

Patient Values

It takes a great deal of ingenuity and patience to pick contrarian stocks with the belief that they will offer potential high returns over time. Croft Value Fund managers Russell and Kent Croft, and their staff of 5 analysts believe in such a commitment and follow a disciplined, multi-step process to get the best ideas for picking shunned or beaten down stocks for their portfolio.

Q: What is your investment philosophy?

A: We are looking for values in stocks and businesses that are sustainable. We are not restricted by the market capitalization of the company and are a generalist in our approach. We are looking for companies that are either mispriced, or have assets that are not valued in the market, or are generating consistent growth.

As contrarian investors, we buy shunned or overlooked stocks trading at a price below their intrinsic worth. We look carefully for a gap between a company's intrinsic value and current stock price. The opportunities we see there is what drives us and generates our stock ideas.

Q: Why do you prefer the contrarian style of investing?

A: We believe reduced risk is inherent in our philosophy as our long-term and committed investment approach offers potential for high returns over time. Our contrarian outlook triggers interest in stocks when they are beaten down. We think there is downside protection in such stocks and believe that trying to buy these stocks at 80 cents on the

dollar and holding them for three to five years, gives us a chance to capture a lot of upside at lower long-term risk. We may be wrong a certain percentage of the time, but this philosophy has worked well for us in different market cycles over the past 18 odd years of our existence.

Q: What is your investment strategy and process?

A: Our strategy is about generating ideas and turning them into stock commitments. We follow a disciplined, multi-step process to get the best ideas for our portfolio. Ideas originate from a variety of expert sources, both internal and external and during a year, we get more than a 1,000 stock ideas in different market caps and in industry sectors. Next, we whittle this number down to about 500 ideas based on acceptable valuations arrived at using a traditional valuation measure like price-to-earnings. We also look for cash flow, book value, and hidden assets of the companies or parts of businesses not reflected in the current stock price. We further narrow down the 500 ideas to 200 and continuously monitor those to decide about their inclusion in our portfolio.

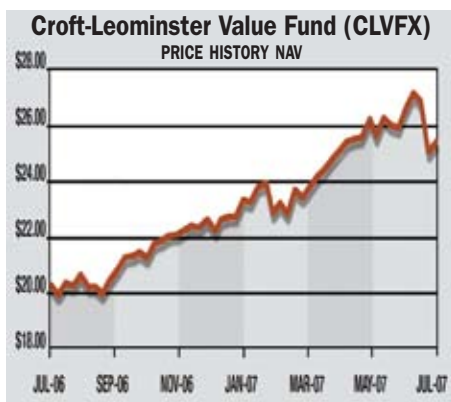


RUSSELL G. CROFT has been a portfolio manager for each Fund since 2006.

Before coming to Croft-Leominster, Inc. in 2001, Croft had experience working for Gabelli & Company in New York.

Croft holds a B.A. degree (1996) from Washington and Lee University and obtained his M.B.A. (1998) from the University of London.

“We are generalist stock pickers trying to find the next best value and contrarian play and are not restricted to a specific sector or by any artificial boundaries of capitalization.”



The ideas fall into three categories - the catalysts, growth and reasonable price (GARP), and the contrarian stocks. We allocate capital equally among these three categories in the portfolio. A catalyst could mean improvement or change in several indicators such as, balance sheet, a management change, an asset realization, a new product or a stock buyback. GARP companies are very often those that look cheaper relative to both the market and industry growth rates.

The third category is the contrarian plays or the beaten down stocks that can come from a short term or a medium term market overreaction. The slide in certain stocks could be media overreaction over complications from restructuring or product launch difficulties that market fails to understand or is impatient for its outcome.

From the three categories, we identify our 80 or so best ideas and the portfolio may finally contain between 65 to 85 ideas.

Q: Can you give a couple of examples of how these ideas have translated into stock picks in the three categories?

A: Weyerhaeuser, known for its paper business and is our current top holding, is a typical catalyst category stock. The company owns 6.4 million acres of timber assets in North and

South America. They are into real estate management and home building business too. Valuations from recent deals in the sector suggest that Weyerhaeuser's timber assets, excluding their paper business, are close to the company's entire market capitalization today. We got interested, because the company did not announce any plans to realize the value of its timber assets. Consequently, the market undervalued the business and that was our catalyst. We believe that sometime in the future, the management will realize the potential value of these assets, and we are willing to wait for that to happen. In fact, it seems the management has already initiated such action and can get value changing into a REIT, even make an outright sale of the timber assets or monetize that value in other ways.

Foster Wheeler is an example of a contrarian idea that has been in our portfolio for about five years now. We bought the company just after it emerged from bankruptcy. Foster Wheeler is into engineering and construction with focus on energy infrastructure. We have always been interested in that sector and want to be a part of the energy infrastructure build out that is inevitable given that both in the United States and globally, there have been multiple decades of underinvestment in energy infrastructure. This was just the kind of contrarian, or undervalued shunned stock we want. Our research also revealed the company had good engineers and a new, more efficient management. The stock trades at about 15 times earnings but we think it can grow earnings at about 20%. Therefore, we took a position that worked well for us in the last five years.

Q: What is an example of a growth and reasonable price - GARP pick?

A: General Cable. They sell electrical and other type of cables for power transmission. The company trades at

about 13.5 times 2008 earnings. We think it can grow earnings 15% to 20% over the next 3 years. We consider the company valuation as an example of our stock idea for growth at a reasonable price. The company has good management and cash reserves. More importantly, it is trading quite cheap relative to the market multiple and we believe its margins can improve from about 8.5% to 9.5%. Over time, that multiple should catch up with at least the market, yielding good returns from the stock. Again, since our country's utility network needs to be upgraded, there is a good potential for the company to grow earnings long term. This is not an aggressive but a long-term steady earnings growth of about 15% to 20% story. Therefore, in ideas like General Cable, we can be nimble and take some of the short-term turbulence in the market and wait for long-term returns.

Q: How do you conduct your research?

A: We have five general analysts who do not focus on any specific sector. Apart from these internal sources, we get ideas from other respected money managers with whom we have had long-term relationships. We discuss with them the most attractive ideas. We also use some paid independent research as well as that from Wall Street. We are continuously in contact with companies, either personally meeting them or through telephone.

Knowing management is important to us and we go to many industry conferences to meet them. Whenever necessary, we even travel abroad, to meet the management of international companies. Specifically, we focus on the Q&A part of earnings conference calls where we listen to other money managers and analysts asking management questions for which we would like answers.

Q: How do you build your portfolio and what is your benchmark? What is the portfolio turnover?

A: Since we are a multi-cap fund and cannot be boxed on a certain market cap, we do not structure the portfolio against any specific benchmark. We do not allot more than 5% at cost in any stock, or 20% in any single industry, and the fund again is diversified between 65 to 85 names. We generally get measured against the S&P500 that represents more of larger cap companies. Due to our multi-cap approach, in our top ten holdings, we have an \$180 billion company like AIG and a comparatively small, around \$2 billion Canadian company called Petrobank. We also have only an 18% portfolio turnover since our goal is to buy long term and hold on to the stock for at least three to five years.

Q What is your buy and sell discipline?

A: Our buy approach, whether adding to a position in stages, or small increments or filling the full position outright, depends on the nature of the company. If we are buying a small company without much liquidity, we may take our time buying it. Sometimes, we will buy some of a stock and if our conviction level gets stronger, buy more at a better price. Overall, we take just a couple of days, not months, to buy our positions. We act quickly and nimbly if we feel strongly about a name.

We will sell a position if our original thesis is no longer valid since we bought the stock. This happens, if the stock is static or it is down 20%, or vice versa. In case of any wrong decision of ours, something that we missed, we accept our losses and sell the stock. Conversely, we will actually buy the stock even if it is steeply down, if we believe there are no fundamental changes and it is only a short-term phenomenon. More importantly, we treat every investment on its individual merits. There is no specific level for a sell decision. It is not neces-


sary that if a stock is down 20%, we will sell. However, sometimes, a poor investment pick will trigger an immediate sell decision.

Q: Can you give an example of a sell decision?

A: Tyco is a recent example of a bad pick of ours. We have long had a position in Tyco. We bought the company stock when it had problems and even got some decent returns. At first, we were quite excited when the company announced it was splitting up into different entities. However, our research into the company, over a period of one and half years, threw up concerns about the value of each specific entity, standing on its own. Therefore, we decided to sell the position before the breakup. Generally, we actually like to look for conglomerates that are splitting since the market undervalues them just because they are conglomerates and the approach of ours has been quite successful in the past. However, Tyco was an exception.

Q: What are your views on risk and how do you control it?

A: We believe, our investment approach itself, looking for 80 cents on the dollar, is inherently less risky in the long term. Moreover, diversity is a key factor because we do not tie ourselves to an index and, do not allot more than 20% in any one industry, in case a major crisis hits it.

The other risk control measure is our upper limit of 5% in one stock at cost. We try to maximize returns by constructing a less risky, cheaper portfolio in the market with better earnings prospects as the lower P/E over time provides us with more leverage in a downside situation. We believe it is easier for a stock to fall steeply when it is trading at 45 times earnings and misses an earnings quarter, than when it is trading at 11 times earnings. We thus cover both the downside and upside of an investment, to cut risk. 

Croft-Leominster Value Fund

Symbol	CLVFX
Website	www.croftleo.com
Address	Croft- Leominster Inc Canton House 300 Water Street Baltimore, MD 21202
Tel. No.	800-551-0990
Inception	05/10/1995

PORTFOLIO

Total Net Assets*	\$22.9
Avg Mkt Cap (\$ Weighted)*	\$39,900
Average Price/Earnings Ratio	15.1x
Average Price/Book Ratio	4.43x
Turnover Ratio	22%

INVESTMENT INFORMATION

New Investment	Open
Min Initial Investment	\$2,000
Min Subsequent Investment	\$200
Min Initial IRA Investment	\$500

RISK (AGAINST S&P 500 DAILY REINV IX - 3 YEARS)

Alpha	0.39
Beta	1.05
R-Squared	0.67
Ann. Std Deviation	9.39
Sharpe Ratio	1.40

RETURNS VS. LIPPER LG-CAP CORE INDEX

	CLVFX	Index
1 Year (Cum.)	22.31%	16.13%
3 Year (Ann.)	17.97%	11.76%
5 Year (Ann.)	16.90%	11.81%

RETURNS VS. S&P 500 DAILY REINV INDEX

	CLVFX	Index
1 Year (Cum.)	22.31%	14.24%
3 Year (Ann.)	17.97%	12.85%
5 Year (Ann.)	16.90%	13.70%

FEES AND EXPENSES

Max Sales Charge - Front	0.00%
Max Sales Charge - Deferred	0.00%
Max Redemption Fee**	2.00%
Total Expense Ratio	1.50%

PORTFOLIO MANAGER

Kent Croft	1995
Russell Croft	2006

*millions **1 months after purchase

Data through: 07/31/2007

Source: Company Documents; Lipper

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Our interview covers investment philosophy and strategy, research process, portfolio construction and risk control for funds. Through an interview we uncover long-term strategies and processes that help to generate long-term returns.

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