

Opportunistic, Not Contrarian

While many investors feel lost in the face of the credit crisis and the difficult stock market, for Larry D. Coats, the co-manager of the Oak Value Fund, the current environment provides abundant opportunities for finding businesses with sustainable advantages and attractive valuations. Thorough understanding of the business and industry fundamentals are a crucial part of the strategy of being prepared for the attractive pitch.

How would you describe your investment philosophy? What are your core beliefs in money management?

We are opportunistic buyers of businesses with sustainable competitive advantages. Our approach is based on the principles of Benjamin Graham, which are relatively straightforward. The first one is that equities should be viewed as businesses and pursued with the same diligence and thought process as in buying the entire business. As he said in his book, *The Intelligent Investor*, "investing is most intelligent when it is businesslike."

The second principle is to always require a margin of safety in the allocation of capital. That means that we attempt to buy companies at a discount to our estimate of their intrinsic value. We're very focused on the ongoing value of the business from an operating and a cash flow standpoint.

The third principle is to remember that the market is a vehicle that facilitates your goals, but it doesn't require any specific action. The idea is to take advantage of the opportunities that the market presents, not to follow the market. Based on those principles, our philosophy is about investing in good businesses, with good management, and at attractive prices.

What's your definition of a good business?

Those are the businesses that have demonstrated the ability to produce predictable, growing, excess cash flow. The management is shareholder-oriented and has demonstrated its ability not only to run the business, but also to allocate the excess cash to higher returning investments. In terms of valuation, we attempt to buy businesses at a discount of 30% to 35% to their intrinsic value.

The greatest challenge in this approach is finding the businesses that truly qualify as good businesses.

The predictability of the cash flow is the most difficult part of the equation. We sometimes reference Porter's framework of a company's positioning relative to customers, suppliers, competitors, and substitute products.

How does that philosophy translate into an investment process? How do you find and evaluate ideas?

We are indeed students of business models, focused on understanding the businesses and the extent to which they have sustainable advantages. We attempt to buy those businesses in a very opportunistic fashion, recognizing that the market is just a vehicle. Overall, we attempt to be prepared every day in the batter's box, hoping for the attractive pitch to come across the plate.

We start with the list of businesses in the Russell 1000, the Russell 2000, and the S&P 500, and we select the companies that meet our definition of a good business. Then we work on that universe to find the above-average businesses and the truly great ones. Ideally, we'd like to buy all the truly great businesses at value prices, but there aren't that many opportunities. So, we end up with a mix of above-average and truly great businesses in almost any market environment.

What are the milestones of your research process?

We rely on our own research and valuation work, which includes interviewing and evaluating the managements. We do our research from the perspective of owning the entire business, not just the equity, and we spend time understanding the business model and the company's place within the industry.

We believe that the good decision making takes place at the intersection of knowledge, insight and judgment. Our shareholders trust our decision making capabilities, which depend very much on

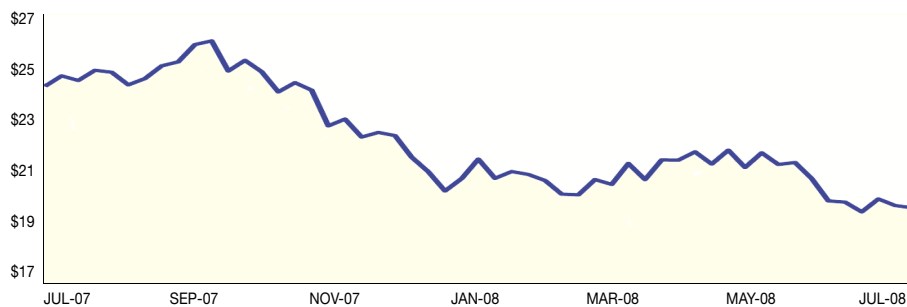


LARRY D. COATS, JR., President & Chief Executive Officer of Oak Value Capital Management, Inc. has over 20 years of experience in the investment business. He serves as co-manager of the Oak Value Fund, along with the firm's co-founder, David R. Carr, Jr. Mr. Coats is also a member of the firm's decision making Investment Committee and is President of the Oak Value Trust Board of Trustees. He dedicates most of his time to investment research and portfolio decision making and maintains oversight responsibility for the various functional areas of the firm. The firm manages individual portfolios for institutions and high net worth clients, operates as a sub-adviser for several financial intermediaries, and is the investment adviser to the Oak Value Fund.

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Performance - Price History N.A.V.

Oak Value Fund (OAKVX)



	2005	2006	2007	2008 YTD*
S&P 500	4.91%	15.79%	5.49%	-11.39%
OAK VALUE FUND	-1.37%	14.18%	4.87%	-9.09%

*AS OF 08/31/08

the research that contributes to our knowledge base; on the insight, which is a reflection of our experience through the years; and on a framework that takes the knowledge base and the insight at the point of decision making.

That's where we, as a team, work extremely well together. The fund has two co-managers and we make decisions about the businesses that we would like to own and for the tactical allocation. We require consensus to ensure that we have cleared all the issues, addressed all the concerns, done the research that needs to be done, and placed it in the appropriate context.

Could you give us some examples of specific holdings to illustrate how an idea becomes a holding?

On the portfolio level, we believe in the notion of competition for capital. We allocate our resources on a day-to-day basis in a very opportunistic manner, both around the companies that we currently own and around a flow of businesses that we've identified. Finally, we focus on the ideas where the conclusions from the research are positive, while the short-term market dislocations give us particular opportunities.

A good example would be Apollo Group, the U.S. largest operator of for-profit universities. During the credit crisis in the second quarter, there was significant concern about funding student loans, especially in private sourcing. However, less than 5% of Apollo's students actually have exposure to private funding.

In that case, our long-term research and understanding of the education industry presented an opportunity when some of Apollo's competitors disclosed problems with their funding sources. Many of these companies came under pressure, providing us with the opportunity to invest in a high-quality business with significant barriers to entry and operating margins of about 25%. It has very high returns on capital, no leverage on the balance sheet, and net cash of about \$600 million. It was trading at about 13 times earnings due to the pressure in the industry.

In another example, we were saying for years that some technology business models were evolving to the point of being able to deliver the predictability and the sustainability that we look for. We were waiting for the 'For Sale' sign on the lawn to invest in them. In the spring of 2006, we bought shares of Oracle, the world's largest database company and an application and middleware company. The stock was trading at about \$13 dollars at less than 14 times forward earnings.

At the same time, Oracle's business model had evolved to the point, where half of its revenues were recurring due to maintenance contracts and service agreements. The revenue recognition had become much more sustainable and predictable as it was no longer dependent upon the sale to new customers. We still own Oracle and while the transition had been painful for the company, it resulted in more predictable economics and very high operating margins.

Overall, we take a very long-term view based on business models and opportunities. As a result of that long-term view, we had recently become investors in Microsoft and eBay.

What is your portfolio construction process? What benchmarks do you compare yourself against?

We primarily compare ourselves to the S&P 500. We run a relatively concentrated portfolio with about 20 to 25 mid and large-cap companies but they are broadly diversified across industries. Currently, we have no exposure to utilities, telecommunications, and energy, although we have indirect energy participation through our holdings in Praxair.

In the consumer discretionary businesses, we have invested in two U.K companies - Cadbury, the chocolates and confectionary business, and Diageo, the largest premium spirits business. We are overweight technology relative to the S&P 500 with Oracle, Microsoft, eBay, and Cisco. In the industrial space, we own 3M and United Technologies.

Currently, we are also overweight the financials, but that includes a 9% exposure in Berkshire Hathaway, which is not a purely financial company. We also own American Express and Capital One, which are both susceptible to consumer spending pressures. Other holdings include Aflac, which sells supplemental insurance in the U.S. and cancer insurance in Japan; Aon, the second largest broker for property and casualty insurance in non-life and non-health; and Moody's, which is in the business of selling research and opinions, not taking on balance sheet risks of loaning or investing its capital.

The point is that even within the sectors, we have significant diversification across business models. Overall, the portfolio represents a collection of businesses that generate above average operating margins in excess of 20%, returns on equity of 25%, while the debt-to-total enterprise value is less than 20%. The main characteristics are high profitability and return on equity without the need to employ significant leverage.

We estimate that the revenue growth on a forward five-year basis is between 8% and 10%, and the earnings per share growth is between 13% and 15%. These businesses generate nearly 50% of their revenues from outside of the

U.S, so we are geographically diversified and with a focus on global operations. Even Apollo, in the education business, recently bought a Chilean for-profit university and a Mexican for-profit University.

What is the rationale behind owning American Express and Capital One, two companies that carry the client risk of non-payment, and not owning Visa or MasterCard, which are just payment processors?

Unlike Visa and MasterCard, which are basically clearing houses, American Express controls its entire value chain and the relationship with both the retailer and the consumer. Its model is tilted more towards spending, not towards lending. Over time, that 'closed loop' model should allow American Express to deliver a network effect of value. The company is able to keep a larger percentage of the total merchant discount, as opposed to sharing that with the issuing bank and the processing bank.

Therefore, on a long-term basis, American Express has more control over its future. On a short term basis, it is certainly exposed to the slowdown in consumer spending, but we invest for the long term and we use the opportunity to buy companies during periods with significant dislocation. The current environment, while challenging in the short run, represents a great long-term opportunity.

Capital One depends more upon lending, but it has demonstrated the ability to diversify its funding sources. It is not entirely dependent upon the capital markets for its day-to-day funding of cardholder receivables. It bought a couple of banks over the last five years, and the different funding sources spare it some of the challenges of the traditional credit card businesses. The company has continuously demonstrated good strategic decisions to the advantage of their shareholders. Its long-term earning power is very significant and the business continues to weather the current challenging environment on the operating side.

In this environment, it is very common to assume that consumer spending and credit will never recover; that these businesses are permanently doomed. We believe that both Capital One and American Express have sustainably advantaged business models and attractive valuations. Of course, we wouldn't

exclude Visa and MasterCard as they too are good businesses.


What is your view on risk and how do you manage it?

Although we are bottom-up stock pickers, we attempt to manage a portfolio that is prudently and deliberately diversified. Since it is a relatively concentrated portfolio, the individual stock risk has to receive adequate attention. We have to understand the business models and the value chains of the businesses, and to identify correlations even at the individual business line level.

In addition, we are cognizant of a top-down view of our exposure. Overall, we believe that we hand-pick the best of the best in terms of opportunities, while minimizing the correlations at the business level. We are also sensitive to the currency exposure because of the large exposure to global markets.

It is important to note that we also focus on balance sheet risks. Through the years, we have owned some highly leveraged companies and have concluded that they are not our cup of tea. We are also sensitive to the potential for increased regulation, to political risks and uncertainties, and to the dependency on large or individual customers. Ultimately, that risk manifests itself in the company's ability to control its future and its ability to drive above-average economics.

At its core, we view risk as the potential for permanent loss of capital. On a short term basis, we recognize that we need to be aware of the market volatility. Also, we are aware of the risk that all value managers face, namely, buying stocks just because they are cheap and provide a margin of safety. Some people refer to such as "value traps".

We are very sensitive to the entry points. I believe that you can be sensitive to short-term issues, while staying focused on the long-term opportunity, and there's a very fine line between contrarian and opportunistic investing. We are more in the camp of being opportunistic. Our goal is not to be early in the stock, but to invest when the long-term and the short-term opportunities are appropriately reflected in the stock price. 

Oak Value Fund

Symbol	OAKVX
Website	www.oakvaluefund.com
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Telephone	800-622-2474
Inception	01/18/1993

PORTFOLIO	
Total Net Assets*	\$95.0
Avg Mkt Cap (\$ Weighted) *	\$60,700
Average Price/Earnings Ratio	21.26x
Average Price/Book Ratio	4.63x
Turnover Ratio	44%

INVESTMENT INFORMATION	
New Investment	Open
Min Initial Investment	\$2,500
Min Subsequent Investment	\$100
Min Initial IRA Investment	\$1,000

RISK (AGAINST S&P 500 DAILY REINV INDEX - 3 YRS)	
Alpha	-0.18
Beta	0.97
R-Squared	0.87
Ann Std Deviation	10.28
Sharpe ratio	-0.26

RETURNS VS. S&P 500 INDEX		
	OAKVX	Index
1 Year (Cum.)	-11.39%	-11.14%
3 Year (Ann.)	2.71%	3.66%
5 Year (Ann.)	4.89%	6.92%

FEES AND EXPENSES	
Max Sales Charge - Front	0.00%
Max Sales Charge - Deferred	0.00%
Max Redemption Fee**	2.00%
Total Expense Ratio	1.37%

PORTFOLIO MANAGER	
David R. Carr, Jr	1993
Larry D. Coats, Jr	2003

* millions **3 months after purchase
Data through: 08/31/2008; Source: Company Documents; Lipper

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