



LATEEF

INVESTMENT
MANAGEMENT

Lateef Q4 2011 Commentary

While we were pleased with the underlying business performance of our companies in 2011, we were disappointed that their market prices did not keep pace with their growth in cash flow and intrinsic value. Instead, this year was driven largely by macro events focused on resolving the fiscal irresponsibility of a few European countries and the frustrating impasse over how our own government should live within its means. The companies in our Multi-Cap and Large-Cap portfolios, on the other hand, are fundamentally strong as they all generate free cash flow, most have little-to-no debt, and in aggregate, grew earnings by over 26% for the last year. We believe in time our companies will be accorded a valuation that properly reflects their quality and growing earnings power. With another year of P/E compression, we believe the market and our stocks offer compelling value.

In the fourth quarter of 2011, the S&P 500 reversed most of the selling pressure that occurred during the third quarter for a gain of 11.8%, which drove a +2.1% return for the year. The flattish performance in the S&P 500 masked its unusual volatility where the market peaked at +9% in May and bottomed at -15% in October before finally settling at +2%. Investor confidence grew from an improving U.S. economy, an expanded European Union bailout fund, and a coordinated effort among the world's central banks to enhance liquidity in Europe by swapping U.S. dollars for Euros, enabling lower borrowing rates. Although the S&P 500 full-year return of +2.1% was not heroic, it benefited from a safe-haven perception and outperformed the 2011 losses posted by other major countries such as the UK -2.7%, France -14.4%, Germany -14.7%, Japan -16.2%, China -17.4% and Brazil -18.1%.

Net of fees, the Lateef Non-Taxable Multi-Cap Growth Equity composite gained 11.3% in the fourth quarter, while the Lateef Non-Taxable Large-Cap Growth Equity composite increased 10.7%. For the full year 2011, the Multi-Cap rose 0.20%, while the Large-Cap composite advanced 0.15%. Our performance slightly trailed the S&P 500 for the fourth quarter and the year as the stock prices of some of our technology and cyclical growth companies were weaker due to concerns that a potential recession in Europe and a slowing economy in Asia would impact overall discretionary spending. The best performing sector for the S&P 500 for 2011 was Utilities at +20%, where we had no exposure due to heavy regulation and modest long-term growth prospects.

While the European debt crisis dominated investor attention for much of 2011, the increasingly appealing foundation of support for the prospect of higher stock prices was largely overlooked. Corporate earnings, as represented by the S&P 500 for the trailing twelve months of \$95.40/share, are at record levels and increased 19% over last year. At the current S&P 500 prices, the P/E ratio of 13.2x trailing earnings and 11.6x consensus earnings for 2012 is very compelling especially compared to its 50-year average of 15x. Interest rates on the benchmark U.S. ten-year treasury of 1.9% are at borrowing levels that haven't been this low for 70 years.



We were pleased with the earnings reports of our companies throughout the year and believe our portfolio is well positioned for further fundamental strength in 2012. Recent commentary by many of our companies reinforces our conviction in their ability to continue growing and adding value.

- **Accenture (ACN):** Pamela Craig, CFO, said, “In management consulting, we had strong bookings, in large part because of increased client demand for projects that deliver near-term and structural cost take-out, especially for sourcing and other parts of the supply chain. Bookings also reflected demand for services on large scale business transformation programs. And we continued to see clients seeking to drive new revenue through improved sales and marketing effectiveness. Overall, we see our clients taking proactive action in focused ways to respond to the current more volatile market conditions.” (12/16/11)
- **Ansys (ANSS):** Jim Cashman, CEO, said, “The reason we can offset the headwinds of what is going on globally from a macro level is that, in general, everybody is looking for innovation. Companies are looking for ways to excel and gain market share. Long term, if you don’t have a stream of products that are capturing then it’s very difficult to survive in this world, particularly with all the changes that are being enforced on people. (11/16/11)
- **MasterCard (MA):** CFO Martine Hund-Mejean said, “Yes, Europe is a very interesting topic. Our growth rates have been steadily moving up from about late last year 14% GDV growth, Gross Dollar Volume growth, all the way to the latest quarter about 17%. So, we actually saw volumes increasing, and our business actually doing very well.” (12/11/11)
- **Starwood Hotels (HOT):** Vasant Prabhu, CFO, noted that there are 350 hotels in pipeline that will open in the next four years, 80% of which are outside the developed world. Today, the emerging market pipeline is 70% of Starwood’s entire existing international footprint. Of the pipeline, 84% is managed contracts and over 75% upper upscale and luxury. Geographically, the pipeline is targeted 60% Asia Pacific, 8-9% Africa and the Middle East, 5% Latin America and the remainder rest of world. (11/18/11)

Our companies benefit from several powerful secular growth trends such as deploying analytics (which Accenture’s CFO told us “is the next frontier”) for more effective marketing, supply chain management, and risk management. Our companies are also benefiting from the proliferation of wireless devices, the penetration of paperless commerce, the voracious appetite for digital storage especially for video sharing, demand for scarce oil from a friendly neighbor with a 50-year proven supply, record ratings for proprietary content on cable TV, and the increasing demand for more flexible hiring of temporary IT and financial professionals. These trends are intact and are sustainable even after overdue fiscal reforms are enacted.

We are also pleased that over 85% of our Multi-Cap companies and 95% of our Large-Cap companies are buying back their stock this year, a testimony to their ability to generate excess cash flow and allocate capital to retire their stock at an attractive price. This will benefit remaining shareholders as future earnings are spread over fewer shares.



Portfolio leaders for the fourth quarter were primarily cyclical growth or market-related companies that rebounded from their oversold position last quarter. Leaders for Multi-Cap included Robert Half +34.9%, Starwood Hotels and Resorts +24.9%, and Affiliated Managers Group (AMG) +22.9%.

Robert Half reported third quarter EPS of \$.31/share which more than doubled from last year and exceeded consensus estimates by \$.03/share. The company noted strength across all its business segments and said pricing remains strong and ahead of its pay rates.

Starwood reported third quarter EPS of \$.42/share which increased 68% from last year and exceeded consensus by \$.03/share. The worldwide lodging recovery continues with healthy RevPar (revenue per available room) growth of 7.4%. Starwood remains well positioned to benefit from emerging market growth as 80% of its pipeline is outside developed markets and its emerging market pipeline is now 70% of the scale of its existing international footprint. Later in the quarter, Starwood announced a new \$250 million share repurchase plan due to its attractive stock price and anticipated excess cash flow.

AMG reported healthy positive net flows of \$5 billion for the third quarter despite unusual volatility and investors reacted positively to the anticipated impact of rebounding equity markets on its underlying assets and fees.

Portfolio leaders for Large-Cap included Invesco (IVZ) +30.3%, Starwood Hotels & Resorts (HOT) +24.9% and Express Scripts (ESRX) +20.7%. Similar to AMG, Invesco benefited as investors extrapolated rebounding equity markets to higher assets and fees for the company. Invesco's long-term flows were a positive \$3.3 billion and have been positive ten of the last eleven quarters. Invesco planned to buy back \$100 million of stock during the fourth quarter, which would bring full-year repurchases to 5% of outstanding shares.

Express Scripts rebounded from its 31% sell-off during the third quarter as investors rallied behind its third quarter EPS growth of 22% powered by excellent operating efficiencies and the benefits of the wave of generic drugs still to come in 2012.

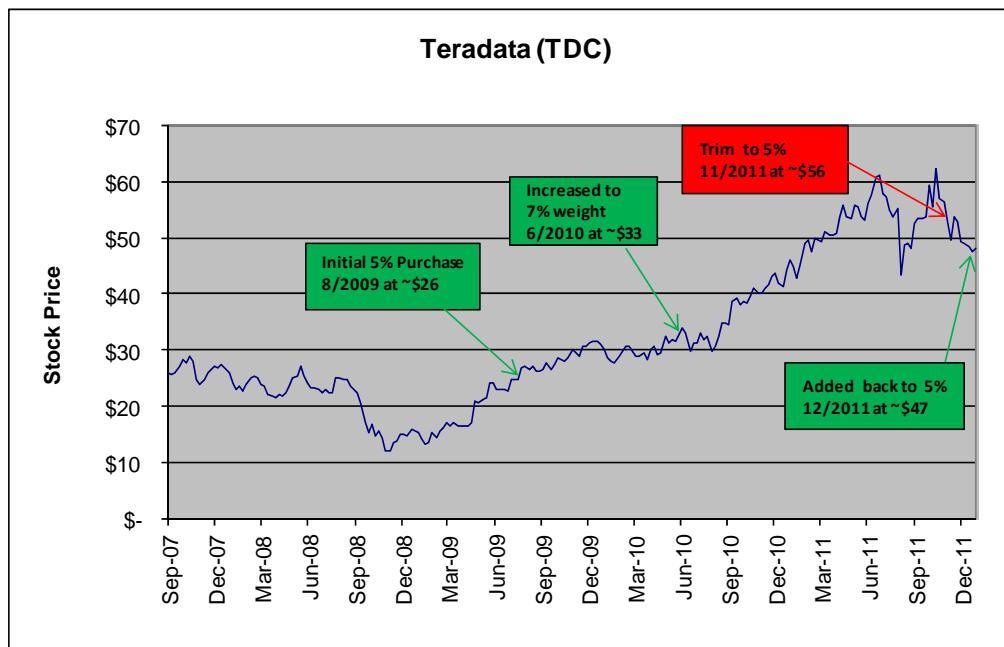
Our performance laggards for the quarter for both Multi-Cap and Large-Cap included Teradata (TDC) -9.4%, Expeditors International (EXPD) +1.6%, and Accenture (ACN) +2.2%. Teradata reported robust third quarter earnings of \$.59/share, which grew 28% from last year and exceeded consensus estimates by \$.03/share. The company raised its guidance for revenues and earnings for the full-year 2011, but investors were concerned that operating margins would be pressured near-term due to increased investments in R&D and the doubling of TDC's original 2011 plan to expand its sales force because of higher product demand.

Expeditors reported 11% earnings growth, slightly below consensus estimates. Additionally, volume in its Air-freight and Ocean-freight segments declined at low single-digit rates but faced prior year comparisons averaging 30%. Operating margins declined as Expeditors steadily increased staffing throughout the year, with the conviction that their personnel is the company's greatest competitive differentiator and will allow for longer-term gains.



Accenture reported solid quarterly earnings growth of 19%, but investors reacted to management lowering its fiscal 2012 EPS guidance by \$.04/share, solely due to different foreign currency assumptions and conservative comments about the macro-economic environment, especially Europe. All five of its operating groups and all three geographic regions delivered double-digit constant currency revenue growth. Guidance for FY 2012 bookings growth and free cash flow were unchanged from last quarter and its guidance for free cash flow of \$3.1-\$3.4 billion represents 12% growth and an attractive 8.6% free cash flow yield.

This quarter, we trimmed Teradata to a 5% weight in both Multi-Cap and Large-Cap as the weight had reached low double digit percentage levels in many accounts due to appreciation. We trimmed the stock at about \$56/share, where we thought the stock price had approached our estimate of fair value. Later, the stock dropped \$10/share in reaction to weak overall results from Oracle, even though the area of data analytics where Oracle competes with Teradata more than doubled in revenues and provided evidence of a healthy analytics market. The stock was also weak in reaction to concerns that flooding in Thailand may cause a shortage of disk-drives which are a component of Teradata's data warehouse product. Since the stock price fell below our price limit, which hadn't been the case for months, we added the stock to newer accounts and we topped-off the position to our target weight of 5% in many existing accounts.



Our portfolio adjustments demonstrate the advantage of our valuation and pricing discipline. We employ relevant valuation methodologies to estimate intrinsic value that guides us to allocate capital where we have the greatest potential appreciation. In the case of Teradata, we averaged three valuation methodologies to derive our fair value estimate: free cash flow yield, discounted cash flow forecast, and return on reinvested capital. Our valuation work, in conjunction with our fundamental research,



helps us minimize risk in security selection by providing a margin of safety below which we buy and the discipline to trim or sell if upside is limited.

Our portfolio is positioned where the top eight companies have a target weight of almost 60%. This is one of the most concentrated portfolios we have had in years and reflects our conviction in their business outlooks and return potential. We believe our stocks offer the unique combination of quality and value as reflected by the following characteristics for the Multi-Cap product:

Strong EPS Growth

- The trailing twelve month median earnings growth for our portfolio grew 26% vs. 19% for the S&P 500.
- Consensus earnings estimates indicate that our portfolio will grow 23% in 2011 vs. 17% for the S&P 500.
- The two-year average compound growth in earnings from 2010-2012, according to consensus estimates, is 18% for our portfolio and 13% for the S&P 500.
- As of year-end 2010, our composite EPS growth has more than doubled the S&P 500's cumulative growth in the last seven years.

Attractive Valuation

- Our portfolio has over 50% upside potential appreciation to our conservative estimate of intrinsic value.
- Our free cash flow yield of 6.4% is attractive, especially versus the 10-year U.S. Treasury yield of 1.9%.
- All of our companies generate positive free cash flow and we believe this free cash flow will increase over time.

Superior Businesses

- The ROE of our portfolio of 27% exceeds the S&P 500 ROE of 21%.
- Approximately 50% of our portfolio companies' revenues are generated outside the U.S. with less than 15% from Europe.
- Excluding our financial positions, over 65% of our portfolio holdings have positive net cash on their balance sheets.

For additional insight into your portfolio, our Q4 2011 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