), one of the largest hotel companies in the world. When that business spun out in 2011, the shares given to the **Marriott** shareholders were a very small percentage of the value of **Marriott**. And so typically, when that happens, the **Marriott** shareholders simply are not interested in holding this other company. It's new. They don't necessarily know it all that well.

At the time, the timeshare business was perceived as being a less interesting business in the hotel business. Also, the large-cap managers who owned **Marriott** didn't have much interest in holding a small-cap company. And so, the stock generally falls pretty sharply after the spinoff, which gives us an opportunity to do our homework and make the investment.

Also, the information is incomplete. So you have to do your homework and really get to know the business. We have to understand the business. I would say companies do a lot better job of presenting spinoffs these days than they used to, but we still see opportunities in that theme.

Most of the money we manage is actually invested in the dividend strategies. I think that a lot of smaller-cap investors don't appreciate dividends. Very few actually look for them within companies. And I think that some small-cap investors don't really want to see them. After all, if a company is small and it's got nothing better to do with the cash than to give it back to shareholders, why would I want to invest in that? That would be the negative case.

Our view on dividends is that dividends tell you three important things about a company. Number one is it tells you that the company can, and at least the management team believes that it can, sustain the free cash flow that it's generating because ultimately sustainable free cash flow is the source of your dividends.

Secondly, because they have made this long-term financial commitment, we think that companies that pay dividends are more likely to be more disciplined about other ways in which they allocate capital via buybacks. They may be more price sensitive about how they buy back stock or make acquisitions. The bar gets raised if they know they have to pay their dividend. And so a dividend can help discipline capital allocation.

### Highlights

*Thomas E. Browne, Jr. discusses Keeley Teton's small- and mid-cap strategies. He explains that they have two distinct strategies: one that focuses on companies undergoing significant corporate change, such as emerging from bankruptcy or being spun off from larger companies, and one that focuses on small- and mid-cap companies that pay dividends. Mr. Browne believes that smaller-cap investors tend to underappreciate the benefits of dividend-paying companies — sustainable free cash flow, more attention to the leverage, and acknowledgement of who owns the companies — and he notes that dividend-paying stocks have historically produced good risk-adjusted returns. He says he is more optimistic than most about the direction of the market and adds that buying when the market is down has historically paid off for investors.*
*Companies discussed: Crane Holdings Co. (NYSE:CR); Airbus SE (OTCMKTS:EADSY); Boeing Co. (NYSE:BA); Air Lease Corp. (NYSE:AL); Columbia Banking System (NASDAQ:COLB); Umpqua Holdings Corp. (NASDAQ:UMPQ); Marriott Vacations Worldwide Corp. (NYSE:VAC) and Marriott International (NASDAQ:MAR).*

And then the third thing that dividend tells you is that the management team and the board understand who owns the company because they're focused on returning capital to the owners.

**1-Year Daily Chart of Crane Holdings Co.**

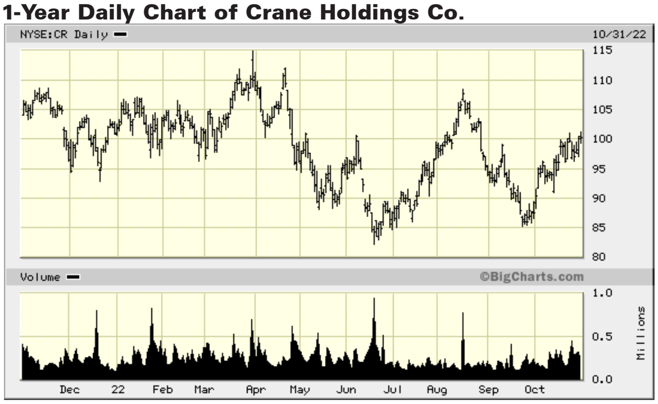


Chart provided by www.BigCharts.com

If you think about those three things, sustainable free cash flow, more attention to the leverage, and acknowledgement of who owns the companies, those are a pretty good starting place to make an investment. If you compare that to the perception, to the view that small-cap companies that pay dividends are not interesting, we think that difference is what is interesting to us.

**TWST: And with dividends, I would think that especially people that might be nearing retirement or in retirement years might look to dividend strategies as a way to fund their retirement years.**

**Mr. Browne:** They certainly have. If you look at dividend-oriented large-cap funds and you look at dividend-oriented ETFs, they've garnered a lot of investor assets over the last 10 years. There's clearly not been as much attention paid to them in small- and mid-cap companies, despite the attractive characteristics of the companies and the good investor experience of dividend strategies.

**TWST: Given what's going on with the economy right now, any overall advice for investors as they look to the end of this year and into next year?**

**Mr. Browne:** I'd say we're more optimistic than most. We read a lot of doom and gloom these days. But if you look at the first half of this year, when the market was down 20% or so, if you go back historically and look at returns after periods of big declines, the returns tend to be good. For example, with the Russell 2000, since it was originally constituted in 1978, there have been 33 rolling six-month periods where the Russell 2000 was down more than 15%. In 30 of them, it was up in the next six months, and in 33 of them, it was up over the next 12 months. So buying when the market is down has historically paid off for investors.

**TWST: Are your clients and customers watching the economy pretty carefully with current interest rates and inflation?**

**Mr. Browne:** I think everyone is. Interest rates have gone up a lot more than people expected at the beginning of the year. Inflation has been far stickier than the Federal Reserve was telling us it would be a year ago. We had expected inflation to be tougher to manage than the Fed was saying a year ago, simply because when you looked at the potential rebound in the economy, and what had been a couple of years of pretty strong commodity price increases, as well as the fiscal and monetary stimulus, it seems hard for us to believe that inflation would not pick up.

At this point, by early next year, a lot of the commodity prices and some of those sources of inflation will have anniversaried, if you will. And so, at this point, it seems like inflation will come down. And the question will be how much and how quickly? So I think we're a little more optimistic about inflation than most people. Where I'm a little more pessimistic is will the Fed be able to get it back to 2%? That seems like a long stretch from here.

**TWST: Anything we haven't talked about you'd care to bring up?**

**Mr. Browne:** We're optimistic. The dividend strategies have produced good returns in difficult periods. This year is proving to be one of those and the dividend strategies are doing what they should. In addition, our strategies have been out of favor the last several years, so we're optimistic about what we can do for investors over the next several years. Over the last few years, we've faced the headwind that value has been out of favor relative to growth. Small cap was out of favor relative to large cap, and dividend-paying stocks were out of favor relative to non-dividend paying stocks.

**1-Year Daily Chart of Air Lease Corp.**

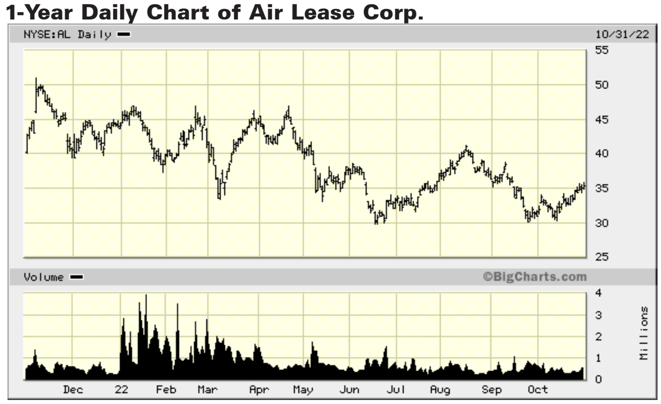


Chart provided by www.BigCharts.com

Over the last year or so value has come back into favor, but it's been out of favor for a long period of time. So we think that there's still some legs to that one. Small cap still has underperformed large cap for the most part, but we trade at rock bottom historical relative valuations. Finally, dividend strategies have performed better recently, but also suffered for about a five-year period of underperformance. We think that what we're doing is very timely in that the three main drivers of what we do stand to be in favor for a period of time. When we invest in stocks, we look for companies where the future is likely to be better than the recent past. I think that pertains to the strategies that we manage.

**TWST: Thank you. (ES)**

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The Portfolio Manager's views are subject to change at any time based on market and other conditions. The information in this posting represents the opinions of the individual Portfolio Manager and is not intended to be a forecast of future events, a guarantee of future results, or investment advice.

As of September 30, 2022, the Keeley Funds owned the following holdings: Crane Holdings Co. (NYSE:CR) 1.9% in Keeley Small-Mid Cap Value Fund and 1.6% in Keeley Mid Cap Dividend Value Fund; Air Lease Corp. (NYSE:AL) 1.5% in Keeley Small-Mid Cap Value Fund and 1.3% in Keeley Mid Cap Dividend Value Fund and 1.4% in Keeley Small Cap Dividend Value Fund; Columbia Banking System (NASDAQ:COLB) 1.7% in Keeley Small Cap Dividend Value Fund; Umpqua Holdings Corp. (NASDAQ:UMPQ) 1.3% in Keeley Mid Cap Dividend Value Fund and 1.4% in Keeley Small-Mid Cap Value Fund; Marriott Vacations Worldwide Corp. (NYSE:VAC) 1.2% in Keeley Small Cap Dividend Value Fund and 0.8% in Keeley Mid Cap Dividend Value Fund.

Securities of smaller companies present greater risks than securities of larger, more established companies. The stocks of smaller companies may trade less frequently and experience more abrupt price movements than stocks of larger companies, therefore, investing in this sector involves special challenges. Dividend paying investments may not experience the same price appreciation as non-dividend paying investments. Portfolio companies may choose not to pay a dividend or it may be less than anticipated.

*Investors should carefully consider the investment objectives, risks, charges and expenses of the Fund before investing. The prospectus, which contains more complete information about this and other matters, should be read carefully before investing. To obtain a prospectus, please call us at 800-533-5344 or visit www.keeleyfunds.com.*

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