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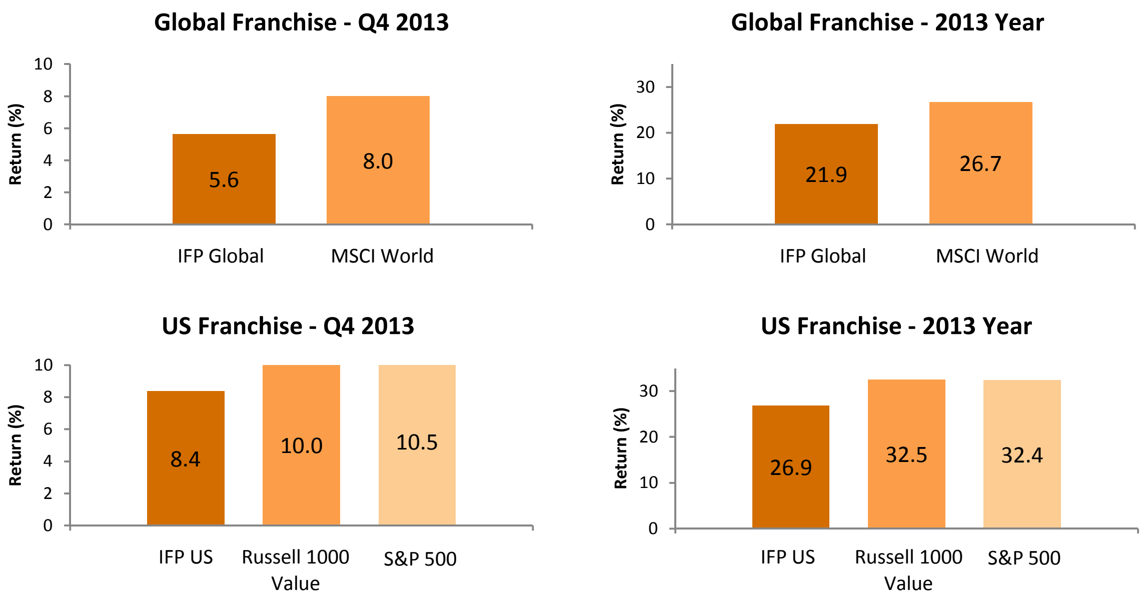
Fourth Quarter 2013 Global and US Franchise Commentary

Executive summary

The Global Franchise and US Franchise strategies generated attractive returns in the fourth quarter, as well as for the full year of 2013. Both strategies rose less than the wider equity market, which is to be expected when equity markets appreciate at a fast pace over a short period of time. We are satisfied that these results reflect the appropriate return profile for Franchise portfolios at this stage of the market cycle.



Returns in USD and net of fees for the representative accounts. Please refer to the disclosure at the end of this document for details.
Source: Independent Franchise Partners, LLP and Northern Trust.

During the quarter we sold **Verisk Analytics** in both Global and US Franchise and made adjustments to a handful of other positions.

The estimated free cash flow yield for Global Franchise is 6.1% and the estimated free cash flow yield for US Franchise is 5.9%.

Later this January we will hold two webinars for our clients, one for US Franchise and one for Global Franchise. The webinars will provide you with an update on each strategy and will cover portfolio changes, exposures and returns during 2013. We will also take a closer look at valuations in consumer staples and how these valuations have driven portfolio activity. Please let us know if you have not received an invitation.

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Franchise returns in 2013

Both Franchise strategies generated returns in excess of 20% in 2013. Broader equity market indices, however, rose even more. Looking at various asset classes, it is evident that higher-risk assets led investment returns in 2013. For example, internet retail stocks rose 70% and biotech stocks rose 68%. By comparison, the Barclays Capital US Treasury Bond 10yr term index fell 6%. The comparative returns earned by the Franchise portfolios in this environment do not surprise us.

Indeed, as we enter a new year, we would expect the portfolios to lag should equity markets continue to advance at a similar rate in 2014. However, as our experience has shown, should the market cycle turn and equity markets fall, then we would expect the strategies to preserve capital better than the average equity portfolio or broad market indices. It is this return profile – attractive absolute returns in rising markets and superior capital preservation in down markets – that has historically allowed the Franchise strategies to generate above-average returns over full market cycles with the added benefit of lower absolute volatility.

Investment returns – Q4 2013

	Global Franchise (%)				US Franchise (%)			
	Top		Bottom		Top		Bottom	
Stock Returns (%)	**McGraw Hill Financial**	**+19%**	**Japan Tobacco**	**-10%**	**McGraw Hill Financial**	**+19%**	eBay	-2%
	Apple	**+18%**	**Swedish Match**	**-9%**	**Apple**	**+18%**	Verisk Analytics	-0%
	Abbott Labs.	+16%	Danone	-4%	Abbott Labs.	+16%	Philip Morris Int.	+2%
	Zimmer	+14%	Davide Campari	-3%	Zimmer	+14%	Coach	+4%
	Scotts Miracle-Gro	+14%	Experian	-2%	Scotts Miracle-Gro	+14%	Novartis	+4%

Total returns in USD for the period the stock was held during Q4 2013. Source: Independent Franchise Partners, LLP and Factset.

	Global Franchise (bps)				US Franchise (bps)			
	Top		Bottom		Top		Bottom	
Contribution to Portfolio Return (bps)	**McGraw Hill Financial**	**+66**	**Japan Tobacco**	**-28**	**McGraw Hill Financial**	**+79**	eBay	-5
	Mondelēz	+65	**Swedish Match**	**-19**	Mondelēz	+74	Verisk Analytics	-0
	Apple	**+59**	Danone	-11	Accenture	+72	Coach	+9
	Abbott Labs.	+39	Davide Campari	-8	**Apple**	**+61**	Philip Morris Int.	+9
	Reckitt Benckiser	+37	Experian	-6	Microsoft	+51	General Mills	+16

Contribution to portfolio return in USD. For complete attribution and methodology, please contact clientservice@franchisepartners.com
Source: Independent Franchise Partners, LLP and Factset.

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Strong results and talk of a DOJ settlement boost McGraw Hill Financial

McGraw Hill reported quarterly financial results in the second half of October, with particularly strong results at the S&P Index and Platts businesses. More recently, media reports have suggested the company is in talks with the U.S. Department of Justice about its civil fraud lawsuit and could potentially settle in early 2014. McGraw Hill's shares now trade on an estimated free cash flow yield of 5.5%. As discussed later in this commentary, we reduced the position size in both portfolios during the quarter due to the recent share price appreciation and commensurate reduction in valuation.

Apple rises on strong iPhone demand

Apple announced strong fourth-quarter results, assisted by robust demand for its high-margin iPhones. Gross margins across the business remain healthy and the company provided guidance for sustained sales growth for the holiday season. Apple's shares offer an estimated free cash flow yield of 7.8%.

Japan Tobacco shares give back some of their gains year-to-date

We believe that the recent decline was primarily driven by speculation that **Japan Tobacco** is unlikely to increase prices above the government-mandated VAT hike next year. In addition, Philip Morris International issued guidance for slower earnings growth in 2014, which weighed on tobacco stocks more generally in November. We don't view either of these news items as material to our long term investment thesis. Japan Tobacco's shares offer an estimated free cash flow yield of 6.8%.

Competition weighs on Swedish Match

In its most recent quarterly results, **Swedish Match** reported that its US cigar business came under competitive pressure, leading to reduced earnings. In addition, the company continues to face competition in the Swedish smokeless tobacco market. Notwithstanding these challenges, Swedish Match's franchise remains resilient and the company's shares offer an estimated free cash flow yield of 6.2%.

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Investment returns – 2013 Calendar Year

	Global Franchise (%)				US Franchise (%)			
	Top		Bottom		Top		Bottom	
Stock Returns (%)	**Moody's**	**+58%**	C&C Group	-9%	**Moody's**	**+58%**	**Strayer Education**	**-15%**
	McGraw Hill Financial	+45%	Swedish Match	-1%	McGraw Hill Financial	+45%	AbbVie	-0%
	Wolters Kluwer	+45%	AbbVie	-0%	Scotts Miracle-Gro	+45%	Brown-Forman	+0%
	Scotts Miracle-Gro	+45%	Coach	+3%	Microsoft	+44%	Coach	+3%
	Microsoft	+44%	Kraft Foods Group	+4%	MSCI	+41%	Kraft Foods Group	+4%

Total returns in USD for the period the stock was held during 2013. Source: Independent Franchise Partners, LLP and Factset.

	Global Franchise (bps)				US Franchise (bps)			
	Top		Bottom		Top		Bottom	
Contribution to Portfolio Return (bps)	**Mondelēz**	**+186**	Swedish Match	-1	**Johnson & Johnson**	**+232**	**Strayer Education**	**-14**
	Novartis	**+149**	AbbVie	+1	**Moody's**	**+206**	Brown-Forman	+1
	Moody's	**+146**	C&C Group	+1	**Mondelēz**	**+205**	AbbVie	+1
	McGraw Hill Financial	+140	Kone	+2	**Novartis**	**+183**	Kraft Foods Group	+9
	Reckitt Benckiser	+127	Kraft Foods Group	+7	McGraw Hill Financial	+172	Coach	+14

Contribution to portfolio return in USD. For complete attribution and methodology, please contact clientservice@franchisepartners.com
Source: Independent Franchise Partners, LLP and Factset.

Moody's continues to benefit from strong global debt issuance

Global corporate debt issuance continues to be supported by low interest rates and the constrained balance sheets of banks. As one of the leading credit rating and research agencies in what is essentially a duopoly market, **Moody's** continues to benefit from this favourable environment. The shares offer an estimated 5.3% free cash flow yield. We reduced the weight of the stock in both portfolios during the year given the strong share price performance and subsequent compression of the stock's valuation.

Activist investor highlights latent potential at Mondelēz International

In July, activist investor Nelson Peltz proposed the merger of PepsiCo and **Mondelēz**. His proposal highlights the latent margin expansion potential at Mondelēz and the attractive valuation of its shares. In our view, however, Mondelēz does not need a merger to generate attractive returns for shareholders. We believe the company's broad exposure to faster growing emerging markets, coupled with attractive chocolate, gum and biscuit category exposure, should allow it to generate healthy revenue growth. That revenue growth, when combined with margin expansion, should lead to attractive free cash flow compounding. Mondelēz's shares offer an estimated free cash flow yield of 5.1%.

Johnson & Johnson and Novartis rise on healthcare sector rotation

Both healthcare companies delivered encouraging operating results and returns on their investment in research and development. Their new product launches should support attractive free cash flow growth over the medium term.

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Johnson & Johnson is making progress in restoring the supply of its over-the-counter healthcare brands to the market as it resolves longstanding manufacturing issues in its Consumer Healthcare division. In addition, a range of newly launched prescription drugs are helping to sustain growth in its pharmaceutical division. Johnson & Johnson's shares offer an estimated 6.2% free cash flow yield and 2.9% dividend yield.

Novartis announced the retirement of Chairman Daniel Vasella in January. Subsequently, management has indicated that they are considering strategic alternatives for non-core assets like the company's Vaccines and Animal Health divisions. While an outright disposal of non-core assets is possible, we do not anticipate a significant strategic shift in the company's pharmaceutical business. Novartis has an exciting portfolio of recently launched compounds which, together with its late stage pipeline of new prescription pharmaceuticals, should support attractive free cash flow compounding. Novartis' shares offer an estimated 6.3% free cash flow yield and a 3.2% dividend yield.

Strayer education fell on negative new student growth

Strayer reported negative new student growth for the fourth quarter of 2012. Despite an optically attractive valuation, we took the decision in March 2013 to sell the position and re-invest the proceeds in other portfolio companies where we saw a clearer path to sustainable compounding of free cash flow.

Portfolio changes emphasise quality and valuation – Q4 2013

	Initial Purchase	Addition	Reduction	Final Sale
Global Franchise	--	--	**McGraw Hill Financial** Scotts Miracle-Gro	**Verisk Analytics**
US Franchise	--	**Abbott Labs** **Microsoft** **PMI**	**McGraw Hill Financial** Scotts Miracle-Gro	**Verisk Analytics**

Reflects initial purchases, final sales and stocks for which there was a material change in portfolio weight during the quarter.

Final sale of Verisk Analytics

Since we initiated the position in **Verisk Analytics** in the first quarter of 2011, the company has delivered strong growth in its core insurance information business and has established an attractive position in the healthcare analytics market. It is also led by a management team that has an impressive track record of carefully allocating capital. We continue to admire the quality of Verisk's franchise and see several growth opportunities for the company. However, the share price has appreciated well ahead of its free cash flow growth and the estimated free cash flow yield has fallen below our 4.5% valuation threshold. As a result, we sold the position in both Global and US Franchise in October.

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Substantially reduced McGraw Hill Financial

McGraw Hill Financial's shares have risen strongly in recent months as the company continues to benefit from buoyant debt issuance trends. We continue to see potential for good free cash flow compounding combined with good capital discipline. However, with the shares offering an estimated free cash flow yield of 5.8% by the latter part of October and early November, we felt a smaller position was more appropriate. We reduced the position in Global Franchise by 120 basis points and US Franchise by 200 basis points.

Added to Abbott Laboratories, Microsoft and PMI in US Franchise

Abbott Laboratories is a well-diversified healthcare company with an attractive exposure to emerging markets and margin expansion opportunities in its Nutritional and Diagnostics divisions. We added to the position in early October at an estimated free cash flow yield of 5.2%, as weak emerging market currencies and an infant formula recall in China weighed on the share price.

We believe **Microsoft's** business software segments are the crown jewels in its franchise and another good set of quarterly results continues to support this thesis. We are also encouraged by its progress in the nascent cloud computing category. In addition, we continue to see potential room for improvement from greater strategic focus and cost cutting. We added to the position in October at an estimated free cash flow yield of 8.5%.

We also added to the position in the world's largest branded cigarette manufacturer, **Philip Morris International**, in October at an estimated free cash flow yield of 6.7%.

Franchise portfolios continue to offer attractive free cash flow yields

The Global and US Franchise portfolios offer estimated free cash flow yields of 6.1% and 5.9% respectively for 2014.

These estimated free cash flow yields are slightly lower than they have been in the past few years, reflecting the sustained share price appreciation of the underlying portfolio holdings; the estimated free cash flow yield for both portfolios at December 31, 2012 was 6.6%. Nevertheless, we see the current valuations consistent with our experience in prior market cycles.

We plan to provide clients with an in-depth briefing on valuations in consumer staples and how they have driven recent portfolio activity during our two webinars later this month. Please let us know if you have not received an invitation.

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Ongoing research

During the quarter we held over 50 due diligence meetings with companies including, Abbott Laboratories, Coach, Imperial Tobacco, Mondelēz, Moody's, MSCI, Omnicom, Rightmove and Time Warner.

Commercial developments

We are pleased to welcome Richard Crosthwaite to our investment team. Richard has eight years of analytic experience on both the buy-side and sell-side. He joins as part of our long-standing commitment to evergreen the investment team by recruiting and developing bright, young investors. Along with Karim Ladha, who joined in 2011, Richard is the second addition to the investment team since the launch of the firm almost five years ago.

Client assets in the US Franchise strategy exceed $2.3bn compared to $1.8bn a year ago. This includes over $900m in the two pooled vehicles we launched in December of 2011. Please contact us if you would like further information about US Franchise.

Client assets in Global Franchise exceed $9.4bn. Future capacity in the strategy is available via a wait-list process. Please contact us if you would like to be added to that wait-list.

We have again requested that Ernst & Young conduct a voluntary testing of our internal controls procedures under international standard ISAE3402 and US standard SSAE16. The previous audit revealed no significant issues with our controls. The auditors expect to have their next report available in the first quarter of 2014. Please let us know if you would like a copy.

Hopefully it is still early enough in the new year to thank you for your support and wish you all the best for 2014. We are, of course, grateful for the trust you have placed in the Franchise strategies and in the firm. We remain completely dedicated to investing your portfolio in keeping with the rigours of the Franchise quality and value criteria.

As ever, we measure our success through long term investment results and enduring client relationships.

We welcome your comments, suggestions and questions.

Sincerely

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The goal of the Franchise strategies is to earn attractive long-term returns while minimising business and valuation risk. All investments involve risk including the loss of principal. Total returns and total shareholder returns reflect the combination of share price appreciation and dividends. Past returns are no guarantee of future results.

Return data has been provided for informational purposes only as an indication of the investment team's record in managing Global Franchise and US Franchise portfolios. Returns have been provided for our representative Global and US Franchise portfolios, reduced by a pro-rated current management fee: 0.80% for Global Franchise and 0.68% for US Franchise. These fees reflect the standard management fee that applies while total firm assets remain above $5 billion. Additional costs and other fees may apply (e.g. custody, fund expenses) so actual returns achieved may be lower. Full composite returns and disclosure are available upon request.

The volatility of the indices referred to in this letter may be materially different from the individual performance attained by a specific investor. In addition, client and fund holdings may differ significantly from the securities that comprise the indices. The indices have not been selected to represent an appropriate benchmark to compare an investor's performance, but rather are disclosed to allow for comparison of the investor's performance to that of certain well-known and widely recognised indices. You cannot invest directly in an index.

The MSCI World Index is a free float-adjusted market capitalization weighted index that is designed to measure the equity market performance of developed global markets.

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