LATEEF

INVESTMENT MANAGEMENT

Lateef Second Quarter 2010 Commentary

After posting four consecutive positive quarterly returns for a cumulative gain of 50%, the S&P 500 index fell 11.4% in the second quarter pushing the year-to-date return into the red by 6.6%. Market corrections of 10% or more are to be expected; in fact they have occurred on average once every two years during the last 80 years. This decline rattled some investors, still fresh from their experience in 2008. The Wall Street Journal noted that the only other time in the last 80 years that the DJIA had fallen that far that fast so early in an economic rebound was in 1950 at the beginning of the Korean War.

Warren Buffett has said that "The number one quality you need to be a successful investor is the right temperament and the right intellectual framework…an investor will succeed by coupling good business judgment with an ability to insulate his thoughts and behavior from the super-contagious emotions that swirl about the marketplace."[1] We are mindful of the forces that "swirl about the marketplace" and will offer our perspective on those that drove this correction. However, we view ourselves as business analysts, not macro-economists, and therefore will focus our letter on communicating how our companies are performing at the business level, which we find encouraging, and we believe will ultimately drive stock prices higher to intrinsic values. **In fact, we believe our companies have created tremendous value that is not being recognized.**

The wrestling match between the bulls and bears in the stock market arena this quarter focused on at least five concerns that drove stocks out of the ring. First, investors were anxious about Greece's sovereign debt crisis, which led to similar concerns about the lofty sovereign debt levels relative to GDP in Portugal, Italy, Ireland, and Spain. Without trivializing their necessary fiscal and labor reform, the reality is that Greece represents 0.6% of the world economy and is just 2% of the U.S. GDP and should not derail the prospects of our owned businesses..

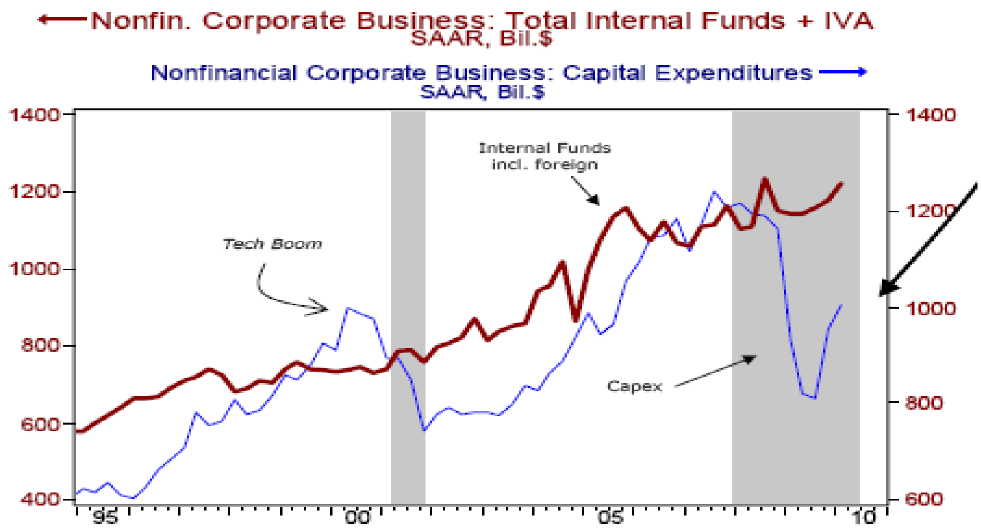
Second, regulation uncertainty remains a distraction and is effectively handcuffing spending plans for many businesses. Potentially sweeping regulatory reform discussions are active in the healthcare, energy, finance and for-profit education industries which account for 40% of the S&P 500. Once the rules and regulations are final, affected companies will have visibility to resume long-term planning and return excess capital to shareholders which should restore investor confidence.

Third, the economic recovery was questioned by some who fanned fears about a double-dip recession. While the economic recovery is muted by the deleveraging effect of consumers and state governments, the U.S. is recovering nonetheless with GDP growing 2.7% in Q1'10 and likely slowing to a 2%+ rate the rest of the year.

Other encouraging signs include the yield curve which is steep at 232bp and has historically signaled future growth. The Institute for Supply Management manufacturing index in June was 56.2 which is in an expansionary mode with readings above 50. Over one-half of the fiscal stimulus spending package of $626 billion has yet to be spent. Non-financial corporate balance sheets are healthy with cash as a

[1] Outstanding Investor Digest June 1993

percent of total assets at an all-time high of 6%. According to Strategas, capital spending has dramatically lagged income from nonfinancial businesses but has recently turned higher with pent-up demand.



Fourth, confidence was shaken for consumers and investors alike. Concerns about tepid private sector job creation and volatile markets caused investors to run for cover in the perceived safety of bond funds by investing an additional $395 billion despite 10-year treasury yields below 3%, and withdrawing $4 billion from stock mutual funds. Another threat to investor confidence was the "Flash Crash" on May 6th for which there is yet a clear explanation.

Lastly, the oil spill in the Gulf is an epic nightmare for BP, Gulf residents and wildlife. The government reaction to ban all offshore drilling fueled uncertainties for the energy sector but will not affect our position in Suncor which has over 50 years of proven reserves onshore in Canada. If anything, the problem in the Gulf of Mexico makes Suncor's assets more valuable.

At the business level, our companies' growth and business momentum is accelerating and we believe intrinsic values are rising. Here are a few examples of how our businesses are powering through this economy and why we are enthusiastic about the business value creation of our companies.

- In May we visited with the entire management team of Scripps Networks Interactive's (SNI) cable network business in a private full day meeting. We were able to gain_insights to their successful renegotiations of each of their distributor, affiliate fee contracts for the Food Network – the upside to these contracts was a key tenet to our original thesis. Management spoke more about dominating the food, shelter and travel categories and we gained conviction in the broader market opportunities available to SNI. We were one of the first investors to meet with the new and dynamic Travel Channel President, Laureen Ong who formerly led the successful National Geographic channel. Her programming changes to Travel will be visible in the first part of 2011 and we look forward to the eventual 30% revenue contribution from each HGTV, Food Network, and Travel. SNI has led ad pricing growth for the past 5 years and it continued with industry leading ad growth in Q1'10. With 70% of SNI's revenue coming from advertising, the company is enjoying a rebound in pricing and ad dollar volume as reflected by their 16% increase in organic revenues last quarter (higher ad costs have been confirmed by ITT Educational Services). We also look forward to seeing a material contribution from the impact of the newly rebranded Cooking Channel which launched over Memorial Day, and SNI's_international strategy over the next 3-5 years. **On a day when the broader market fell 4% and SNI dropped 5%, we walked away convinced of SNI's growing underlying business value that is underappreciated.**

- Accenture reported F3Q EPS on June 24th that was $.03 better than expected. Revenues in constant currency grew 4%, their first year-over-year growth in four quarters. They then guided to F4Q revenue growth of 5%-9% and FY'11 growth of 7%-10%. The company also expects free cash flow (FCF) to increase by $200 million from their last guidance to $2.3-$2.5 billion. Chairman and CEO Bill Green commented during its earnings call that "the U.S. recovery is solidly under way but it is not widespread yet. But in a lot of industries we're starting to move from recovery to expansion…In Europe we haven't seen the recovery kick in yet." Based on signs of positive momentum, such as new bookings in financial services that are at an all-time high and higher year over year by 35%, Accenture has hired 40,000 people in the last 3 quarters and intends to hire 10,000 more in the next quarter.
- Visa's CFO Byron Pollitt on June 8th said that "the world continues to travel and, as the recovery proceeds, it's very broad based and very global in nature." Cross-border volume growth accelerated to +19% in May, from +15% in April and from +12% in the March quarter. In May, total processed transaction growth remained robust at +20% compared to +19% in the March quarter. Moreover, he added that "nothing has happened at all in recent months that would cause us to revisit our guidance, so we affirm all aspects of our earnings guidance going forward for both 2010 as well as fiscal year 2011 (which are for at least 20% EPS growth each year)."[2]
- MasterCard's CEO Ajay Banga on June 10th, affirmed strength in Europe, "Interesting, it's almost a tale of two Europes, right? There's what we read in the newspapers about debt crises and sovereign debt issues and currencies…On the other hand, if you look at volumes on the ground, cross-border volumes in Europe are doing exactly what they were doing in January, February and March."[3] Last quarter, MasterCard reported earnings growth of 24%, operating margins expanded almost 5 percentage points to 53.5% and management expects 2010 revenues to grow double-digit, operating margins to expand 3-4 percentage points and earnings to grow 20%-30%.
- We attended the Berkshire Hathaway Annual Meeting in May, where Warren Buffett reported strong first quarter results and added that, "What was a sort of sputtering recovery months ago seemed to pick up steam in March and April. We've seen a pretty good uptick."
- Expeditors International in a May 26th 8-K filing reported accelerating gains in cargo volume with April tonnage for airfreight +49% compared to +40% for Q1 and April tonnage for ocean freight +18% compared to +14% for Q1. Furthermore, Singapore Airlines, one of the largest air freight companies in the world, carried 11% more tonnage in May than in April, the largest sequential monthly gain in four years.
- EMC Corporation reported record first quarter 2010 results with EPS growth of 62%, revenue growth of 23% and record quarterly free cash flow of $1.1 billion. Chairman and CEO Joe Tucci

[2] UBS Global Technology and Services Conference 6/8/10
[3] UBS Global Technology and Services Conference 6/10/10

> added that, “Our private cloud strategy and focus on four multi-billion dollar markets—each expected to experience rapid growth for many years to come—are resonating very well with customers. We are confident in our ability to lead the next major wave of IT, maintain a long-term double-digit revenue growth rate and continue to take share."[4]

Our performance slightly lagged the S&P 500 for the second quarter and year-to-date primarily due to the perceived impact of new government regulation affecting ITT Educational Services (ESI), Visa (V) and MasterCard (MA), and to a lesser degree, the impact of the equity market correction on Affiliated Managers Group (AMG) and State Street (STT). ESI’s stock weakness was in reaction to increased scrutiny of the for-profit education industry. The final regulation is expected in November. ESI offers a compelling value to its open enrollment “career changer” graduates who earn an average of $33,000/year and we believe that DOE Secretary Arne Duncan is mindful of unintended consequences of adverse regulation. ESI’s P/E ratio of 8x 2010 EPS and FCF yield of more than 9% on 2009 cash flow more than discounts possible regulatory threats.

Despite strong underlying business trends at Visa and MasterCard, both stocks were weak during the quarter due to a surprise Durbin Amendment to the financial regulation bill regulating debit interchange fees but largely leaving Visa’s and MasterCard’s network fees unscathed. The bill allows for a “reasonable and proportionate” fee that includes an allowance for fraud. We don’t believe the direct impact on Visa and MasterCard will be material, but the surprise element of the Amendment and the confusion by investors over the real financial impact on the card processors contributed to the stock weakness.

AMG and State Street declined due to general equity market weakness and finance reform uncertainty. Shortly after the quarter closed on July 7th, State Street pre-announced better than expected Q2 earnings with operating EPS of $.93/sh compared to consensus forecasts of $.72/sh. The stock responded by climbing 10% that day, highlighting how low investor expectations have become and how much better business operations are than generally perceived. We believe AMG has the ability to earn close to $8/share in 2011 and offers a compelling value with a P/E of just 8x.

As we did in the first quarter of 2009, we used volatility as an ally to slightly modify our All-Cap Equity portfolio in appropriate accounts. We now have 7% target weights in Accenture, Teradata, Qualcomm, ITT Educational Services and Aflac which together offer an 80% upside to our estimate of intrinsic value and a P/E of 12x 2010 consensus estimates. While we still believe the upside potential and business quality at ADP and Ecolab are attractive to hold in our Large Cap Growth portfolio, we used these positions as a source of funds in our All-Cap portfolio.

We slightly increased our weights in Visa and MasterCard to 5% and added a new position in Robert Half (RHI) to our All-Cap portfolio. RHI is a respected $3.5 billion market cap leader in professional staffing with specialization in finance and accounting. There is solid evidence that temporary staffing is rebounding in clerical and light industrial positions. Traditionally RHI experiences a 6-month lag in its upturn, and we believe we are at that inflection point which will lead to much higher revenues, earnings and cash flow. RHI has no debt, and its cash of $350 million is equal to 10% of its market cap. We

[4] Earnings Release April 21, 2010

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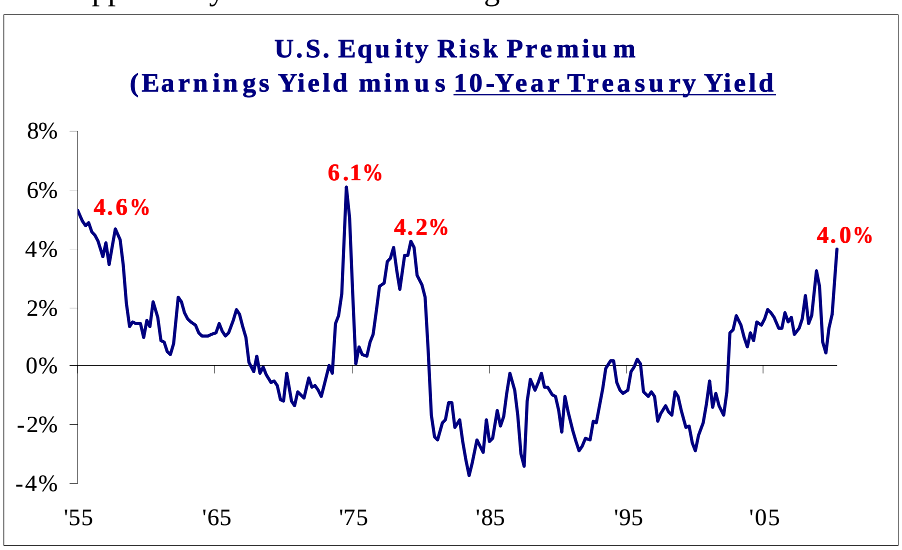
believe it offers attractive upside to our estimate of intrinsic value which is close to where the stock was just two months ago.

In our Large-Cap Growth portfolio in appropriate accounts, we added Apple Inc. and Invesco LLC and removed ITT Educational Services and AMG due to their smaller market cap weights. We believe that Apple's current product portfolio will enable them to grow operating profits in the low-to mid-teens over the next five years. The iPhone and Mac both have single digit market share which we believe should grow meaningfully. New products such as the iPad would be additive to our growth assumptions. At $238, Apple's P/E is 17x consensus 2010 estimate of $14.26/sh but excluding its $42 billion in cash, or $45/share, its P/E is just 14x earnings and offers a 6% free cash flow yield.

Invesco is a top-ten U.S. asset management company that is being transformed under veteran CEO Marty Flanagan who has focused the company on strong investment performance, cross-selling products worldwide, building out its global operating platform and rewarding its people for long-term results. The company has instituted common operating platforms, added the Powershares Capital Management of ETFs, W.L Ross & Co. and the recently announced acquisition of Morgan Stanley/Van Kampen business. Operating margin leverage is significant and the company is poised for earnings growth with the benefits of its performance and recent positive flows.

We are optimistic about stocks in general for the following reasons:

- For the past 16 years, the market capitalization to GDP of U.S. stocks has ranged from .70x - 1.90x with a median of 1.25x and currently stands at .85x. This implies nearly a 50% return potential to its median value.
- As the following chart indicates, the earnings yield of the S&P 500 index (inverse of P/E ratio) less the yield on the 10 year treasury yield of 4.0 percentage points, is at a 20 year high, and at a level that has been rarely exceeded in its 55 year history. Recently investors have sought refuge in the proverbial mattress of bonds despite their low yields and the recent sell-off in stocks represents an opportunity for investors looking to re-enter the market.



Source: Strategas

- Lateef's hallmarks for investing are quality and value. Our conviction is built on our diligence in maintaining regular contact with our companies and their constituents. As enthusiastic as we are for stocks in general, we believe our stocks are uniquely attractive:
    - Our free cash flow yield is over 9% and we believe the free cash flow will increase over time.
    - There is more than a 50% upside potential appreciation to our estimate of intrinsic value.
    - Cash as a percentage of market cap is over 10% in 40% of our portfolio which is a sign of balance sheet strength and compelling value.
    - Excluding our financial positions, over 75% of our portfolio holdings have positive net cash on their balance sheets.
    - All of our companies generate positive free cash flow and consensus earning growth in 2010 for our portfolio is over 30%.
    - The ROE of our portfolio of 23% has consistently exceeded the S&P 500.
    - The P/E of our portfolio of 14x consensus 2010 EPS is in line with the S&P 500 P/E of 13x despite much better quality and return metrics.[5]

We believe that as investors turn their attention toward business metrics in the upcoming second quarter earnings reporting period and throughout the year, and focus less on important but less relevant macro-headline concerns, equity investors are positioned to be rewarded for their stamina and will ultimately emerge victorious in wrestling the bear.

For additional insight into your portfolio, our Q2 2010 webcast is available at www.lateef.com. Thank you for your trust and confidence, and as always, please contact us with any questions.

Sincerely,

Lateef Investment Management

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[5] (Note our P/E adjusts for RHI which has a high P/E on cyclically depressed earnings.)

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