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Investment Strategy Outlook - Small Cap Equity

Quarter Ended September 30, 2006

The quarter ending September 30 was quite good for FMI portfolios as they advanced roughly 4.5% compared to a 0.4% gain for the Russell 2000. Contributions came from a variety of stocks, including Advo, which was the target of a takeover by Valassis Communications. Fortunately, we sold Advo immediately after the deal was announced because subsequently, Valassis got cold feet and is now trying to scuttle the agreement. The two are now engaged in litigation. While the big premium paid by Valassis made for a happy day in July, clients with good memories may recall that the deal value was only slightly higher than what we paid roughly 15 months prior. We took the proceeds and reinvested them in what we consider to be a superior franchise, Harte-Hanks, an investment we discuss in more detail below.

Another takeover aided results in the quarter. A group led by Texas Pacific announced they would take Petco, the pet supplies retailer, private at a nice premium. Family Dollar Stores also advanced significantly in response to good sales and earnings results. From a group perspective, commercial services, retail and process industries were all strong in the quarter.

On the downside, Bisys' modestly disappointing sales and earnings update hurt the stock. This has been a frustrating and heretofore lousy investment for us. Some clients may wonder why we don't sell this stock. The answer is that each day we come to work, we begin with a clean slate. Every new idea and every existing investment is evaluated on its merits and investment potential looking out three to four years. The simple truth is that Bisys was sicker than we thought when we initially bought the stock. With perfect hindsight, it was a mistake to have bought it when we did. Over the past 12-18 months, however, the company has been on the mend. The balance sheet is now debt-free with over $100 million in cash. The two core businesses are very profitable and generate free cash flow in excess of net income. We believe a private buyer could generate an attractive return paying a 30% premium to the current price.

Arrow Electronics (semiconductor and systems distribution) and Werner Enterprises (trucking) were also weak in the September quarter. Fears of an economic slowdown appear to be the culprit. From a group perspective, the poor performers were technology services, distribution services and transportation.

From a big picture standpoint, a couple of themes we have hammered on for awhile seem to be playing out. First, housing has rolled over; new and existing home sales have declined sharply, and prices have dropped substantially, not only in the more speculative regions, but also in the Midwest, Mid-Atlantic and South. So far, we haven't seen the reverse wealth effect on consumer spending that was expected. Perhaps the windfall from the sudden drop in gasoline prices has masked the impact in the short run. However, we continue to expect a tougher environment for consumer discretionary spending in coming quarters.

Second, energy prices have retreated. Oil peaked around $78 per barrel and now trades for approximately $60. Natural gas prices are down over 50% from late last year. As we indicated in our letter of June 30, the fundamentals seem to support a much lower price. Our relatively light position in energy stocks should help performance over the coming year or so.

We were also not surprised to see the meltdown of Amaranth, the hedge fund that declined 60% speculating on levered energy derivatives. This debacle was precipitated by a sudden move in the energy markets. This world of energy trading is tiny compared to that of credit derivatives and credit default swaps, where we anticipate more meaningful "events" in coming years. The credit default swap market is estimated to exceed $26 trillion, or more than twice the size of the U.S. Gross Domestic Product (GDP). Perhaps we will address this situation in more detail in a future letter, but suffice it to say that the hedge funds and the banks are up to their eyeballs in these products. Everyone operates with the assumption that the counterparties on all of the interlocking trades are going to meet their obligations at the appointed time. History suggests that this may not happen. We think the mad rush to hedge funds over the past several years is going to end badly. While it may be self-serving, we advocate a prudent, even "plain vanilla" approach to investing, particularly with overall valuations elevated and financial risk perhaps greater, due to the untested nature of the credit derivatives market.

As a reminder to newer investors with Fiduciary Management, our first and third calendar quarter commentaries have a brief overview of performance and pertinent macro developments, followed by a description of a few of the portfolio investments. The second and fourth quarter letters usually deal with a particular theme, or a more detailed economic and stock market overview. Our letters are archived on our website, www.fiduciarymgt.com, under the "About Us" tab.

Harte-Hanks, Inc.

Description
Harte-Hanks provides advertising and marketing services via two distinct operating units: Direct Marketing (60% of revenues and 55% of income) and the Shoppers business. In Direct Marketing, Harte-Hanks provides vertically integrated customer relationship management (CRM) services, including database construction, data analysis and lead generation. Additional capabilities include customer acquisition campaigns, telemarketing and fulfillment. In the Shoppers business, Harte-Hanks is the leading publisher and distributor of coupon booklets delivered via third-class mail to 13 million residents in California and Florida.

Good Business
- Harte-Hanks has leading market share and technology within its two respective businesses.
- The Direct Marketing business benefits from the trends toward target marketing.
- The Shoppers business capitalizes on the decrease in newspaper subscribers and the desire for businesses and individuals to advertise locally.
- The Shoppers business is generally a recurring revenue business.
- Direct Marketing has longstanding Fortune 500 relationships.
- The company generates a return on invested capital (ROIC) greater than 15%, which is higher than its weighted average cost of capital (WACC).
- Harte-Hanks has a modest amount of debt and generates substantial free cash flow.

Valuation

- At current prices, the shares trade at approximately 18.3x and 8.5x earnings per share (EPS) and earnings before interest, taxes, depreciation and amortization (EBITDA), respectively. This is a discount to the broader indices, especially smaller market capitalization benchmarks.
- Over the past ten years, the shares have traded between 18-30x EPS and approximately 10x EBITDA.

Management

- Richard Hochhauser, who has been with the company since 1975, is President and Chief Executive Officer. Mr. Hochhauser replaced Larry Franklin, current Chairman, in these positions in 2002.
- Dean Blythe, who has been with Harte-Hanks since 2001, is Chief Financial Officer.
- Collectively, Harte-Hanks' executives and officers own one-third of the company's shares.

Investment Thesis

The shares of Harte-Hanks have not kept pace with the market in 2006, resulting in an attractive entry point for this strong franchise. Share performance has been flat, due primarily to the media sector's underperformance and slower internal growth when compared to 2005. The shares trade at or near the low end of historical parameters. Growth opportunities should be better-than-average over the next three to five years, combined with very strong cash flow generation for expansion, share repurchases and dividends.

ADESA, Inc.

Description

ADESA provides wholesale vehicle auction and related redistribution services, which account for 87% of revenue and 70% of profit. The company also provides short-term inventory-secured financing for used vehicle dealers, which accounts for 13% of revenue and 30% of profit. ADESA's operations span North America with 54 used vehicle auction sites, 38 salvage vehicle auction sites, and 85 loan production offices.

Good Business

- The auction business has significant barriers to entry in the form of facilities, technology, and expertise.
- The company earns fees from sellers and buyers for facilitating the exchange of vehicles through an auction marketplace, and for providing floor plan financing for used vehicle dealers. While not strictly recurring, these fees are largely predictable in nature.
- The ROIC is just under 10%, and ADESA sees this moving into the double-digits. The return is more impressive when one considers the company owns the vast majority of its real estate.
- The debt-to-capital ratio is 26.3%, and ADESA generates solid cash flow.

Valuation

- The stock has underperformed the Russell 2000 by nearly 30% since its initial public offering (IPO) in June 2004.

- ADESA trades at a discount to the Russell 2000 weighted average on the basis of price-to-earnings (P/E), price-to-sales, enterprise value-to-EBITDA (EV/EBITDA), and price-to-book.
- A private equity firm acquired ADESA's competitor, Insurance Auto Auction, for 10.1x trailing EBITDA. ADESA is more than 20% below this value.

Management

- Dave Gartzke is Chairman and Chief Executive Officer. Although a former utility company executive for ALLETE, he is supported by individuals with auto industry experience.
- Brad Todd is President of Auction Services. He has been with the company since 1994.
- Cam Hitchcock is President of Dealer Services. He joined ADESA as Chief Financial Officer in 2004, and previously served as Treasurer of Dean Foods and Lear.

Investment Thesis

ADESA is one of the largest competitors in the used and salvage vehicle auction markets, which should exhibit stable growth over the long term. The business model is attractive, as the company generates a high degree of recurring revenue and does not take inventory risk. ADESA operates in a defendable niche, and is fiscally sound. The stock appears to be significantly undervalued.

Option Care, Inc.

Description

Option Care is a national provider of specialty pharmacy services (60% of revenues) and home infusion services (40% of revenues) to patients with acute and/or chronic conditions. The company services its patients through a network of 113 pharmacy locations and two high-volume distribution facilities. Option Care complements its drug distribution services by managing patient compliance and providing reimbursement support.

Good Business

- Option Care has the only national network of home infusion therapy centers. The company has established relationships with over 300 payer organizations and over 25 drug manufacturers.
- The business is durable, serving the aligned needs of biotech drug manufacturers, payers and patients by ensuring that compliance dosage requirements are met.
- Revenues are highly recurring due to the chronic disease states of those who are served by the company.
- The business has low capital requirements. Over the last six years ROIC has averaged 13%.
- The balance sheet is strong with $19 million in cash and only $86 million in debt.
- As a payer, government represents only 18% of revenues.

Valuation

- The specialty pharma group has traded for an average multiple of 17x, ranging from a low of 13x to a high of 27x over the past five years. Option Care trades at an industry average P/E despite a stronger growth profile and balance sheet.

- On a price-to-sales basis the industry has traded for 1.2x on average over the past five years. Option Care trades near the lower end of the group's historical range (0.5x to 3x).
- Option Care has an attractive free cash flow yield of approximately 5%.
- Buyout transactions have taken place at significantly higher valuations.

Management

- Rajat Rai has served as the company's Chief Executive Officer since early 2001. Rajat began his tenure at the company in August 1992 and has held various positions, including that of Chief Operating Officer.
- Paul Mastrapa was appointed Chief Financial Officer in 2002. Previously, Paul founded and subsequently served as the CEO of AdvoLife, a venture capital-backed provider of private pay chronic care management services.

Investment Thesis

Option Care operates a defendable business as one of the few remaining independent specialty pharmacies, and the only national home infusion network of scale. Demand for the company's products is both recurring and inelastic. The company has a strong financial profile and possesses an attractive internal pipeline of growth through its franchisees. Over the next three to five years the company will benefit from the inherent growth in the biotechnology drug pipeline. The valuation is attractive.

Thank you for your confidence in Fiduciary Management, Inc.

Fiduciary Management Inc.
Small Cap Equity Composite
12/31/2000 - 09/30/2011

Year	Total Return Gross of Fees %	Total Return Net of Fees %	*Benchmark Return %	Number of Portfolios	Dispersion %	Total Composite Assets End of Period ($ millions)	Total Firm Assets End of Period ($ millions)	Percentage of Firm Assets %
2001	20.42	19.57	2.49	125	1.88	$ 587.2	$ 1,458.2	40.27%
2002	-4.78	-5.46	-20.48	154	1.47	$ 649.7	$ 1,731.0	37.53%
2003	27.18	26.22	47.25	167	1.93	$ 1,206.9	$ 2,927.0	41.23%
2004	20.92	20.02	18.33	181	1.00	$ 1,486.6	$ 3,085.8	48.18%
2005	11.12	10.26	4.55	186	0.69	$ 1,605.8	$ 3,174.4	50.59%
2006	18.46	17.56	18.37	147	0.73	$ 1,606.8	$ 3,589.4	44.77%
2007	-0.92	-1.72	-1.57	161	0.85	$ 1,520.2	$ 3,960.4	38.39%
2008	-21.06	-21.69	-33.79	145	1.16	$ 1,212.4	$ 4,062.5	29.84%
2009	35.72	34.56	27.17	165	0.97	$ 2,004.6	$ 7,008.9	28.60%
2010	23.45	22.43	26.85	170	0.48	$ 2,477.7	$ 9,816.0	25.24%
Q1 2011	7.18	6.96	7.94	182	0.19	$ 2,699.2	$ 11,338.0	23.81%
Q2 2011	1.16	0.96	-1.61	179	0.11	$ 2,718.9	$ 11,819.6	23.00%
Q3 2011	-16.12	-16.29	-21.87	178	0.31	$ 2,188.9	$ 10,357.9	21.13%

*Benchmark: Russell 2000 Index®

Effective January 2012, 2004 – 2011 gross and net composite returns and dispersion were restated due to an error.
Returns reflect the reinvestment of dividends and other earnings.
The above table reflects past performance. Past performance does not guarantee future results. A client's investment return may be lower or higher than the performance shown above. Clients may suffer an investment loss.

Fiduciary Management, Inc. (FMI) claims compliance with the Global Investment Performance Standards (GIPS®) and has prepared and presented this report in compliance with the GIPS standards. FMI has been independently verified for the periods 12/31/1993 - 09/30/2011. Verification assesses whether (1) the firm has complied with all the composite construction requirements of the GIPS standards on a firm-wide basis and (2) the firm's policies and procedures are designed to calculate and present performance in compliance with the GIPS standards. The Small Cap Equity composite has been examined for the periods 12/31/1993 - 09/30/2011. The verification and performance examination reports are available upon request.

FMI was founded in 1980 and is an independent investment counseling firm registered with the SEC and the State of Wisconsin. The firm manages over $10.3 billion in assets of pension and profit sharing trusts, mutual funds, Taft-Hartley funds, insurance company portfolios, endowments and personal trusts. The firm includes both institutional and mutual fund business. Although the firm has participated in wrap programs, it is a separate and distinct business, and is excluded from firm-wide assets.

The FMI Small Cap Equity Composite was created in January 1980. These accounts primarily invest in small to medium capitalization US equities.

The FMI Small Cap Equity Composite reflects time-weighted and asset-weighted returns for all discretionary accounts, with a market value greater than $500,000 as of month end. A small percentage of composite assets (typically ranging from 0-5%) historically has been invested in unmanaged fixed income securities at the direction of account holders. From December 31, 1993 thru September 30, 2002 all accounts included were managed for at least one quarter, from October 1, 2002 to present all accounts were managed for at least one month. All returns are calculated using United States Dollars and are based on monthly valuations using trade date accounting. All accounts in this composite are fee paying. Gross of fees returns are calculated gross of management fees, gross of custodial fees, gross of withholding taxes and net of transaction costs. Net of fees returns are calculated net of actual management fees and transaction costs and gross of custodial fees and withholding taxes. Dispersion is calculated using the standard deviation of all accounts in the composite for the entire period.

Currently, the advisory fee structure for the FMI Small Cap Equity Composite portfolios is as follows:

Up to $25,000,000	0.90%
$25,000,001-$50,000,000	0.85%
$50,000,001-$100,000,000	0.75%
$100,000,001 and above	0.65%

The firm generally requires a minimum of $3 million in assets to establish a discretionary account. High Net Worth individuals may establish an account with a minimum of $1,000,000, however, the firm reserves the right to charge a minimum dollar fee for High Net Worth individuals depending on the client servicing involved. The minimum account sizes do not apply to new accounts for which there is a corporate, family, or other substantial relationship to existing accounts. In addition, the firm reserves the right to waive the minimum account size and minimum annual fee under certain circumstances. A complete list and description of all firm composites is available upon request.
Policies for valuing portfolios, calculating performance, and preparing compliant presentations are available upon request.

The Russell 2000 Index® measures the performance of the small-cap segment of the U.S. equity universe. The Russell 2000 Index is a subset of the Russell 3000® Index representing approximately 8% of the total market capitalization of that index. It includes approximately 2,000 of the smallest securities based on a combination of their market cap and current index membership. The Small Cap Equity composite uses the Russell 2000 Index® as its primary index comparison.