Value Investor INSIGHT
The Leading Authority on Value Investing
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Entrepreneurial Investing

Great entrepreneurs are often tenacious, frugal and willing to make concentrated bets. The same traits also work quite well in investing, says Atticus Lowe.

Although he handles the heavy research and analytical lifting at West Coast Asset Management, Atticus Lowe has a unique resource in firm co-founder Paul Orfalea, the founder and Chairman until 2000 of business-services firm Kinko's. "Paul is intuitively brilliant and tenacious," says Lowe. "Drop him in any foreign country with nothing and he'd figure out how to be successful right away."

Such resourcefulness has translated into excellent returns for WCAM investors, who have earned a net 13.7% annually – vs. 2.3% per year for the S&P 500 – since the firm started investing in January 2001.

Lowe is currently finding the biggest potential upside in smaller-cap companies with unappreciated growth prospects, particularly in healthcare and energy. See page 2

INVESTOR INSIGHT

Atticus Lowe
West Coast Asset Management

Investment Focus: Seeks companies that are cheap based on underlying cash flow, new growth prospects and non-core assets that could be monetized.

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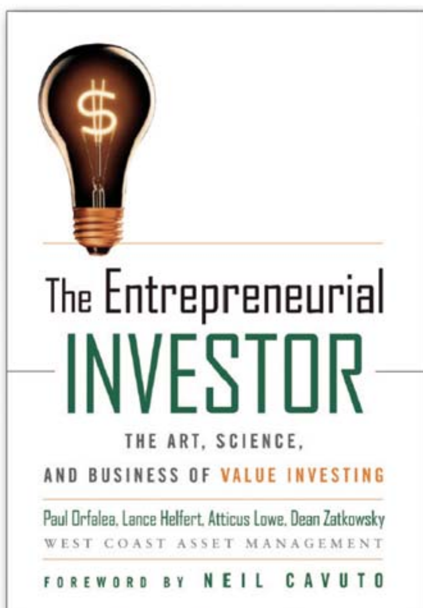

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Investor Insight: Atticus Lowe

West Coast Asset Management's Atticus Lowe describes the investing insights of his firm's unique co-founder, why he pays so much attention to company culture, why healthcare is a fertile area for ideas and what he thinks the market is missing in Contango, Noven Pharmaceuticals, Angiotech Pharmaceuticals and National Home Health Care.

Your firm bills itself as "the entrepreneurial investor." How does that inform how you invest?

Atticus Lowe: We describe entrepreneurial as being focused, opportunistic and involved. Entrepreneurs tend not to be afraid to put more of their eggs in one basket, so because we want each decision we make to have a meaningful impact on our results and to be rewarded when we're right, our portfolio is concentrated in only 10-15 stocks. We believe that the more companies you own, the more mediocre your results will be and the more exposed you are to market risk.

By opportunistic, we mean having the flexibility to take the opportunities the market gives us, which is why we're not at all bound by an investing style box. We're all-cap and all-category, although our sweet spot has been in companies under $2 billion in market cap, for which we believe the market is less efficient. Also, while we think everything we buy is a great value, some might consider some of what we own to be more growth-oriented.

We're also involved, which means relying only on our own research and really getting to know a company and its people at every level. That's a clear influence from our co-founder, Paul Orfalea, who built Kinko's from the ground up until retiring as Chairman in 2000, right before he founded our firm. We're less interested in management reciting financial metrics and more interested in what their motivations are and how much of a shareholder perspective they take in running the business. Are they focused on growing for the sake of getting big or are they solely focused on per-share value? By owning so few stocks, we should be able to know how a company works almost like an insider. By having meaningful positions in the companies we own, we can also take more active positions when necessary.

How else is Mr. Orfalea's experience incorporated in what you do?

AL: Paul attributes a big part of Kinko's success to a strong and self-reinforcing culture, so we pay a lot of attention to that in our research (*see box*). An example of a company with a great culture that we currently own is Johnson & Johnson [JNJ]. They truly care about co-workers, suppliers, shareholders and customers in a way that most companies don't. Interests are aligned across the board, employees are more motivated and decision-making is less top-down, so they can be more nimble in reacting to change. We see their culture as a real competitive advantage. Combine that with the fact that it's cheap based on cash flow, has a strong business mix across pharmaceuticals, medical devices and consumer products, and has a tremendous opportunity to grow overseas, we think it's a very good long-term value.

Another big input from Paul is our focus on the balance sheet and cash flows. As someone who actually had to worry about making payroll, he's very focused on limiting downside. We try to identify opportunities in which a company is trading at a significant discount to future cash flows, but which also has a high amount of net tangible assets like cash, marketable securities and real estate.

Healthcare and energy appear to be fertile areas for you today. Why?

AL: In each case we're finding companies with the type of profile we find particularly attractive. In healthcare you find a lot of companies with a great deal of cash, that have competitive advantages in the form of patents, that are cheap based on underlying approved products and that also have great growth catalysts in the form of new products or services.

Atticus Lowe

Cultural Awareness

Paul Orfalea, who started West Coast Asset Management with partner Lance Helfert in 2000, is not your typical investment-firm founder. For one thing, he had spent his previous 30 years building a successful big business, Kinko's. For another, he suffers from severe cases of both dyslexia and attention deficit disorder. "Paul is the most unique individual I've ever met," says Atticus Lowe, WCAM's chief investment officer.

WCAM's research focus on the corporate culture of prospective holdings is one of many direct inputs from Orfalea, says Lowe. "We're basically looking for a selfless culture rather than a ruthless one. An example would be Whole Foods Market, where the front-line workers feel and act like owners and are vested with a great deal of responsibility for making decisions."

Divining a culture isn't so difficult, says Lowe, but requires a significant amount of legwork – talking to employees, suppliers and customers. "We don't consider a company's culture to be a touchy-feely notion at all, but a key determinant of whether it will be successful or not."

In energy we've often been able to identify companies that are undervalued based on existing proven reserves, but that also have a lot of option value from undeveloped and unproven assets that we believe have a high probability of being successful and providing tremendous additional value to shareholders.

We also like consumer products companies. Wrigley [WWY], for example, is Paul's favorite business in the world. He loves the checkout-line, discretionary-spending aspect of the business and we think they have competitive advantages from their strong brand positioning, distribution and scale. Like J&J, they also have great growth opportunities outside the U.S., especially in Asia and Eastern and Western Europe. Another general trend we see in their favor is the fact that people chew more gum as they smoke less, which is happening in many parts of the world.

Are there particular types of companies you tend to avoid?

AL: We generally shy away from capital-intensive companies with high fixed costs and from technology companies that have high levels of what we call reinvention risk. High-fixed-cost companies in cyclical businesses can get in trouble very quickly. Also, something like Apple Computer is a great company, but to justify its current valuation you have to make a lot of assumptions about future products and cash flows that we're not comfortable making. There are just too many other opportunities out there for us to own something like Apple or Research In Motion or Google at their current valuations.

But you will own a technology company like Microsoft [MSFT]?

AL: We do own Microsoft. We think they have a strong and predictable competitive advantage, a margin of safety with all the cash on the balance sheet and are just throwing off huge amounts of cash flow, a lot of which they're using to buy back stock. We don't think it's as screaming a buy today [at $30] as it was when we got in at $23 last year, but we still think it's a good value.

Describe your general buy discipline.

AL: We can usually tell within five minutes if something is cheap enough for us to buy. We look at what we call the "entity value," which is the current market capitalization, plus net debt, less assets that don't support the underlying business and could be monetized. We then compare that entity value to our estimate of the value of the cash flows of the ongoing business, plus the value from new growth prospects or other potential catalysts. There's no magic formula; we're just looking to buy at the biggest discount to the present value of estimated cash flows, in companies with the most shareholder-focused management possible.

I would add that we try not to get overly fancy in our modeling of cash flows. We make as few assumptions as possible and leave plenty of room for error. If you change just a few numbers in a massive DCF model, you can dramatically skew the results. That's why you see stocks like Whole Foods Market [WFMI] get absolutely hammered when people change their growth assumptions a few percentage points. In many cases the fundamental business hasn't really changed that much.

Those types of overreactions are one of the main reasons something gets cheap enough for us to buy. Another reason is when we think there's just a fundamental misunderstanding of a business or its growth prospects. I can't speak in detail about it here, but we own 4 Kids Entertainment [KDE], which licenses and produces a broad range of children's products under brand names like Yu-Gi-Oh, Teenage Mutant Ninja Turtles and Cabbage Patch Kids. They have $120 million in net cash and a property in development – which the market isn't yet ascribing value to – that we believe could increase shareholder value dramatically.

ON COMPLICATED MODELING:

Stocks get hammered when growth assumptions change slightly – a key reason things get cheap enough to buy.

You've had success investing in convertible bonds – what appeals to you about that as an asset class?

AL: It's rare to find good opportunities, but converts can be ideal investments for us. We have more protection of capital, a high rate of return in what we think would be the worst-case scenario and a big upside potential if things go the way we expect. For example, we bought converts of BioMarin Pharmaceutical when the stock was at $4 and the bonds were trading with a yield to maturity of around 10%. We thought cash flow from the company's already-approved products more than protected the convertible in the worst-case scenario, so we'd at least get our 10% yield. But we also thought there were products in the pipeline that had great potential, though the risk was high enough that we didn't want to buy the stock. Things worked out very much as we'd hoped and we sold the bonds at a nice premium when the stock was trading north of $15.

Tell us about one of your stock ideas, Noven Pharmaceuticals [NOVN].

AL: Noven makes transdermal drug-delivery patches. Its primary business today is in the hormone replacement therapy (HRT) market, where it markets products through a 49%-owned joint venture with Novartis. This is a multi-billion market dominated by Wyeth's oral Premarin and Prempro products. Transdermal patches make up about 16% of the market, of which the Noven joint venture has captured half.

We think Noven's HRT patch will take share in what is once again a growing market. Its estrogen is the bioequivalent to a

woman's natural estrogen, while Wyeth's products are derived from the urine of pregnant horses. In addition, the Noven patch uses only 8% of the amount of drug used in Premarin and Prempro, which we think will increasingly make a big difference in the eyes of prescribing doctors.

In addition to the HRT business, Noven and Shire Pharmaceuticals recently received FDA approval for Daytrana, the first patch available for the treatment of attention deficit hyperactivity disorder (ADHD). This is a $3 billion market and Daytrana has patent protection for more than 10 years. Noven received a $50 million payment upon FDA approval and gets additional large milestone payments as sales targets are reached. It also gets an ongoing 40% gross margin on all product it supplies to Shire.

You've invested successfully in drug-delivery companies before. What do you like about the business?

AL: Drug-delivery businesses are beautiful because partners will often pay for all the development of the drugs and because a proprietary technology can be leveraged over and over. Also, with pharmaceutical companies losing patents and facing generic competition, there's a lot of demand from them to try to extend lifecycles by differentiating products through things like how a drug is delivered.

What are the advantages of transdermal patches?

AL: Patches have many benefits over pills or injectable drugs, including increased patient compliance and convenience, steady delivery levels and the ability to introduce less drug into the body for the same efficacy.

Specific to Noven, its translucent patches are less than 1/3 the size of competing products, provide better adhesion with less irritation and allow for the use of even less drug than other patches. Their technology also allows patch versions of drugs that would otherwise not fit into an acceptable patch size. Daytrana patches, for example, would be bigger than a compact disk if they were formulated using the competition's technology. Noven has also been able to squeeze therapeutic doses of two drugs, such as estrogen and progestin, into a patch no bigger than one containing one drug.

How strong is Noven's intellectual-property protection?

AL: We think it's very strong. The key components of their "DOT Matrix" technology are patented through at least 2014. The company has also developed what it believes will be the next patentable generation of the technology, which further expands the number of molecules it can deliver transdermally.

Is a big part of your bet here on the product pipeline?

AL: Yes. The company has identified more than 35 compounds that it believes can be delivered using its technology, across a wide range of markets, including hypertension, anxiety, Alzheimer's, sexual-desire disorder and pain-relief. They are pursuing their own proprietary products as well as collaborating with existing partners and new ones, like Procter & Gamble and Endo Pharmaceuticals.

INVESTMENT SNAPSHOT

Noven Pharmaceuticals
(Nasdaq: NOVN)

Business: Development, manufacture and marketing of transdermal drug delivery technologies and – by itself and with partners – prescription transdermal products.

Share Information
(@4/27/07):

Price	**23.91**
52-Week Range	16.30 – 27.80
Dividend Yield	0.0%
Market Cap	$592.0 million

Financials (TTM):

Revenue	$60.7 million
Operating Profit Margin	(-13.6%)
Net Profit Margin	26.3%

Valuation Metrics
(Current Price vs. TTM):

	NOVN	S&P 500
P/E	36.6	20.5
P/CF	29.0	15.2

Largest Institutional Owners
(@12/31/06):

Company	% Owned
O.S.S. Capital	6.0%
T. Rowe Price	5.9%
Barclays Global Inv	5.7%
West Coast Asset Mgmt	5.6%
BlackRock Advisors	4.9%

Short Interest (@ 3/12/07):

Shares Short/Float	10.7%

THE BOTTOM LINE

Atticus Lowe believes the company's transdermal patch technology will have numerous new-product applications as pharmaceutical companies look to extend product lifecycles. Based on a sum-of-the-parts analysis of existing and potential new products, he believes the shares are worth at least 30% more than today's $24 price.

Sources: Company reports, other publicly available information

Any pipeline is difficult to value, but it's a bit less subjective here because the new products typically involve drugs that are already proven to work. That takes the biggest risk out of the equation and lessens the time to market.

With the stock currently trading around $24, how are you valuing the business?

AL: Because Noven accounts for its joint venture with Novartis under the equity method, the revenues and profits from it aren't in operating income, which confuses many investors at first glance. In 2006, Noven's pre-tax share of the profits was $46 million, which we expect to grow at least 10% per year. We conservatively ascribe a present value of around $300 million to Noven's share of this business.

The manufacturing relationship and additional milestones from the new Daytrana product is worth another $95 million, while the company also has approximately $180 million in net cash and equivalents. That leaves the pipeline, which we've analyzed in great detail and think can generate cash flows worth a minimum of $200 million in present value.

Add it all up and we believe the shares have an intrinsic value 30% above today's current market capitalization of around $600 million. The wildcard, of course, is the value of the pipeline, which could eventually be worth many multiples of what we've assumed.

It's interesting that Goldman Sachs just reported a new 10.6% ownership stake. We think Noven is a logical acquisition candidate – several large companies would love to employ its technology across their existing portfolios – though we wouldn't expect anything to happen until more of the pipeline materializes.

Your next healthcare idea, Angiotech Pharmaceuticals [ANPI], is surrounded by some controversy.

AL: Angiotech was originally a pure play on Boston Scientific's paclitaxel-eluting Taxus coronary stent, on which it receives a net royalty of about 6% from licensing its coating technology. As a first step toward diversification, the company last year paid $785 million to buy American Medical Instruments, which sells more than 5,000 products, including things like biopsy needles, surgical knives and sutures. These tend to be high-margin niche products that don't attract a lot of competition.

The company is currently surrounded by an extreme amount of negative sentiment relating to Taxus stents, which we think is ultimately not a big part of its business. A new coronary stent from Abbott Laboratories, which uses a different coating than Angiotech's, is coming out soon and their studies to date have shown it to be more effective in certain applications than the Taxus stent. While the market responded as if that was the end of the story, there is still a huge body of data that supports the efficacy of the Taxus product.

Isn't the efficacy of coronary stents in general under some question?

AL: Yes, but again we believe the market is overreacting to still inconclusive and conflicting evidence. People may use the Taxus stent less in the future, but our research indicates that the product is completely viable and will be in the market for a long time. We estimate the dis-

INVESTMENT SNAPSHOT

Angiotech Pharmaceuticals
(Nasdaq: ANPI)

Business: Development and sale of technologies that improve the performance of medical devices. Also makes and markets its own specialty medical devices.

Share Information
(@4/27/07):

Price	**5.66**
52-Week Range	5.28 – 15.37
Dividend Yield	0.0%
Market Cap	$481.0 million

Financials (TTM):

Revenue	$315.1 million
Operating Profit Margin	19.4%
Net Profit Margin	1.5%

Valuation Metrics
(Current Price vs. TTM):

	ANPI	S&P 500
P/E	40.8	20.5
P/CF	9.2	15.2

Largest Institutional Owners
(@12/31/06):

Company	% Owned
Natcan Inv Mgmt	10.7%
Letko, Brosseau & Assoc	7.9%
I.G. Inv Mgmt	6.3%
Legg Mason	4.9%
Blackrock Inv Mgmt	3.5%

Short Interest (@ 3/12/07):

Shares Short/Float	n/a

THE BOTTOM LINE

As the market overreacts to concerns about the Taxus coronary stents on which the company earns royalties, says Atticus Lowe, it is also ignoring dramatic growth prospects. Ongoing business lines warrant a share price 35% higher than today's and Angiotech's new-product pipeline could be worth "multiples" of that, he says.

Sources: Company reports, other publicly available information

counted net present value of stent royalties to Angiotech at $350 million, which we think is conservative given that the net after-tax royalty from Taxus sales in 2006 was over $100 million.

Why do you consider that "ultimately not a big part" of the business?

AL: Because of the growth prospects in the American Medical Instruments' business and from a tremendously robust new-product pipeline.

The AMI business should generate EBITDA of $55 million this year and we think they have considerable potential to expand sales through product improvements using Angiotech's technology. For example, they're applying "echo coating" technology to biopsy needles, which allows the needles to be seen in ultrasound imaging. This is a clear improvement over competing products, which should result in significantly increased market share – at 90% gross margins – in a $200-million market.

Another exciting product AMI has is called the quill, which is a knotless suture. Each stitch has little microquills going in opposite directions which allow the stitch to go in smoothly, but not move in the opposite direction. It saves doctors valuable time and improves aesthetics, while resulting in a suture that holds more strongly than a staple. The suture market is a multi-billion-dollar one and they have real potential to take share with this product, given that they already have an inroad from an existing AMI business.

Overall, we see AMI's EBITDA growing at least 10-15% per year, perhaps much more. At the multiple of EBITDA at which comparable businesses trade – around 14.5x – we value the AMI business at around $800 million.

Your values for the stent and AMI businesses exceed the company's $850 million enterprise value by 35%. What upside do you see from the product pipeline?

AL: We actually believe Angiotech's pipeline is by itself worth multiples of the company's current equity value. They have more than 10 products in the pipeline with $1 billion-plus sales potential, each having a good chance of success. So at the current share price of around $5.70, there's just a huge gap here between what we think the company is worth and its market value.

The closest-to-market product in the pipeline is called vascular wrap. For patients suffering from peripheral vascular disease and hemodialysis, a graft is used to bridge the arteries, resulting in a lot of scarring and patient discomfort. Angiotech's wrap, coated with paclitaxel, is placed around the graft and has been shown to improve healing and dramatically reduce scarring. It's gone through pivotal trials in Europe with great success and we think this is a shoo-in for approval, providing annual sales potential for the company of at least $500 million.

Another highly promising product would allow steroid injections directly into joints, with the same efficacy but using only one-tenth the amount of steroid used in traditional cortisone shots. If they can reduce the amount of drug and take away the side effects, usage of this product would be extremely high.

We don't think it's a stretch to imagine Angiotech as a major medical-device player in the next five years, in the league of a company like Boston Scientific.

ON ANGIOTECH'S FUTURE:

We actually believe the new-product pipeline is by itself worth multiples of the company's current equity value.

Why is Contango Oil & Gas [MCF] one of your top energy picks?

AL: We first came across Contango in 2002 at an investor conference and were stunned by how differently Ken Peak, the CEO, talked about running his business. He owns 13% of the shares and comes at it completely from a shareholder's perspective. He sees his job as allocating capital, leaving the operations to others.

The company is entirely opportunistic, with development assets focused in the Gulf of Mexico and the Fayetteville Shale in Arkansas. Ken a few years ago attracted two first-class development people to generate prospects in the Gulf of Mexico in exchange for a small overriding royalty interest on each successful project. He built them a state-of-the-art, 3-D seismic lab and two of the first four wells Contango drilled in the Gulf were significant discoveries. The fifth and sixth wells, completed in the past six months, were enormous successes – an independent engineer the company hired estimates these two wells alone have total proven and probable natural-gas reserves of 123 billion cubic feet equivalent, net to Contango, which will likely prove conservative as development drilling continues.

The Fayetteville Shale is a natural-gas bearing Mississippian-aged shale, several hundred feet thick at a depth of approximately 5,000 feet. The company controls 44,000 gross acres in the sweet spot of the shale with its partner Alta Resources, in which Contango has a 70% working interest.

They also own a 10% interest in a Freeport, Texas liquid-natural-gas facility that goes online in January of next year. ConocoPhillips and Dow Chemical have contracted the existing capacity and each guarantees delivery of gas through take-or-pay arrangements. The entire facility is financed with debt that is non-recourse to Contango.

The current operating financial metrics of Contango are dramatically bad. Why?

AL: The Gulf and Fayetteville developments are recent, so they're just starting to get cash flow from those. Any historical numbers have only costs from those efforts and little revenues. That's probably a big reason people are ignoring the stock – cash flow will look dramatically different a year from now.

How do you value Contango's shares, which currently trade at just over $30?

AL: This is one of those cases where no analyst covers the stock and we think the market just doesn't have any idea of the assets the company has.

Using $6.50 [per million cubic feet] natural-gas prices – well below current NYMEX strip prices of around $8.50 – we put a risked present value of approximately $500 million on Contango's share of the current proven and probable Gulf of Mexico reserves. That's around $31 per share.

For the Fayetteville shale reserves, making conservative assumptions that 75% of the acreage is drillable, 50-acre well spacing is utilized, drilling and completion costs are $2.5 million per well, 1.8 billion cubic feet of natural gas is recovered per well and that it takes Contango 12 years to drill its 660 locations, we estimate Contango's interest is worth another $32 per share.

Based on initial capacity, the Freeport natural-gas facility is expected to generate approximately $7.5 million in annual EBITDA for Contango, which we're valuing at $75 million – about $4.70 per share – including the potential for future expansion.

Finally, the company has other oil and gas assets, including venture capital investments in alternative energy, which we value at another $2 per share. All in, we believe Contango is worth around $70 per share. And that ascribes no value to an additional 100,000 net acres the company has offshore in the Gulf of Mexico, which we believe has tremendous future option value.

If the market doesn't recognize this value, we think Ken won't hesitate to sell particular assets or the entire company to those who will.

Risks?

AL: There's always hurricane risk in the Gulf of Mexico, but it's manageable here because the wells are located close to shore and there won't be that many of them. The properties will also be insured.

There's some risk that natural gas prices collapse, but we think the supply would adjust relatively quickly if prices got much below our price estimates for the future, which would have a stabilizing effect.

Your last idea, National Home Health Care [NHHC], is a quirky one.

AL: This is a small home healthcare provider in the northeastern U.S., serving Medicare, Medicaid and private-market patients. The company primarily provides nursing services, from monitoring to medication supervision to changing of surgical dressings. It also provides physical therapists or speech pathologists as part of a patient's convalescence. In general, home healthcare is a fast-growing sector of the market, cheaper than providing the same services elsewhere and favored by patients over hospital care.

Unlike your other healthcare ideas, this doesn't appear to have any intellectual property to speak of.

AL: It is in a competitive, service business, but the stock is so darn cheap that there's a huge margin of safety. It's a

INVESTMENT SNAPSHOT

Contango Oil & Gas
(Amex: MCF)

Business: Development, exploration and production of oil and natural gas, primarily in the Arkansas Fayetteville Shale and offshore in the Gulf of Mexico.

Share Information
(@4/27/07):

Price	**30.55**
52-Week Range	10.44 – 30.85
Dividend Yield	0.0%
Market Cap	$485.2 million

Financials (TTM):

Revenue	$2.8 million
Operating Profit Margin	(-454.3%)
Net Profit Margin	(-100.1%)

Valuation Metrics
(Current Price vs. TTM):

	MCF	S&P 500
P/E	n/a	20.5
P/CF	n/a	15.2

Largest Institutional Owners
(@12/31/06):

Company	% Owned
West Coast Asset Mgmt	10.6%
WS Capital	3.8%
Ruane, Cunniff & Co	2.9%
Bonanza Capital	2.8%
WS Venture Mgmt	2.5%

Short Interest (@ 4/10/07):

Shares Short/Float	2.3%

THE BOTTOM LINE

Through significant natural-gas discoveries and other opportunistic energy investments the company has – under Wall Street's radar – amassed valuable assets that are now poised to bear fruit, says Atticus Lowe. He believes the company's Gulf of Mexico and Fayetteville Shale reserves alone are worth more than twice today's market value.

Sources: Company reports, other publicly available information

micro-cap, with a market value of about $65 million and net cash and receivables of $36 million. Revenues are over $100 million and we expect them to generate $8 million in EBITDA this year. If you include working capital, at the current share price of $11.70 it trades at an enterprise-value-to-EBITDA multiple of only 4x, versus the average peer multiple of 8.8x. So at peer levels, the stock should trade for closer to $20 per share.

What's the problem?

AL: Management, unfortunately, is in our opinion not pursuing the best interests of shareholders. The company entered into a favorable-to-management merger agreement last November with a private-equity firm, allowing top management to back into a significant equity interest upon reaching certain milestones. They didn't adequately pursue other options and put in place an absurd breakup fee. Management controls 51% of the company and the proposed merger does not require a "majority-of-the-minority" vote from independent shareholders, which is obviously self serving. Another bidder, a nearby company, just offered $12 per share, which we assume the management group will try to beat.

Given the scenario you've described, why isn't this hopeless for shareholders looking to get involved today?

AL: We definitely don't think the story is over. The jury is still out on whether the board of directors – which in our opinion is either incompetent or unethical – will do the right thing. If the board properly shops the company, we believe it would fetch much more than the current bids. As shareholders, we intend to exercise appraisal rights and vote against any deal not at fair value. Many non-insider shareholders have publicly said the same thing.

This is a different type of investment for us, but we're very well protected on the downside and still have significant upside. The downside protection comes from a very cheap valuation, having two bidders who are willing to pay the current share price, plenty of cash on the balance sheet and a dividend yield of 2.5%.

Are you seeing any dark clouds on the horizon for the market going forward?

AL: We're certainly not alone in this, but we are worried about how an ongoing housing downturn will affect consumer spending. We also think people might be underestimating the impact on the U.S. middle class of the "flattening" of the world. Business owners are increasingly hard-pressed to keep operations in the U.S. when competitors can match their quality at better prices by producing overseas. While U.S. companies are well-equipped to adjust to that and take advantage of growth outside the U.S., we're still at the very early stages of knowing the long-term extent to which globalization will affect the incomes of many U.S. workers.

More than anything, we're focused on individual opportunities rather than reacting to bigger-picture trends. By focusing on stocks we know very well, with a high level of tangible downside protection, we've so far captured more than the market return in up markets and only 15% of the market's loss in down markets. For value investors, that's kind of what it's all about. VII

INVESTMENT SNAPSHOT

National Home Health Care
(Nasdaq: NHHC)

Business: Provider of home healthcare services such as patient monitoring, medication administration and physical therapy, primarily in the northeastern U.S.

Share Information
(@4/27/07):

Price	**11.66**
52-Week Range	8.80 – 14.05
Dividend Yield	2.6%
Market Cap	$66.0 million

Financials (TTM):

Revenue	$104.1 million
Operating Profit Margin	6.2%
Net Profit Margin	3.6%

Valuation Metrics
(Current Price vs. TTM):

	NHHC	S&P 500
P/E	18.0	20.5
P/CF	14.2	15.2

Largest Institutional Owners
(@12/31/06):

Company	% Owned
Heartland Advisors	7.8%
West Coast Asset Mgmt	3.8%
Dimensional Fund Adv	3.7%
Bank of New York	1.2%
Overbrook Mgmt	1.2%

Short Interest (@ 3/12/07):

Shares Short/Float	n/a

THE BOTTOM LINE

The company's 4x EV/EBITDA multiple is significantly lower than the average valuation given to peers, says Atticus Lowe, because "management is not pursuing the best interests of shareholders." If the company were sold after a fully competitive bidding process, he believes the shares would be worth closer to $20.

Sources: Company reports, other publicly available information