

Turtle Creek Equity Fund

Q1 2010

Quarterly Manager Commentary

Recently an investor asked what seemed to us to be an unusual question. We were explaining that we value companies based on discounting their expected future cash flows back to the present. The investor commented: "Haven't you had to throw all of your models out the window? Hasn't the credit crisis invalidated your assumptions?" We were taken aback by this question because the credit crisis has done nothing of the sort to our approach. We explained that the assumptions and long term forecasts for our companies were not impacted in a meaningful way by the recent crisis. Indeed, the crisis and ensuing economic recession have validated our assumptions – our companies have been remarkably resilient.

While near term cash flows were, in many cases, impacted, this was short term in nature since we own companies that reacted swiftly to adjust their businesses to the downturn in demand. The performance of our companies is no accident – the most important part of our investment process involves choosing the right companies: sound businesses with strong management that drive their intrinsic value higher over time, even in difficult periods like the recent credit crisis. During the crisis, many companies have gone bankrupt and many more have been forced to issue equity at very low prices. In contrast, we own companies that had (and continue to have) strong balance sheets and talented management teams that were able to make the adjustments required to preserve cash flows and long term value.

All of our companies have now reported their results for calendar 2009 and these results are consistent with our long term forecasts. While 2009 was a challenging environment, financial results were surprisingly strong since our companies took such decisive steps to deal with the economic downturn. With 2009 behind them, many of our companies see the potential to expand margins as revenues begin to recover. In many circumstances, the downturn has provided opportunities for our companies to build long term value by reinvesting in their businesses and by making strategic acquisitions.

In fact, during this quarter, three of our companies announced meaningful acquisitions. The acquisitions were part of each company's long term strategic plan and were well priced and well structured. The acquisitions expand the global footprint of all three of the businesses, each of which are – or are well on their way to being - global leaders in their industry. While we are confident that these acquisitions enhance value, the market does not always immediately reflect these gains – presenting an opportunity for us.

Although the price of our portfolio was down 2.6% this quarter, rest assured that we were taking advantage of this "negativity" by repositioning some of our capital towards those companies offering the greatest value. Our companies continue to perform well and we are excited about their prospects. The quality of the companies in our portfolio has never been higher and our portfolio continues to trade at a historically large discount (approximately 60%) to its value. We look forward to continuing to produce superior returns and financial security for our investors.

Your Partners at Turtle Creek

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