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# FINDLAY PARK PARTNERS LLP

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## FINDLAY PARK AMERICAN FUND NEWSLETTER 29<sup>TH</sup> MARCH 2012

**Price of Dollar Shares: \$52.45**

**Price of Sterling Hedge Shares: £28.61**

Please note that the Net Asset Value of the Fund may fluctuate and that investors are exposed to foreign exchange risk if they are invested in the Dollar-class of share.

The above prices are based upon a 9.00am valuation on the above date.

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4<sup>th</sup> Floor, Almack House, 28 King Street  
London, SW1Y 6QW

T: +44 20 7968 4900 – F: +44 20 7000 1321

Registered in England & Wales no.: OC303640  
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## Performance

Since the beginning of the year the Fund is up 11.3% which compares with a rise of 12.0% in the Russell 2000 and 11.3% in the S&P 500. Having raised a fair amount of cash in the middle of last year, ahead of the problems in the third quarter, we have been relatively slow to put most of this back to work but the cash level is now around 8%, having started the year at about 14%. Despite this drag in what has been a strong market this year, the Fund has performed roughly in line with the indices.

To remind investors, we stress tested all our companies in the summer of last year for a weaker economic environment. We added to those companies we felt we could live with in a variety of different economic outcomes, and we reduced one or two of the more cyclical companies whose earnings could be more severely impacted by a double dip. So far the outlook has improved significantly for the US economy from the third quarter of last year, when people felt there was a strong chance of a double dip. Late last year we added to our Brazilian weighting which held back the performance in 2011. This year it has recovered nicely, giving us a bit of beta on the upside and we felt we were buying the individual companies at very depressed valuations where the downside was very limited. The structure of the portfolio was therefore to have about 81% in the US and Canada, in companies that we felt had very reasonable return potential over two or three years but could also be held in a much worse economic environment, just over 11% in Latin America and the rest in cash. There continue to be many uncertainties structurally in the world, from the Middle East to China to oil and overall G7 debt levels.

With hindsight we should have been a little more aggressive in putting our cash to work when it became apparent, just before Christmas, that the LTRO financing option from the European Central Bank had taken away the threat of a Lehman moment in Europe with all the banks melting down. In our view this buys Europe some time but by no means solves Europe's problems. We are likely to continue to keep cash around current levels. The whole team seems to have situations they would like to add to on any dip in the market, and there are only a limited amount of companies which we feel are close to a level where we want to sell. This is normally an encouraging sign.

## Economy and Stock Market

**One negative on the US stock market is that margins have rebounded so sharply they have moved to record highs. We think they will stay high in the short run but there is a limited amount of upside leverage left and earnings will grow more in line with sales than they have done over the**

**last two or three years. Within the portfolio we are focussing intently on finding companies that still have good margin leverage but this significantly reduces the amount of the US stock market that we can focus on.** This is something we normally do anyway, but we are particularly focussed on this at the moment. The other negative is politics; in the past, whether Democrats or Republicans won the election it did not have too big an impact on the stock market. Politics have polarised, driven by the success of the Tea Party in the mid-term elections. Tough decisions need to be made and they continue to be put off. The stock market has moved up almost 30% from the lows in the third quarter of last year and now does not look quite as cheap as it did in the past 18 months at just under 14 times this year's earnings on the S&P 500. The valuation looks reasonable relative to very depressed interest rates but we think one has to assume they will normalise at some stage. The good news is that many corporations are able to issue debt and refinance their balance sheets on very attractive terms and a large proportion of companies are able to raise ten plus year debt in low single digits and buy back their stock on a high single digit free cashflow yield. **Corporate balance sheets are in the best shape we can ever remember and companies are generating huge amounts of free cashflow.**

The economy has been steadily improving since the double dip worries in the middle of last year. Unemployment has now fallen from around 10% to just over 8% and **there are clear signs the housing market is beginning to bottom and improve.** It is believed that about 1.5-2% of the unemployed come from the downturn in construction and these people are hard to employ in other parts of the economy. It would be very positive for employment if the housing market starts picking up, particularly if the auto market also continues its improvement. Car sales are still depressed relative to normalised levels and the industry is a large employer. State and local governments are also coming to an end of employee layoffs, judging by figures over recent months. These have been major headwinds to the economic recovery. Worker mobility has been one of the positive factors of the US economy over the years, and the downturn in the housing market across the country has meant that many companies are unable to take on skilled labour in the way they have in the past. **If the housing market recovers, it is a big positive for the US**

We have highlighted the energy boom going on in the United States in recent newsletters. One shouldn't underestimate how positive this is longer term; the possibility that America is self-sufficient in energy within the next decade. **This is creating a lot of jobs, not only in the energy industry but very cheap natural gas is reinvigorating investment in chemicals, steel, fertiliser and many other energy intensive areas of the economy.**

**Silicon Valley is booming again** after going into hibernation following the technology bubble in 2000. House prices are up sharply there, office space is in very short supply and there is a very upbeat feel to Silicon Valley and other technology centres around the country. Jon Tredgett's note from a recent West Coast trip, which we have included under the portfolio section, sums up a lot of these trends. **Since late last year we have been encouraging members of the team to go to technology conferences, not only to see if they can find any investments in the sector, but also to understand some of the trends to make sure none of the rest of the companies in the portfolio will be suffering from new trends such as social media, aggressive steps by Amazon etc.** Technological changes are coming thick and fast and one needs to be on top of these to understand where companies' business models will be three to five years down the road- one of the key things we look at when making investments. We have very strict investment criteria within our investment philosophy and strategy and probably only 10-20% of technology companies would meet our investment criteria. However, the whole sector is as cheap as we can remember it throughout our whole investment careers since the late seventies. Unlike 1999 and 2000, when Wall Street was manufacturing new competition in each subsector of the technology market, there have been few IPOs over recent years. Companies are generating large excess cashflow and are perhaps more mature than they were in the past, growing more slowly but with a more predictable income stream. Anthony has owned CA Technologies for the last couple of years. This company generates around 90% of its revenues from long-term contracts. It has been growing revenues in the mid-single-digits, free cashflow a little higher than that, and also buying back a modest amount of stock. The performance of the shares over the last couple of years has been OK but somewhat disappointing relative to our expectations despite the very low valuation. In January the company announced they were significantly increasing the dividend and also much more aggressively buying back stock with their free cashflow. This announcement was made in line with the results, which were very much as expected. The stock jumped over 20% in a day and has since appreciated more. This was in many ways a eureka moment. Technology investors generally do not want to invest in technology companies growing slowly, and they tend to want more excitement. However some of these franchises are now very strong, albeit more mature, and the risk reward in these stocks can be very compelling. We felt that many investment bankers would be going around other companies in the technology sector which were generating significant excess cash and were under-levered. They could point to the stock price reaction of CA Technologies and we have seen quite a strong trend towards more companies doing this.

In the last few newsletters we have been highlighting how around 70% of the companies in the portfolio have been actively repurchasing their shares with their free cashflow, particularly during

setbacks in the market. Some companies had been very aggressive in doing this. We always try to invest in companies where we think the business model will be as good or better 3-5 years down the road, so we can see the earnings and cashflow at that time with some degree of predictability. Stock market valuations are still relatively cheap and if companies can buy back their stock aggressively at the right moments you can build significant value over and above the growth rates of the underlying companies without the multiples changing, in a rather low-risk manner. **This is one of the main attractions of the US stock market at the moment.**

Treasury yields have backed up over the last few weeks, we think in response to increasing signs that the US economic patient is slowly but steadily recovering. We have been trying to make sure that only a limited amount of investments within the portfolio are direct beneficiaries of lower interest rates, and have actually been building up, at the margin, companies that actually benefit from higher interest rates, which we would expect to normalise over time. Some of these latter companies were our worst performers last year, we cut back many of them in the middle of the year as we realised rates were unlikely to go up short term, but we have a list of 6 or 7 companies which we really like longer-term, whose earnings could increase quite significantly if interest rates pick up. These companies generally sell on sufficiently low valuations now that there is a lot of optionality in the share price for interest rates picking up.

**The banks have just gone through another stress test which was very severe.** They were told that they had to have at least 5% tier one capital if the following events happened: the economy dropped 8% in real terms in a short period; the stock market dropped 50%; residential and commercial property dropped a further 30%; and unemployment went to 13%. When this stress test was announced late last year, we sounded out management of various banks that we had been looking at in the US to see what they thought. They seemed remarkably relaxed about their capital position given this very onerous environment. As we mentioned in the last newsletter, we have been building up, from a very small base, our investments in some US banks, with more of a focus on the strong get stronger than buying the most distressed ones. **Most of the banks seemed to pass the test fairly easily.** It is always impressive how quickly American companies are able to put problems behind them and move forward; think of the Japanese banks in the early nineties! US banks are therefore more investable than they have been, in our view, for many years, although we are unlikely to have a large portion of the portfolio in these. As investors know, we never make large bets within the portfolio. The performance has come about by having a wide array of companies and sectors that meet our very strict investment criteria and free cashflow requirements.

Over the last few months we have made a few still rather small investments in companies that benefit from the housing market bottoming and recovering over the next few years. Many of these stocks never got cheap enough, even on normalised earnings, for them to be large positions, given how complex the whole housing market had become. Affordability is as cheap as it has ever been, particularly as rental rates have been moving up quite sharply over the last two or three years, as people have been scared away from the housing market and moved towards renting. 30-year conforming mortgages are available at around 4% which is very cheap financing for a fixed-rate mortgage which can be pre-paid any time without penalties in the US. Investors are moving in and buying houses without mortgages, as we hear that yields between 8 and 10% are available. Even private equity has been sniffing round but has not yet made any big investments. We have been great fans of Sam Zell over the years, and always like to listen to what he has to say on the property markets, where he has been such a successful investor. He has been looking hard at creating a company that would buy up houses, rent them out and be able to come public on the stock market with a 5% plus yield. However, running a portfolio of houses is very management-intensive and he has not yet found a model or group of people that can make this work. However, there are many housing-related people currently unemployed, who are putting together groups of investors to buy houses. This is America! When there are bargains around, money will appear to take advantage of it. Single family housing starts peaked at 1.8 million, troughed at 400,000 and were around 450,000 last year. During the downturn, household formations, which in the past had been running at at least 1.2 million per annum, dipped down as low 500,000-600,000 in 2009 and 2010. This is driven a lot by unemployment going up and young people staying at home. There is only a limited time you can actually stay with your in-laws, and it looks like the dam broke in 2011 with about 1.1 million new household formations! Around 300,000 houses per annum fall out of the market from age or destruction **and if employment growth continues to drive pent-up new household formations this will really help the housing market.** We recently met with a housebuilder who used Phoenix as an example where the average house price has dropped from \$265,000 to \$108,000 between 2005 and 2012. A record volume of houses has traded in the last 12 months, 2/3 of which were distressed. Canadians, where the housing market is very good, are coming in, as are Latin American buyers in Florida. Investors are buying without a mortgage, with apparently around a 10% plus yield in Phoenix, with good appreciation potential over the next few years. Availability of mortgages has been a drag on the housing market over recent years. However litigation was recently settled around mortgages and banks, and banks are very keen to make new loans rather than buy securities. It is hard to know how quickly the housing market can recover but the fact that it is even coming back to life should be a major plus for the US economy.

Another negative factor we keep a close eye on is the price of oil. America has little tax on the price of gasoline and given the size of the country, travel is a big portion of consumer expenditures. When oil prices reached this level in the middle of last year it seemed to have quite a drag on the economy. However demand and supply looks favourable over the next few years supporting a lower oil price.

## Portfolio

We mentioned earlier that many members of the team had gone to technology conferences over recent months, an area that Findlay Park has not normally been associated with! When earnings estimates for the S&P 500 came down in the middle of last year the worst reductions were at technology companies, which tend to have a very short product cycle and distributors and end customers reduce inventory very rapidly when things slow down. Things can move the other way very quickly and we saw this when technology stocks led the market on the upside well before the lows in March 2009. Technology stocks are as cheap as we can ever remember in our investment career and America has come roaring back creating new technology companies. Jon Tredgett produced some good notes after his trip to the West Coast, and we include some of his thoughts below.

- **The US's lead is accelerating:** the US has historically been a leader in technology / internet, but they lagged in mobile technology. In mobile data - arguably the most profound change since the adoption of the internet - the US is dominating. 65% of smartphone operating software shipments in 2011 were US companies (ie Apple's iOS, Google's Android, Microsoft's Windows) – up from 5% in 2006 - and this is likely to rise further when Windows 8 launches (many investors appeared hopeful for Windows 8 and its “Metro” touch interface). This US mobile computing dominance is self-reinforcing as application developers write more and more applications for these platforms.
- **Capital allocation was a big focus:** one of the major changes this sector has undergone in the past 10-12 years is capital allocation. Many management's expressed their priority for returning more capital to shareholders long-term, and they discussed the merit of dividends and buybacks vs internal investment / capex and acquisitions. Beneficiaries: shareholders.
- **Demand:** most component suppliers (ie semiconductors) said demand will trough this quarter, but few wanted to comment on the slope of the upturn – too early to determine. **Mobile Data changes commerce:** mobile data (smartphones, tablets, etc) penetration rates are rising faster than the internet

(which in turn was faster than the radio or TV). Mobile data has already changed the way people consume information (media, email etc) and is starting to impact commerce, especially local commerce & location-based services. The line between commerce & ecommerce has blurred: multi-channel distribution is becoming a necessity for several retail models (ie Williams Sonoma is 35% online today and eBay's acquisition of GSI Group was a move in this direction). Ecommerce is only 8% of retail sales today (was 4% in 2004). Mobile commerce is deflationary (in a recent survey discussing the reasons for abandoning an in-store purchase 52% of respondents said they found the item online at a better price). Mobile payments will help facilitate mobile commerce. Bypassing **Visa and Mastercard** is tough. Evidence of the shift to mobile data: in 4Q10 mobile data devices outshipped PCs (notebooks & desktops); there are almost 1bn smartphone subs globally (18% penetration and grew 35% in 2011); 85% of the world's population is covered by commercial wireless signals - more than those connected to the electricity grid; and 50% of Facebook, Pandora and Twitter users access their service via mobile.

- **Internet Advertising remains a strong growth category:** a \$73bn market in 2011 but there remains a disconnect between the amount of time spent on the internet (25% and rising) and the share of advertising spend (18%). The Mobile advertising sub-segment is promising: only a \$3.5bn market today (5% of internet advertising) but is expected to be a \$33bn market by 2016. Only 25% of Fortune 1000 companies have a mobile advertising campaign today. Google has a lock on this area and Facebook should in the future.

- **Virtualisation and Cloud Computing:** in short, cloud computing allows companies to turn IT capex into opex - IT becomes a variable cost which you can turn on and off depending on your workloads. The average cost saving by moving to a cloud environment is estimated at 20-40%. This has profound implications for the cost structures of companies as IT has been as high as 40% of capex historically. For example, in companies that manage their own data centres the costs associated with labour & energy alone are higher than the cost of buying servers, hence the importance of IT products that can reduce labour like virtualisation or energy consumption technology (use existing resources better). We are early in the adoption cycle of the cloud. The cost of computing power has collapsed and open source technologies have reduced the cost of developing applications.

- **Analogue semiconductor companies:** the mobile data trends highlighted above should be positive for our analogue semiconductor companies (Texas Instruments, Analog Devices) because analogue content per device should continue to rise as mobile devices proliferate. Every time a computer becomes less "geeky" and more interactive with human senses - touch, sound, video - it requires analogue processing to turn all those "zeros" and "ones" into the analogue / real world environment. Several



companies talked about increased electronic content in automobiles (Sensata Technologies, Atmel, Maxim Integrated Products, Molex, Amphenol).

• **What are the negatives?** There are a lot of positive developments in technology today which will make companies more efficient & competitive, but there are some negatives: (1) keeping your employees is very tough: there is so much money being made in Silicon Valley today and this is disruptive. It will lead to a surge in innovation in future years and new applications – which is good - but it will also lead to a rise in employee turnover - a lot of headcount disruption for technology companies. I think companies located outside of California will be better insulated in this regard; (2) tax risk - US technology companies are earning a lot more money yet many of them don't pay a lot of taxes, and their government needs tax dollars. As commerce shifts increasingly to the Web I question how long the current tax regime can stay in place; (3) there are only so many advertising dollars available: I liken the explosion of ad-supported business models to the explosion in cable TV channels we saw in the US over the past 25 years – only so many can be supported and eventually you see a consolidation. I think the same thing will happen in the internet. In the near-term I think there is going to be an oversupply of companies trying to build a community on platforms like Facebook in order to establish ad-supported business models. Just like in 1999-2000, there will be a lot of innovation but there will be a massive amount of losers that will look like stars for a short period of time.

We have around 13% of the Fund in technology companies, all of which meet our investment criteria. One area within technology we have been building up over the last six months has been the bank technology sector, which makes up about 3% of the portfolio, via three different companies.

The bank technology space over the last decade has changed considerably both from the technology sellers perspective and their end customers. Previously banks took the best solution from each company and installed the product into their own platforms, which has led to complex legacy systems. These past decisions are proving costly – as cost reductions programs are more difficult to implement when you have outdated multiple IT systems. In addition the implementation of the 'next generation' of bank technology products such as mobile banking are more complicated and expensive to implement given the complexity of the underlying system. The core processors offer a solution to this architecture by way of their platforms, which once installed can be modified to the banks individual needs, whilst allowing for the next generation of the products to be installed in a cost efficient manner. In addition these systems allow the banks to focus on revenue generation whilst also enabling cost reduction programs to be more effectively implemented. The growing strategic importance of a bank's IT systems

from both a revenue and cost containment perspective is demonstrated by the fact that strategic level IT decisions are no longer being decided by the IT department but rather at the corporate suite level.

The attributes of the bank IT sector resonate very well with our investment criteria, in that the industry has consolidated and whilst growth has slowed it is still respectable despite the weak banking backdrop over the past few years. Even during the severe banking downturn this group of companies posted flat to positive organic growth and continued to generate significant amounts of free cash due to their high degree of recurring revenues, long term contracts and essential nature of their services. They are increasingly returning this free cashflow to shareholders via increased dividends and share repurchases. Valuations in the space are on average 12-13x FCF which are much lower than historic multiples. As discussed earlier in this newsletter, the banking sector is now in a recovery phase with balance sheets largely rebuilt and credit quality much improved. It therefore seems to us that banks are now in a far stronger position to spend on technology products again which in turn ought to allow our bank technology holdings to experience an acceleration in organic growth, all this at a time when valuations on these stocks are much lower than in the past.

#### Fidelity National Information Services

Fidelity National Information Services was first purchased for the Fund in early 2010 following its acquisition of Metavante, which highly complemented its existing product base. 2010 was an integration year, against a backdrop of an improving bank environment albeit still fragile. The company's backlog began to build in late 2010, however due to the nature of the projects this tends to take 9-12 months to translate into revenues, whilst at the same time incurring implementation and commission costs.

In 2011 the back log began to convert into revenue and the company delivered 5% organic top line growth, 12% EPS growth and \$3.20 per share in free cashflow.

Following an acquisition attempt by private equity in late 2010 the company increased its debt profile - it simply did what private would have done, but to a lesser extent. Net debt to EBITDA began 2011 at 3.2x, falling to 2.7x at year end. By the end of 2012 this figure should fall to 2.5x or 4.4x net debt to free cashflow. This is despite a quadrupling of its dividend to 2.5% and the purchase of 5% of shares outstanding.

Against an improving domestic banking environment, the company also has a strong international growth platform which grew 22% organically in 2011 and represents 21% of company revenues, this segment grew organically during the entire downturn.

Valuation is attractive on an absolute level at 13x 2012 free cashflow and significantly below the group's historical multiple despite an improving environment both domestically and internationally.

### Fiserv

Fiserv is a business we have followed for a long time and have owned in the past. Roughly half of profits derive from the provision of core processing services to banks and the other half from the provision of payment services to the same customers. Like its peers, the company benefits from a highly recurring and highly profitable stream of revenue. The highly recurring nature of its revenues has helped the company to deliver double-digit earnings growth for 26 consecutive years, which is a remarkable and perhaps underappreciated track record. In October management disclosed a multi-faceted and detailed plan to accelerate revenue and cashflow growth. Subsequent to that disclosure we have invested significant time to better understand the business plan, including two visits to their Milwaukee headquarters. The company has invested very heavily in recent years and is on the cusp of harvesting benefits from these investments. We think there is potential for Fiserv to be perceived very differently in the future if they can deliver on the promise of their long-term strategy. In the more immediate future, we see a visible and diversified pathway to attractive earnings growth and think the company has scope to deploy free cashflow to the benefit of shareholders. The shares trade on around 13.5x 2012 earnings which we think is good value for this franchise.

### Jack Henry

Jack Henry provides technology products and services to over ten thousand banks and credit unions in America. We have been following this company closely for a number of years. Their broad suite of products helps their customers to process transactions, automate their internal business processes and manage their mission-critical information. They are therefore a fairly important service provider to their customers. Another characteristic of Jack Henry's business that we like is the high degree of recurring revenue in the form of support and service contracts which represent almost 90% of each quarter's revenues. This percentage is up from around 50% a decade ago because at that time the business was far

more reliant on selling one-off software licenses. Since then the business has gradually transitioned to more of an outsourced model where revenues are earned over the life of the contract rather than upfront. We like this dynamic as it gives the business model and financial outlook much more visibility and predictability. With the hundreds of bank failures over the last few years Jack Henry has faced somewhat of an organic headwind, probably to the tune of around 2-3% of lost revenues per annum at a very high margin. Despite this headwind, the company has still managed to generate positive overall organic revenue growth and also grow earnings and free cashflow in the low teens. In the current environment bank balance sheets are now somewhat repaired and therefore bank CEO's are more willing to spend again on technology products and upgrades, also we'd expect the rate of bank failures to decline, as a result we would hope to see Jack Henry experience an acceleration in organic revenue growth from current levels. Although the stock trades on an apparently high p/e multiple, on a free cashflow multiple the stock is attractive at 13-14x our estimate of next 12 month free cashflow. Also the balance sheet is virtually debt free which gives the company lots of optionality for future share buybacks, dividend increases or tuck-in acquisitions.

Hopefully investors will understand that the type of technology companies we invest in have very attractive long-term business models with very good free cashflow characteristics. With such a large team, not many stones go unturned within the US market and quite often at our weekly Wednesday morning meeting one manager who has been travelling in America will spark a thought process from their trip that leads other members of the team towards new investment ideas.

#### Allegheny International

Another stock we have added to is Alleghany which is another insurance holding company which focuses on growing its book value. We have invested in this company for at least 10 years and in January increased our position to one of our largest holdings. Most of its operating income comes from property and casualty insurance subsidiaries and there was considerable excess cash at the parent company. Over recent years they built an investment team to invest some of the excess capital into equities, of which the company has an excellent record. They recently announced they were purchasing Transatlantic, a world-wide reinsurer specialising in casualty but also property reinsurance. They have underwriters in 23 different countries and it is a much better franchise and business than some of the purely Bermuda-based reinsurance companies. Joe Brandon, who used to run General Re has been

brought in to run the insurance operations of Allegheny. The arbitrage position has meant that shares of Allegheny dropped from around \$330 to \$280 at a time when the acquisition was about 10% accretive to tangible book value. Formerly the insurance operations drove growth of 3 or 4% in book value per annum while investments drove the growth to around double digits over the last 10 years. Under the new structure, even at the bottom of the cycle the insurance business should allow book value growth of 7-8% per annum, which would accelerate if the insurance cycle turns as we think is beginning to happen. The shares were therefore selling at about 78% of book value and about 70% of year-end 2012 book value. The insurance subsidiaries should be dividending up enough income, even at this stage of the property casualty cycle, giving the parent company a high free cashflow yield at current levels. If the cycle turns and premiums start growing rapidly, earnings will rise but there will be less capital available to the parent. The company bought back 4% of its shares last year, before announcing this transaction, and has the ability to buy back 5 or 6% of its shares per annum, which will be very accretive to book value at such a discount. If the cycle turns, we believe the shares will end up selling above book value giving very good risk/reward from where we bought the shares. Also we think they have got a much more dynamic management team in place than they have had in the past. Joe Brandon worked for Warren Buffet for seven years and, after a recent meeting with him, we think he can add a lot of value on the insurance side and probably attract new teams to move in where they can get a very good return on investment as they expand. He also seems to have a good rapport with the CEO. The stock essentially has no coverage on Wall Street.

## Conclusion

The cash position has continued to fall since the beginning of the year from around 14% down to 8% as the team, who have been extensively on the road over the last couple of months, have been finding many new and interesting investment ideas despite the move up in the market from the lows in the third quarter. We continue to take the top off some of our secular growth companies where the valuations have moved up but we seem to have many more good new ideas than things we want to reduce at the moment, which tends to be a good sign.

It is encouraging that the US economy continues to grow with the unemployment rate falling from around 10% to just over 8%. This is without any real pick-up in housing and construction, which people estimate knocked around 1.5-2% off employment. Many of these people tend to be lower skilled and unable to move to other areas. This tends to be the case for auto production, which is now beginning to recover towards more normalised levels after several years of much lower production. Even state and

local governments appear to have reduced their workforces sufficiently that this will be a more stable factor on employment than it has been since 2009. Valuations in the market seem reasonable, even if you assume more normalised interest rates. The companies continue to buy back record amounts of stock and American companies generally have the best balance sheets we can ever remember. Around 70% of the companies in the portfolio are actively repurchasing their own shares, often quite aggressively, particularly during weaker periods in the market. **The maths of using this free cashflow to buy back stock across the portfolio over the next two or three years should add significant value to the overall return.**

We are likely to continue to have a reasonable cash cushion as there continue to be many things to worry about with fiscal deficits and overall debt levels, especially in the G7 countries. Current low interest rates are probably unsustainable. We should have been a little more aggressive in reducing our cash weighting following the introduction of LTRO just before Christmas by the European Central Bank, which clearly took away the risk of a Lehman moment in Europe. Corporate profit margins are at record levels in the United States after companies have had years of benefit from globalisation and also the benefit from severe cost cutting in 2009. We think margins will stay elevated for the moment, but longer-term they are likely to revert more towards the mean. We are therefore really focused on only holding companies that have significant upside leverage to margins over the next few years. Politics remains a negative in America having been a neutral over recent decades with both parties much more polarised than they have been in the past and unable to make tough decisions. The high oil price is also a negative but supply/demand over the next few years looks more positive now.

Overall we feel good about the portfolio, the new idea flow and the underlying companies. The difficulty is handicapping macro things such as the oil price, China, Europe etc. Hence a bit of a cash buffer in the portfolio, which has been stress tested for weaker economic times during the difficult third quarter of last year. We are happy to live with most of our companies in a variety of economic outcomes. If the economy were to make a very robust recovery we would likely underperform a little but we still feel it is a time to be a sensible steward of capital.

We added to the Latin weighting at the end of last year, which has helped the performance this year.

<b>Annual Performance</b>	<b>Findlay Park \$ change</b>	<b>Russell 2000 change</b>	<b>S&amp;P 500 change</b>
<b>Inception to Year end 1998</b>	-0.40%	-8.49%	16.81%
<b>1999</b>	49.10%	19.62%	19.53%
<b>2000</b>	1.28%	-4.20%	-10.14%
<b>2001</b>	9.31%	1.03%	-13.04%
<b>2002</b>	-11.25%	-21.58%	-23.37%
<b>2003</b>	39.48%	45.37%	26.38%
<b>2004</b>	24.82%	17.26%	9.14%
<b>2005</b>	15.67%	3.09%	2.86%
<b>2006</b>	24.06%	17.00%	13.62%
<b>2007</b>	16.24%	-2.75%	3.53%
<b>2008</b>	-30.87%	-34.80%	-38.49%
<b>2009</b>	33.25%	25.22%	23.45%
<b>2010</b>	23.93%	26.28%	12.80%
<b>2011</b>	-2.54%	-5.67%	0.41%
<b>YTD</b>	11.26%	12.01%	11.28%
<b>Performance since inception</b>	424.50%	80.96%	33.57%
<b>Compounded Rate of Return from inception to 28 March 2012</b>	12.52%	4.31%	2.08%

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