

# Client Focus

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Co-founder Tom Hurvis

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## The Rx For Uncertainty

INVESTING SPOTLIGHT  
Navigating the Shifting  
Healthcare Landscape





## All Investing Is Local— and Global

In February I had the honor of introducing Chicago Mayor Rahm Emanuel at an event hosted by the Chicago Council on Global Affairs. As I was preparing for my introduction of Mayor Emanuel, I was reminded of one of the most famous axioms of American politics: “All politics is local.”

Former Speaker of the U.S. House of Representatives Tip O’Neill famously used this phrase to convey the idea that no matter how strongly voters feel about national issues, they ultimately vote based on issues that affect their lives on the local level.

At William Blair & Company, we believe that when it comes to the markets, all investing is local—and global.

Successful portfolios are built by going out and finding the highest-quality, most-promising companies, regardless of where they are located. Whether it’s to Abbott Park, Illinois; Mumbai, India; Zurich, Switzerland; or anywhere in between, we conduct in-depth research that involves meeting company management, touring facilities, and interviewing competitors and customers.

Every company and every financial market operates within an increasingly interconnected world economy. You don’t need to look any further than the performance of U.S. stock markets so far in 2013

to see that this is the case. Fueled by continued strong corporate performance and an improving housing market, the Dow Jones Industrial Average and the S&P 500 surged throughout the first four months of the year and reached all-time highs in early May. But the robust momentum of U.S. equity markets was temporarily interrupted in late March by the tumultuous bailout of banks in the Mediterranean island nation of Cyprus.

Within this environment, we believe that investors are best served by an approach that combines a global perspective and a local understanding. Our investment professionals draw upon a nuanced understanding of evolving trends, as well as insights that can be gained only through “feet-on-the-street” research and knowledge of local marketplaces and competitive landscapes.

I recently returned from a trip to Europe where I visited our offices in London and Zurich, as well as our newest office in Frankfurt. With the opening of our Frankfurt office in March, we now have offices in 12 cities across five continents. As we expand our global reach, we remain steadfastly focused on using this global perspective to provide customized solutions that are tailored to your unique goals and circumstances.

On a final, somber note, please join us as we send our thoughts and prayers to the victims and countless others affected by the tragic bombing at the Boston Marathon.

Sincerely,

John Ettelson  
PRESIDENT AND CEO

# The Rx for Uncertainty: Navigating the Shifting Healthcare Landscape

The Supreme Court’s decision in June to uphold the major provisions of the Patient Protection and Affordable Care Act (ACA) and President Obama’s reelection in November answered any remaining questions about whether the landmark healthcare reforms would become a reality.

The most important aspects of the law—including the mandate that every individual has health insurance and the creation of health insurance exchanges—will take effect in 2014.

What additional changes are in store for the United States’ healthcare system, however, are yet to be determined.

William Blair & Company equity research analyst Ryan Daniels said there are three major issues facing the U.S. healthcare system: controlling costs, improving quality, and increasing access.

Daniels, who was named to *The Wall Street Journal’s* “Best on the Street” list in 2010 for his coverage of healthcare providers, said that the ACA will be effective in expanding

access to health insurance and healthcare services.

In addition to requiring all individuals to have health insurance and creating online health insurance exchanges, the ACA expands Medicaid eligibility and requires all companies with at least 50 full-time employees to provide health insurance for their employees or face a penalty.

“But what the law doesn’t do is reduce healthcare costs or improve quality of care,” Daniels said.

## Healthcare costs: An unsustainable trend

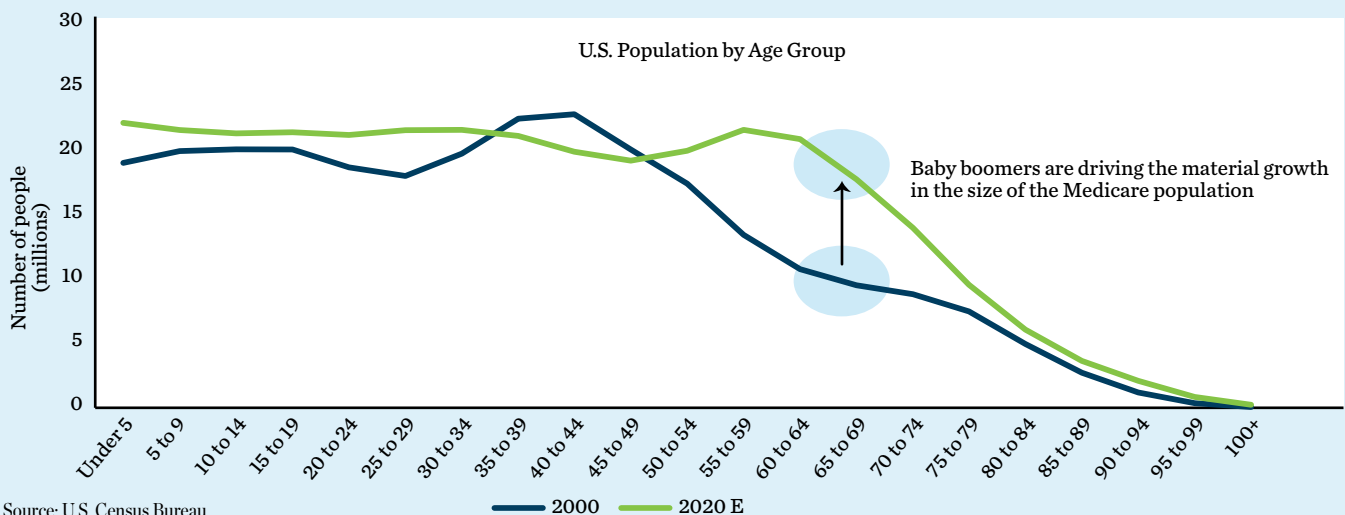
The rising costs of healthcare pose a dire threat to the country’s financial health, Daniels said. U.S. healthcare spending currently equals about 18% of the U.S. gross domestic product (GDP), a far greater percentage than in any other industrialized country, according to the Organization for Economic Cooperation and Development (OECD).

Driven by factors such as the aging U.S. population and increasing obesity rates, U.S. healthcare spending is projected to equal a whopping 50% of GDP by 2082, according to the Congressional Budget Office.

“We have to reduce healthcare costs,” Daniels said. “They’re simply too high for the U.S. to bear going forward.” >>

## The Aging U.S. Population

With approximately 10,000 baby boomers reaching Medicare eligibility age every day, the aging of the U.S. population is one of the primary drivers of soaring healthcare expenditures.



Source: U.S. Census Bureau

Healthcare has become a huge input cost for U.S. companies.

“General Motors spends more on healthcare per car than they do on steel, and Starbucks spends more on healthcare than they do on coffee beans,” Daniels said. “It’s really making the U.S. less competitive.”

Most alarming, according to Daniels, is that the current value of future healthcare commitments is nearly four times larger than the national debt.

“The debt is not the problem; healthcare expenditures are the problem,” Daniels said. “The healthcare problem is the debt problem, period.”

**“You can’t address the debt issue unless you address healthcare. Healthcare is going to remain at the forefront of the national discussion, and there is more reform ahead of us.”**

#### **Savings from reform?**

An independent analysis from the Congressional Budget Office in 2010 showed that the ACA was projected to shave nearly \$140 billion from the federal deficit over the next decade. Daniels said that he and many others in the healthcare industry do not believe those savings will actually occur.

He said those projected savings are based on several assumptions that in all likelihood will never come to fruition. “There’s a lot of creative accounting built into the legislation,” he said. “Unfortunately, garbage in, garbage out.”

For example, as a way to encourage physicians to treat the surge of newly covered Medicaid patients, the ACA increases the Medicaid reimbursement rate to 100% of the Medicare reimbursement rate in 2013 and 2014. But in 2015, the ACA stops providing federal funding to pay for the increased Medicaid rates. Daniels said it is highly unlikely that Congress would allow the Medicaid rate to relapse, and, if it did, doing so would undermine any savings from the Medicaid expansion.

“A lot of the math here doesn’t work. This is not going to save the system money,” Daniels said. “It’s not a political statement; it’s a fact.”

#### **Low ROI**

Despite paying more for healthcare per capita than any other developed country, the United States lags well behind in many quality-of-care measures.

In addition to having a life expectancy at birth that trails many other industrialized countries, the United States has the highest occurrences of hospitalizations for many chronic diseases, according to the OECD.

Thirty-three percent of U.S. adults experienced problems accessing healthcare because of costs in 2010, eight percentage points higher than the next-highest industrialized country.

“Put simply, we are the best at providing care and the worst at promoting health,” Daniels said. He compared the U.S. healthcare system to a factory that is excellent at fixing equipment when it breaks, but terrible at maintaining the equipment and keeping it from breaking in the first place.

“Many of the issues plaguing our healthcare system stem from the fact that we spend too much on acute care and not enough on preventative medicine,” Daniels said.

He said one of the most promising opportunities for slowing the growth of healthcare expenditures is a shift in how hospitals get reimbursed. Currently U.S. hospitals are paid predominately through a fee-for-service model, in which the insurance company pays the hospital based on the amount of services provided. As a result, hospitals view the services they provide as a revenue driver rather than as an expense.

Shifting toward a fee-for-value system that pays hospitals based on the outcomes achieved for the patients will reduce hospitals’ incentives to overprescribe services and create more of a focus on preventative medicine and an efficient delivery of services.

### **Investment amid uncertainty**

The changes created by the ACA will likely be just the beginning of healthcare reform. As Congress looks to strengthen the country’s fiscal future through significant debt reduction, changes to Medicare, Medicaid, and other entitlement programs are sure to be at the center of that debate.

“You can’t address the debt issue unless you address healthcare,” Daniels said. “Healthcare is going to remain at the forefront of the national discussion, and there is more reform ahead of us.”

One thing that seems fairly certain, however, is that Medicare reimbursement rates will decrease. As a result, Daniels believes that healthcare companies with heavy exposure to Medicare and high gross margins will be the most at risk, as the government looks to create savings wherever possible.

The companies that are best positioned to do well in the new healthcare landscape are ones that can offer solutions for controlling costs and increasing efficiency, such as preventative healthcare, healthcare information technology, and disease management.

“We as a team try to find unique investment opportunities that have innovative solutions, provide better care at a lower cost, or can benefit from the demographic trends without taking much of the risks of Medicare reimbursement cuts,” Daniels said.

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## **Healthcare Reform: The Next Steps**

Under 2010’s Patient Protection and Affordable Care Act, 2013 is the year when many of the new taxes to pay for expanded health insurance coverage are implemented, and 2014 is “when the rubber really hits the road” in terms of expanding coverage, according to William Blair equity research analyst Ryan Daniels.

### **2013**

- *Excise tax of 2.9% on medical devices*
- *Medicare tax increase of 0.9% for individuals earning more than \$200,000*
- *Employers lose tax deduction for subsidizing retirees’ Medicare Part D coverage*
- *Medicare bundled care pilots*

### **2014**

- *All individuals required to have health insurance or face a penalty*
- *Health insurance exchanges created*
- *Employers with 50 or more employees required to provide health insurance or face a penalty*
- *Medicaid eligibility expanded to 133% of poverty level*
- *Insurance industry charged an \$8 billion annual fee*

### **2015-2017**

- *Penalties for lack of individual coverage continue to increase each year*

### **2018**

- *40% tax on “Cadillac” health insurance plans*

# Tom Hurvis

## How Old World Industries co-founder Tom Hurvis went from writing ads to manufacturing antifreeze ... and had fun every step of the way.

“Have fun, make money.” Tom Hurvis, chairman of Old World Industries, LLC, believes that’s the best way to run a business. With Old World Industries, which manufactures PEAK antifreeze and other automotive products, topping more than \$1 billion in sales, one could conclude he is on to something.

Equipped with a bachelor’s degree from Lawrence University and an M.B.A. from the University of California—Berkeley, Tom began his career in advertising in 1962. Three years later, he founded his own ad agency. There, he created the buzz and offbeat artistry that made Screaming Yellow Zonkers a big hit in the snack world.

Joining him at the agency was his friend Riaz Waraich. In their spare time, Tom and Riaz started a chemical trading company in 1973. The timing was right and profits were high—at least until President Nixon removed price controls. The team quickly realized they needed to diversify. And diversify they did.

Old World Industries now markets more than 90 automotive products, including PEAK (which has a 32% share of the North American antifreeze market), Herculiner pickup truck beds, and Splitfire Spark plugs in more than 60 countries.

The story of Hurvis’s transition from ad guru to chemical trader to

automotive-products manufacturer might make one think that his success was serendipitous. In fact, it has been Hurvis’s ability to create a distinct corporate culture and execute a well-defined, shrewdly designed business model that have made Old World what it is today.

### Creating a culture

“Duke it out.” That’s how Hurvis describes his management style. “Conflict, as long as it is respectful, helps generate ideas and introduce new perspectives.” He smiles when talking of the early days. “Riaz and I would argue and fight, others would hurry from the room, and then Riaz and I would go enjoy a great lunch together.”

Hurvis relishes the entrepreneurial spirit that can be found throughout the company. “We hire smart people who are given the freedom to do their job well and yet understand they are part of a collective effort,” Hurvis says. He is especially proud of the long tenure of Old World’s employees. “People who come here stay. We are a family.”

“Old World Industries has one of the healthiest business cultures I have seen,” says Matt Gooch, William Blair & Company’s head of European banking.

In 2012 William Blair advised Old World on the divestiture of its ethylene oxide and ethylene glycol manufacturing facility in Clear Lake, Texas, to Thailand-based Indorama Ventures for \$795 million. Gooch, who was the lead banker on the deal, talked with Hurvis virtually every day for five months during the process—a transaction that became complicated as large chemical companies from Asia, South America, and Europe fought to win the sale during a time of fluctuating commodity and input prices.

“Hurvis is very demanding; he pushed and challenged us at every step, ending each conversation with his hallmark ‘GID’ (Get it done!),” Gooch says. “But he was also an inspiration, and his optimism helped us to find the solutions to close the deal.”



*Old World Industries co-founder Tom Hurvis and his wife, Julie*

### “A strategic and forward-thinking guy”

As he was building Old World into the multifaceted company that it is today, Hurvis and his team focused on building strong relationships with suppliers, vendors, and jobbers. “On any given day we talk to Exxon, Wal-Mart, China, and the local convenience store,” Hurvis says. Old World’s relationships with its customers and stakeholders are based on a strong foundation of trust and integrity. “We never blew a price, and we never missed a payment,” he says.

Gooch says that much of the company’s success is because of Tom’s foresight in positioning PEAK as a consumer products company. Throughout its history, Old World has used celebrities from the world of sports, such as Mike Ditka, Wayne Gretzky, Richard Petty, and Danica Patrick, to market its products. “Along the way, Tom somehow convinced buyers to pay a higher price for a standard commodity,” Gooch says.

Dick Kiphart, the head of Private Client Advisors at William Blair, has served with Hurvis on the Lyric Opera of Chicago’s board of directors for several years. “Tom is a strategic and forward-thinking guy,” Kiphart says. “He knows when to take on unusual business risk where potential returns are high.”

As evidence, Kiphart points to the Clear Lake plant, which Hurvis purchased in 1999 for \$40 million during a cyclical low. The acquisition enabled Old World to vertically integrate its product line “from ground to shelf,” which has been

critical to the company's success; plus, the sale of the plant last year generated a hefty profit for Old World.

"Tom has the vision to understand long-term supply-and-demand trends, and he has the hustle to exploit them," says Jim Mabie, who, along with his son Dave Mabie, manages Hurvis's financial assets at William Blair. In 2010, the U.S. Environmental Protection Agency called for cleaner emissions. Today, one of Old World's best-selling products is Blue Def, a diesel exhaust fluid that reduces emissions and improves fuel economy and eventually will be required in every diesel-run vehicle in the United States.

### Having fun giving it away

"He dives into all of his interests with the same energy, intensity, and long-term vision that he gives to his company," Mabie says. Hurvis has worked extensively with Renée Fleming, the Lyric's creative consultant, on the Lyric's Renée Fleming Initiative, which promotes awareness and education through master classes. Hurvis is also the primary funder of On Target Laboratories, which is developing a revolutionary targeting solution that allows surgeons to identify cancer cells more easily.

Of all of Hurvis's philanthropic endeavors, education is his greatest passion. Hurvis serves on the board for Providence St. Mel School on Chicago's West Side and Lawrence University; his wife, Julie, is a very active board member of Chicago High School for the Arts (ChiArts), Chicago's first public high school for the arts. Hurvis's most recent energies are focused on Parent Power Chicago, an initiative that helps parents of Chicago school children understand and tap into the educational resources that are available to them.

"It is as fun giving money away as it is making it," Hurvis says. Profound words coming from a man who knows a thing or two about the relationship between fun and money.

One should not assume that the listed client approves or disapproves of William Blair & Company or the advisory services provided.

## EQUITY RESEARCH

# Talent Assessment and the Science Behind Hiring

In a business climate defined by volatility, decreasing margins, and heightened global competition, companies depend on advanced data analytics to maximize the efficiency of their operations. Firms are beginning to apply this to their human resources departments as well.

Companies are increasingly using quantitative testing tools and analytics to make better hiring decisions. Vendors that provide tools for pre-interview screening and other talent assessment are well positioned to benefit from this trend, according to William Blair & Company equity research analyst Tim McHugh. One of the leading companies in this space, according to McHugh, is SHL, which was acquired by Corporate Executive Board last year.

In a recent report titled *The Science Behind Hiring: Close Look at Talent Assessment and CEB's SHL Acquisition*, McHugh notes that 78% of companies in a proprietary William Blair survey said that they plan to increase their use of talent assessments during the next few years.

One of the primary drivers of this trend is the growing recognition of the high cost of making a bad hire. McHugh said that most hiring decisions are still based on subjective assessments made during interviews by managers who have little training in how to make judgments about potential employees.

"We believe that businesses are beginning to pay more attention to the financial repercussions of bad hires, which may make them more inclined to spend more on additional resources before making hiring decisions," McHugh said.

*To receive a copy of McHugh's report, please contact your William Blair representative. Visit [williamblair.com/ResearchCoverage](http://williamblair.com/ResearchCoverage) for important disclosure information and a full list of the more than 550 growth companies covered by William Blair's equity research analysts.*

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