Fiduciary Management Inc.
Investment Counsel

225 East Mason Street
Milwaukee, Wisconsin 53202
414-226-4545

INVESTMENT STRATEGY OUTLOOK

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That giant sucking sound you're hearing is not the outflow of U.S. jobs to Mexico due to NAFTA as predicted by Ross Perot several years ago, but rather, the air being let out of the technology and biotech "bubble" to which we've referred in our last two letters. We have no way to know if this is just another "buying opportunity" for the "growth at any price" and momentum investors, but ultimately, the speculative stocks won't rebound - and in the end it won't be pretty.

The shift in sentiment and decline in many of the overvalued stocks in today's market over the last few weeks has been simply breathtaking. Over the past month, the NASDAQ has declined 19.7%; the Interactive Week Internet Index fell 24.3%; and the Merrill Lynch Biotech Holders Trust is down 24.3%. Individual stock declines off their 52-week highs (for the most part in the last 6-8 weeks) have been stunning: Ariba, down 71%; Red Hat, down 82%; Commerce One, down 72%; MicroStrategy (see our last letter, dated March 7), down 87%; and EBay, down 45%. Against that backdrop, your portfolio did very well. In fact, as of this writing, your portfolio has bested all of the averages, to include the Dow, S&P 500, NASDAQ and Russell 2000. Indeed, we have witnessed a stunning reversal over the last several weeks in favor of the value segment of the market where we are positioned. Venerable market forecaster, Bob Farrell of Merrill Lynch, probably summed it up best in the April 10 issue of Barron's when he said, "We're seeing a sea-change in investor preference, away from so-called New Economy stocks to so-called Old Economy stocks. This dramatic shift in the last few weeks foreshadows an extended period of under-performance by the NASDAQ and particularly the technology sector."

Our view, as we have discussed with you in the past, is that technology, including the Internet, will be an increasingly important part of most companies. Your portfolio companies' technology strategies are key inputs to our research. The stock market likes black and white stories like "new" versus "old" economy, but in reality, all companies have to face a changing world and figure out how to defend a niche and make money. Pure play "new economy" companies heretofore have been too expensive and risky to own. Perhaps if the markets cooperate, we will get a chance to own the better ones at a good price.

In our January letter, we commented on the significant share repurchase activity in your portfolio. Specifically, over 75% of the companies in your portfolio have implemented active share repurchases. We also commented that we felt there was a strong likelihood that the attractive valuations would result in increased merger activity. In the first quarter, two of your companies were acquired. Sterling Commerce was acquired by SBC at a 46% premium, and Financial Security Assurance at a 52% premium, by Dexia. Additionally, Consolidated Stores has engaged Credit Suisse First Boston to look at possible ways of enhancing shareholder value. We believe that we will continue to see acquisition activity continue at a high level because of the strong underlying fundamentals of your companies and the extremely attractive valuations - on a P/E multiple basis, your portfolio is still priced 55% cheaper than the S&P 500!

On that score, we would like to highlight a few of the companies currently held in your portfolio.

What *Has* Worked

Arrow Electronics

Arrow is the world's number one distributor of semiconductors, passive electronic components and mid-range computer systems. The Company has the number one market share in the United States, Europe and the Far East. The stock has recently broken out of a slump, having appreciated 41% this year, yet still sells at just 14 times recently raised estimates. Despite widely held views that the "Dell model" (a direct relationship between supplier and customer) and business-to-business e-commerce would usurp the function of the distributor, Arrow, and a handful of other top tier players including your Pioneer-Standard holding — up 25% in the past nine months — are currently thriving.

The last few years have been confusing and frustrating for investors as a cyclical downturn in semiconductors over the 1996-1998 period began to transition into a recovery. While the timing of the cycles is obviously not perfectly predictable, distributors typically lag the semiconductor manufacturers by one to four quarters. The absence of an immediate recovery by Arrow and the other distributors last year seemed to scare investors into thinking that the bigger secular issues previously mentioned were at work. This caused the stock to underperform in 1999. Now that growth has resumed, the stock has recovered strongly; yet this equity still trades at a significant discount to its historical relative and absolute valuation range, suggesting a nagging concern by the market that Arrow's success will be fleeting.

We have spent a great deal of time analyzing supply chain management, "BtoB e-commerce," and vertical portals, particularly as they relate to the Internet. We expect the more commodity aspects of distribution, the so-called demand fulfillment business, to be negatively impacted by advanced supply chain techniques employed by the likes of Ariba, Commerce One or Vertical Net. Value added distribution, the so-called demand creation end of the business, should continue to thrive as it involves a whole host of activities ancillary to the delivery of a part, and in many cases, involves physical alteration of the part. Furthermore, end customers are looking to outsource non-core tasks, and distributors like Arrow have built the infrastructure to satisfy these demands. Approximately 65% of Arrow's current business is demand creation and that percentage has been growing steadily in recent years. As the market further recognizes that top tier value added distributors have a defendable role in the electronics supply chain, the P/E multiple should expand. We will obviously keep a keen eye on the rapidly changing landscape, but in the meantime there is a nice cyclical recovery in place and earnings are growing rapidly. Having the patience to stick with this sound idea has paid off handsomely for you.

Sungard Data Systems

Sungard Data is the leading provider of investment software and services to banks, brokerage firms, and investment institutions. Sungard is also the leading provider of computer data disaster recovery solutions and recently added an application service provider (ASP) offering that leverages existing processing infrastructure. Sungard's investment software products are diverse, addressing complicated derivative applications, portfolio management systems, on-line trading and trade adjudication. The disaster recovery business has become an absolute necessity as information becomes the most valuable corporate asset. These services are provided under multi-year contracts. The ASP industry has recently captured Wall Street's attention, with companies such as Exodus and USInternetworking, unprofitable and unproven, trading in excess of 100 times revenue. Sungard has a very robust model in the ASP area, selling to Blue Chip customers who have come to rely on the Company's reputation in the disaster recovery market. The irony is that Sungard can fund a wonderful growth opportunity internally while still remaining highly profitable. Sungard's net income of $200 million is roughly equal to Exodus' total revenues (Exodus lost $130 million last year), yet has a market capitalization less than one-fifth that of Exodus!

Most of the Sungard businesses are characterized by high degrees of recurring revenue (83% for the firm as a whole), strong margins and superb free cash flows. Sungard's cash flow exceeded $300 million last year and the balance sheet sports no debt and a net cash position of nearly $400 million. Long term clients of Fiduciary Management know this company well, as it was a big winner for us during much of the 1990s, appreciating over 500% in the seven years during which we owned it. Due to valuation and year 2000 concerns, we stepped to the sidelines at the end of 1998. With those worries negatively impacting the stock last year, we reinvested. This proved premature, as the Company missed, by four cents, its first quarter in nine years last September. The stock was clobbered, eventually dropping to 5.5 times earnings before interest, taxes, depreciation and amortization (EBITDA).

This was an incredible valuation for a company of this quality and we took that opportunity to make Sungard a very large position. With steady operating performance in Q4 and a positive outlook for Q1, the stock rebounded nicely, up 59% through March. Even with this rebound, the stock still trades for less than 10 times EBITDA and 21 times earnings, a discount to the market and comparable companies.

What *Hasn't* Worked... But What We Believe Will

Consolidated Stores

Consolidated Stores is the leading close-out merchandiser in the United States with over 1,230 Odd Lots, Big Lots, Pic 'N' Save and MacFrugal's stores and 1,320 K•B Toys locations. The Company's K•Bkids.com is also one of the top on-line toy retailers. The stock has been disappointing over the past two years, due to problems integrating the MacFrugal's acquisition, bringing on a new distribution center and inventory management system, and the start-up of the Internet toy business. The issues regarding the core franchise are behind the Company now and the closeout business is solidly back on the growth track. This business earned $1.15 last year and is expected to earn $1.35 this year and remains an excellent free cash story. Consolidated Stores is far and away the leader in the closeout sector and achieves a superior margin and return on capital.

Unfortunately, what was once excitement surrounding the K•Bkids.com Internet venture has now turned 180 degrees as the market has soured on e-tailing. eToys, for example, has gone from $86.00 to $8.00! The market appears to be worried that K•Bkids.com will be a longer-term drag on overall Consolidated Stores' earnings. Thus, the planned IPO of K•Bkids.com is now in jeopardy and is likely the reason why the Company recently hired Credit Suisse First Boston to "explore various options to increase shareholder value." We believe management is highly motivated to do what it takes to deliver shareholder value, including divestiture of K•Bkids.com. A reasonable valuation on the core business -a 15%+ growth story with excellent free cash characteristics — is 20 times earnings. If the Company reaches the reasonable target of $1.35 this year (excluding K•Bkids.com) and the market starts to look at $1.55-1.60 next year, the stock could push toward $30.00 or higher. With the stock currently at $12.00, we are very excited about the prospects. With Credit Suisse First Boston on board, the catalyst is there to make it happen.

Casella Waste Systems

Casella Waste is a regional, integrated, non-hazardous solid waste services company with current operations focused in the Northeastern part of the United States. In most of its markets, Casella has the largest market share for both collection and landfill of waste. The business model is sound, with strong recurring revenues that are under contract and end-market demand that is recession resistant. The Company closed on the acquisition of KTI Inc. in December, which brought along scarce disposal capacity in the form of two waste-to-energy facilities (incineration) in the Northeast. Additionally, KTI is involved in the recycling of waste and the production of finished products, where they convert recycled plastic and paper. Casella has established an enviable position in solid waste in the Northeast, which is the region with the highest internal growth in the country. In Q3 ending January 31, internal growth (volume and price) increased over 9% and the outlook for the core collection and disposal assets remains very bright. As expansions become more difficult to obtain, the value of the Casella franchise increases.

Currently, the negatives that came along with the KTI acquisition, specifically the businesses that have been slated for divestiture, have overwhelmed the positives, sinking the stock. Earnings estimates have retreated to $1.15 from $1.45 for the fiscal year ending April 30, 2001 and the stock is down from $18.00 to $7.25. This appears to be a major overreaction, since the problems seem to be transitory, and very fixable. The Company is going to divest the unattractive businesses that came with KTI. We have been assured of that and believe it will happen soon. Unless there is a significant change in the economic landscape, the $1.15 estimate for April, 2001 looks conservative. Moreover, proceeds from divestitures will be used to reduce debt. At current share prices, the P/E multiple is 6.7x and the EBITDA multiple (market value plus net debt, divided by earnings before interest, taxes, depreciation and amortization) is 4.1x. We believe the stock will appreciate several-fold from the current levels over the next few years.

G&K Services

G&K Services is the third largest uniform rental company in North America. Our longer-term clients will remember our first successful stint with this stock in the early 1990s, when it appreciated fourfold. As was the case with Sungard, our reentry last year into the stock was less than elegant. Nonetheless, this is an excellent business that we not only know well, but are confident can deliver solid operating margins and growth. Like Sungard, it is characterized by recurring revenue. Best of all, and despite a modest bounce off the bottom, the stock is wonderfully cheap right now - in fact, on a valuation basis, very close to our purchase price in the early 1990s. We have done a LBO analysis of this company, which we would be happy to provide to our clients upon request, that suggests attractive returns even at a 75-100% premium to today's price. While we do not expect a LBO, the exercise is useful in assessing downside risk. Currently the stock trades for approximately 10 times calendar 2000 estimated earnings and 5 times EBITDA. The nearest comparable public company, Cintas, trades at 27 times earnings and 10 times EBITDA.

Every cheap stock has a story, and G&K is no exception. Theirs is a two-part problem. First, they purchased National Linen Services two years ago and it came with warts that have taken management longer to address than most expected. Not coincidentally, when the Company announced the National Linen acquisition, that is when we sold our original position. Problems getting these operations up to G&K standards and growth rates hurt the stock last year. We felt the Company was making steady progress even though the stock had fallen to attractive levels; that is when we repurchased the stock. Unfortunately, all were blind-sided in early 2000 by problem number two, which was the difficulties encountered cranking up their direct sales business. Cintas has a wonderful direct business and we applaud G&K's management for going after this attractive market. Many mistakes were made, however, and there is much work left to be done. The good news is that the Company has put Dick Fink, the current chairman and long time former CEO, temporarily in charge of the direct business. The situation is now stabilized and he will run it until a capable executive is hired.

The depressed stock gave us the opportunity to double our positions. We will continue to closely watch the progress of the Southeast division (where most of the National Service problems were located) and the direct sales division. Management has given Wall Street fairly conservative guidance for the next few quarters and if this comes off without additional slippage, the stock should start to recover. Ultimately, we hope to see G&K return to the land of premium multiples, where the Company lived until 12 months ago. If so, the stock could be fantastic.

As we said in our last two letters, we're extremely excited about the return prospects for your portfolio for the next 12-36 months. Overall, your companies should experience growth of over 16% in the first quarter, and 17%+ for the full year. Whenever your companies have sold at roughly 12 times estimated earnings and a 55% discount to the market, it has been a recipe for outstanding returns going forward.

If you have any questions pertaining to your portfolio or the market, please call us at (414) 226-4545, or toll free, at (800) 264-7684. As always, thank you for your continued confidence in our investment style and the disciplines we employ here at Fiduciary Management, Inc.