FIDUCIARY
MANAGEMENT, INC.
Investment Counsel

100 East Wisconsin Avenue, Suite 2200
Milwaukee, Wisconsin 53202
414-226-4545

INVESTMENT STRATEGY OUTLOOK - LARGE CAP EQUITY

Quarter Ended March 31, 2005

Fiduciary Management large capitalization portfolios had a very good March quarter, gaining modestly compared to a decline of approximately 2% in the Standard & Poor's 500. Financial and technology stocks generally performed poorly in the quarter; thus, our underweighted positions in these two sectors helped. The portfolios got a nice boost from the announced buyout of Sungard Data Systems by a consortium of private equity firms, led by Silver Lake Partners. We were not particularly surprised to see this offer as Sungard has always exhibited a high degree of recurring revenue and excellent profitability. Our best guess is that the new owners will sell the Availability operation and eventually bring the Investment Services division back out into the public arena. We'll certainly keep tabs on this well-managed enterprise. ConocoPhillips and BHP Billiton were also very strong in the quarter, continuing a multiyear run for energy and natural resource-related equities. We reduced our positions in both of these stocks during the quarter, as they moved closer to fair value. Two other stocks, VF Corporation and Yum! Brands, continued to climb even after extraordinary 2004 performance; they reached our valuation targets, and were sold. Kroger, Time Warner and Comerica detracted from the results in the March quarter. We remain optimistic about the long-term prospects for each of these investments.

On the buy side, we took advantage of the turmoil and negative publicity in the insurance brokerage industry to establish a position in Willis Group, the third largest player in the industry, which we allude to in more detail below. We think Marsh & McClennan and Aon will lose share to Willis over the next few years. Another industry that is out of favor is hospital management, and we used this circumstance to initiate a position in Health Management Associates, which is also presented below. Additionally, we have had Accenture on our radar for some time; the departure of Sungard gave us the opportunity to buy this high quality franchise, which is also discussed below.

Typically, we would not see this much turnover in the portfolios. An unusual combination of strong relative moves and the takeover of a large holding explains the higher-than-normal activity. Our view of the markets and the economy remains about the same as we communicated three months ago. This letter, as well as those from previous quarters, can be easily accessed at www.fiduciarymgt.com.

A snapshot of our portfolios relative to the Standard & Poor's 500 (S&P 500) shows a weighted average trailing twelve months price-to-earnings (P/E) ratio of 15.4 versus 22.1. The weighted average enterprise value to earnings before interest, taxes, depreciation and amortization (EV/EBITDA) ratio is 7.6 versus 12.3 for the S&P 500. The price-to-book ratio of our portfolios is 3.3 compared to 4.0 for the S&P 500. The debt-to-total capital ratio is 27.4% versus 32.6% for the S&P 500.

As is our custom for this letter, we present a few of the investments below.

Accenture Ltd.

Description

Accenture employs over 100,000 people worldwide, who provide management consulting, software solutions and integration, and business process outsourcing (BPO). Approximately two-thirds of the company's revenue comes from consulting, and about one third from BPO. Over 17,000 employees are in low-cost countries, including more than 11,000 in India. Accenture's global reach, broad expertise and excellent reputation put them in an elite group for large-scale engagements. The company is essentially debt-free and has over $3 billion in cash.

Good Business

- Accenture has a reasonably high degree of recurring revenue due to the typically long-term nature of the engagements. Existing projects often segue into follow-on work, too.
- The company has a well-known and respected business franchise, which should gain share at the expense of troubled companies such as Electronic Data Systems.
- The company is solidly profitable, has low capital intensity, and a high return on invested capital (ROIC).
- The company has reasonable control of its major costs (labor).
- The balance sheet has $3 billion in cash, and no debt.

Valuation

- The P/E ratio of 17.4 is near the low end of its range since the company went public in 2001.
- The company has better financial characteristics than the S&P 500, yet trades at a discount.
- The company trades at a premium to Electronic Data Systems and Computer Sciences Corporation, but is a vastly superior company. Compared to other business or technology services companies with similar financial characteristics, Accenture is undervalued.

Management

- William Green, 51, has been Chief Executive Officer since September of 2004. Prior to that he was the Chief Operating Officer, managing director and head of the communications and high-tech practices.
- Joe Forehand, 56, is Chairman of the Board. He served as Chief Executive Officer from 1999 through August of 2004.
- Tim Breene has served as Chief Strategy Officer since 2001.
- Employees own over 40% of the stock.

Investment Thesis

Accenture is a large, diverse and well-managed firm addressing technology, communications, and various other vertical markets, along with the BPO needs of the Fortune 500 and Global 500 customer base. An investment in this company provides several fundamental attributes. First, it gives exposure to the growth of technology without the risk of owning a primary technology company — thus avoiding technology obsolescence, short product cycles and typically poor ROIC. Second, it captures the trend toward outsourcing, which is well-established and growing. Finally, the firm is very strong financially. These benefits can be obtained at a very reasonable valuation and a discount to the S&P 500.

Willis Group Holdings Ltd.

Description

Willis is the third largest global insurance broker, with revenues of $2.2 billion. As an insurance intermediary, the company provides professional insurance, reinsurance, risk management, financial and human resource consulting and actuarial services to corporations, public entities and institutions around the world. Willis reports its business in three segments: Global (49% of revenues), North American (35%), and International (16%). In addition to several equity investments in subsidiary brokers, Willis has over 300 offices in 80 countries, and a global team of 14,500 associates serving clients in 180 countries. Key customers include over 30% of the UK FTSE 100 and nearly 10% of the Fortune 1000 with an average relationship of more than ten years.

Good Business

- Willis has a strong global franchise, offering highly-specialized insurance lines to an extensive and diverse client base operating in numerous businesses and industries throughout the world. Clients range in size from major multinationals to middle market companies.
- As an insurance distributor, Willis' business model is not highly capital-dependent. This is evidenced by a negative net trade cycle and ROIC of 18.2%.
- Revenues are modestly recurring as approximately 30% are derived from fees. As Willis gains more large accounts, this figure could increase to 40%. Historically, Willis' brokerage relationships have been durable, thus commission revenue could be viewed as recurring as well.
- Willis has a good balance sheet.

Valuation

- Since the company's initial public offering (IPO) in 2001, Willis' 12-month forward P/E has ranged from 12x to 21.9x, with a median of 14.5x and an average of 15.9x; it is currently less than 14x.
- At 6x trailing earnings before interest, taxes, depreciation and amortization (EBITDA), the shares trade two multiple points below their historical average, and at the low point of the historical range.
- Peer companies of similar profitability and franchise value trade for over 20 times earnings.

Management

- Joseph Plumeri has been Chairman and Chief Executive Officer since late 2000. Plumeri's previous experience at Citigroup has aided Willis' sales force improvement and cost rationalization. Plumeri owns 4.6 million shares (2.9% of shares outstanding, or $179.4 million of stock) and has committed not to sell as long as he is at the company.
- Willis has a deep management team, averaging 19 years of experience in the industry, and 13 years with Willis. Executives are specialists in each of the major insurance offerings.
- Managerial and employee incentives are aligned with shareholders, as approximately 6,000 employees have invested or acquired interests representing approximately 18% of the fully diluted share base.

Investment Thesis

The insurance brokerage industry is a superior business, characterized by low capital intensity, good profit margins and above-average long-term growth. The industry does, however, exhibit some cyclicality, as one would expect given its ties to the Property & Casualty underwriting cycle. The insurance pricing cycle has turned soft in recent quarters. Despite this softening, we believe Willis' growth prospects remain solid over the long-term. The company should continue to grow market share through bolt-on acquisitions and by gaining clients from Marsh and Aon. The stock is attractively priced for long-term investors.

Health Management Associates, Inc.

Description

Health Management Associates (HMA) is one of the largest non-urban general acute care hospitals. The company operates 52 hospitals primarily in the Southeast. Major markets include Florida (22% of total licensed beds), Mississippi (19%), and the Carolinas (9%). HMA provides an array of inpatient and outpatient services including general surgery, internal medicine, obstetrics, and specialized services such as open-heart surgery and neurosurgery.

Good Business

- The company has a durable business model, serving as the sole provider of medical services to a predominately aging demographic profile in the company's major markets. This provides for favorable pricing with both managed care and governmental payers.
- Hospital revenues are fairly predictable, as services provided are often necessities. Therefore, a certain population and demographic will actuarially determine a certain admission level.
- HMA has an industry-leading ROIC of 12.5%, attributable to superior expense management, and a track record of improving acquired under-performing hospitals.
- The company has one of the strongest balance sheets in the industry. Current debt-to-capitalization is 32%, and debt to EBITDA is 1.4x. Interest and fixed charge coverage are 42x, and 8x, respectively.
- Operating a highly variable cost model allows HMA to maintain margins and profitability throughout industry cycles.
- HMA's mix is roughly 50% managed care, 35% Medicare, 9% Medicaid, and 6% private pay. In the next two years Medicare prices will increase 4% and 2-2.5%, respectively. Managed care pricing should increase 8-10%.

Valuation

- Relative to its rural peer group HMA trades in-line on trailing EV/EBITDA, and roughly two multiple points below the group's average forward P/E multiple.
- During the past ten years the forward P/E multiple has varied between 10x and 45x, with a 21.5x average, approximately in-line with the long-term growth in earnings. The current P/E ratio is 17.4.
- Downside is limited due to private market transactions occurring at HMA's current 1.5 multiple of sales.

Management

- Joseph V. Vumbacco, age 59, became Chief Executive Officer in January of 2001. Previously, he served as President, Chief Administrative Officer and Chief Operating Officer.
- Robert E. Farnham, CPA, age 49, has been Senior Vice President and Chief Financial Officer since March of 2001. In the six previous years he was Senior Vice President and Treasurer.

Investment Thesis

The hospital industry has been under a cloud over the past couple of years due to weaker-than-expected admissions, bad debt and reimbursement worries. We believe the first two of these worries are short term, while the last will be an ever-present risk. We feel HMA's valuation compensates us for assuming these problems. A continued moderate increase in employment will benefit admissions, and growth in net revenues per adjusted admission. Good demographics aid the long-term outlook.

Thank you for your continued confidence in Fiduciary Management, Inc.