



July 25, 2006

Dear Investor:

All stock market corrections are discouraging for investors and investment managers. During any correction, the uncertainty as to the length and magnitude of the correction are at times as bad as the actual declines. In general, we struggle through these periods by comforting ourselves with the profits that we have made in the past and the expectation of profits that we will make in the future. Unfortunately, the severe downturn in stock prices from March of 2000 to October of 2002 has made us all more sensitive to declines in the market. This has created an investment climate that is more about fear than it is about opportunity. Investors perceive that the market is riskier. Price to earnings ratios for individual stocks and for the market as a whole continue to decline. In technology, this is occurring even as the technology industry benefits from the world wide increase in capital spending. Thus, the market is getting cheaper and the potential of future rewards for investing in the market are increasing. The attractive valuations that now exist are confirmed by the large number of companies that are being taken private at a premium. In these transactions most of the cash to buy out existing shareholders is being borrowed, since the cash flows of these companies are sufficiently strong to service the debt. For example, this month an investor group agreed to pay \$29 per share for the outstanding stock of the pet retailer PETCO. Prior to this announcement the stock was trading at \$19.45 per share.

We are not certain that the risk has changed from where it has always been, but the potential for future rewards for investing in the market is getting better all the time. Unfortunately, it is difficult to determine when those rewards will be realized. Currently, the market and individual stocks are trading more on technical factors and less on fundamentals. In addition, increased short interest levels in individual stocks has now caused very compelling valuations relative to the stock market in its' entirety. We believe that patient investors will be rewarded.

Markets tend to suffer from herd mentality, but the current market appears to be more driven by it than normal. We have mentioned in the past how short selling or short covering causes greater volatility in the stock market. Hedge fund short selling has certainly magnified the moves of individual stocks and broad sectors during this downturn. This activity, although painful in the short run, is creating opportunities for us to significantly outperform the market in the future. We have identified and invested in numerous stocks that because of the correction

have very attractive valuations and where our fundamental analysis has us very confident in the future growth of the company. Selected examples are as follows:

- Irwin Financial Corp (IFC) - In general, we have been avoiding bank stocks because the current interest rate environment is making it more difficult for banks to grow earnings. Irwin is a bank holding company that has suffered a share price decline from \$36 early in 2004 to a low of around \$18. The downturn was caused by a decline in the profitability of its mortgage banking subsidiary. They have announced plans to dispose of this unit as well as reduce costs in their home equity loan division. The bank is selling at ~1.1 times its tangible book value of \$17.90 per share while most banks are selling at 2 – 4 times tangible book value. We expect the company to earn more than \$2.00 per share in 2007 with a sustainable growth of 15% per year. Our average cost is around \$20 per share.
- Portfolio Recovery Associates (PRAA) - PRAA buys portfolios of defaulted consumer receivables. There are many companies in the collections business, but this company is by far the best. Since inception in 1996, the company has increased its earnings every year at a compound annual growth rate of 104%. We are forecasting growth to average 25% in the future. At \$41.00 per share, PRAA has a 16.3 trailing PE ratio and a 13.25 forward PE ratio. Much to our surprise, the short interest has increased to more than 20% of the shares outstanding. We are very confident in the company's ability to meet or exceed analyst's estimates over the next 12 months.
- Comtech Group Inc. (COGO) - COGO is a module engineering and design firm that is focused on the rapidly growing Chinese market. The company is very profitable and grew revenues 67% year over year in the first quarter. The company's founder and other members of management own approximately 50 % of the company. The stock price is currently less than 20 times our estimate of calendar 2006 earnings. Recently, we took advantage of the 40% drop in stock price to add to our position, taking it to over 4 % of the portfolio.
- Noble Corporation (NE) - NE is a provider of offshore contract drilling services to oil and gas exploration companies around the world. We expect that oil and gas prices will continue to trend higher until prices reach a level that causes a major decrease in demand. So far we have not seen a change in behavior in the United States and automobile sales in China have increased 50% this year. Noble is in a multi year period of strong profit growth as it replaces lower rate, long-term contracts and with new long-term contracts at much higher rates. We took advantage of a recent 30% drop in the share price to purchase a 2% position in the stock at a price that was less than 10 times estimates for earnings in the next twelve months.

These are just a few of the compelling stock values that exist in the portfolio. We are taking advantage of this decline to add to existing positions that we think are particularly good values or to initiate new positions in stocks that have fallen dramatically. As you might expect given the overall drop in the stock market, a number of stocks in the portfolio that we held at the

beginning of the quarter suffered significant declines in share prices. We sold some positions prior to the drop, others we did not. We are confident that the stocks we continue to hold will recover and that by taking the actions that we are during this downturn, we will see the portfolio grow at a faster rate than the market. We can't predict the exact timing of any move in individual stocks or the market, but historically, valuations like those that currently exist have rewarded investors with above average returns over longer time periods.

The following are results for selected indices for the quarter, year-to-date and the last twelve months as well as the average annual return for the last three years:

	3 Months Ending 06/30/06	YTD Ending 06/30/06	12 Months Ending 06/30/06	3 Years Ending 06/30/06
Russell 2500 Growth Index	-6.12%	4.98%	14.61%	17.03%
Russell 2000 Growth Index	-7.25%	6.07%	14.58%	16.27%
NASDAQ Composite Index	-7.01%	-1.08%	6.48%	10.90%

Lastly, we took advantage of the Fourth of July break to move to a new location just across the highway from our prior address. Our new space is a much better fit with our current size. All of us are enjoying the new space and are finding it to be a very effective working environment. We look forward to meeting with you and giving you a tour.

Sincerely,



Edward P. Hemmelgarn
President / Portfolio Manager



Karen Mroz-Bremner
Portfolio Manager / Research Analyst

EPH/bad