Akre Capital Management, LLC

Moderator: John O'Bannon
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Operator: Good afternoon, my name is (Shayna Wagner), and I'll be your conference operator today. At this time, I would like to welcome everyone to the Akre Focus Fund Semiannual conference call. All lines have been placed on mute to prevent any background noise. After the speaker's remarks, there will be a question-and-answer session. If you would like to ask a question during this time, simply press star then the number one on your telephone keypad. If you would like to withdraw your question, press the pound key. Thank you. Mr. John O'Bannon, you may begin your conference.

John O'Bannon: Thanks, (Shayna).

Mutual fund investing involves risk, including the potential loss of principal. The fund is non-diversified, meaning it may concentrate its assets in fewer individual holdings than a diversified fund. Therefore, the fund is more exposed to individual stock volatility than a diversified fund. The fund may invest in small and medium capitalization companies, which involve additional risks, such as limited liquidity and greater volatility than larger capitalization companies.

At this point, I'd like to turn the call over to Chuck Akre, Portfolio Manager of the Akre Focus Fund – Chuck?

Chuck Akre: Thanks, John. And thank you all for joining our call today. As you know I am Chuck Akre, and I am the Portfolio Manager of the Akre Focus Fund. I'm extremely pleased to have this opportunity to chat directly with our shareholders, because as you know we did not enjoy this luxury in our prior relationships.

Accordingly, we've prompted shareholders and other friends of the fund to submit questions concerning things which are important to them, and we've received quite a few, and so we will try to answer them later on in the call. If time permits, we will also take some calls from those of you who are on the line today.

Today, I'd like to share with you three things at least, the first is how we're selecting our investments, the second how we – how we are structuring the portfolio, and thirdly, how we – how we view the world today as it relates to our portfolio.

In addition, I'd like to just introduce our team here at Akre Capital Management, I'll just identify them so that you can get to know them as you – as you may in the future have direct contact with one or more of them, if you have not already.

Drew Schaefer is here, who is the President and Chief Operating Officer of Akre Capital. Patty Callahan, the Executive Assistant; John O'Bannon, whom you have heard from is our Fund Liaison person. Stacy Cahill is the Operations Manager; and Carolyn Hylton is the Client Service Manager. John Neff is an Analyst; and Tom Saberhagen is an Analyst. And you should know that Tom, John Neff and I are the three here working on ideas.

Before I get to those three points, I'd like to just give you a brief bit of history. The fund cleared the SEC on the last day of August in 2009, and we began receiving outside shareholder investments around the middle of September. It took just seven days for the first platform, and several months for the other custodians to make our investor class shares available on their NTF, their no transaction fee platforms.

In addition, many of you know that we also offer an institutional class of shares as well. And these two classes differ in two important ways, first the investor class, the AKREX, is delivered to investors with no transaction fees by their broker custodians, while the institutional class, the AKRIX shares, causes the share purchaser to incur a brokerage commission. Offsetting that commission in the AKRIX shares is an expense ratio which is lower on annual basis points by 25 basis points.

We are big believers in the funds ourselves, and have over $2 million of our own funds directly invested alongside yours.

Today, we have just over 210 million in the fund, and we're delighted by this enthusiastic response, as it is a reflection of both significant shareholder interest in our investment approach, as well as positive investment results in our first several months of operation. By contrast in our prior fund life, we held just $9 million in assets after three full years of operation.

Importantly in this early start-up phase, many well respected organizations have written highly complimentary pieces about our new fund, many of these pieces have pointed to our track record achieved in our former role. Perhaps you've seen them in print, but in the event that you have not seen the pieces, you can find them by reference on our fund Web site, akrefund.com, under the news heading. And in many – it may even be that we have not captured all of the positive comments, and if you know of one that's not referenced, please let us know about them.

Now back to the issues at hand. The first issue I said that I want to talk about was selecting investments. And many of you well know our description of the three legged stool, this is our construct for the three outstanding issues we focus on when searching for investments. And leg number one is what we call the business model. And it simply means that we're looking for truly outstanding businesses which have a history of earning way above average returns on the owner's capital, and when they – when they have done that, and we believe they're likely to continue to do that, it represents to us something special and unique, which is going on, and we spend a lot of time trying to understand that.

The second leg of the stool is what we call the people model, and that goes to the issue of the people who run the business. And we like managers who exhibit equal parts of skill and integrity, and particularly as it relates to integrity, we want to find managers who have a history of having acted in the best interest of all shareholders. That is, they see that what's happening at the company level also happens at a per share level.

The third leg of the stool, sometimes we just call it the glue, is the reinvestment model. And in the – we think that the reinvestment issue is perhaps the most important element facing an executive in the company today. And we want to find opportunities where because of the skill of the manager, and the nature of the business, there's an opportunity to reinvest the excess cash that the company generates in ways that continue to earn these above average returns as we referenced in leg number one.

And when we find a business that has all of these characteristics, we frequently describe it as our compounding machine. You know our notion is that compound return is the bottom line of all investing, and it doesn't make any difference whether or not you're talking about a CD or private equity or anything in between. So what're trying to do in our – in this portfolio is to compound our fellow shareholders' capital at above average rates while incurring a below average level of risk.

The second point I mentioned that I wanted to talk about was portfolio construction. And we will be delivered in trying to focus our capital on a relatively small number of outstanding businesses. And in the past, we've had in individual positions routinely in the mid teens percentage wise, currently no positions are above mid single digits, and this reflects both timing issues as we start up, and a reflection of our general cautiousness in this market.

It is logical from our perspective to expect a reasonably concentrated portfolio, which nearly always has a cash balance of at least five percent or more. This cash is designed to keep us in balance when shareholders have other ideas, and the timing of which we have no way to predict, so we don't try.

Further, we've always had an interest in holding cash to be able to take advantage of opportunities which the market may periodically deliver. For example, during this current transition or start-up period, we're currently holding 38 percent cash.

The third issue that I said I wanted to talk about was our outlook – our world view and our outlook on the market. And it's just perfectly obvious to us that the consumer has greatly diminished access to credit versus two and three years ago. Furthermore, the consumer is unpleasantly underemployed, so with these twin constraints, we believe it is sensible to be cautious as the consumer still represents 70 percent of our economy. Accordingly, we've made it a point to be invested in places which we believe have only modest direct connection to the consumer's discretionary spending.

We are always optimistic, and will remain so, just cautious. And oh, by the way, fully one in four mortgages is underwater according to numerous reports. This is a serious problem, which we as a nation must resolve for a full recovery to occur in our economy. Our belief is that we will have ample opportunities to deploy our cash at attractive valuations as the months roll by.

Many of you know that we posted today on our Web site the top 10 holdings as of March 31. And prior to today's posting, you had a chance to see the entire portfolio as of January 31. We will update our top 10 holdings each quarter 15 business days following the quarter's close, and semiannually we will publish our entire portfolio.

We'd like now to just to go to some questions which we've received, you've submitted by e-mail. And if time allows, we'll take some additional questions from you listeners today. So I'll just start off with several questions that we received in advance of today's call.

The first was given the importance you place on management integrity per your recent CNBC appearance, how do the SEC charges against Goldman Sachs affect your willingness to buy Goldman Sachs shares, even at lower prices? What if similar fraud charges were made against the company we own in the fund?

Well the first part is that obviously the questions raised by the SEC charge are serious, and as it relates to our being willing to take a position in Goldman Sachs, we would – we certainly will wait and see how this unravels. We don't own Goldman Sachs in the portfolio currently. And if charges similar to these were made against the company we own, it would cause us to reevaluate seriously whether we wanted to own this and make a judgment about the charges raised, and whether or not we had an ability to make a judgment on the charges, and if we did not, we quite likely would get out of the position until the air cleared.

A second question that's come in would be do you see the market over valued or under valued and why? And are you trying to time the market with your cash holdings? Well as I said in my remarks about the world today, the investment world today, we are cautious. And I guess the answer to the first part of the question is I do not see the market over valued, nor do I see it particularly under valued. You know it's had a rise of somewhere between 75 and 80 percent off the March 9, 2009 low, and many of the great bargains are not in front of us today. However, there are lots of terrific businesses today which are selling at reasonable valuations, and we've put money to work in the good many. Our portfolio today has 20 separate holdings.

The third question that's come in that I'll read is given your view of the constrained consumer, in what kinds of businesses are you finding the most opportunities to invest? Well you can see from our list of top 10 holdings that we announced today that there are three businesses among the top 10 that are off price retailers. And while it's true that they receive their money from discretionary dollars of the consumers, we think that those businesses in particular are particularly well suited to an environment with a constrained consumer. Individuals are going to go out and spend money on necessities, as well as some non-necessities. And when they can find places that will allow them to pay less for items than they might have paid in the past, they'll likely find their ways to those stores. And it certainly occurred in my family, and it may well have occurred in yours.

In addition to that, we have in the portfolio a couple – a couple of financial service companies that are selling at historically low valuations relative to tangible book value, and in at least one case, it's a – it's a place where you know there's been a history of very high compound growth in book value, and another case where there's a fabulous brand name, and the – and the shares are at an important discount to book value today. And our experience as investors has been that in financial service companies you know capital solves the problem at the end of the day. And when we're able to buy financial service companies, whether they're property casualty companies, or banks, or whatever, at significant discounts or even close to book value, and we found that in the past, we've been very successful with those investments.

In addition to that among the top 10, you – we have some manufacturing businesses, some advertising businesses, some distribution businesses, and some information distribution businesses. And in – and in almost all cases, they're places that we think will not be directly negatively influenced by the – by the constrained consumer.

So after those three questions, let me – let me just go ahead and see if maybe a couple more questions that have come in. Another question that has been raised is do you think American Tower is attractively valued? It seems to be selling at a rather high PE ratio. And the answer is it is attractively valued, we think that – we think that it's perhaps one of the best – it is certainly – it is certainly one of the best business models that we own in our portfolio. It is richly valued in our mind, it sells in the neighborhood of 20 times free cash flow for 2010, and – but we think that the economic value per share is likely to compound at a rate that's in the upper teens for some time to come. And we view it as a – as a vertical real estate business that has extraordinarily high gross margins, and we've owned American Tower in our other portfolios before the advent of Akre Focus Fund and we own it in this portfolio, and are proud to own it.

Another question that's come in is what is your average percentage cash since January 1, 2010? I'm a potential investor, and I'm having trouble evaluating focus funds, equity performance against an all equity benchmark. Is there a better way to evaluate your equity performance? Well as I mentioned in my opening remarks, during the first quarter, we were 50 percent invested on average, our first quarter return – was 4.8 percent.

And so I think it's a fair way to look at things is just to see how we're doing. But I would caution that looking at three months or six months or so on is an inappropriate way to value any manager, and what we can suggest to you is that if you look in our – under the news items of our – of our Web site, you will find others who have written about our record as mutual fund managers in our prior fund, and you can see what kinds of returns were developed there over a period of nearly 13 years.

With that, why don't I pause for a moment and see if (Shayna) has any questions, and if not, we'll just wrap it up. (Shayna)?

Operator: At this time, I would like to remind everyone, in order to ask a question, press star then the number one on your telephone keypad. Again, that's star then the number one on your telephone keypad.

Your first question comes from the line of (Taza Guanga).

(Taza Guanga): Hi, I'm (Taza). I am a private investor in your fund. The question I have is what – I looked at our cash allocation, and it's usually larger than that you normally hold. What I could not bring myself to understand is how do you justify your normal management expenses in such a large position of your fund that you hold in cash?

Chuck Akre: I'm sorry, how do I justify what?

(Taza Guanga): Your fund management expenses, basically your (action) management charge in such a large portion of your fund is invested in cash.

Chuck Akre: Well first of all, as you know, the management expense is 90 basis points, and the overall gross expense ratio is capped at 149 basis points. And that's similar to the fund we managed before, and not out of line. Certainly there are funds which are – operate at lower gross expense ratios, and funds that operate at higher. And so that's the expense ratios that exist, we'll put the money to work as quickly as we're able to, and being with the amount of caution that we think is prudent, as I outlined in my – in my comments.

(Taza Guanga): OK, thank you.

Chuck Akre: Yes.

Operator: Your next question comes from the line of (Steve Carpino).

(Steve Carpino): Good afternoon. Another individual investor, and a long-time investor in your previous fund. Question is, and I know we can't predict the future of the market, but where would you expect your cash position to be let's say six months from now?

Chuck Akre: Well thanks for being an investor in this fund and our prior fund. You know I would – I would say to you that I hope that our cash position is a good deal lower than it is today, and that's as bold as I'll get. We have continued to put money to work, and when we get – when we find spots that make sense for us to put it to work, we'll put it work. And you know it would not be – it would be surprising to see some of our holdings in the fund become much larger as a percent, instead of the list of holdings themselves getting much larger. But again, I would hope that in six months, we have a lot lower cash balance than we have today. Thanks.

(Steve Carpino): OK, thank you.

Operator: Your next question comes from (Daniel Baldino).

(Daniel Baldino): … bond and am now shareholder of the new one. I have two questions, the first is relating to one of the portfolio companies, and that's (WMS) Industries. And I was wondering if you could just talk for a moment about what the characteristics of that company and its business are that make it in your opinion an attractive compounding machine. And my second question is sort of – is unrelated to the portfolio, and that is are you still a director of (Enstar), does that – are those – that – sort of affiliations carrying over in your new role here at your own firm?

Chuck Akre: Great. As it relates to the second question, I am a director of (Enstar), and so in that regard, I've been – I've been a director there for you know I guess a year and a half, something like that. And at the present time, the directors of the professionally managed portfolios, of which we are a part, have a rule that we may not invest in that because I'm an investor. So I hope that answers your question.

(Daniel Baldino): That does …

Chuck Akre: Secondly, as it relates to (WMS) Industries, we have been invested in the – in the gaming space historically primarily in operators. And we believe, and we can see it in the – in the numbers that this economy is difficult for casino operators. For now going on close to two years, the number of visits to casinos are down, and plays per visit are down, and on top of that, competition is growing as more and more states and jurisdictions approve and allow gaming where in the past they did not for any number of reasons.

It's a – it's a business which we believe is a very enduring business, that is gaming, and it's been going on as nearly as I can tell since the beginning of mankind. And so from that point of view, it has an interesting and attractive demographic.

In the case of (WMS) you know the free cash flow per share growth picked up – has picked up, we believe is going to pick up sharply in the year ending June of next year, and for several years beyond that. We think we're at a pretty good place to be from a valuation point of view you know it's not – it's not a dirt cheap business, but the – but our multiple of free cash flow is in the upper teens. And we think they're better positioned than its – than their competitors, their domestic competitors. And we have the long awaited replacement cycle in the United States, which we're not making any prediction about when it occurs, but certainly the machines on the floors of casinos generally are getting very long in the tooth.

And when the market improves, casino operators depend very much on the newest and latest machines in order to keep – attract and keep customers. So we have – we have a replacement cycle, which is now about twice as long as it has been historically, that will kick in. We have growth in the number of casino – number of slot machine positions in the United States over the next two or three years just from – just from the – just from the casinos that are just

– either just now being added, or going to be added over the next couple of years, and we have growth in slot machine positions outside the U.S.

When you put all that together, we think that (WMS) can compound their free cash flow per share, or their book value per share at rates that are in the upper teens, and we find that attractive. I hope that's helpful.

(Daniel Baldino): That's very helpful, thanks very much.

Chuck Akre: Yes, great. Well I – (Shayna), I think it's about time for us to wrap this up. Do you want to just see if there are anymore calls?

Operator: Sure. At this time, if you'd like to ask a question, you can press star then the number one on your telephone keypad.

And this is about all the time we have. Presenters, would you …

Chuck Akre: Thank you – yes, all right. Anyhow, well thank you very much for dialing in today to our first call to shareholders, we want to thank you very much for your continuing interest in the Akre Focus Fund. And you know we say around here that our shareholders are our most important asset. Thanks again.

Operator: This concludes today's conference call, you may now disconnect.

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Definitions:

Basis Point: One hundredth of a percentage point (0.01%). Basis points are often used to measure changes in or differences between yields on fixed income securities, since these often change by very small amounts.

P/E Ratio: The P/E ratio is equal to a stock's market capitalization divided by its after-tax earnings over a 12-month period, usually the trailing period but occasionally the current or forward period.

Free Cash Flow: Cash balance left after deducting tax and capital expenditure from earnings before interest, tax, depreciation, amortization