

Client Focus

Cliff Hanger

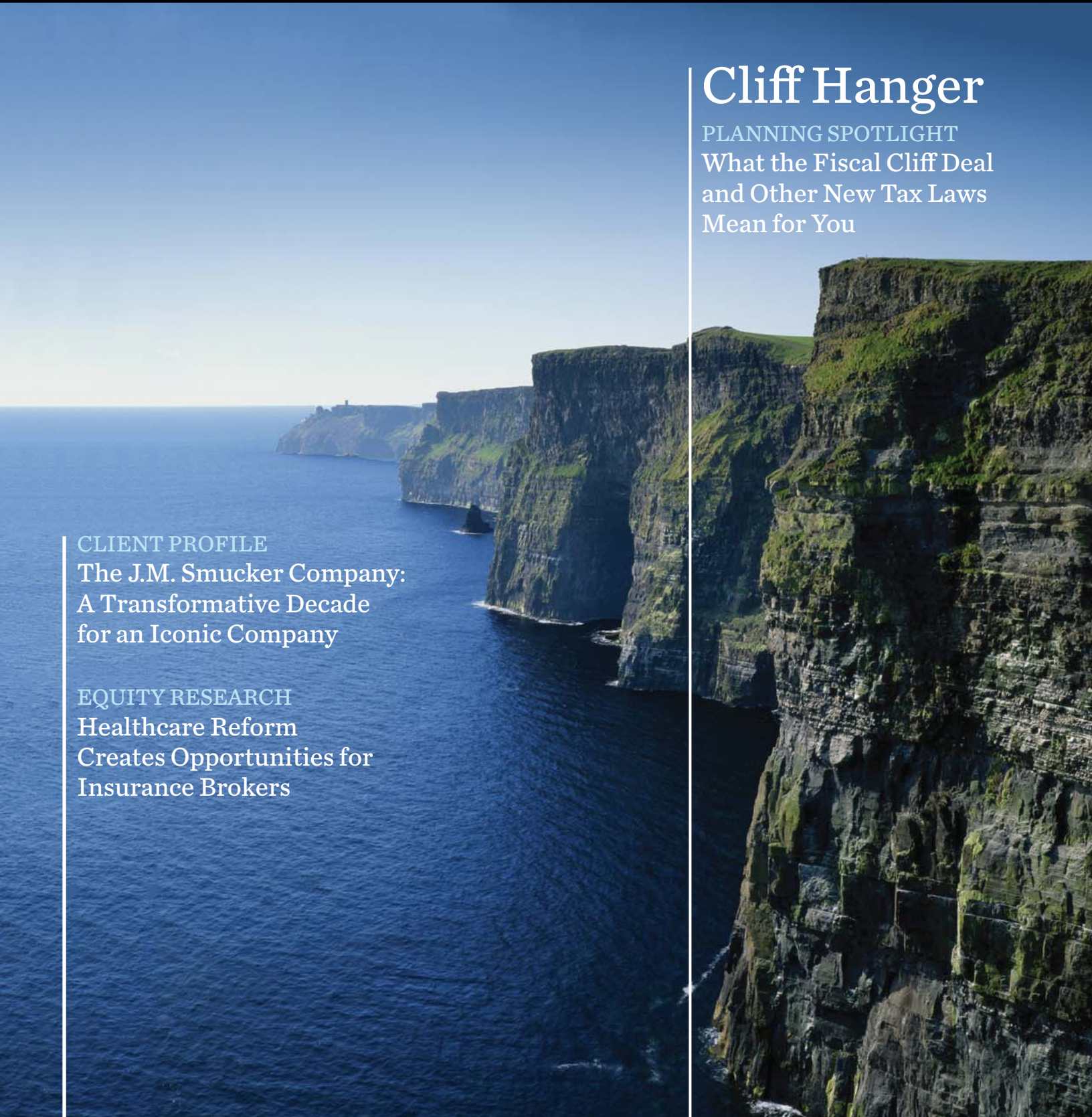
PLANNING SPOTLIGHT
What the Fiscal Cliff Deal
and Other New Tax Laws
Mean for You

CLIENT PROFILE

The J.M. Smucker Company:
A Transformative Decade
for an Iconic Company

EQUITY RESEARCH

Healthcare Reform
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Looking Back on a Year of Uncertainty and Equity Gains

For a year that began with escalating violence in Syria in early January and ended with Congress scrambling to pass a deal that would avoid the fiscal cliff on December 31, it is no surprise that 2012 was defined by market volatility throughout all four quarters.

Despite the volatility driven by continued concern over eurozone debt, U.S. fiscal policy, and unrest in the Middle East, equity markets produced solid returns for 2012. Buoyed by strong corporate performance, the Dow Jones Industrial Average gained 7.3% and the S&P 500 gained 13.4%. The gains were not limited to U.S. markets, as the Dow Jones World (excluding U.S.) Index was up 13.6% and the MSCI Emerging Markets Index was up 15.1%.

As we look ahead, we do not expect 2013 to offer a reprieve in terms of global economic uncertainty. In the United States, markets breathed a sigh of relief when Congress reached an 11th hour (more like a 12th hour) deal to avoid the across-the-board tax increases that were scheduled to go into

effect on January 1. But there will be no rest for the weary, as Congress gears up to debate the “sequestered” spending cuts and the federal debt limit later this year.

In a world where the next round of political brinksmanship or economic uncertainty is always just around the corner, we are convinced that success is defined by one's ability to remain focused on long-term goals.

The J.M. Smucker Company, which is profiled on page 2, is a perfect example. By staying true to the company's mission and values and by not being distracted by economic turbulence, Smucker has been able to successfully execute several significant transactions over the past decade that have strengthened the company's portfolio of brands. On a personal note, it has been tremendously gratifying to see Smucker's growth over this period. It is a company that truly cares about its customers and employees and the quality of its products.

As we quickly move into 2013, I want to thank you for the trust you have placed in us. We look forward to helping you, your families, and your companies continue to work toward your financial goals in the new year.

Sincerely,

John Ettelson
PRESIDENT AND CEO

Smucker's Appetite for Growth

In a December 2002 article titled “The ‘Peanut Butter & Jelly’ Deal,” Client Focus highlighted The J.M. Smucker Company’s \$731 million acquisition of Procter & Gamble’s Jif and Crisco brands.

“The combination of these three American icon brands (Smucker’s, Jif, and Crisco) ... creates a new and exciting company with leading positions in three significant food categories, excellent earnings power, and a strong financial position to pursue new product development and acquisition opportunities,” the article said.

Over the past decade, the Orrville, Ohio-based company has more than made good on that assessment.

Highlighted by its \$840 million acquisition of International Multifoods in 2004 and the blockbuster \$3.4 billion acquisition of Folgers in 2008, Smucker has built on its heritage of producing the world’s finest jams and preserves and created tremendous value for shareholders in the process.

In addition to the world-famous fruit spreads that the company has been producing since founder Jerome Monroe Smucker started selling apple butter in 1897, the company now boasts a full portfolio of food products. The Smucker family of brands now includes nearly 40 brands across North America, including Jif, Crisco, Robin Hood, Folgers, Café Bustelo, R. W. Knudsen Family, Santa Cruz Organic, Pillsbury, and Dunkin’ Donuts.

“Smucker’s has always been an iconic brand, but the Jif and Crisco transaction was truly a transformational acquisition for the company,” said Brent Smith, who is the head of consumer M&A for William Blair. Smith, along with William Blair CEO John Ettelson and bankers from throughout the firm’s corporate finance and debt teams, has advised Smucker on 11 transactions since 1999.

Barry Dunaway, senior vice president and chief administrative officer for Smucker, said the family’s decision to go forward with the transaction illustrated its belief in the company’s potential. >>

TEN YEARS

As *Client Focus* celebrates its 10th anniversary, we get caught up with one of William Blair & Company’s most iconic—and mouth-watering—clients.

“It has been a privilege to work with The J.M. Smucker Company over the years. It is a great company made up of even better people, and we are thrilled that we have been able to help support their growth.”

William Blair CEO John Ettelson

A Decade of Transformation

Through strategic acquisitions of brands like Jif, Crisco, and Folgers and continual product innovation, Smucker has transformed its product portfolio and financial performance since 2002.

	2002	2012
Sales (million)	\$687	\$5,526
Sales from fruit spreads, toppings, and syrups	45%	9%
Sales from peanut butter	7%	12%
Sales from coffee	0%	48%
Profits (million)	\$34	\$460
Stock Price	\$35.15	\$86.24

Sources: The J.M. Smucker Company’s 2002 and 2012 annual reports. Stock prices are as of January 2, 2002, and December 31, 2012.

CLIENT PROFILE

“Tim and Richard Smucker [the company’s chairman of the board and CEO, respectively, and great-grandsons of the company’s founder] felt the company could do so much more in the industry and that the employees were capable of managing a larger, more complex company,” Dunaway said. “The Jif and Crisco transaction really got the flywheel turning.”

That wheel has continued to turn vigorously since then. The International Multifoods transaction in 2004 allowed Smucker to acquire leading Canadian brands such as Bick’s and Robin Hood.

Smucker’s growth and expansion reached another inflection point in 2008 when the company acquired another iconic brand from Procter & Gamble: Folgers, the No. 1 U.S. retail coffee brand. In the four years since the Folgers transaction, Smucker’s sales have more than doubled, to \$5.5 billion in 2012, and coffee accounted for 48% of total sales in 2012.

Innovation in Flavor and Finance

As Smucker looks to continue its impressive trajectory, Dunaway said growth will continue to come from the growth of its core business, strategic acquisitions, and innovation. Smucker launched 60 new products in 2012 alone and plans to launch up to 100 more in 2013.

The company’s innovation, however, is not limited to new products you’ll be seeing in grocery stores. For both the Jif-Crisco and Folgers transactions, Smucker (with the help of William Blair’s investment bankers) executed the mergers using a relatively seldom-used and complex structure called a Reverse Morris Trust. The Reverse Morris Trust allowed Smucker to acquire

the brands from Procter & Gamble while minimizing the tax implications for P&G and its shareholders.

“Despite their traditional heritage, Smucker is an innovative acquirer on the cutting edge of transaction structure,” Smith said. He added that Smucker is the only acquirer to have used the Reverse Morris Trust structure for more than one transaction.

“Our company has been fortunate to experience transformational growth over the past decade. We are extremely grateful to all of our employees and other constituents who have contributed to that continued growth and success.”

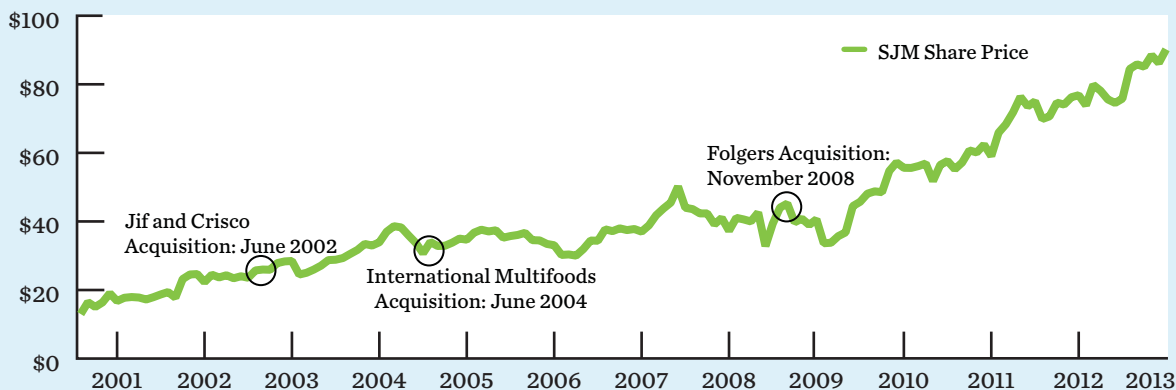
Smucker CEO Richard Smucker

The Folgers transaction was also noteworthy in that it involved the issuance of \$400 million of debt by Smucker in the midst of the credit crisis. William Blair’s Michael Ward, who has advised Smucker on multiple debt transactions, said it was one of the first private placements to price following the virtual shutdown of credit markets the week of September 15, 2008.

While the company’s focus remains predominately on North American markets, Smucker recently made a minority investment in a family-run oats producer in China. Dunaway said this venture will give Smucker valuable insight into Chinese consumers.

Acquisitions Bear Fruit

William Blair’s Brent Smith said Smucker’s management team has done a remarkable job creating value for its shareholders, growing the company’s market capitalization nearly 15 times, from less than \$700 million in 2001 to approximately \$9.5 billion today.



Source: Google Finance

Not a recommendation. Past performance is not an indication of future results



In addition to its iconic jams and preserves, Smucker's family of brands now includes more than 40 well-known brands.

Focused on Long-Term Growth

Smucker's strong, steady growth and financial performance since 2001 is doubly impressive considering it occurred over a 12-year period marked by two severe market crashes and heightened volatility.

Dunaway said the company's consistent performance is the result of management's relentless focus on long-term results. "It's really about the long term and what's best for all of our constituents: consumers, customers, employees, suppliers, communities, and shareholders," he said.

Smucker's unique culture is evident in the way it treats its more than 4,800 employees. *Fortune* magazine has consistently recognized Smucker as one of the 100 "Best Companies to Work For." "Relationships are fundamental to how we do business," Dunaway said.

Although William Blair's first transaction with Smucker was not until 1999, the relationship between the two companies dates to the 1980s. Paul Smucker, Jerome's grandson, met former William Blair CEO Ned Jannotta through their work together with the W. K. Kellogg Foundation Trust.

"It has been a privilege to work with The J.M. Smucker Company over the years," said Ettelson. "It is a great company made up of even better people, and we are thrilled that we have been able to help support their growth."

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

EQUITY RESEARCH

Healthcare Reform Creates Opportunities for Insurance Brokers

As the major provisions of the Patient Protection and Affordable Care Act of 2010 begin to take effect in 2014, insurance brokers should be well positioned to capitalize on growth opportunities created by the landmark reforms.

In a recent report titled *Distribution Opportunities in New Health Insurance Landscape*, William Blair & Company equity research analyst Adam Klauber said the creation of healthcare exchanges "are a game-changer for the entire healthcare insurance industry." Klauber said that Aon, National Financial Partners, and eHealth are among the companies that are best positioned to benefit from this trend.

Starting in 2014, the Affordable Care Act creates state and federal exchanges for individuals to purchase health insurance from participating providers. While these government-run public exchanges are getting most of the attention, Klauber said the bigger story will be the eventual adoption of these exchanges in the private sector.

He said that employers are likely to embrace exchanges as a way to slow rising healthcare costs by engaging employees in their healthcare choices. "The benefit brokers and consultants that embrace exchanges are likely to gain key advantages over competitors, and to enjoy a sustainable and highly profitable growth engine," Klauber said.

He said the reforms also will put increasing pressure on commissions and result in significant industry consolidation in the benefits distribution space.

To receive a copy of Klauber's report, please contact your William Blair representative. Visit 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.

Cliff Hanger

What the last-minute deal to avert the fiscal cliff means for you and your taxes in 2013

On January 1, President Obama and Congress came to an agreement on legislation to address the “fiscal cliff”—the combination of higher taxes and forced spending cuts that were scheduled to go into effect at the beginning of 2013. The American Taxpayer Relief Act (ATRA) prevents income tax rate increases for all but about the top 1% of taxpayers and extends the deadline for the implementation of the automatic spending cuts for two months.

ATRA also extends other income tax breaks for individuals and businesses and addresses the alternative minimum tax (AMT) and estate tax. The act does not, however, extend payroll tax cuts that were in place for 2011 and 2012, so payroll taxes will increase for all workers in 2013.

By delaying the decision on the automatic spending cuts (or “sequester”) for two months, Congress will be forced to tackle these issues, along with the decision about raising the federal debt ceiling, later this year.

NEW MEDICARE TAXES

It is also important to keep in mind that high-income taxpayers will face two new taxes, which were not part of ATRA, starting in 2013. Taxpayers making more than \$200,000 (single) or \$250,000 (married filing jointly) will face an additional 0.9% Medicare tax on earned income above those amounts and a 3.8% Medicare surtax on investment income.

For more information about how these two new taxes could affect your tax situation, please see our recent Financial Planning Update, “Two New Medicare Taxes in 2013,” in the Private Investors Resources section of williamblair.com

Individual income taxes

- *Ordinary income tax rates:* ATRA makes permanent the 2012 ordinary-income tax rates for individual taxpayers earning less than \$400,000 (or \$450,000 if married filing jointly). For taxpayers above these thresholds, the top marginal tax rate increases from 35% to 39.6% starting in 2013.
- *Long-term capital gains and dividends:* ATRA makes permanent the 2012 capital gains tax rates of 0% and 15% for taxpayers earning less than \$400,000 (single) or \$450,000 (married filing jointly). For taxpayers above these thresholds, the long-term capital gains rate increases to 20%. The act also makes permanent the long-term capital gains treatment for qualified dividends, which means that taxpayers making more than the thresholds will face a rate increase from 15% to 20% on qualified dividends.
- *Limits on itemized deductions:* ATRA brings back limits on itemized deductions and personal exemptions. These limits begin phasing in at income levels of \$250,000 (single) or \$300,000 (married filing jointly).
- *Alternative minimum tax:* ATRA makes the AMT “patch” permanent and retroactive to January 1, 2012. For 2012, the AMT exemption amounts will be \$50,600 for individuals and \$78,750 for married couples filing jointly. These amounts are indexed for inflation for years after 2012.
- *Charitable IRA rollovers:* Under certain circumstances, ATRA allows taxpayers age 70½ or older to make a direct tax-free rollover from an IRA to a qualified charitable organization. Distributions taken in December 2012 or January 2013 may be retroactively applied to 2012.
- *Other income tax items:* ATRA extends through 2013 (and in some cases retroactively to January 1, 2012) other tax breaks for individuals, including the deduction for state and local sales tax in lieu of state and local income tax and various child- and education-related credits and deductions.



Estate taxes

Under ATRA, the top estate tax rate increases to 40%. This is an increase of five percentage points over the 2012 rate, but significantly less than the 55% rate that was scheduled to return for 2013. The estate and gift tax exemption amount will continue to be \$5 million adjusted annually for inflation. For 2013 the exemption amount will likely increase slightly from the \$5.12 million 2012 exemption. ATRA also makes permanent a portability provision that allows for the transfer of one spouse's unused estate exemption to the surviving spouse.

Businesses

The act also extends several tax breaks for businesses, including bonus depreciation; enhanced Section 179 expensing; accelerated depreciation for qualified leasehold, retail, and restaurant improvements; the Work Opportunity Tax Credit; and the research and development credit. Owners of pass-through entities, such as sole-proprietorships, partnerships, limited liability companies, and S corporations, should also be aware of how ATRA's individual income tax changes will affect the taxation of business income.

How will you be affected?

In addition to the changes highlighted above, ATRA includes other provisions that may affect you or your business. Please contact your William Blair advisor to discuss how the new tax laws will affect your personal situation in 2013 and beyond.

This information has been prepared for informational purposes and is not intended to provide, nor should not be relied on for, accounting, legal, tax, or investment advice. Please consult with your tax and/or legal advisor regarding your individual circumstances.

TAX CHANGES FOR 2013

Taxpayers at all income levels will face a slew of tax changes in 2013. Here is a rundown of some of the most important changes going into effect this year:

ALL TAXPAYERS

- Increase in payroll taxes for Social Security from 4.2% to 6.2% on the first \$113,700 of earned income
- AMT exemption "patch" now permanent and indexed for inflation
- Option to deduct state and local sales taxes instead of state income taxes restored for 2012 and 2013
- Distributions from IRAs directly to charities are restored for 2013 and, under certain circumstances, are made retroactive for 2012
- Estate tax exemption of \$5 million (as indexed for inflation) for wealth-transfer taxes now permanent; top estate tax rate increases from 35% to 40%

INDIVIDUALS MAKING > \$200,000

(OR \$250,000 PER COUPLE)

- 3.8% Medicare surtax on investment income
- 0.9% Medicare tax on wages greater than these thresholds
- Limitations on itemized deductions and personal exemptions begin for those earning \$250,000 (or \$300,000 per couple)

INDIVIDUALS MAKING > \$400,000

(OR \$450,000 PER COUPLE)

- Top marginal tax rate increases from 35% to 39.6%
- Tax rate for long-term capital gains and qualified dividends increases from 15% to 20% (plus 3.8% Medicare surtax)

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MARKET OUTLOOK

George Greig's Global Market Outlook

Following a year in which a “crisis in the making” attitude defined market sentiment, William Blair’s global strategist for Investment Management, George Greig, provided his annual global market outlook.

“The market outlook is stabilizing and improving and should provide a better growth outlook in the intermediate term, while valuations are attractive,” Greig said during the December 6 presentation.

He said drastic risk avoidance has created an anomaly in which investors keep seeking low-risk assets even though productive assets (e.g., corporate assets, equities, and corporate bonds) and productive real assets (e.g., resources and real estate) are producing relatively high returns and risk-free assets are producing minimal returns. “This psychological bias appears to be the only factor that can preserve this kind of anomaly in the markets for as long as it has persisted,” he said.

Greig also provided outlooks for macroeconomic conditions in China, Europe, and the United States, as well as for corporate performance. “It really is corporate performance that drives market returns in the long run,” he said. “The most effective strategy you can execute in the equity market is to buy good companies.”



To view a replay of Greig’s presentation visit
www.williamblair.com/webinars

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