



Talking With C.T. Fitzpatrick

Portfolio Manager, Vulcan Value Partners

Waiting to Strike

by Sarah Max

C.T. Fitzpatrick is a value investor through and through, but with one important distinction. "We don't buy cheap stocks," says the manager of the \$1.1 billion Vulcan Value Partners fund. "We look for quality businesses we want to own and wait until they get cheap."

While it sounds simple enough, the strategy isn't just a matter of screening for companies that fit well-defined criteria. It's a dance of patience and precision. Or, to borrow an analogy from one of his favorite pastimes, "it's about reading the water and knowing when to strike," says Fitzpatrick, who recently celebrated his 50th birthday fly-fishing in Spain. "When the conditions are right, you can catch some really big, beautiful fish."

Fitzpatrick's investment career started in earnest 25 years ago when, after a stint on Wall Street and business school at Vanderbilt University, he went to work at Southeastern Asset

Management in Memphis. Working alongside lauded value manager Mason Hawkins for 17 years, Fitzpatrick learned the craft of value investing.

While he's grateful for his time at the firm, best known for its Longleaf Partners funds, Fitzpatrick had his own aspirations and investment ideas. Meanwhile, he and his wife-a fellow Southerner he met at a New York restaurant when they were both looking for "a decent plate of collard greens"-wanted to move back to Alabama. In 2007, he quietly opened Vulcan Value Partners in Birmingham, initially managing separate accounts, then launching two mutual funds in 2010. Today, working alongside 32 employees, he manages more than \$8 billion in assets.

Assets have come to the firm quickly, but Fitzpatrick says the lion's share of his investors aren't chasing results, as good as they may be. His Vulcan Value Partners fund (ticker: VVPLX) is up an average of 22% a year over the last three years, putting it in the top 1% of large growth funds. The \$1 billion Vulcan Value Partners Small Cap (VVPSX), though in the red for this year, also ranks at the top of its peer group over the last three years. Nevertheless, Fitzpatrick closed the fund to new investors late last year. "Small-caps are pretty overvalued right now," he says. "We're not going to buy silly stuff because assets are coming into the fund."

THE PUBLISHER'S SALE OF THIS REPRINT DOES NOT CONSTITUTE OR IMPLY ANY ENDORSEMENT OR SPONSORSHIP OF ANY PRODUCT. SERVICE. COMPANY OR ORGANIZATION. Custom Reprints 800.843.0008 www.djreprints.com D0 NOT EDIT OR ALTER REPRINT/REPRODUCTIONS NOT PERMITTED 49162

Vulcan Value Partners

	1-Yr	otal Retu 3-Yr	rns≁ 5-Yr*
VVPLX	21.4%	21.8%	6 N/A
S&P 500	16.9	16.8	N/A
Top 10 Holdings		Ticker	% Of Portfolio**
Aberdeen Asset Mg	(mt.	ABDNF	5.5%
Oracle		ORCL	5.2
Discovery Commun	ications	DISCK	4.7
eBay		EBAY	4.5
Visa		V	4.5
Apple		AAPL	4.3
WellPoint		WLP	4.1
Franklin Resources		BEN	4.0
MasterCard		MA	3.9
Nasdaq OMX Group		NDAQ	3.9
Total:			44.6
*All returns are as of 07/31; t	hree-and five	-year returns	are annualized.

*All returns are as of 07/31; three- and five-year returns are annualized. **As of 06/30. Sources: Vulcan;Morningstar

Most of the 30-some holdings in the Vulcan Value Partners fund are marked by their ability to consistently churn out free cash. On average, the stocks in his portfolio generate more free cash flow than they produce in stated profits, he says. (In other words, they often have expenses, such as depreciation, that reduce earnings, but don't require an actual outlay of cash.) While the investment mandate is relatively broad-medium and large companies, including some based outside the U.S.-Fitzpatrick is a stickler about the green stuff. "If a company doesn't generate free cash flow," he says, "there is no further analysis."

Companies that are worthy of further analysis are added to an "MVP" list of about 500 holdings, whose valuations they update and track at least quarterly. If valuations prove constant, the Vulcan team will strike—when the price is right. Stocks get serious consideration when their free cash flow yields rises above the firm's estimate of fair value yield. "There are companies that I've personally followed for my entire career, waiting for the chance to buy," he says.

Case in point: InterContinental Hotels Group (IHG), the largest hotel company in the world by room count. Fitzpatrick started watching from the sidelines in the 1990s when the company, named Bass at the time, began shifting its focus from real estate and focusing instead on franchising and long-term management agreements. The stock eluded him a few times, including during the financial crisis when "there were other things we liked that were even cheaper, including Boeing (BA) and Starbucks (SBUX)," says Fitzpatrick.

Then, finally, in late 2011 a window opened, and Fitzpatrick got in for about \$20 a share. The stock has since doubled, but Fitzpatrick isn't going anywhere. "They have a beautiful stream of free cash flow," he says, "and it's getting better all the time."

Fitzpatrick goes into all positions with a five-year horizon, minimum, but he'll lighten up or double down on holdings as the stocks swing higher and lower. In some cases, he'll trim a holding to make room for a competitor with equally good prospects.

In August 2011, for instance, Fitzpatrick lightened up on MasterCard (MA) to make room for shares of Visa (V), which he bought at \$85 after the latter's stock price was hit hard by legislation to cap debit card fees. MasterCard's stock was relatively immune since its U.S. business is focused on credit cards. Three years later, Visa's stock is trading around \$214 a share, but Fitzpatrick thinks neither company has reached its limit. "They have a global duopoly," he says. "Their only real competitor is cash, and cash doesn't advertise." As more transactions move from cash to plastic, both companies should grow faster than global gross domestic product. Meanwhile, they have little or no overhead: "They don't build factories," Fitzpatrick says. "They don't have inventories."

The theme of recurring revenue carries over to technology. Top holding Oracle (ORCL), for example, has software subscriptions that make it a "huge cash-flow machine," he says. Fitzpatrick moved into the stock in June 2012, when it was trading near \$27 over concerns that the company would lose market share to "snappy" cloud-based competitors. The stock is now above \$40, but Fitzpatrick thinks the market isn't giving Oracle due credit for shifting more of its business to the cloud. "They are cannibalizing themselves, which is the right thing to do," he says.

The same goes for Apple (AAPL), which Fitzpatrick bought in April 2011 at \$50 (split adjusted) a share. While growth for the giant isn't what it used to be, it was unduly punished over fears that other smartphone and tablet makers would snag market share. "This is a company that is not going to allow itself to be rattled," says Fitzpatrick, who trimmed his holding when Apple's market value reached \$700 billion in September 2012, and added some back when it fell to \$400 billion last year.

The same can be said of his investors, who have provided steady capital to execute his ideas, "even when owning Apple a year ago seemed stupid," he says. Without them, he says, he'd be skunked. ■

V U L C A N V A L U E P A R T N E R S

Vulcan Value Partners Fund:

The Vulcan Value Partners Fund seeks to achieve long-term capital appreciation by investing primarily in mid- and largecapitalization U.S. companies believed to be both undervalued and possessing a sustainable competitive advantage.

Vulcan Value Partners Small Cap Fund:

The fund seeks to achieve long-term capital appreciation by investing primarily in small-capitalization U.S. companies believed to be both undervalued and possessing a sustainable competitive advantage.

Vulcan Value Partners, LLC is an investment adviser registered with the Securities and Exchange Commission under the Investment Advisers Act of 1940. Vulcan Value Partners has no editorial control over the article's publishers or the content, subject matter and timing of the article. The opinions expressed in the articles are those of the author as of the date when the article was published. Economic and market conditions may have changed and Vulcan Value Partners' views regarding the prospects of any particular investment may have changed. It should not be assumed that recommendations made in the future will be profitable or will equal the performance of the securities discussed in the article. The return on capital is a measure of how efficiently a business employs its assets to generate operating returns.

RISKS:

The Funds may invest in the securities of companies with small or medium market capitalizations. Small or medium-sized companies may have more limited product lines, markets, and financial resources than larger companies. In addition, their securities may trade less frequently and in more limited volume than those of larger companies. Small- or mid-cap stocks may be more volatile than those of larger companies and, where trading volume is thin, the ability to dispose of such securities may be more limited. Because the Vulcan Value Partners Small Cap Fund normally invests at least 80% of its equity assets in securities of smaller companies, these risks may be increased.

The S&P 500 Index is an unmanaged index of 500 common stocks chosen for market size, liquidity, and industry group representation. It is a market-value weighted index. The Russell 1000® Value Index measures the performance of the large-cap value segment of the U.S. equity universe. It includes those Russell 1000® companies with lower price-to-book ratios and lower expected growth values. The Russell 2000 Index includes the 2000 firms from the Russell 3000 Index with the smallest market capitalizations. The Russell 2000® Value Index measures the performance of those Russell 2000® companies with lower price-to-book ratios and lower forecasted growth values. The S&P 500, Russell 1000® Value, Russell 2000® Value and Russell 2000® Index figures do not reflect any fees, expenses, or taxes. Investors cannot invest directly in an index.

As of June 30, 2014			
Current Quarter	YTD	1 Year	Annualized Since Inception
6.05%	4.82%	28.46%	17.09%
5.10%	8.28%	23.81%	15.82%
5.23%	7.14%	24.61%	15.51%
2.94%	0.62%	19.52%	20.11%
2.38%	4.20%	22.54%	15.58%
2.05%	3.19%	23.64%	16.65%
	Quarter 6.05% 5.10% 5.23% 2.94% 2.38%	Current Quarter YTD 6.05% 4.82% 5.10% 8.28% 5.23% 7.14% 2.94% 0.62% 2.38% 4.20%	Current Quarter YTD 1 Year 6.05% 4.82% 28.46% 5.10% 8.28% 23.81% 5.23% 7.14% 24.61% 2.94% 0.62% 19.52% 2.38% 4.20% 22.54%

*Total Gross Expense Ratio 1.18%/Total Net Expense Ratio 1.18%

**Total Gross Expense Ratio 1.35%/Total Net Expense Ratio 1.26%

The performance numbers shows the fund's historical performance. Past performance is not indicative of future results. Investment return and value of shares will fluctuate. Upon redemption, shares may be worth more or less than their original cost. The current performance may be higher or lower than the quoted performance. Vulcan Value Partners does not have a sales charge. Please call 1-877-421-5078, or visit our website, www.vulcanvaluepartners.com, for the most recent month-end performance results.

The holdings referenced in the article had the following percentage of total net assets in the Vulcan Value Partners Fund as of June 30, 2014: InterContinental Hotels Group (2.72%), Boeing (0.00%), MasterCard (3.88%), Visa (4.46%), Oracle (5.17%) and Apple (4.26%). The holdings referenced in the article had the following percentage of total net assets in the Vulcan Value Partners Small Cap Fund as of June 30, 2014: Starbucks (0.00%). Holdings are 'subject to change'.

ALPS Distributors, Inc. is the distributor for the Vulcan Value Partners Fund, Vulcan Value Partners Small Cap Fund and LongLeaf Partners Fund. ALPS Distributors, Inc. is not affiliated with Southeastern Asset Management, Inc.

Please call 1-877-421-5078 to obtain a copy of the Prospectus, which should be read carefully before investing to learn about the investment objectives, risks, charges and expenses of the Vulcan Value Partners Fund and the Vulcan Value Partners Small Cap Fund.

VUL000260 Expires October 31, 2014



PERFORMANCE THROUGH DISCIPLINE