



# Johnston Asset Management

GLOBAL INVESTMENTS

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## *As We See It....*

After a powerful rally off the calamitous lows of March 2009, most expected the market to take a breather; it did for a few weeks from late January into mid February. The market did not correct because it was “tired”, but rather because the outlook for sustained economic recovery muddled a little. The balance in the US Senate shifted, potentially blocking the passage of healthcare reform and impeding the government’s ability to move forward on other issues. Companies started reporting earnings that occasionally disappointed. Unemployment remains stubbornly high in spite of other indicators that have been steadily improving. Nonetheless, equity markets resumed their ascent and ended the quarter with mid-single digit gains, an impressive outcome given the uncertainty the global economy faces.

Our growth equity portfolios underperformed slightly in the quarter. We were under-represented in financials, industrials and consumer discretionary, the three best performing sectors. Given how much these groups had sold off, we are not surprised to see them recover as strongly as they did, particularly financials. However, we are not inclined to chase this performance. We continually look for leading companies that have sustainable competitive advantages, growth opportunities, and attractive valuations. While we always look, we rarely find this combination in those three sectors.

Looking forward, we remain cautious. Global economies remain in a tenuous recovery phase. Market valuations around the world are in the moderate to high range, and interest rates can only go up. Growth has been driven by massive fiscal stimulus measures. Going forward, we need the private sector and consumers to take up the charge. In sum, equities remain the most attractive asset class, but the coast is not yet clear.

## *Stock Spotlight...*

One of our newest international holdings is Autonomy based in London, England. Autonomy’s software is geared towards getting computers to understand people. Known as “meaning-based computing,” Autonomy has a dominant market position and the market is growing rapidly.

In the past, computers were only able to efficiently process **structured data**, data that is organized in rows and columns and managed by databases. Today, **unstructured data** (such as email, word documents, powerpoint slides and videos) volume is growing exponentially and already exceeds that

of structured data by a ratio of 4-to-1. While enterprise’s most valuable data is increasingly unstructured, ironically, it is largely inaccessible to computers even though it is created by computers. That is, until Autonomy.

Autonomy's unique technology allows computers to understand the meaning of unstructured information and is able to automate chores that could only be done manually before. For example, many companies under legal investigation have used Autonomy to search files for all related documents, emails and voicemails, replacing small armies of lawyers that were used for this task in the past (this was big business in 2009). Autonomy is the de facto standard for law firms, securities firms and regulators. Another example is in the war against terror, the US, France, Italy, Spain and the U.K. use Autonomy to sift through vast amounts of data and retrieve key information in an urgent fashion and to perform video surveillance and analyze closed-circuit TV footage. Finally, retailers such as Levi’s, Costco and FedEx use Autonomy to increase web site sales and improve customer loyalty and satisfaction.

Over 20,000 global companies rely on Autonomy's technology today, including 86 of the Fortune 100. While they have a long and impressive customer list, we believe that that market is only beginning to appreciate Autonomy’s capabilities. There will be many more applications that leverage Autonomy’s unique ability to rapidly find meaning hidden in data.

We are attracted to the company because of its unique and differentiated technology as well as its software business model, which is characterized by high margins and returns on capital. There are high barriers to entry as Autonomy’s technology is protected by 170 patents. Moreover, at its core, there is a formidable connector library that enables Autonomy to access data from over 400 repositories and 1000 file formats in over 100 languages. Competitors are dissuaded from re-engineering these capabilities because Autonomy licenses this capability to the industry on reasonable terms on an OEM basis. The customer list is a literal who’s-who in technology, including IBM, HP, Oracle, Intel, Cisco and Adobe among the 400 OEM customers. Not only does this program increase barriers to entry, it represents a high-margin, high-growth opportunity that is under-appreciated by investors.