FIDUCIARY MANAGEMENT, INC.
Investment Counsel

100 East Wisconsin Avenue, Suite 2200
Milwaukee, Wisconsin 53202
414-226-4545
www.fiduciarymgt.com

INVESTMENT STRATEGY OUTLOOK – SMALL CAP EQUITY

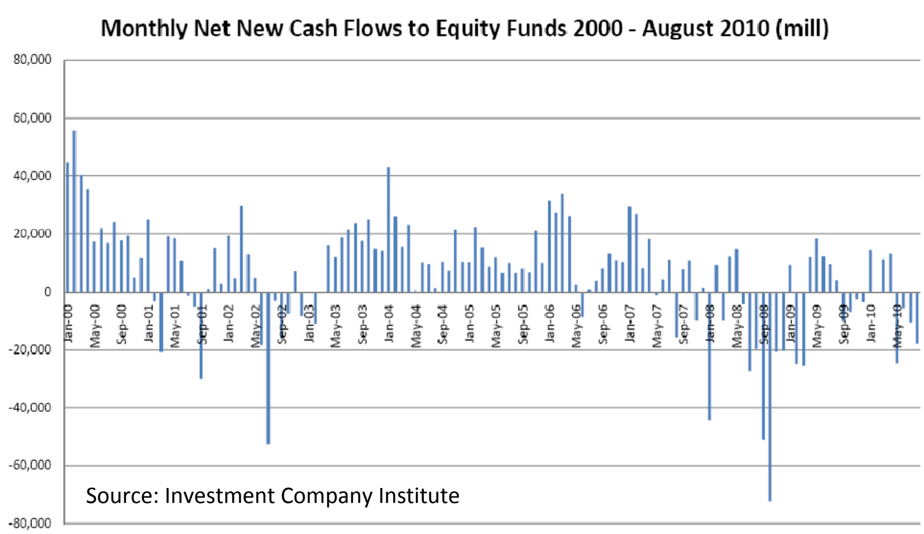
September 30, 2010

September 30, 2010

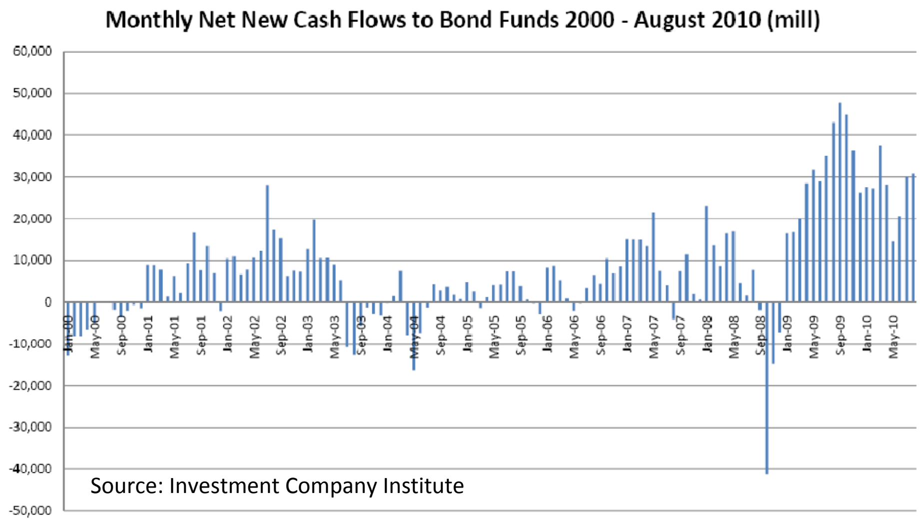
FMI small cap portfolios returned approximately 8.3% in the quarter, compared to 11.3% for the Russell 2000. Health Technology, Health Services, Non Energy Materials and Energy were the groups that trailed the benchmark in the quarter. Beckman Coulter and West Pharmaceuticals both stumbled in the period but in our opinion, remain solid long-term investment ideas. Eagle Materials and Carlisle continue to feel the effects of weak housing and real estate construction. Both of these stocks were purchased into the teeth of the downturn. We don't know how long the environment will remain depressed, but both are strong companies that can weather difficult times. On the plus side, Financials and Industrial Services were relatively strong, led by Affiliated Managers Group, Dresser Rand and Bristow Group.

Clients should note that our September 30 and March 31 letters offer a brief commentary followed by an equally brief discussion of a couple of investments. The December 31 and June 30 letters are typically longer and delve into various subjects in more detail. Incidentally, quarterly commentaries for ten years are available on our website, www.fiduciarymgt.com.

At the recent price of $676, the Russell 2000 is not far above the $614 it hit in March of 2000. Since then, owners of this index have just a slight price gain plus a meager yield from the dividend. Many stock investors have lost hope over this very difficult period; indeed, the past 10-year period is one of the worst on record. The mood of the day is captured by Byron Wein (formerly Morgan Stanley's strategist, now with Blackstone) in a piece entitled "Two Gloomy Afternoons." On two successive recent Fridays, Mr. Wein convened (as he has for 25 years) a group of investors to discuss the investment landscape. The group articulated a host of worries, including uncontrolled debt expansion, the onset of another recession, an anti-business bias in Washington, onerous regulations, and a general feeling that the U.S. had lost its way. If that wasn't gloomy enough, Albert Edwards, of Societe Generale, weighed in on the subject, saying equities were locked in a "Vulcan death grip."



These sentiments are reflected by net negative equity fund flows in recent years, particularly over the last few months. According to the Investment Company Institute (ICI), $57 billion has been withdrawn from equity mutual funds just since May. A mirror image of this phenomenon has taken place in the bond market. Performance has been excellent, with the 10 Year Treasury bond achieving an annualized 7.3% return over the past ten years (the Standard & Poor's 500 Index delivered a negative 1.8%). Recently, fund flows into the bond market have hit record levels. From May through August, ICI reported that $81 billion has moved into bond funds, and since 2008, a staggering $590 billion. In August, Bloomberg reported that according to Deutsche Bank, the ten lowest yielding U.S. corporate new issues in history have been sold in the past 14 months.



Unfortunately, the track record of the typical investor is not very good; if history is any guide, these fund flows will be poorly timed. Each year, Dalbar, a financial services firm, measures how fund investors actually perform, based on flow-of-funds data, compared to the stated index returns. Basically, the firm weights returns by when the flows occur. Over the 20 years ending last December, Dalbar figured investors compounded their money at 3.2%, rather than the stated S&P 500 return of 8.2%. Most investors seem incapable of avoiding the herd mentality. A brief recap of money flows shows lousy timing with respect to popular investment themes in biotechnology, technology/telecom, emerging markets, and real estate/financials. Recently, *Fortune's* very funny Stanley Bing penned a piece called "Come Back, Little Investor!" He suggests ten simple steps Wall Street can take to win back the small investor, including quarterly pancake breakfasts, but we like the last one best: **Stop losing my $%*#@ money!** Not following the crowd is the first step.

Our contrary indicator light is blinking bright yellow. Rather than chasing the final leg of one of the greatest bond markets in history, we think investors should remain engaged or even increase equity exposure. The stock market has more going for it than is popularly believed. After a long period of low or negative growth, revenues have been growing for three straight quarters, according to The Leuthold Group. Through June, the top 300 U.S. companies grew at 9% and the next largest 900 firms, at 9.9%. Corporate profitability and cash flow is also quite good. Credit Suisse reports that free cash flow as a percent of GDP is about twice its long-term average. This money will flow toward buy-backs, dividends and acquisitions. Deals have been heating up recently on Wall Street, with a total value through September 20 of $516 billion, including several high profile ones such as Alcon, purchased by Novartis, Smith International, acquired by Schlumberger, and Millipore, bought by Merck AG. Valuations, which for years were near the high end of their long-term ranges, are now about average on most measures. Deflation, which seems to be on everyone's mind, is still a concept and not a reality. Inflation is low, but above zero. As we said in last quarter's letter, mild deflation has historically been pretty good for stocks.

Past Ten Years			10 Year ACR	Next Ten Years			Annual Compound Return	Total Return	
Q2 1929	to	Q2 1939	-3.65	Q2 1939	to	Q2 1949	8.62	128.54	
Q1 1929	to	Q1 1939	-2.79	Q1 1939	to	Q1 1949	9.12	139.36	
Q3 1929	to	Q3 1939	-2.74	Q3 1939	to	Q3 1949	7.74	110.79	
Q1 1928	to	Q1 1938	-2.54	Q1 1938	to	Q1 1948	11.76	203.87	
Q1 1930	to	Q1 1940	-1.42	Q1 1940	to	Q1 1950	9.65	151.31	
Q2 1930	to	Q2 1940	-1.42	Q2 1940	to	Q2 1950	12.19	215.88	
Q4 1928	to	Q4 1938	-0.65	Q4 1938	to	Q4 1948	7.21	100.63	WORST
Q3 1928	to	Q3 1938	-0.10	Q3 1938	to	Q3 1948	8.12	118.31	
Q3 1930	to	Q3 1940	0.18	Q3 1940	to	Q3 1950	12.57	226.85	
Q4 1927	to	Q4 1937	0.20	Q4 1937	to	Q4 1947	9.61	150.39	
Q4 1929	to	Q4 1939	0.23	Q4 1939	to	Q4 1949	9.09	138.67	
Q2 1928	to	Q2 1938	0.44	Q2 1938	to	Q2 1948	9.52	148.39	
Q3 1964	to	Q3 1974	0.49	Q3 1974	to	Q3 1984	15.58	325.30	BEST
Q1 1931	to	Q1 1941	0.71	Q1 1941	to	Q1 1951	14.47	286.14	
Q4 1964	to	Q4 1974	1.24	Q4 1974	to	Q4 1984	14.76	296.23	
Q4 1998	to	Q4 2008	-1.38	Q4 2008	to	Q4 2018	?	?	
Q1 1999	to	Q1 2009	-2.99	Q1 2009	to	Q1 2019	?	?	
Q2 1999	to	Q2 2009	-2.22	Q2 2009	to	Q2 2019	?	?	
Q3 1999	to	Q3 2009	-0.15	Q3 2009	to	Q3 2019	?	?	
Q4 1999	to	Q4 2009	-0.95	Q4 2009	to	Q4 2019	?	?	
Q1 2000	to	Q1 2010	-0.65	Q1 2010	to	Q1 2020	?	?	
Q2 2000	to	Q2 2010	-1.58	Q2 2010	to	Q2 2020	?	?	
						Average	10.67	182.71	

Source: The Leuthold Group

We anticipate an inflation pick-up over the long run, due to profligate fiscal and monetary policies, but we believe stocks are the best way to deal with that outcome anyway. Consumers are repairing their balance sheets, albeit slowly. Unfortunately, the same can't be said for governments, but many politicians appear to be getting the message that we've crossed the line on deficit spending. The elections in November will be a pivotal referendum on spending.

Certainly many negatives that were highlighted and harangued over the last few years in these letters remain. Some issues need to turn around before the economy and the market regain solid footing; specifically, businesses must feel more confident about regulations and taxes in order to hire new employees or invest in capital and research & development. The government and the Federal Reserve also have to back off. History demonstrates, however, that if investors wait for an "all clear" sign, a large part of the upturn will be missed. In the table above, we have updated and reprinted data from our March 2009 letter showing 10-year stock returns following the 15 worst 10-year periods (measured by quarters, so there are nearly 300 data sets). While there are obviously no guarantees in the equity business, we like the odds that the next 10 years' return will fall within the range of the worst, 7.2% and the best, 15.6%.

Below we highlight a couple of recent investment ideas.

The St. Joe Company

Description

St. Joe is Northwest Florida's largest private landowner. The company owns 577,000 acres of land, with 404,000 acres (70% of the total) within 15 miles of the coast. This includes over 130 miles of frontage along the Gulf of Mexico and several bays, 5.7 miles of sandy beach, and additional 78 miles of frontage along the Intracoastal Waterway.

Good Business

- St. Joe has large-scale landholdings. The company's value-add is in securing entitlements for higher and better uses for the land.
- There is a goal to derive a growing stream of recurring revenue and income from commercial real estate via joint ventures and leases.
- Much of St. Joe's land was acquired in the 1930s and 1940s at a low cost basis. Gross margins on lot sales should approximate at least 50% on a normalized basis. Capital expenditure is minimized by selling entitled land to homebuilders, third-party developers and investors, and partnering with third parties to develop the land.
- This is an easy business to understand.
- The company has $194 million of net cash.

Valuation

- Shares of St. Joe have been decimated following the collapse in the residential and commercial real estate market, particularly in Florida. The stock is down 71% from its high of $85.25 in July 2005.
- Land use entitlements in hand or in process represent just 6% of total landholdings. Valuing the non-entitled land at "swampland" prices of $1,500/acre implies the market is valuing the entitled land for only $45,000/acre.
- Inflation adds to the margin of safety since the company's landholdings should be worth more in the future versus what is implied by the current market value.

Management

- Britt Greene, 55, has been CEO since May 2008 and President since October 2007. He was promoted to COO in August 2006. Greene, who joined St. Joe in January 1998, has led the company through entitlement, planning, permitting, design, and sales for several of its projects.

- Greene replaced Peter Rummell, who was focused on positioning St. Joe as a developer of second homes and resorts for the affluent, whereas Greene has a more balanced approach and is also focused on securing entitlements for primary residential and commercial purposes.
- Bill McCalmont, 54, has been CFO since May 2007. Prior to joining St. Joe, he was CFO of Ace Cash Express from August 2003 to January 2007, and a member of a real estate consulting group from 2001 to 2003.

Investment Thesis

St. Joe represents a way to participate in the resumption of southward migration to Florida, which has good weather and no state income tax. The current share price implies we are paying little for any upside from the new Northwest Florida Beaches International Airport (commenced commercial flights in May) helping accelerate absorption of the company's land. Our analysis shows the intrinsic value of the company is vastly higher than the current stock price. St. Joe also represents a hedge on inflation.

Woodward Governor Co.

Business Description

Woodward Governor is a leading designer and manufacturer of energy control systems and components for aircraft and industrial turbines, reciprocating engines and other power generation equipment. Woodward has four primary operating segments: Turbine Systems (43% of sales) - energy control systems to OEMs of industrial gas, aircraft, and steam turbines; Airframe Systems (22%) - actuation systems, cockpit and motion control systems, and electromechanical components; Electrical Power Systems (14%) - products that assist in the generation, distribution, and conversion of electric power; and Engine Systems (21%) - products for reciprocating engines, including products for gas and diesel engines.

Good Business

- Woodward is a key supplier of energy control systems and components to virtually every major engine and turbine manufacturer. Over the years, the company has developed a sizable installed base of systems, which generate a steady stream of high margin aftermarket revenues.
- Approximately 30-35% of total revenue is generated through the sale of aftermarket parts and maintenance, repair and overhaul services, and can be considered recurring in nature.
- Woodward's return on invested capital (ROIC) comfortably exceeds its cost of capital. Over the trailing 5-year and 10-year periods, the company's ROIC has averaged 13.7% and 11.0%, respectively.
- The business is not capital intensive, which leads to a significant amount of excess free cash flow (FCF) generation. For instance, in fiscal 2009, Woodward's FCF was $190 million or $2.70 per share.

Valuation

- Since September 2008, Woodward's common stock has underperformed the Russell 2000 Index by 2500 basis points.
- We estimate Woodward's normalized FCF is approximately $150 million, or greater than $2.00 per share. The stock currently trades for 14.0 times our estimate of normalized FCF.
- Over the trailing 5 and 10-year periods, Woodward's price-to-earnings (P/E) multiple has averaged 18.0 and 15.5, respectively. Thus, the company's current P/E multiple is in-line with historical averages. However, we estimate that in fiscal 2010, Woodward's organic sales will have declined by a cumulative 15-20% from the peak in fiscal 2008. This suggests that the company's current earnings are very depressed.

Management

- Current CEO, Tom Gendron, has been employed by Woodward for the past 18 years and has significant industry experience. He owns approximately 900,000 shares outright, which represents 1.3% of total shares.
- Previous Chairman and CEO, John Halbrook, remains a key director of the company. He continues to own approximately 2,100,000 shares outright, which represents 3.0% of total shares.

- Woodward has a shareholder ownership culture across the entire organization. For example, the company's profit sharing plan owns 7,500,000 shares, which represents 11.0% of total shares.
- Importantly, executive compensation has a significant link to ROIC and long-term EPS growth.

Investment Thesis

Woodward Governor's current share price is 40% below its all-time high reached in 2008. The sharp decline was driven by the global economic crisis and its negative impact on global infrastructure spending, as well as the commercial aerospace cycle. Despite short-term worries about the economy, we believe Woodward is attractively positioned to outperform during the next up-cycle in both the commercial aerospace and power generation market.

Management Note: Pat English, Chief Investment Officer, has directed the investments of Fiduciary Management for over twenty years and will continue to do so. Through his leadership, we have built an excellent research team that is fully inculcated into the Fiduciary Management investment culture. Pat has functioned as both the Chief Investment Officer and a critical decision maker, along with John Brandser, Chief Operating Officer, across a variety of strategic and tactical matters for many years. Those familiar with Fiduciary Management know that Pat and Ted Kellner have been operating in a state that is akin to co-CEOs for a long time. Ted has been more of an external CEO and Pat more internal. Pat now officially adds the title of CEO and Ted becomes Executive Chairman and remains on the portfolio management committee. John adds the title of President. Additionally, Andy Ramer, who joined FMI in 2002, has been named Director of Research. He and Pat have and will continue to work closely with the team vetting and researching investment ideas, building on the thirty-year track record of the firm. The entire investment group, along with key client service and marketing executives, not only have an ownership stake in FMI but are also invested alongside our clients.

Thank you for your continued support of 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.