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INVESTMENT STRATEGY OUTLOOK

April 2004

Fiduciary Management, Inc. portfolios had a strong first quarter, slightly underperforming the 6.1% return for the Russell 2000. The quarter played out in two parts, a first half rally dominated by consumer growth stocks followed by a decline and corresponding outperformance by more value-oriented issues. Midway through the quarter, investors seemed to question expected growth rates and valuations. Additional factors in this reversal were escalating terrorist activities, worse than expected employment numbers, the recognition of decelerating earnings growth in the back half of 2004, and the heating up of election year politics. To punctuate the seesaw nature of this market, it rallied again right at the end of the quarter and into early April, apparently in response to a better than expected March employment figure and an Institute for Supply Management (ISM) number of 62.5, which indicates stronger manufacturing activity.

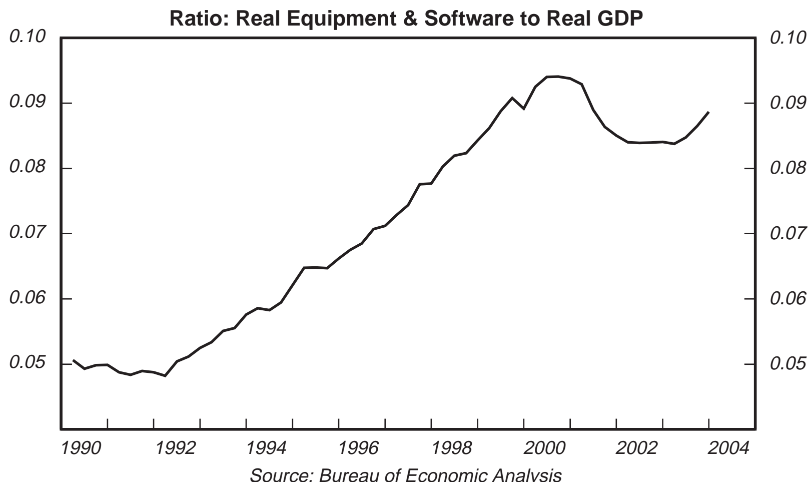
In spite of some healthier economic news, we maintain our belief that overall stock market valuations remain too high relative to the long-term growth prospects for equities in general. We do not see fundamental growth rates over the next five years being above average. Areas of worry include poor consumer and government balance sheets, nascent inflation rumblings and a lack of meaningful job growth. In next quarter's letter, we will discuss these issues in more detail.

Our research department spends the great majority of its time analyzing individual securities and more specifically, their long-term fundamental prospects. Along with this bottom-up focus, we are also cognizant and careful about the portfolio's industry and economic sector exposure. We have never "managed to an index." We will, however, tilt our research effort toward the sectors that appear to have more value, while moving away from areas that look overvalued. Over the past five to six years, we have been underweighted in technology. That hurt the portfolio relative performance in the late 1990's as well as during 2003. It was, of course, a big positive factor in the 2000-2002 time frame. We continue to believe that broadly speaking, technology remains overvalued and unattractive. The portfolio's technology weighting is approximately 10% versus the Russell 2000's 20%. Our technology exposure continues to be in "downstream" ideas, i.e. users of technology rather than inventors of technology.

Financial Services is another sector where the portfolio has been intentionally underweighted in recent years. We believe the very favorable conditions that have existed for this group are, or will be, disappearing. The laundry list of difficulties this sector faces includes: excess capacity (mutual funds, banking, finance), an over levered consumer, an inflated housing market, credit derivatives, hedge fund accidents, and an unfavorable interest rate environment. The portfolio's financial sector exposure is approximately 9%, all in niche insurance stocks, compared to 21% for the Russell 2000. By way of comparison, the Russell 2000's financial weighting fifteen years ago was 12%.

As a check on our sanity, we theorize that sector weightings, in a broad stock market index, should roughly match their commensurate percentage of the gross domestic product (GDP), or

the real economy, over time. Any weighting in excess of its position in the real economy suggests a growth premium. According to the Bureau of Economic Analysis, technology related industries are approximately 9% of GDP (see chart). Other studies suggest it is even smaller. The financial services look to be approximately 15% of the real economy, yet over 20% of the index.



Our relatively light exposure to technology and financials will be a sizeable factor in whether or not the portfolio outperforms the benchmark over the next few years. Our contrarian bent and a sober look at the fundamentals of these two groups gives us the confidence to stick with this position.

As is our custom for the April letter, we highlight a few of your holdings.

RUDDICK CORPORATION

Description

Ruddick is a holding company that is engaged in two businesses, Harris Teeter and American & Efird. Harris Teeter, which is Ruddick's primary business, operates a regional chain of 140 higher-end supermarkets that are located in six southeastern states but with a heavy concentration in North Carolina (about 80% of the stores). Harris Teeter accounted for 89% of sales and 87% of operating profit in fiscal 2003. American & Efird, which accounted for the remaining 11% of sales and 13% of operating profit, manufactures and distributes industrial and consumer sewing thread.

Good Business

- While not immune to the threat of competition from Wal-Mart and other supermarkets, Harris Teeter caters to a higher demographic and emphasizes broader selection, higher quality products and service, and faster check out.
- Food is a consumable basic necessity, which results in strong recurring revenue, and the products have low price points.
- This is an easy business to understand.
- The return on invested capital (ROIC) is 9% and we believe it can get to 11%.
- The company has solid finances.

Valuation

- At 13.2x trailing earnings, the stock trades at the low end of its historical absolute and relative valuation ranges.
- The stock trades at a price/sales multiple of 0.29x, which places it at the mid-point of its ten-year range of 0.24-0.35x.

Management

- Thomas Dickson has been president and chief executive officer since February 1997. His compensation is tied in part to improvements in return on equity (ROE).
- Compensation is modest, and the overhang and dilution from options is minimal.
- Employees own about 18% of the stock through the employee stock ownership plan (ESOP). Directors and executive officers as a group own over 10% of the stock, with the vast majority owned outright (i.e., ex options). Therefore, total inside ownership approximates 30%, thereby aligning the company's interests with those of the public shareholders.
- Ruddick's decision to continue to own A&E is questionable and may serve as a distraction to management going forward.

Investment Thesis

Ruddick increases our exposure to consumer staples, a defensive move in light of current valuations in the stock market and the state of the consumer. The stock should be supported by steady, albeit modest, earnings growth and a 2.1% dividend yield.

WERNER ENTERPRISES

Description

Omaha-based Werner Enterprises is a leading truckload (TL) carrier in the United States, Mexico and Canada. The company was founded by C.L. Werner in 1956 with one truck and has grown to be the third largest publicly held TL carrier domestically. The company operates a fleet of roughly 8,000 power units and 13 terminals in the United States. Of the total tractors, approximately 87% are company-owned with the balance being owner-operators. The principal types of freight transported include consumer products, retail store merchandise, food and paper products, beverages, industrial products and building materials.

Good Business

- Werner's business model is fairly predictable. The company is well diversified from a customer and industry standpoint and has a very good track record of revenue growth.
- Werner is one of the higher-quality franchises in an industry with increasing barriers-to-entry. With larger companies looking to outsource more of their transportation, there is a great reliance on transportation partners such as Werner that can meet service requirements.
- ROIC is acceptable, but more importantly, is improving. As the company has focused its attention on productivity, returns have increased from 7% to over 9%. ROIC should be over 10% next year.
- The investment provides exposure to an economic upturn.
- Werner has an excellent balance sheet and valuable assets. The company has over $1 per share in cash and the youngest fleet age in the industry.

Valuation

Shares currently trade at approximately 5.0x next year's estimated earnings before interest, taxes, depreciation and amortization (EBITDA) and 0.85x revenues. This is on the lower-end of historic valuations. Over the past 5 years, Werner has traded on average at 5.6x EBITDA and between 1.1x and 0.6x revenues.

Management

Clarence L. (C.L.) Werner is chairman of the board and chief executive officer. He beneficially owns about 28% of the outstanding shares. C.L. has three sons that are also involved in managing Werner, including Gary, vice chairman; Curtis, vice chairman-corporate development; and Greg, president and chief operating officer. These gentlemen make up four of the nine members of the company's board of directors.

Investment Thesis

Werner Enterprises provides exposure to a cyclical economic upturn at a reasonable valuation. Currently, this is difficult to find in the overall market. Additionally, the company's focus on profitability rather than growth should result in valuation expansion over the intermediate term.

UNITED STATIONERS INC.

Description

With annual sales of approximately $3.8 billion, United Stationers is the leading broad line wholesaler of office products in North America. The company supplies over 40,000 items, roughly half of which are "technology" products like printer cartridges, to nearly 15,000 resellers and delivers these products within 24 hours. Its primary customer base is the independent office supplies dealer, but they also serve supermarkets, drugstores and "big box" office supply stores such as Staples (who is also a competitor).

Good Business

- The company is a leader in its niche and has only a fraction of the $75 billion industry.
- While there is white-collar employment sensitivity to the business, revenues are largely recurring in nature. Most of the products are consumed.
- The barriers to entry are high due to logistics, software, and service requirements.
- The ROIC has averaged 10-15% since the mid- 1990's. It is currently on the low end of that range due to weak employment trends.
- Capital expenditure (CAPEX) requirements are modest and the company generates very solid cash flow.
- United Stationers has a solid balance sheet.

Valuation

- The price to earnings (P/E) ratio has generally ranged from 9 to 20 and is currently 13.
- The enterprise value to EBITDA ratio is currently 7.3 times 2004's estimate. The long-term range is 6-9.
- The price-to-free cash flow multiple is 11 versus the long-term range of 6-20.

Management

- Dick Gochnauer, chief executive officer, joined the company in July of 2002 and has significantly and positively changed the culture of the firm. Previously, United did not have a good grasp of their costs or profitability of accounts. We believe the company can continue to reduce expenses, while modestly growing revenues. Prior to United, Gochnauer was chief operating officer of Golden State Foods and executive vice

president of Dial Corp. He was also president of Stella Cheese, at the time a division of Universal Foods.

- Kathy Dvorak, chief financial officer, has been with the company since 1982 and in her current position since 2001. She appears to be very hard working, diligent and committed to delivering results.

Investment Thesis

United Stationers faces long-term pressure on gross margins, not unlike other distribution companies, but steady to rising operating margins due to further reorganizing and optimizing of the cost structure. We believe the company can gain 100 basis points of margin ($1 per share pretax) over the next three years and perhaps more if white-collar employment advances. Strong free cash flow provides an opportunity for share repurchases or tuck-in acquisitions. The P/E multiple should expand modestly, perhaps to 15-16 in a steady overall stock market environment.

Thank you very much for your continued support of Fiduciary Management, Inc.