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ValueInvestor INSIGHT

The Leading Authority on Value Investing

Capital Appreciation

Owning companies that are unlikely to generate headlines or set pulses racing has paid off more than handsomely for Fiduciary Management's Pat English.

Pat English wasn't planning to be in it for the long haul when he joined Milwaukee's Fiduciary Management, Inc. as an analyst in 1986. He'd moved to follow his wife as she pursued a medical degree – "I wasn't expecting to make a long-term investment," he says.

Fiduciary investors can be glad he did. English, now CEO of the $12.5 billion (assets) firm, has been a driving force behind its flagship small-cap strategy earning a gross (as of 12/31/11) annualized 14.6% since 1980, vs. 10.4% for the Russell 2000; its large-cap strategy, which posted an 8.8% annualized gain since 2001, vs. 1.5% for the S&P 500; and the international strategy, which began on December 31, 2010 and was down -0.8% last year, vs. -12.2% for the MSCI EAFE.

Focused on companies obsessed with their own returns on investment, English is finding opportunity today in such varied areas as adhesives, consumer products, pharmaceuticals, technology distribution and food services. See page 2

INVESTOR INSIGHT

Pat English
Fiduciary Management, Inc.

Investment Focus: Seeks companies whose under-pressure stock prices most misrepresent the underlying return-on-capital dynamics of their businesses.

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FIDUCIARY MANAGEMENT, INC.
Investment Counsel

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Investor Insight: Pat English

Pat English and Andy Ramer of Milwaukee's Fiduciary Management, Inc. describe what "quality" means to them in assessing a business, why they'll make exceptions to buy in industries they usually avoid, what golf lessons translate to investing, and what they think the market is missing in Henkel, Arrow Electronics, Sysco and Compass Group.

Your strategy focuses on assessing a company's business before its stock. Describe the primary elements of that.

Pat English: Our fundamental belief is that top management and Wall Street are overly optimistic, which leads to inefficiency in how stocks get priced. For a time that may be to the upside, but it works on the downside as well when there's the inevitable disappointment. Our goal is to have identified a full bullpen of companies that we believe have good businesses, so that we're prepared to take advantage when disappointment hits and their shares become attractive.

These bullpen companies have certain typical characteristics. They have high levels of recurring revenue. They have minimal financial risk – little to no net debt for smaller-caps, and no more than 30-40% debt to total capital for large caps. Their businesses aren't complicated, nor are the investment theses. We pay careful attention to our return on time, so we're not interested in tackling highly complex, time-consuming ideas.

Our most important focus is on understanding a business' return on invested capital and, perhaps more importantly, its return on incremental invested capital, which I've learned to appreciate more and more over the past 25 years. We scrub the financials to get a reliable picture of the company's historical full-cycle ROIC and want to see it significantly ahead of its weighted average cost of capital, which means the company is creating shareholder value. If a bad acquisition has been written off, for example, we'll evaluate whether some or all of that writeoff should be added back to the capital base in assessing the return on capital. We're not just looking backwards, but also want to see that prospective returns – based on our estimates of earnings and the investments necessary to generate those earnings – are going to be attractive.

Related to this emphasis on ROIC, we're looking for management with a clear shareholder focus. What you have too often is a mentality that bigger is always better: If an acquisition offers a 5% ROI and cash is only earning 2%, do it. This doesn't make sense – it adds risk and likely doesn't cover the true cost of capital. If that's all they can do with the money, we'd rather they return it to us and we'll reinvest it somewhere else. To foster our way of thinking, we want top management paid on returns, not growth, and for them to own stock outright rather than through options. The only way to think like an owner is to actually be one.

What puts pressure on share prices of companies you admire?

PE: It's often normal cyclical or company-specific pressure that Wall Street has no patience to see through. We like it when Street research talks about waiting for industry fundamentals to improve or for evidence that a turnaround is taking hold. Once those things happen the stock may have already moved 25% or more. If we believe the pressure is temporary and the valuation is compelling, we'll take that time risk.

Andy Ramer: To give an example, we bought Sanderson Farms [SAFM], the fourth-largest producer of chickens in the U.S., in January 2011 when the stock fell into the $30s because the industry was losing money due to rising supply, falling demand and higher commodity feed costs. We'd seen this before and were comfortable that the industry and company were responding and that the imbalances would work out over 12 to 18 months. We were surprised how quickly

Pat English

Of Course

By the end of his freshman year at Stanford, Pat English started to reconsider his dream of being a professional golfer. "I was fifth on my college team. Given the number of division-one programs and how many players made it on tour, I didn't need to be a genius to figure out that wasn't going to happen," he says.

His backup plan has proven to be a hole-in-one. After graduation, English spent two years as an analyst at Dodge & Cox and in 1986 joined Milwaukee's Fiduciary Management, where by 1989 he was Research Director and where he is now CEO and Chief Investment Officer, overseeing $12.5 billion.

With a son starting out in the business, English draws on his own time as a golfer for lessons to impart. "I tell my son often about this guy on our Stanford team we called "Moon Man," who seemed to be operating in this lunar zone of some sort. His swing wasn't great and he didn't strike the ball that cleanly, but he always scored well because he never blew himself up. Investors forget that lesson all the time and over-reach, over-concentrate and take on too much risk – none of which is necessary to score well."

the market starting pricing in the recovery, so sold our stake at the end of last year when the stock was in the low $50s.

PE: It's not always a cyclical issue. One good example that goes back to late 2008 is McGraw-Hill [MHP], which we bought when the stock traded down toward $20 as the market feared that the Standard & Poor's ratings business was doomed and that the educational business faced potential spending cutbacks and vulnerability to the digital distribution of books. Our basic view was that these issues were manageable and that both franchises were sounder than the market believed. On a sum-of-the-parts basis we thought the stock was worth $45-50, which is close to where we sold it in the fourth quarter of last year. There is likely more value there, but we were disappointed that despite the heavy pressure activist investor JANA Partners put on the company, the best it could do was a spinoff of its education business. At the then-current price, we weren't willing to accept the regulatory and litigation risk that remained for the ratings business.

You've written about getting interested again in pharmaceutical stocks. What's behind that?

PE: It was our contention for some time that the research efforts of the large pharmaceutical firms were not generating positive economic value. The cost of new-drug development and the length and uncertainly of the regulatory approval process had changed so significantly that the expected net present values of drug pipelines had in many cases turned negative. Stocks that looked cheap really weren't if you valued the drug pipelines correctly.

It has taken years, but this dynamic has been changing. Industry management is taking a much more thoughtful approach toward how they're spending R&D money and we believe the net present value of drug pipelines is again turning positive. The companies have also begun to trim bloated overhead structures. To the extent the market is slow to recognize this, there can be opportunity in select cases.

What's a representative current example?

PE: GlaxoSmithKline [GSK] is one we believe is well positioned because of its less onerous patent-expiration issues, its diversified product mix across therapeutic classes, geography and molecular formulations, and its new-product pipeline that is showing improved productivity and has a number of meaningful, novel drugs in phase-III development.

When we bought this in the third quarter of last year, the valuation to us implied that the market viewed the existing drug franchises as almost a runoff-asset situation and placed little to no value on the pipeline. On a sum-of-the-parts basis, we still believe the stock's fair value is 60-75% higher than the current share price [of $45], while in the meantime we're earning a better than 5% dividend yield.

ON NATURAL GAS:

The time to buy is when supply is full and pricing is depressed – certainly the case with natural gas today.

You largely avoid both energy producers and banks. Why?

AR: In energy exploration and production, the commodity nature of the business makes companies struggle to earn their cost of capital over time, but what concerns us as much is that management teams too often don't even focus on ROI and just want to grow. When we find exceptions to that, we will invest. We own Devon Energy [DVN], for example, which has a production mix that is about two-thirds natural gas and one-third oil and natural gas liquids. It has superior acreage positions with low entry costs and royalty burdens, a great balance sheet, and its return on invested capital over a cycle is in the top three in the industry. The stock [at a recent $70.60] is under pressure because of the severe downdraft in natural gas prices, but we think the market is missing the deep portfolio of liquids-rich areas Devon can target for development – over 90% of its current capex is going into crude oil or wet gas – and on which it can earn very nice returns. The time to buy commodity-related businesses is when supply is full and pricing is depressed, which is certainly the case with natural gas today. In this management's hands, we're more than willing to ride out the cycle.

PE: The issue with banks is primarily that it's too difficult to see the assets and do our own underwriting of the loans and investments they make. They get their ROE from high leverage and low margins, which is a risky premise from the get-go, and they go through loan booms and busts that make returns over time not very good. We'd much rather own a money manager, say, which has high margins and low leverage and has nice returns through a cycle.

Comerica [CMA] looks like a Devon-like exception in your portfolio. Why is it a bank you're willing to own?

PE: Comerica has an excellent long-term credit track record, which makes us less concerned about the black-box nature of the business. We're comfortable we understand what it does, which is basically plain-vanilla lending with nothing exotic elsewhere on the balance sheet. The stock [now trading at $32.30] has been under a cloud because the economy has been weak and the interest-rate environment has been poor. We basically view this as an excellent call option on both of those trends eventually returning to the mean.

On what do you primarily focus in your research?

PE: We've developed over 25 years a comprehensive research format we go

through in vetting ideas, with a detailed list of questions to answer about every prospective investment. A big part of that goes toward understanding industry dynamics and trends, the competitive environment, and how the company stands apart in any number of areas – its products, distribution, cost structure, selling effort, etc.

Also key is understanding how management makes capital-allocation decisions – not surprisingly focused on the emphasis on return on capital – how they measure it and how they're compensated on it. This is often where we'll hit roadblocks. For instance, Dentsply [XRAY] is in a business we love, an oligopoly providing dental supplies that mostly aren't subject to reimbursement and that produce stable, recurring revenues. We'd like to own it, but management seems to have decided the best path is to do acquisitions we believe are value-destructive. We'll keep it in our bullpen until that changes.

Our financial analysis centers on assessing margins, earnings power and returns on capital over time. We set target prices based on the valuation levels at which we believe companies with certain margin structures and return profiles should trade. If it's a 10% EBIT-margin business through a cycle, say, we'll be interested if it trades at less than 1x revenues on an enterprise-value basis. We're often counting on the business improving from some level of under-earning today, which will also result in a revaluation – say from 0.7x EV/Revenues to 1.2x as that happens over the ensuing few years.

We always ask before buying whether we'd be comfortable putting the stock in a lockbox for five years and not touching it. If we're not, we shouldn't buy it. That's not an argument for putting your head in the sand, but we think you need that level of confidence in the business to think most clearly when things go temporarily awry and clients are questioning you.

You run very concentrated portfolios given your level of assets. Why?

PE: In small cap – which for our purposes is anything under about $4 billion in market cap – we typically have about 45 stocks. Our large-cap and international strategies each have about 25 positions. Given some overlap in large cap and international, that means we own roughly 85 unique names at a time.

Our basic goal is to hold enough stocks to be well diversified across industry sectors, while not holding so many that our investment team becomes difficult to manage. We don't mimic our benchmarks, but we do believe it's prudent to have exposure to most major economic sectors. In our large-cap portfolio, for instance, our 25 stocks are probably going to represent 60 different industries. We have an unwritten rule that each of our investment professionals essentially puts their entire net worth only in our stocks. This focuses everyone on what is best for clients and is also a good risk mitigator in that with your net worth on the line, you will be sensitive to diversification and prudence in all that you do.

We have a total of seven analysts, including myself, and we believe when investment teams have more than 10 people they start to break down. Egos get in the way, people start to specialize and you just can't have the quality of collective discussion we think is necessary.

ON TECHNOLOGY:

We like to attack difficult industries that are important drivers of growth through the side door, so to speak.

Do you follow any particular rules on position sizes?

PE: It's fairly rare for a position in any of our portfolios to get higher than 5-6% of the portfolio, but we do make distinctions based on our level of conviction. One of our biggest small-cap holdings, for example, is Patterson Companies [PDCO], which is in the dental-supply market I described earlier in speaking about Dentsply. Patterson is a high-ROI business, with lots of recurring revenue, secular industry tailwinds, a great balance sheet and plenty of liquidity in the market. The negative investment issues are primarily related to the stagnant economy. Given our conviction in the business long term, we're happy to make it a larger position.

Describe why Arrow Electronics [ARW] is high on your conviction list today?

PE: We're typically not attracted to most technology businesses because of cutthroat competition, potential technology obsolescence, short product cycles, and the excessive use of stock options. The return on time is also a problem – you spend so many hours analyzing new products and technology trends that 50% of your time gets spent on 5-10% of your portfolio.

At the same time, technology is an important driver of economic growth and grows at above-GDP rates, so we want to have exposure to it. We like to attack difficult industries through the side door, so to speak. In Arrow, we have a leading distributor of technology products – including semiconductors, software and electronic components – that supplies mostly small and medium-sized companies. That allows it to benefit from the growth in high tech without the typical risks associated with tech stocks.

How high-quality do you consider this business?

PE: It's gotten much better in recent years. It's more geographically diverse, with 50% of Arrow's revenues coming from the Americas, 30% from Europe and the rest from Asia. The company has 1,200 suppliers and more than 125,000 customers, so there's no over-dependence on certain products or vertical markets. Management recognized a number of years ago that growth for growth's sake was not conducive to shareholder value, so they re-focused on turning assets more rapidly and pursuing a better mix of busi-

nesses. Over a full cycle, we see this as a 12-13% ROI business.

Isn't there plenty of cutthroat competition in this market?

PE: Avnet [AVT] is the primary competitor and has done battle with Arrow for decades. But this is still a big and growing industry, with over half of the market made up of smaller players that don't have the economies of scale and supplier relationships that Arrow and Avnet do. That leaves plenty of opportunity for both of the leaders to take additional share. There are also ample growth opportunities in new product categories and overseas.

How inexpensive do you consider Arrow's shares at a recent $42?

PE: We think there's a real disconnect between the current valuation and the improved quality of the business. It used to be that when Arrow went through a down cycle it would be lucky to make money, but indicative of how the structure of the business has changed, it made good money through the last cycle and was still earning its cost of capital even at the cycle bottom.

Given its long-term return on equity profile and assuming a normalized EBIT margin level of roughly 5% – it's 4.5% today – we believe Arrow's stock should trade at 50-60% of revenues on an enterprise-value basis. It's traded in that range many times in the past – when it was arguably a much inferior business – but today the stock trades at only 28% of revenues.

At 55% of $22 billion in revenues, the enterprise value today would be around $12.1 billion. Less $1.5 billion in net debt would leave a market cap of $10.6 billion, which on 112 million shares outstanding would translate into a share price of $95. Once the market stops treating Arrow as some sort of pariah, there's just enormous upside in the stock.

Sticking with the "side-door" theme, describe your interest in Sysco [SYY].

PE: Sysco is the largest food distributor in North America, distributing 300,000 products to roughly 400,000 restaurants, schools, hotels, nursing homes and other food-service providers. Restaurants account for about two-thirds of the business.

Restaurants are by and large not very good businesses – highly competitive, tough to manage and not particularly profitable over time. You'll have the rare breakout growth story like Chipotle, a stalwart to invest in like McDonald's and maybe an occasional turnaround, but it's a tough area for value investors.

That said, due to demographics and changes in lifestyles, the restaurant business overall is secularly growing. Just as we want to get at technology growth through Arrow, we believe Sysco provides similar access to restaurants.

And Sysco is an even better business. It's the industry leader with 18% of the U.S. market, twice the size of the next biggest player, US Foods, and is much more profitable. It has very high recurring revenue and a route-based model in which the incremental customer is extremely profitable. Even in a shaky economic climate and with some self-inflicted wounds, it's earning almost 20%

INVESTMENT SNAPSHOT

Arrow Electronics
(NYSE: ARW)

Business: Global distributor to OEMs and commercial users of technology products, including semiconductors, storage devices, software and electrical components.

Share Information
(@3/29/12):

Price	**42.07**
52-Week Range	25.71 – 47.50
Dividend Yield	0.0%
Market Cap	$4.71 billion

Financials (TTM):

Revenue	$21.39 billion
Operating Profit Margin	4.4%
Net Profit Margin	2.8%

Valuation Metrics
(@3/29/12):

	ARW	S&P 500
Trailing P/E	8.1	16.2
Forward P/E Est.	8.4	13.6

Largest Institutional Owners
(@12/31/11):

Company	% Owned
Fidelity Mgmt & Research	9.8%
Wellington Mgmt	9.7%
Artisan Partners	8.1%
First Pacific Advisors	4.3%
Vanguard Group	4.1%

Short Interest (as of 3/15/12):

Shares Short/Float	1.0%

THE BOTTOM LINE

Even though it has significantly improved the quality of its business and offers a "side-door" way to play technology growth, the market treats the company as "some sort of pariah," says Pat English. At the EV/Revenues ratio at which he believes the shares should trade – and at which they've traded in the past – the stock would be $95.

Sources: Company reports, other publicly available information

returns on invested capital. This is one where if you think in terms of the lock-box analogy, you could put this away for five years and be pretty confident upon opening the box that the challenges have ameliorated and that the core business was fundamentally sound.

What are the challenges you're expecting to get better?

PE: One is high unemployment, which translates into fewer out-of-home meals and a shift in spending from the casual-dining outlets Sysco mostly serves toward quick-service restaurants like McDonald's and Chipotle. Some people think casual dining is now in secular decline, but we don't believe that. The changes in lifestyles and consumer habits that fueled the casual-dining boom are unlikely to have permanently disappeared.

Another big issue for the company has been its giant enterprise resource planning [ERP] software implementation, which has been a beast. This year and next are the maximum spending years, and the entire system will cost them over $1 billion before it's fully operational. The goal is to dramatically improve supply-chain efficiency and productivity, improving customer service while driving down costs. It's very difficult to say how Sysco's efforts will ultimately pay off, but we have no reason to believe they won't, and we've seen similar companies like W.W. Grainger leverage their new ERP systems to achieve significant margin improvement. At the moment, the effort is costing them approximately 35 cents per share in earnings on top of the capitalized costs and management distraction. That dynamic will obviously change as the project winds down.

What upside do you see in the shares, now at $29.80?

PE: Without the ERP-system spending and assuming modest improvement in the economy, we believe Sysco's earnings could be pushing $3 per share within the next two years, up from a run rate of around $2 per share today. As earnings recover, we'd also expect some multiple expansion. The company's average P/E multiple over the past ten years has been 19x, but even at 16-17x our estimate of normalized earnings, we'd have a $50 stock. On top of that we're getting a 3.6% dividend yield.

Does acquisition-related growth concern you here?

PE: We do normally look askance at growth by acquisition, but in this case it can make sense to do bolt-on acquisitions that can be integrated fairly quickly into the existing distribution system.

More concerning today are the impact of higher gasoline prices on delivery costs and the potential for accelerating food inflation hitting both end-user restaurant demand and Sysco's ability to pass on cost increases. Our assumption is that neither issue becomes too acute, but they are things to monitor.

Turning to a non-U.S. idea, what attracts you to Germany's Henkel [HEN:GR]?

AR: The company is interesting in that it has a strong position in both industrial and consumer end markets. Roughly half of the business is in adhesives, where

INVESTMENT SNAPSHOT

Sysco
(NYSE: SYY)

Business: Food and related-product distribution to restaurants, hospitals, nursing homes, schools and other entities serving out-of-home meals in North America.

Share Information
(@3/29/12):

Price	**29.78**
52-Week Range	25.09 – 32.76
Dividend Yield	3.6%
Market Cap	$17.41 billion

Financials (TTM):

Revenue	$41.02 billion
Operating Profit Margin	4.7%
Net Profit Margin	2.8%

Valuation Metrics
(@3/29/12):

	SYY	S&P 500
Trailing P/E	15.3	16.2
Forward P/E Est.	15.4	13.6

Largest Institutional Owners
(@12/31/11):

Company	% Owned
State Street	4.9%
Vanguard Group	3.9%
First Eagle Inv Mgmt	3.6%
Wellington Mgmt	3.4%
Invesco	3.2%

Short Interest (as of 3/15/12):

Shares Short/Float	3.5%

THE BOTTOM LINE

The sluggish economy and a massive software implementation project that is currently all costs and no benefits is obscuring the enduring quality of the company's business, says Pat English. As those two challenges ameliorate, he believes the company can earn $3 per share within two years, justifying a share price of closer to $50.

Sources: Company reports, other publicly available information

Henkel is the global market leader supplying manufacturers in a broad range of industries, including mobile phones, cars, shoes, furniture and solar panels. Adhesives overall are taking global market share from fasteners, and Henkel benefits in the business from economies of scale and fairly high switching costs. We also like that while adhesives represent a minimal share of the cost of a given product, their contribution to its efficacy is substantial. There are a few cents' worth of adhesives in an Apple iPhone, for example, but the cost of failure is very high.

On the consumer side, the company is a big player in laundry and personal care. Its better known brands include Dial soap, Purex and Persil laundry detergents and Schwarzkopf hair-care products. While not every part of this portfolio is firing on all cylinders, we like that these consumer brands generally benefit from good brand loyalty and ongoing repeat consumption.

The company has been through a fairly significant operational overhaul. Is that process ongoing?

AR: Most of the heavy lifting has been done since Kasper Rorsted took over as CEO in April 2008. He has discontinued or sold some weaker brands, rationalized the manufacturing footprint and significantly reduced headcount, resulting in operating margins increasing from 10% in 2007 to 13% last year. The target for 2012 is 14%, and we see no reason the business can't earn 15-16% margins on a normal basis. That would still fall short of what companies like 3M earn in adhesives or Procter & Gamble and Unilever earn in consumer products.

Is this a growth story?

AR: This is a typical name for us in that you're not going to see off-the-charts growth. The main drivers are the use of adhesives in new applications and strong emerging-markets growth across product lines. Just over 40% of total revenues today come from emerging markets, and the company expects that will be 45-50% relatively soon.

Over a cycle we expect the overall company to grow at a mid-single-digit annual rate, which it can leverage into low-double-digit EPS growth as margins expand.

The company's consumer-products business in North America has been struggling. Is that fixable?

PE: That is the part of the business that Wall Street is hung up on and it hasn't done well. They installed new management just over a year ago, which is focused on improving the company's product development and innovation, which has lagged. We're watching it closely and certainly don't want it to break down further, but in the end this business accounts for less than 10% of total revenues and our view is that they will either turn it around or get rid of it, either of which would benefit overall margins.

At a recent €46.20, how cheap are the shares?

AR: The stock trades for 12.5x our 2012 EPS estimate of €3.70, while the European peer group trades at 18-20x. Given our view that this is an above-average company, we don't believe such a discount is warranted.

Looking at enterprise value to revenues, the current multiple is around 1.4x, against the 1.8-2.0x at which we believe a company with this margin struc-

INVESTMENT SNAPSHOT

Henkel
(Xetra: HEN:GR)

Business: Producer of branded chemical-based products focused on three primary business lines: Adhesives, Laundry & Home Care, and Cosmetics & Toiletries.

Share Information
(@3/29/12, Exchange Rate: $1 = €0.752):

Price	**€46.17**
52-Week Range	€30.22 – €47.32
Dividend Yield	1.5%
Market Cap	€21.61 billion

Financials (TTM):

Revenue	€15.60 billion
Operating Margin	13.0%
Net Profit Margin	8.0%

Valuation Metrics
(Current Price vs. TTM):

	HEN	S&P 500
P/E	16.0	16.2

THE BOTTOM LINE

The market overemphasizes the company's lagging North American consumer-products business and underemphasizes its strong potential in adhesives and in emerging markets, says Andy Ramer. Based on peer comparisons and on where a company with its margin structure should trade, he sees 40-50% upside from today's share price.

Sources: Company reports, other publicly available information

ture and return profile should trade. However we come at it, we believe there's 40-50% upside in the share price from today's level.

You own the "ordinary" rather than "preferred" shares. What's the difference?

AR: The preferred shares are more liquid and there is a minor difference in the dividend. The ordinary shares trade at a 15% discount, which we don't think is economically justified.

Describe the case for global food-services company Compass Group [CPG:LN].

AR: Compass operates and staffs cafeterias, restaurants and coffee shops on an outsourced basis at corporate locations, sports venues, universities and hospitals worldwide. That accounts for around 80% of revenues, with the rest coming from additional support services for things like cleaning, landscaping and security. Along with competitors Sodexo [SW] and Aramark, it is one of the few firms that can meet the needs of larger clients in multiple geographies and that can use its size for purchasing leverage with suppliers.

This is a high-recurring-revenue business, with customer retention rates well above 90%. In addition, the outsourcing of food services is a global trend that still has plenty of room to run. Only 45% of the overall target market currently outsources its food services, and in certain sectors like education and healthcare that number is only 25-30%.

INVESTMENT SNAPSHOT

Compass Group
(London: CPG:LN)

Business: Provider of food-related services for clients such as factories, hospitals, schools and universities, sports venues, offshore oil platforms and military facilities.

Share Information
(@3/29/12, Exchange Rate: $1 = £0.627):

Price	**£6.53**
52-Week Range	£4.98 – £6.72
Dividend Yield	3.3%
Market Cap	£12.34 billion

Financials (FY ending 9/30/11):

Revenue	£15.83 billion
Operating Margin	6.4%
Net Profit Margin	4.6%

Valuation Metrics
(Current Price vs. TTM):

	CPG	S&P 500
P/E	18.0	16.2

THE BOTTOM LINE

Having significantly revamped its operations and refocused on returns on investment, the company is poised to capitalize on global secular growth in the outsourcing of enterprise food services, says Andy Ramer. He expects EPS growth, dividends and some multiple expansion to translate into an annual mid-teens return on the stock.

Sources: Company reports, other publicly available information

How does Compass distinguish itself against Sodexo and Aramark?

AR: The breadth and quality of services are comparable, but what distinguishes Compass for us is the type of projects they bid on. It stays away from the high-profile project that might be very visible but doesn't generate much profit. They try to avoid competing with the other big players for deals, and are looking for projects where the quality and value of the service can trump just a low price. This approach trades off some growth for margin, which is perfectly fine with us.

To give some historical perspective, Compass was an industry laggard for the first half of the 2000s, until Richard Cousins took over as CEO in 2006 and in a disciplined way got out of over 40 countries with sub-par profits, emphasized organic growth over acquisition, and instilled a clear focus on ROI. Operating margins went from 4.4% to nearly 7% from 2006 to 2011 and now lead the competition. The target today is 8.5%.

The stock has done quite well over the past few years. What is the market missing with the share price at around £6.50?

AR: The P/E on next year's earnings estimate of 47 pence per share is around 14x, which we don't think adequately recognizes the quality of the business. We believe they can lever a top line growing at a mid-single-digit rate into high-single-digit EPS growth. With a better than 3% dividend yield, that would produce a 12-13% annual total return on the stock. If the multiple expands to the 17x or so we consider reasonable for an above-average business like this, our annual return would be in the mid-teens.

Speaking generally again, how well do you recognize mistakes and move on?

PE: Any value investor needs to be highly sensitive to being on the wrong side of a secular issue. It's one thing to be contrarian and another to be foolish.

A few years ago we owned Best Buy [BBY], which had a terrific track record

but whose stock was under pressure from the poor economy and concerns over heightened competition from Internet sellers like Amazon. At the time we basically thought there was enough complexity around buying consumer electronics that Best Buy would hold its own against Amazon, but in watching Amazon's electronic-product sales each quarter it become apparent that that basic premise was flawed. Best Buy wasn't doing terribly, but we almost couldn't believe how fast Amazon was growing. We sold the stock in 2009 in the low $40s, so while our original thesis was wrong, we did recognize that earlier than others. [*Note*: BBY shares now trade around $25.]

More recently in small cap, we sold Alliant Techsystems [ATK] after concluding we were underestimating the potential severity of defense-spending cuts. The current administration, Congress and the American people don't appear ready to accept the kind of cuts that will be necessary in health and social spending, so defense may be the whipping boy in this equation. We didn't want to be on the wrong side of that.

Critique the handling of your Staples [SPLS] position so far?

PE: Our patience is certainly being tested. A few things have kept us from moving on. One, in contrast to Best Buy, Staples has been much more successful in competing online, where it now generates roughly half of its revenue. Two, we believe the company has an obvious lever to pull to increase profitability by getting out of its European retail business. Three, we think it's too early to call Staples secularly challenged, given that the cyclical office-products environment remains poor and U.S. white-collar employment has yet to rebound. If white collar employment rebounds and Staples does not, then we have a problem. It is a mature business, but over the long run should still grow modestly and the stock is highly depressed, carrying a 10% free cash flow yield.

Pat, you were a scholarship golfer at Stanford – how's your game today?

PE: Not great. I need strokes from my 18-year-old, the 16-year-old regularly beats me, and it won't be long before my 13-year-old does as well.

I do think my time playing golf taught me some useful lessons as an investor. For one, you make mistakes all the time and you try to learn from them, but it's always about the next shot. It's about properly preparing and then executing to the best of your ability. That's an excellent mindset for an investor to have.

Another thing tournament golf teaches you is resolve. You can have a bad nine holes, or even a bad round, and still win a four-round tournament. If you hang in there, keep your wits about you and don't take undue risks, the end result can turn out quite well. VII

Fiduciary Management Inc.
Large Cap Equity Composite
12/31/2008 - 12/31/2018

Year	Total Return Gross of Fees %	Total Return Net of Fees %	*Benchmark Return %	Number of Portfolios	Dispersion %	Three Year Ex-Post Standard Deviation Composite	Three Year Ex-Post Standard Deviation *Benchmark	Total Composite Assets End of Period ($ millions)	Total Firm Assets End of Period ($ millions)	Percentage of Firm Assets %
2009	30.92	30.09	26.46	252	1.22	n/a	n/a	$ 3,820.3	$ 7,008.9	54.51%
2010	12.52	11.81	15.06	394	0.31	n/a	n/a	$ 5,923.2	$ 9,816.0	60.34%
2011	2.35	1.74	2.11	509	0.37	18.34%	18.70%	$ 8,434.8	$ 12,273.6	68.72%
2012	16.02	15.32	16.00	575	0.32	13.94%	15.09%	$ 11,270.3	$ 15,253.5	73.89%
2013	31.87	31.10	32.39	685	0.31	11.38%	11.94%	$ 15,785.5	$ 19,705.3	80.11%
2014	13.52	12.81	13.69	725	0.25	8.54%	8.98%	$ 16,084.1	$ 21,001.1	76.59%
2015	-1.54	-2.16	1.38	655	0.27	9.94%	10.48%	$ 14,304.1	$ 21,042.9	67.98%
2016	14.85	14.16	11.96	636	0.32	10.48%	10.59%	$ 12,562.9	$ 22,626.7	55.52%
2017	19.90	19.24	21.83	628	0.32	9.70%	9.92%	$ 12,722.2	$ 25,322.0	50.24%
2018	-3.07	-3.62	-4.38	540	0.29	9.85%	10.80%	$ 9,901.1	$ 19,833.6	49.92%

*Benchmark: S&P 500 Index®

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 - 12/31/2018. 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 Large Cap Equity composite has been examined for the periods 12/31/2000 - 12/31/2018. The verification and performance examination reports are available upon request. Benchmark returns are not covered by the report of independent verifiers.

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 $19.8 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 Large Cap Equity Composite was created in December 2000. These accounts primarily invest in medium to large capitalization US equities.

The FMI Large 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 beginning January 1, 2012. From December 31, 2000 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 equal weighted standard deviation of all accounts in the composite for the entire period. As of 12/31/2011, the trailing three year annualized ex-post standard deviation for the Composite and Benchmark are required to be stated per GIPS®.

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

Up to $25,000,000	0.60%
$25,000,001-$50,000,000	0.55%
$50,000,001-$100,000,000	0.45%
$100,000,001 and above	0.35%

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 S&P 500 Index® is widely regarded as the best single gauge of the U.S. equities market. This index includes 500 leading companies in leading industries of the U.S. economy. Although the S&P 500® focuses on the large cap segment of the market, with approximately 75% coverage of U.S. equities, it is also an ideal proxy for the total market.
The Large Cap Equity composite uses the S&P 500 Index® as its primary index comparison.

Fiduciary Management Inc.
Small Cap Equity Composite
12/31/2008 - 12/31/2018

Year	Total Return Gross of Fees %	Total Return Net of Fees %	*Benchmark Return %	Number of Portfolios	Dispersion %	Three Year Ex-Post Standard Deviation		Total Composite Assets End of Period ($ millions)	Total Firm Assets End of Period ($ millions)	Percentage of Firm Assets %
						Composite	*Benchmark			
2009	35.72	34.56	27.17	165	0.97	n/a	n/a	$ 2,004.6	$ 7,008.9	28.60%
2010	23.45	22.43	26.85	170	0.48	n/a	n/a	$ 2,477.7	$ 9,816.0	25.24%
2011	5.64	4.79	-4.18	179	0.34	21.17%	24.99%	$ 2,523.2	$ 12,273.6	20.56%
2012	11.34	10.43	16.35	182	0.40	15.46%	20.20%	$ 2,609.5	$ 15,253.5	17.11%
2013	33.43	32.33	38.82	180	1.04	12.51%	16.45%	$ 2,801.8	$ 19,705.3	14.22%
2014	7.99	7.06	4.89	178	0.39	9.65%	13.12%	$ 3,006.5	$ 21,001.1	14.32%
2015	-5.72	-6.52	-4.41	171	0.34	11.18%	13.98%	$ 2,597.2	$ 21,042.9	12.34%
2016	21.65	20.65	21.31	171	0.46	12.02%	15.77%	$ 2,596.0	$ 22,626.7	11.47%
2017	15.42	14.49	14.65	171	0.84	11.12%	13.91%	$ 2,774.0	$ 25,322.0	10.96%
2018	-8.10	-8.83	-11.01	160	0.74	11.73%	15.79%	$ 2,220.4	$ 19,833.6	11.20%

*Benchmark: Russell 2000 Index®

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 - 12/31/2018. 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 - 12/31/2018. The verification and performance examination reports are available upon request. Benchmark returns are not covered by the report of independent verifiers.

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 $19.8 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 equal weighted standard deviation of all accounts in the composite for the entire period. As of 12/31/2011, the trailing three year annualized ex-post standard deviation for the Composite and Benchmark are required to be stated per GIPS®.

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

Up to $25,000,000	0.85%
$25,000,001-$50,000,000	0.80%
$50,000,001-$100,000,000	0.70%
$100,000,001 and above	0.60%

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.

Fiduciary Management Inc.
International Equity Composite
12/31/2010 - 12/31/2018

Year	Total Return Gross of Fees %	Total Return Net of Fees %	*Benchmark Return %	Number of Portfolios	Dispersion %	Three Year Ex-Post Standard Deviation		Total Composite Assets End of Period ($ millions)	Total Firm Assets End of Period ($ millions)	Percentage of Firm Assets %
						Composite	*Benchmark			
2011	-0.78	-1.52	-12.15	1	0.00	n/a	n/a	$ 16.7	$ 12,273.6	0.14%
2012	19.35	18.46	17.31	1	0.00	n/a	n/a	$ 76.3	$ 15,253.5	0.50%
2013	25.89	24.95	26.93	1	0.00	9.78	12.22	$ 165.8	$ 19,705.3	0.84%
2014	5.66	4.87	5.92	1	0.00	7.49	10.33	$ 771.6	$ 21,001.1	3.67%
2015	4.24	3.46	5.33	2	0.00	8.14	11.73	$ 2,832.9	$ 21,042.9	13.46%
2016	11.04	10.23	5.34	3	0.38	7.39	11.53	$ 5,946.2	$ 22,626.7	26.28%
2017	16.51	15.70	15.23	3	0.02	7.04	11.20	$ 8,209.3	$ 25,322.0	32.42%
2018	-8.63	-9.27	-10.99	3	0.12	7.22	9.69	$ 6,287.8	$ 19,833.6	31.70%

*MSCI EAFE Net Local Index®

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, Incorporated (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 - 12/31/2018. 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 International Equity Composite has been examined for the periods 12/31/2010-12/31/2018. The verification and performance examination reports are available upon request. Benchmark returns are not covered by the report of independent verifiers.

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 $19.8 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 International Equity Composite was created on December 31, 2010. This composite invests mainly in a limited number (usually between 25-40) of large capitalization (namely, companies with more than $5 billion market capitalization) foreign companies.

The International Equity Composite reflects time-weighted and asset-weighted returns for all discretionary accounts. 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 equal weighted standard deviation of all accounts in the composite for the entire period. As of 12/31/2011, the trailing three year annualized ex-post standard deviation for the Composite and Benchmark are required to be stated per GIPS®. For the periods 2011-2012, the information is not available for the International Equity Composite.

Currently, the advisory fee structure for the International Equity Composite portfolios is as follows:

Up to $25,000,000	0.70%
$25,000,001-$50,000,000	0.65%
$50,000,001-$100,000,000	0.60%
$100,000,001 and above	0.55%

The firm generally requires a minimum of $25 million in assets to establish a discretionary account. 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 MSCI EAFE Net Local Index® is a free float-adjusted market capitalization index that is designed to measure the equity market performance of developed markets, excluding the US & Canada. The MSCI EAFE Net Local Index consists of the following 21 developed market country indices: Australia, Austria, Belgium, Denmark, Finland, France, Germany, Hong Kong, Ireland, Israel, Italy, Japan, the Netherlands, New Zealand, Norway, Portugal, Singapore, Spain, Sweden, Switzerland, and the United Kingdom. It is reported in local currency and net of hedges. The International Equity composite uses the MSCI EAFE Net Local Index® as its primary index comparison.