

**Akre Capital Management, LLC**

**Moderator: John O'Bannon**  
**November 4, 2010**  
**3:00 p.m. CT**

Operator: Good afternoon. My name is (Christy), and I will be your conference operator today. At this time, I would like to welcome everyone to the Akre Focus Funds conference call.

All lines have been placed on mute to prevent any background noise. After the speakers' remarks, there'll 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. I hand the program over to Mr. John O'Bannon.

Please go ahead.

John O'Bannon: Good afternoon, everyone. I'm going to read some compliance disclosures that compliance has us read for the call. 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 mid cap companies which involve additional risks, such as limited liquidity and greater volatility than larger capitalization companies.

At this point, I'd like to go ahead and turn it over to Chuck Akre. Chuck?

Chuck Akre: Thanks, John. And welcome, everybody, to our call here. Our last call with you was in April, I believe, so we're delighted to have a chance to chat. I'm sure many of you have seen our year-end letter to shareholders in the

prospectus annual report dated September. We've addressed a lot of things in that letter that we won't cover again today.

I'll make a couple of comments. Earlier this week, listening to the radio in the morning – a CNBC show had (John Bogle) on as a guest. And (John) is somebody who you are all familiar with. I've met him a few times. He was talking about how in the United States we had exuberant, good, high-quality stock market returns in the '80s and then the '90s. And then during the decade of 2000s, we had lousy stock market returns depending on when you mark the period. They were roughly flat for a decade.

He said that it was intuitive to him that the decade we're now in means we're likely to have better returns. It's just an interesting background from a guy who's been around for more than 80 years and has studied the market. I find that interesting.

Several points that I'd like to talk about specifically, that many of you have raised in either direct conversations with us or in emails or questions that I've been asked by people in the financial reporting community, is this issue of cash in the portfolio.

As you know, when we reported our last fully reported portfolio, it was the July 31 portfolio. That's our fiscal year-end. At that point, cash was 21%. Since then, we've reported our top 10 holdings as of September 30. And I will just tell you that as of last night, even though the fund is significantly larger, cash is still at 21 percent. And at the end of 2009, cash was 65 percent on a much smaller fund. So during the year, we have continued to put cash to work in names which were already in the portfolio as well as having added a substantial number of names to the portfolio this year.

Many of you have asked the question about holding a strategic level of cash. Will we always have 20 percent cash? What's your plan about cash and so on? And the answer is: we certainly don't know. We've expressed very, very directly and very clearly for some time that we thought it has been a time to be cautious even though the market has had a nice experience in 2010 and a had

terrific experience in 2009, nonetheless it's a time to be cautious. It continues to be, from our point of view.

And so we have taken the opportunity to use, put some of the cash to work when the market is giving us attractive opportunities. And we think that is evident in the year-to-date results which the fund has had. As you know, we said to our fellow shareholders at the outset that our goal is to compound our fellow shareholders' capital at above average rates with below average levels of risk. And so we take great pride in the fact that at this point, our year-to-date results are significantly higher than the S&P, and having achieved that, with probably an average cash level this year that was, probably at least 30 percent on average during the year and has been in the 21 percent range since the middle of the summer.

And so we have no strategic plan about keeping that cash at 21 percent. At the end of the day, we would always rather be fully invested because in order for our capital to compound at above average rates, we need to have it invested in businesses which are doing precisely that. And, certainly, we can't get there in a near zero interest rate environment with money sitting in cash.

Along those lines, in our top 10 holdings which we disclosed on the 21st of October, the fourth largest holding was something called Hartford Financial Services, but, specifically, it was that convertible preference shares. We took five or six percent of the portfolio at the time and put it in those shares for the following reasons. Hartford was then, as it is now, selling at a very significant discount to book value, in this case, and, actually, as of today, even, probably 40 percent discount to book value.

They were offering – they were re-capitalizing the company as they paid off TARP funds, had a new CEO, and offered these preference shares with a yield of a little over seven percent. It is mandatorily convertible to common stock in April of 2013. We thought that for the three-year period, one, being able to get a yield of a little over seven percent on that cash was attractive; two, the underlying security that we'd be converting into was selling at a massive discount to book value and tangible book value.

And we thought that in the ensuing three years, they were likely to add, somewhere between \$5 and \$10 a share in earnings to the business, and that by conversion time, we were likely to be able to add a few points per year of additional return. And so we view Hartford not as a business that we have in the portfolio to compound our capital for the long terms, but instead have the place to hold some cash assets during this time where we believe one is paid to be cautious.

And so, in effect, we really think of our resources available as being in the sort of 26 or 27 percent range, but knowing that – that 5 1/2 percent of it is parked away where our returns are much better than 15 basis points or something like that. So that's our notion about cash levels.

We've had a bunch of questions about that. I just thought I'd put that on the table and repeat. At the end of the day, we would much rather have the money invested in operating business that can compound our capital at a higher rate than sitting in cash. We continue to just be cautious.

The second item I wanted to talk about was – what I called the role of our world view. And we have said in writing and we've said to any number of you in person that as a result of 2008 experience, one I certainly hope I don't have to repeat any time in the next several decades. As a result of that, we are trying to make sure that our world view as I call it, is better integrated into our process of identifying and investing in individual companies.

And at the end of the day, we remain very clearly stock pickers one at a time. And that means we are trying to identify these great compounding machines and own them at attractive prices so that our economic value, the cash we have in the portfolio, and the portfolio we have invested in these businesses can likewise compound at a high rate.

And so you've heard us comment several times that it's a time to be cautious. You've heard us comment several times that a number of our top holdings – are likely to be well positioned in an environment in which the consumer is constrained and those are off-price retailers.

The third thing I wanted to do was to introduce you again to our team who is here. John O'Bannon, opened the call and is responsible for our liaison with all of our professional investors. Tom Saberhagen and John Neff are both here, analysts who joined the team a year ago. And a third analyst, he's out on the road, visiting companies and won't be with you today, but I thought I'd take this opportunity to ask Tom and John to talk for a minute about an individual company that is in the portfolio that we've identified.

I'm going to let Tom start and then – and then John.

Tom Saberhagen: Thank you. I'm very happy to be here. I'll be happy to meet some more of you in the future.

When I joined the team here last year, one of the ideas that we had was to take a thorough look at the discount retail space and identify companies that we felt were best positioned to be able to deliver some exceptional values to consumers who are very focused right now on finding bargains and getting the most for every dollar that they spend.

So we looked at many businesses, and Ross Stores stood out as an exceptional opportunity. Ross is one of the leading off-price retailers, which basically means that they sell the same quality name brand goods that you find in a department store, but the prices at Ross, are 20 to 60 percent lower.

We look at the historic financial statements of Ross, and it's clear from that that they have a business model that works. From 2004 through 2009, the business grew at the top line consistently at an 11 percent compound annual growth rate. Store growth and same-store sales growth each contributed consistently to the top line growth, although we were well aware that there were a variety of different macro environments that occurred during this time period.

The top line grew at an 11 percent rate but net income expanded at a rate closer to 20 percent per year in this period. Changes in their purchasing practices and inventory management practices that we discussed with management had expanded their margins in 2008 and 2009. On a per share basis, the earnings expanded at a mid-20s annual rate, which was boosted by

the company's disciplined practice of applying excess free cash flow to share re-purchases and actual retirement of shares.

Diluted shares shrank from 150 million in 2004 to 125 million in 2009. In addition, we're impressed with management stability and their skill. We thought we had identified a compounding machine. But the two important questions became why is that business model so good and is it likely to remain strong well into the future? In other words, what's the nature of the moat at Ross Stores?

We came to understand that Ross moat results partly from their own scale and efficiency but, mainly, from the structure of the full price department store industry. In short, it's combination of high department store product margins, long production and shipping lead times for apparel that's sourced overseas, high one-time manufacturing set-up costs and fashion uncertainty create overwhelming incentive for apparel manufacturers to produce significantly more goods than what their midpoint estimate is of the full price consumer demand.

The off-price channel serves as a cash positive and, typically, even an earnings positive way to sell the so-called excess production of the apparel manufacturer, which is actually in everyone's interest to produce because one of the most costly things that can happen for a department store or an apparel manufacturer is that they end up short on an item that turns out to be more popular than what they had anticipated.

Looking ahead, we see continued opportunity for Ross to increase number of stores and the sales per store at a healthy rate. As such, we look at the price today at about 13 times its near-terms earning potential. And it doesn't seem like a very high price even though it's already come up considerably this year.

This multiple looks even better, if you also choose to adjust it for excess cash that Ross holds on its balance sheet or if you choose to adjust it for the difference between GAAP earnings and free cash flow that we believe exists because of the low maintenance capital requirements that Ross has at its very modestly fixtured stores.

We like shares of Ross as this level, but I would say that it's only one company in the portfolio and we like the whole portfolio better than we like any particular company in the portfolio. So, I hope that gives you some perspective on how we look at Ross Stores.  
And I'll turn it back over to (Chuck).

(Chuck): Thanks very much, Tom. And now we'll ask you John Neff to give us a little insight in one of the names that he's involved with.

John Neff: All right. Thank you very much. And I'll echo Tom's comment about looking forward to meeting those of you who I haven't had yet had met. We're going to talk about (Factset) briefly here. This was a – between a four and five percent position in our fund. (Factset), for those who are unfamiliar, it is a – they do – their customers are businesses not a consumer product. They are provider of integrated global, financial and economic information in analytical tools for use in the investment process and now it's this management and reporting. Ninety-nine percent of their revenue is from subscription, 82 percent of that is from asset managers, and the other 18 percent is from bankers and sell side analysts.

Let me discuss how we think (Factset) sort of fits the three-legged stool process that you heard Chuck described many, many times. The first leg of that stool is the – is finding businesses that just have outstanding business models. (Factset) has 20 consecutive years of 95 percent or better client retention as measured by revenue, they have a very consistently high returns on capital, both on traditionally calculated ROE basis, also a free cash flow ROE basis at or above 30 percent, this over the last 14 years. And that's been accomplished with no leverage.

Last year ended August, the company has a 23 percent net margin, 26 percent free cash flow margin. That former margin puts them in the top 95th percentile of the most profitable companies on the New York Stock Exchange.

Now part of our thesis here in (Factset) is that as good as the business has been, it's going to actually be a better business going forward – thanks to the company's investment in proprietary content during the economic downturn.

Specifically, we think that means more revenue opportunities. It reduces the threat of third parties pulling their content from the (Factset) platform. It translates into more control of the sales process as well as product pricing and it translates into more operating leverage.

We think we see some of that reflected already in terms of how (Factset) has weathered this latest downturn in their end market. Their user count is actually up seven percent from when the Lehman Brothers collapsed and that compares to an eight percent decline in U.S. securities industry employment.

The second leg of the three-legged stool that Chuck so often describes is outstanding management. The management at (Factset) we think fits that bill perfectly. They are very long-tenured. They are homegrown. There is a very unique culture propelling the results at (Factset). The company in terms of a terrific example of how they've allocated capital and thought about the business is that they have the balance sheet and the long-term perspective to invest in proprietary content over the last 2 1/2 years despite the worst end markets that they have ever faced.

And to support this investment, the employee head count at (Factset) is up at 112 percent over the last two years, and yet their operating margins are up 260 basis points over the past two years. That's been partly accomplished by foreign exchange translation which has been favorable to them. But that's been a minority part of that achievement and just, in our view, outstanding by this management team.

The third leg of the investment of the three-legged stool is the reinvestment opportunities and growth opportunities that the company has going forward. And to put (Factset) in sort of perspective vis-à-vis its competition, (Factset) last year, \$640 million in revenue and 42,000 users, that is one-tenth the size of Bloomberg from a revenue perspective and one-twelfth the size of Thompson Financial.

Historically, (Factset) has been an equity only fundamental based product. Fixed income is a very new growth opportunity for the company, currently, in the very low single-digit percentage of total revenue. We estimate between

two and four percent. And, international is only 32 percent of total revenue and climbing.

The fourth sort of overlay in the investment process that we employ is that we don't want to pay too much for a business. You own (Factset) in the fund at a cost of \$67. That is less than 22 times the EPS that they generated this past fiscal year. It's less than 19 times free cash flow that they generated these past 12 months. That is not empirically or absolutely cheap, but in our view, it's reasonable given the three-legged stool, how well (Factset) fits those criteria and the growth opportunities and the lingering fear about (Factset)'s end market.

Stocks at 35 percent year-to-date, and yet the FY – the price to earnings multiple in the next 12 months is equal with the 10-year median. And, again, we think that this is an even better business going forward than it was.

Chuck Akre: Thank you, John. And thank you, Tom.

And the reason I thought it important that they share this is because we are a team here and we all participate in our own way and you all have not had a chance individually to hear them share about some of the ideas in the portfolio. It brings me to the next area that I want to comment about, which is the issue of portfolio management.

The Ross Stores which Tom described and the (Factset) which (John) described are significantly different in terms of valuation. And when we think about building a portfolio and putting individual selections in there, we have what these fellows have described and I've described in the past with our three-legged stool.

And the first leg of that stool has to do with the quality of the business enterprise. And so I said earlier that integrating our world view, having to do with what we think of as the constrained consumer, the notion of off-price retailers is attractive to us. And it turns out that Ross Stores just like the Dollar Tree and TJMaxx, each of three of which are in our top 10 holdings that have been disclosed to you are all really superior businesses with long records of outstanding results, but at valuations which are very modest.

And one of the reasons that they're modest in my judgment is that these businesses have a fair amount of natural competition, and so their ability to perform well is highly dependent upon the skill of the managers and their ability to execute as retailers.

In the other vein, you take a company like (Factset) which has a multiple, that at acquisition, is at least maybe 70 or 80 percent higher than that of Ross Stores, it is in more rarefied air. That is, in the general category of information distribution, information management. It's one of those businesses that when it gets embedded is very hard to move out and in the sense has a greater protection for the kind of earnings it can generate on the owner's capital.

So, in our portfolio, we have a collection of both modestly valued businesses as well as some that are not modestly valued but nonetheless have terrific and highly protective moats going forward, big opportunities.

As money comes in to the portfolio, we select points as the market gives us to put money to work and all of the names that are in our top 10 that you might expect to have multiple entry points and sometimes, we get it right as it relates to the market, sometimes we don't.

But in aggregate, it's produced a portfolio that this year as I said at the outset is significantly ahead of the market despite the fact that it has a large cash balance.

And so I just thought that I'd make those brief comments about the portfolio. Now I don't have anything else that's on my mind right now. Let's see if there are any calls from people on the line, if not, we have some here that others have sent in by email at our request in the last couple of weeks. (Christy), are you there?

Operator: Yes, sir. If you'd like to ask a question, please press star one on your telephone keypad. Once again, that's star one to ask a question. And you have a question from the line of (Timothy Gart) with (Independent Advisors).

Chuck Akre: Great.

(Timothy Gart): OK. You have a brand new portfolio, your asset base is increasing and your portfolio is non-diversified, which is your philosophy. As the assets increase, you're going to be – there's going to be a tendency to focus on larger cap companies. Do you see yourself capping the portfolio at a certain level of assets or are you just going to continue to focus more on larger companies to be able to take a sizeable position in those companies?

Chuck Akre: The answer is we do have several companies in there which are quite large cap. And it's correct of you to point that out. But, in addition, things that you haven't seen is we have added some businesses really which are quite modest in size. And so we will continue as we always have, to go to those places where we think we find great value and great opportunity without regard to market cap.

And that's why this portfolio's charter doesn't put any restrictions on us. But I will just say that historically we've earned a lot of our return in the small and mid-cap arena that makes intuitive sense. And you can probably count on that being the case going forward, but it does – certainly does not exclude opportunities in larger cap companies.

(Timothy Gart): Do you see yourself capping the size of the portfolio eventually?

Chuck Akre: Well, you know, we confronted that question in our old fund early on, and I guess it's a pretty common question amongst investors. In our prior life, we did close the fund at one point for a couple of years and re-opened it. We were able to manage that fund at a size which is many times the size of this, and we expect that will be the case going forward. Therefore, we don't have current plans to cap the portfolio but we will always be aware of opportunities and cash levels.

(Timothy Gart): Just continue to do something unique instead of generic.

Chuck Akre: Thank you very much.

Operator: Again, to ask an audio question, please press star one on your telephone keypad.

And your next question comes from a line of (Shawn O'Brien), a private investor.

(Shawn O'Brien): Chuck, thanks for taking the time to do this call. It's really interesting. And my question relates to some of the positions you have in the portfolio which are all geared toward, as you said, I guess the consumer trading down with the names of Ross, Dollar, (TJX) and even O'Riley, I suppose. When do you feel, if at all you could say, looking at this at the macro economic view, when do you think this economy will turn where you're going to find value or when do you think the economy will turn where people will start buying high-priced goods or be more willing to spend their money and get this economy turned around?

Chuck Akre: Terrific question. The simple answer is that I've got no idea. And, you know, as I said at the outset, our goal and our druthers is always to be, you know, invested. We like to have that money at work operating. When you look at – I also said that we are very interested in trying to incorporate our world view into what we're doing. And I've written about this to some extent this year and talked about it with others. And, you know, the consumer in the United States who is still 70 percent of our economy has 17, 18 percent of the workforce is without a job or working fewer hours than they need to.

Two trillion dollars, according to Meredith Whitney, have been removed from lines of credit either in – available credit either through home equity lines or credit card lines or credit. The prior prospect of higher withholdings on payroll whether it be straight taxes or Medicare or Social Security or other things is a constant source of concern up until Tuesday of this week I'd say likely.

You know, these are things that will cause the consumer to continue to be constrained. What changes that? Well, among other things, businesses have huge levels of cash, but businesses have been not comfortable with what's going on in the administration and Congress and, therefore, have been

reluctant to spend that in a way to create jobs. And so again, I was listening to the radio this morning on CNBC. They had Jack Welch on as a guest host and at the end of the call, he was talking about his own position as being a little right of center in issues relating to a Republican-controlled house and so on.

He said, "Look, the issue is a very simple issue confronting our country. What we need to do as a country is expand the pie and create jobs. And everything that happens in Congress, everything that happens in the administration going forward ought to be addressed to that simple issue. It never ought to be a partisan issue. It never ought to be a line item issue. No one should be the party of no. Everything we do should be judged on the basis of – does it grow the pie and expand jobs." And I would say to you that I don't know when that occurs but that's certainly the thing that we all have to look forward to.

Today, we have retail sales numbers. In some cases, they were surprisingly better than expected, but at the same time the jobs report today had higher than expected unemployment claims. Those messages continue to be mixed. We remain cautious. We remain anxious and at the ready to put money to work.

You know, the nice things about Ross Stores and TJMaxx, and Dollar Tree is that when things were really going and blowing, those businesses did really well. So, we think those are business, for example, that are well positioned for a time to be cautious but have a great record when times were way more robust. So that's the way I'd answer that question. I hope that's helpful.

(Shawn O'Brien): Very helpful. So when I say Tiffany's in the portfolio, I'll know things have turned around.

Thanks, Chuck.

Chuck Akre: That's exactly right.

Operator: Again, to ask an audio question, please press star one. And there are no further audio questions.

Chuck Akre: Great. I think that, you know, I'm sorry to say this but given the fact that you've endured my coughing and sneezing and chortling here, it's probably a good time to wrap it up. We've gone more than 30 minutes. But as you know, if you have questions, please feel free to call anyone of us or John O'Bannon, if you don't know us and we will see what we can do to get back to you promptly.

We appreciate your support. And thank you very much for joining the call today.

Thank you, (Christy).

Operator: You're welcome. This concludes today's conference call. You may now disconnect.

END

**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, and amortization.*

**S&P 500 Index:** *The S&P 500 Index is a capitalization-weighted index of 500 stocks designed to measure performance of the broad domestic economy through changes in the aggregate market value of 500 stocks representing all major industries. You cannot invest directly in an index.*

**Book Value:** *Book Value is an accounting term that refers to the value of an asset, going by the data on its corresponding balance sheet. The value of an asset is based on its original purchase costs, minus depreciation, amortization and other similar devaluing costs.*

**Return on Equity (ROE):** *A measure of how well a company used reinvested earnings to generate additional earnings equal to a fiscal year's after-tax income (after preferred stock dividends but before common stock dividends) divided by book value, expressed as a percentage.*

**Return on Capital:** *A distribution of cash resulting from depreciation tax savings, the sale of a capital asset or securities or any other transaction unrelated to retained earnings.*

**Earnings Per Share (EPS):** *Total earnings divided by the number of shares outstanding. companies often use a weighted average of shares outstanding over the reporting term. EPS can be calculated for the previous year (trailing EPS), for the current year (current EPS), or for the coming year (forward EPS).*