



OAK VALUE CAPITAL MANAGEMENT, INC.

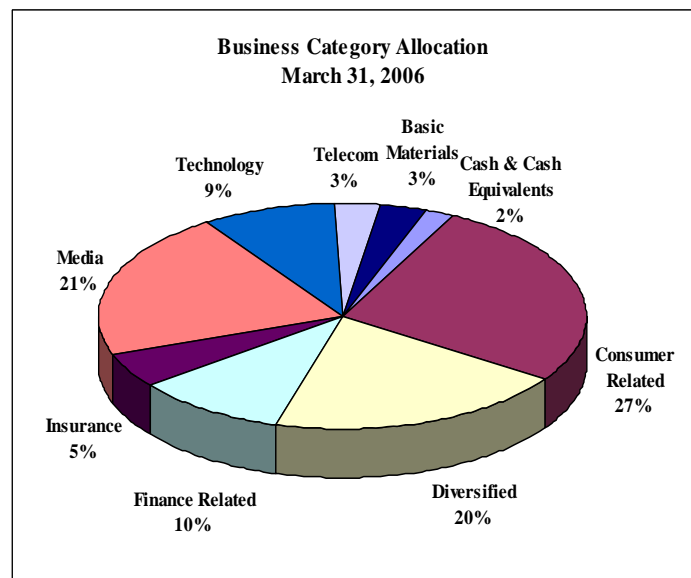
Portfolio Commentary – First Quarter 2006

OVERVIEW AND CONTEXT

In February we wrote in a somewhat sober fashion about client portfolio performance during the fourth quarter and for the calendar year which had just ended. The factors which contributed to that outcome generally persisted through the first quarter of 2006. We recently used the “better game than the score shows” expression to reflect our confidence in the work that is taking place and the opportunities which are arising as a result thereof. The progress which we referenced in this regard is even more reinforced as we write today.

While the S&P 500 advanced more than four percent during the quarter, client portfolios remained essentially unchanged, posting a fractional loss for the period. Weighing most heavily on portfolio performance was an overweighting (and underperformance) in media holdings. The overweighting in an industry that has historically generated higher returns on capital (media), while being underweight in an industry that has historically generated lower returns on capital (energy), has contributed to an extended period of underperformance. This situation (i.e. overweight media and underweight energy) is not new to client portfolios. As technology evolves, so does the value it brings to consumers. We remain finely focused on the impact that changes in technology and in consumer behavior have on the business models of all of the portfolio companies. In the case of portfolio media companies, we continue to reflect a healthy respect for the impact that such evolution might have on their long-term business models and the economics that result. We continue to believe, based on the underlying economics of these businesses and the franchises they represent, that we will be duly rewarded for taking this economically attractive high road. Though the lagging portfolio performance during the first quarter is most significantly attributed to the underperformance of the broad media exposure within the portfolio, there were several individual securities which also played a role in the period’s outcome. Among them were E. W. Scripps, Constellation Brands, Willis Holdings, Tyco and Cendant. On the positive side, Diageo, Berkshire Hathaway, Cadbury Schweppes, IMS Health and Masco made the more relevant contributions.

In client portfolios, 11 holdings have been added within the past 18 months. Collectively, these companies now represent nearly 40 percent of overall client portfolio weightings. Additionally, it is reasonable to expect that these and similar businesses will likely represent an even greater percentage of client portfolios in the coming months as the challenging environment in which we operate has presented our team with what we believe to be a historically distinctive set of opportunities. The metrics which surround this collection of businesses are clearly reflective of the characteristics we define as “good businesses” while the current market environment has made them available at “attractive prices”. In many cases, these businesses have replaced good but somewhat challenged companies as we have used this window of opportunity to position client portfolios for what we believe to be the most attractive risk/reward profile.



PORTFOLIO UPDATE

We have long declared our preference for owning “good businesses with good management at attractive prices.” This philosophical foundation often leads us to a noticeably different investment universe than is likely to be pursued by the traditional value investor. History has demonstrated that we are much better at predicting the extent to which the market is inappropriately pricing the short term challenges of a good business than we are at predicting that a disadvantaged business will be less disadvantaged in the future. Our propensity is to sell businesses that we believe have deteriorating franchises or long term challenges. This is often a difficult decision, particularly when it can be argued that their share prices have adjusted sufficiently to compensate for the revised outlook.

Purchases

During the most recent quarter, we added two new holdings to client portfolios – Masco and Oracle. Oracle is the world’s largest provider of enterprise software and Masco is the largest manufacturer of faucets and cabinets in the US. Indeed, these are two very different businesses. Both have demonstrated an ability to produce predictable growing excess cash flow while their management teams have allocated this cash flow to the benefit of shareholders in the form of business investments, acquisitions, share repurchases and/or dividends. As

value investors, we face an encouraging environment when we can purchase shares of the largest manufacturer of cabinets and the largest provider of database software at essentially the same time for effectively the same margin of safety. The history of our research of these businesses and the industries in which they operate is long and our understanding of their business models is deep. We believe these investments fit clearly within our definition of “*good businesses with good management at attractive prices.*”

1Q 2006 Client Portfolio Activity Summary	
New Positions	Eliminated Positions
Oracle Masco	Boston Scientific Zale Cendant Fidelity National Information (formerly Certegy)
Note: Not all positions may have been owned and/or sold in all client accounts.	

“FOR SALE”

In the midst of the market mania of 2000 when any company related to “technology” traded at, in our opinion, an absurd valuation, we published a White Paper titled *To B2B – Evolutionary Thoughts of a Value Investment Manager* in April 2000. We have included an excerpt from this document herein to bring some longer term perspective to our recent investment in the shares of Oracle.

“There are exciting things going on today. Some of those things are not, in our humble opinion, nearly exciting enough to justify the prices being paid for certain stocks, but the businesses are interesting nonetheless, and they create market dynamics of which we need to be aware. It would be foolhardy for us not to acknowledge the reality and magnitude of the changes occurring and at least have a look. We are handicapped by neither intellectual capital nor capacity, and we don't believe it's a ‘never trust anyone over thirty’ market where only young tech types will be rewarded with extraordinary insight. Many newer, shorter-memored investors have been wildly rewarded up to now for the absence of any sense of fear about markets. We are certain that set of circumstances will not persist forever, and that a shift from emotional drivers of valuation to logical ones may prove painful for some.

Yet we also recognize that a cavalier dismissal of technology companies as fads, without truly peeling back the covers and seeing the real story and ‘doing the math’ for ourselves would be a grave disservice to our clients and ourselves. The willingness to investigate, rather than simply pontificate and castigate, is (we humbly submit) what we believe separates us from the ‘typical’ value investor.

Our attraction has always been to great businesses which:

- *Have franchises somehow protected from the vagaries of competition,*
- *Produce predictable, growing excess cash flow beyond that needed to maintain the business, that*
- *Are shepherded intelligently, by honest management, and*
- *May be purchased at a discount from the rationally determined present value of the future (reasonably expected) cash flows.*

If we can find those aspects in an investment, we care little for the industry identifier it carries; history indicates that superior businesses can be identified and that the virtue of patience nearly always makes them available at a sensible price, sooner or later. We expect technology companies to be no exception to this pattern.

We recognize that some ‘value puritans’ may accuse us of trying to ‘get a little bit pregnant’ by even looking at technology. Our initial investigations into the technology area have indicated that while pricing may have become challenging to say the least (in certain examples quite absurd to say the most) there are in fact viable business models that are worth a second and perhaps a third look. Our preparation in the form of research done now is predicated on the belief that one never knows when the proverbial ‘FOR SALE’ sign will be posted for some of those businesses at stock prices worth paying.”

Oracle

Since the publishing of this White Paper, we have continued our research and analysis of the set of businesses broadly referenced therein. We have certainly owned a few companies on behalf of clients which were arguably along the fringe of this universe, but none has been so squarely in the sights of these projections than that of our recent purchase of Oracle. In our opinion, the “FOR SALE” sign was placed out front during the recent quarter. With a number one position in database software and a number two position in applications software, database license and maintenance revenues now represent approximately 60% of total revenues for the company. Oracle has continued to improve during the nearly six years since we originally published the above excerpt, while its share price has declined from \$60 to the recent levels approximately 80 percent lower. The key components of our investment thesis for this specific company are summarized in the following points:

- ***Growing Recurring Revenue Stream*** – With the purchase of a software license, customers typically purchase annual maintenance service contracts which include updates, fixes and security patches. As such, customers renew those contracts for as long as they operate the software. Consequently, renewal rates for the industry are very high. High switching costs and potential business interruptions typically result in long term relationships. Maintenance revenues represent a high margin recurring revenue stream. This profitable, predictable high return on capital portion of Oracle’s business currently represents nearly half of the company’s revenues. In our opinion, the growth of maintenance revenues as a percentage of total revenues also reduces Oracle’s exposure to new technology spending volatility. Maintenance is built into customer’s spending baselines, whereas new licenses may be viewed as discretionary spending items. We believe this transition in the revenue and profit models of Oracle is supportive of our conclusion that this business is characteristic of that which we view as a “good business.”
- ***Broadened Product Offering*** – Oracle has the ability to provide a complete, integrated solution to large enterprises – database, middleware and applications. Our contacts indicate that Oracle’s “software stack” is increasingly important to customers and that the company has a clear competitive advantage in this regard. IBM offers database and middleware but not applications, while Microsoft offers all three but its applications are typically installed at small to medium sized businesses and work only with its own products. SAP does not offer a database or a broad middleware product. The ability to more closely integrate the “stack” provides Oracle the opportunity to sell more of its database and middleware product along with its applications.

- **Enterprise Application Opportunity** – While PeopleSoft and Siebel (both acquired by Oracle) offered leading products within their particular enterprise function (HR and CRM), their standalone applications were often disadvantaged when competing with SAP. We believe the combined corporate scale and integrated technological architecture Oracle brings to these acquired products should place their applications in a more competitive position. Importantly, Oracle is working to combine the best functionality of each application into a unified enterprise application offering that can be purchased whole or in distinct pieces linked by a common architecture. This will allow Oracle to increase its competitiveness as the number two vendor in enterprise applications.
- **Strong Distribution Platform** – Oracle has historically been known for its strong presence in sales and marketing which allowed the company to overtake IBM in market share in the early stages of the development of the database market. Now, as corporations reduce the number of vendors with whom they do business and limit their technology platforms, Oracle is in position to acquire promising technologies and push them through its distribution to help them gain widespread acceptance. Strong distribution also prevents new entrants from widespread dissemination of their products.
- **Demonstrated Management Execution** – Oracle management, led by founder Larry Ellison, has effectively broadened its product offering, strengthened its franchise, improved its economics and allocated capital. Consequently, we believe the under-appreciation of these achievements has afforded us the opportunity to purchase shares in client portfolios in a business with respectable growth prospects, improving margins, significant excess cash flow generation and a defined, defensible franchise.
- **Attractive Valuation** – Typical of our valuation philosophy, we have considered multiple scenarios with regard to the potential business environments in which Oracle may reasonably operate in the upcoming years. We remain steadfast in our belief that the long-term intrinsic value of a business, any business, is a function of cash flows that such a business will generate in the future. Our use of multiple scenarios which reflect not only a range of likely businesses outcomes, but also a range of what we believe to be prudent terminal multiples has served us well through the years. The application of this methodology as supported by our ongoing due diligence effort led us to conclude that the margin of safety recently afforded us as *value investors* was compelling, in the case of Oracle. In our experience, this methodology works best when applied to “good businesses with good management.” On this one, we believe we have checked the list!

Masco

Though the “Tale” of our recent investment in Masco may not be so easily traced to our writings of prior years, the actual process which led to its recent addition to client portfolios is equally reflective of the long term benefits of our efforts. Our initial work on this company dates back nearly a decade to a time when the company’s management had taken on a long and seemingly successful period of acquisitions in businesses ranging from automobile components to furniture. The result of this activity was a conglomeration of businesses which provided few if any synergistic benefits. Beginning in the 1990’s, the company began to focus on building products and supplies. In 2002 Masco narrowed its concentration to certain parts of the home building and home repair value chain. While exposed to new home unit starts, 60% of the company’s revenues are derived from consumers remodeling or maintaining their homes in one fashion or another. The company’s operating model requires that products must either be predominantly manufactured in the United States because of process/weight restrictions on importing or have such strong brand names (plumbing) that import supplies can be used to gain a cost advantage.

Masco entered the Contractor Services businesses in the 1990’s and has grown through acquisitions to become the only national provider of installation services to large homebuilders and is the largest installer of insulation in North America. The company claims that its products and services are currently utilized in approximately 50% of the new homes constructed in the United States. Our investment thesis in this very good collection of businesses is based on the following key points:

- **Strong Brands** – According to the company, 92% of its product sales are derived from the sale of products which are number one or number two in their categories. With recognizable brands such as Delta, Peerless,

KraftMaid, Behr and Kilz, Masco is able to drive consumer traffic and volumes at the retail, remodel and new home builder levels.

- **Focused Strategy** – After spending \$10 billion on acquisitions from 1997 to 2002 which provided critical scale with its customers, Masco has spent the past three years focusing on key platforms around products that are either brand dependent (plumbing fixtures, cabinets) and/or shielded from import competition (paint, cabinets, windows). The company has exited categories where it is not a leader or where the products do not fit squarely within the home building and remodeling value chain (locks, door hardware). In addition, the company has undertaken a significant simplification of its business, reducing the number of operating units from over 60 in 2002 to fewer than 40 today.
- **Favorable Remodeling Trends** – 60% of Masco's sales are tied to remodeling and repair of existing homes. According to industry studies, 24% of the estimated \$200 billion retail spending on remodeling is spent on maintenance and refurbishment, and most of these expenditures are discretionary. Refurbishment expenses are expected to increase as the percentage of homes that are greater than 25 years old increases from 68% of homes (at 2003) to 75% by 2013. Homes at least 25 years old are most likely to have major renovations, with kitchen and bath remodeling among the most popular categories.
- **Channel Consolidation Opportunity** – Masco has specifically targeted its business to serve the consolidating Do-It-Yourself (DIY) retail channel and national homebuilders. Big box home improvement retailers now control more than 50% of the market and Masco is a large supplier to this channel. The top twenty homebuilders have expanded their market share in terms of units from less than 11% in 1992 to 27% in 2004. National builders believe that in a slowdown of new home sales, they will be able to significantly increase their market share due to their access to land and geographic diversity. Masco, through its strong product line up and contractor services division is positioned as a key vendor to these builders and now has national sourcing contracts with five of the top ten builders.
- **Experienced Management** – Richard Manoogian has been with the company since 1958 and has held the position of Chief Executive since 1985. Other operating managers have extensive tenure with the company and within the particular segments for which they are responsible. Many of these managers were brought to the company through acquisitions and Masco has been able to retain them. Consequently, the company appears to have significant management depth throughout the organization.
- **Increasing Return-of-Capital and Return on Capital** – Masco has committed to returning at least \$1 billion to its shareholders each year through a combination of share repurchases and dividends and did so in 2004 and 2005. In addition, management has focused reporting and compensation practices on return on invested capital (ROIC) – The company has a stated goal of reaching a ROIC of 15% in 2006 and 18% by 2010. As a point of comparison, ROIC in 2003 was 11.3% and has increased every year since then. We believe the management of Masco has successfully transitioned the product offerings, business model and resulting economics of this business from one that was traditionally viewed as highly cyclical to a more predictable and sustainable business.
- **Attractive Valuation** - Classic to our search for good businesses with good management at attractive prices, Masco shares have recently retreated as concerns of an imminent slowdown in new home construction and increases in commodity input prices have given investors reason for near-term pause. Our investment case for this company assumes that there will be a slowdown in new home construction and that commodity prices are likely to remain at recently increased levels. Balancing these broadly held concerns is our expectation that the mix of business that is dependent on remodeling and repair will provide a base of support to the revenue case and that recently taken product price increases will catch up with the commodity input squeeze experienced in the gross margin line. In the face of these headwinds, the company has continued to generate significant excess cash flow and has effectively delivered a significant portion of that cash to its shareholders in the form of share repurchases and dividends. We expect this trend to continue.

Sales

We eliminated four client portfolio holdings during the quarter - **Zale Corp.**, **Cendant**, **Boston Scientific** and **Fidelity National Information Services** (formerly Certegy). Though Zale and Cendant have been positive long term contributors to performance, they have clearly weighed on overall client portfolio performance in recent periods as the challenges they faced on a short term basis were reflected in their share prices. We eliminated these holdings from portfolios during the quarter as management changes and evolving business fundamentals led us to conclude that the investment cases on which we had originally purchased these stocks no longer applied. In a nutshell, while these may still be good businesses, we believe their futures are less predictable and their valuations less definable.

In the case of Boston Scientific (BSX), the highly dilutive purchase of Guidant resulted in a “change in fundamentals” from our standpoint. We remain attracted to BSX’s medical device business, but believe that the price paid and the related execution uncertainties surrounding the Guidant acquisition are a clear departure from our investment thesis. BSX’s base business is one of a leading market share, high returns on capital, and significant cash flow generation. In effect, the margin of safety represented by the valuation of initial client portfolio purchases was significantly diluted by the large and transforming acquisition. It is important to note that our exposure to this particular company never developed beyond that of an initial portfolio weighting.

Certegy was actually one of the top performance contributors to client portfolios during the 2005 calendar year. While we believe it remains a very good business with good management, the combination of a higher valuation and increased leverage from a recent merger resulted in our conclusion that the risk/reward profile of this investment no longer warranted an allocation of client capital.

Top Ten Holdings As of March 31, 2006		
Company	Primary Business	S&P Sector
AFLAC	Supplemental Health & Life Insurance	Financial
Berkshire Hathaway	Insurance, Reinsurance & Capital Allocation	Financial
Cadbury Schweppes PLC	Int'l Confectionery & Beverages Manufacturer / Licensor	Consumer Staples
Constellation Brands	Wine, Beer & Spirits Production / Distribution	Consumer Staples
Diageo PLC	Global Premium Alcohol Business	Consumer Staples
E.W. Scripps	Entertainment & Information / Media	Consumer Discretionary
IMS Health	Information Solutions to Pharmaceutical/Healthcare Industry	Healthcare
Time Warner	Entertainment & Information / Media	Consumer Discretionary
United Technologies	Diversified Manufacturing and Service	Industrials
Willis Group Holdings	Global Insurance Brokerage	Financial

Five Largest Holdings Update

In general, seasoned client portfolios held positions in 21 companies at the end of the quarter, of which 11 have been added within the past 18 months, as noted above. As bottom up investors searching for businesses which meet the prerequisites we have established, we could have predicted neither the pace nor the magnitude of activity. Though we do believe that these holdings should be viewed as “seeds” for future returns, the recent performance of client portfolios continued to be driven by the impact of the largest portfolio weightings. Of the top five portfolio holdings, all have been around for years.

Berkshire Hathaway

The recent business progress at this fine company continues to confirm our thesis regarding the business model and the management execution thereof. During the most recently reported quarter, Berkshire’s insurance businesses posted a slight underwriting profit. As the primary source of capital, in the form of “float”, this underwriting profit

is essentially a negative cost source of funds. Likewise, the ever-growing portfolio of wholly owned businesses grew both organically as well as through acquisitions. On the acquisition front, Berkshire's Mid-America purchase of PacifiCorp closed during the quarter. Finally, the company provided an update on the issue of succession for Mr. Buffett. Though they stopped shy of actually releasing the name of the individual that would assume the helm, the mere fact that the Board has worked through the process to consider the alternatives and has agreed upon a plan of action in the event of Mr. Buffett's passing is clearly in the interest of all Berkshire shareholders. Meanwhile, our investment thesis in Berkshire Hathaway continues to be grounded in the firm belief that this holding clearly represents a "good business with good management" still available at an attractive price.

E. W. Scripps

As we reflect on the recent tenth anniversary of our early purchases of shares of E. W. Scripps on behalf of clients, we are reminded of the original thesis of this investment. At that time, the company management had made the strategic decision to leverage its position in traditional media businesses into a series of investments in emerging media opportunities. The most significant such opportunity in those early days was that of "category cable television", specifically, Home and Garden Television (HGTV). Today, the gentleman who led this charge into new media for Scripps serves as the company's Chief Executive and continues along that same strategic mantra. Scripps' cable television businesses have "emerged" and now represent a greater percentage of the company's profitability than the traditional television and newspaper businesses. Shares of Scripps were among the greatest detractors from client portfolio performance during the first quarter as continued strength in its cable networks was overshadowed by investor concerns about the apparent decline in value of newspaper businesses. This concern was fueled by the disappointing valuation received by one of the newspaper industry's largest participants in its attempt to realize value for its shareholders. We were not surprised by the valuation received in this transaction. Furthermore, we have anticipated the decline in the long term value of the traditional newspaper businesses. Such is in part the basis for our long term support of the Scripps management team allocating its excess cash flow to higher return, higher growth media businesses.

Constellation Brands

Constellation shares experienced a bit of a pullback during the first quarter after having been one of the primary positive contributors to performance during the 2005 calendar year. The pullback is largely explained by the ongoing debate as to whether the company can continue to meet its growth targets via accretive acquisitions. The string of Constellation's successfully executed acquisitions which have served to provide leverage of the existing distribution system as well as geographic and product diversification is impressive. Recent transactions fitting this description include BRL Hardy and Mondavi. Late last year, Constellation made an unsolicited bid for Vincor, a Canadian wine producer, which was ultimately rebuffed by the Vincor management as insufficient. Constellation shares had traded under some pressure as investors became concerned that company management might be tempted to "pay up" for this company in order to attempt to mask some presumed slowdown in its existing businesses. We were not surprised when Richard Sands and his management team walked away and exercised pricing discipline with regard to this potential deal. Though the shares of Constellation did recover somewhat during the quarter, lingering concerns about the company's long term growth continued to weigh on the shares during the quarter. Early in April, after the close of the quarter, the company announced that it had come to an agreement to purchase Vincor at a price which we believe is reasonably within the range of fair to slightly accretive. We acknowledge the risks associated inherent in any long term business strategy which involves acquisitions as a primary vehicle for growth. While our comfort with this management team is high and our respect for its strategy of leveraging the route to market is healthy, our analysis of this holding with a critical eye is ongoing. At recent valuations, we continue to believe the risk/reward profile of this holding justifies the current capital allocation within client accounts.

Cadbury Schweppes

A couple of years ago, we added Cadbury Schweppes to client portfolios and have selectively increased that exposure through the periods since. Cadbury's position within the ranks of our client portfolios' largest holdings is a result of purchases as well as appreciation in the shares. During the most recent quarter, Cadbury further demonstrated its intention to divest businesses and facilities that are not core to its confections and beverage

strategy. These resources were allocated to debt repayment and investments in its core businesses. Specific transactions announced recently included the sale of Grandma's Molasses and Bromor. The company also announced an investment in expanded gum capacity in Mexico, increased its stake in Turkish gum producer, Kent, and moved to further strengthen its African gum business. Though Cadbury shares advanced slightly more than the S&P 500 for the quarter, in our opinion the valuation disparity between this company and its peer group remains.

IMS Health

The disparity between the diminished outlook of many of IMS's customers and the underlying fundamentals of its core businesses persisted during the quarter. The management of this high return business acted accordingly, and in the interest of its shareholders, by advancing its share repurchase plan. Shares ultimately rallied during the period as investors began to turn their attention from the failed transaction toward the underlying fundamentals of the businesses. Subsequent to quarter end, IMS has released earnings which clearly demonstrate that the operating management was not distracted by the potential acquisition. Our belief that IMS's products will play a critical role in helping its clients more effectively allocate resources was again affirmed by these results.

CONCLUSION

In investments, it is important to remember that activity is not necessarily related to nor a predictor of results. Ultimately, the proof is in the results. We have now been at this task for nearly twenty years and have, from a market perspective, experienced many "seasons" while remaining steadfast from a philosophical standpoint. Periods of opportunity are seldom aligned with periods of great results. Furthermore, the basic characteristics of our clients' portfolios are seldom aligned with broader "benchmarks". Such periods of misalignment have often provided opportunity for investors. In our opinion, this is one of those periods.

Finally, we remain committed to the disciplined pursuit of a proven investment philosophy. Our execution has not been and will not be perfect. Even in the midst of this current "season" in which we have found little favor in terms of portfolio performance, we are confident that our execution has and will continue to improve. We have allocated significant effort to the analysis of our historical successes and mistakes in the belief that all of these experiences can and should be instructive. Where appropriate, we have continued to fine tune the analytical process to support our goal of ever improving decision-making. We believe the net effect of this effort will be more successes and fewer mistakes.

We recently announced the appointment of Christy Phillips to the firm's Investment Committee. We view this as a very important appointment and a reflection of our ongoing commitment to a process built on fundamental research and the consistent and disciplined execution of our investment philosophy. (Further information on Christy's background, experience and responsibilities is available at www.oakvalue.com.)

First and foremost, our responsibility is that of making good investment decisions. We will continue to focus our efforts and resources toward that end.

Oak Value Capital Management, Inc. Investment Committee,

David R. Carr, Jr.

Larry D. Coats, Jr.

Matthew F. Sauer

Christy L. Phillips

IMPORTANT INFORMATION

This commentary seeks to describe Oak Value Capital Management Inc.'s ("Oak Value" or "we") current views of the market and to highlight selected activity across client accounts. Any discussion of specific securities is intended to help clients understand Oak Value's investment management style, and should not be regarded as a recommendation of any security. Where shown or quoted, recent company returns (for example calendar quarter or trailing twelve months) are stock price changes only, and reflect neither dividends nor any fees associated with an investment account managed by Oak Value.

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A full disclosure presentation for the Value Composite is available upon request by contacting a member of the Marketing Department at Oak Value at (919) 419-1900.

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