

“The Cash Value of Integrity”

July 30, 2007

Until the subprime mortgage meltdown began, it appeared as if the markets were pursuing high returns with no consideration for the flip side of Return, which is Risk. Yield spreads on junk bonds were narrower than ever; stock prices domestically and internationally were at all-time highs; and capital was available to finance any idea, good or bad – until the bubble burst.

Clearly the worm has turned. With the burgeoning correction provoked by the subprime mortgage market, investors have begun examining their risk exposure, only to find out it has been excessive. The reaction: an instantaneous flight to more stable alternatives.

Given the apparent lack of concern for risk during the first six months of the year, I decided to run a little backtest. I pulled out the study Audit Integrity had provided to Forbes Magazine (dated March 26, 2007) entitled “The 100 Most Trustworthy Companies.” The list of companies is attached.

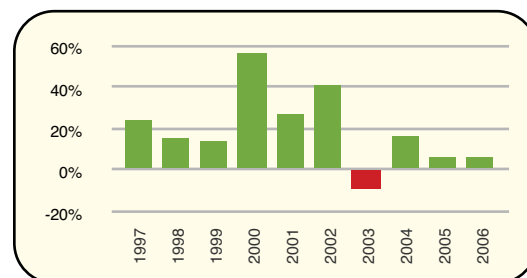
We selected these 100 companies based solely on their accounting transparency, fair governance practices, and lack of high-risk events, and the consistency of these attributes over time. No judgment was rendered in respect to the companies’ valuation or industry segment. Of over 9,000 companies evaluated, the 100 companies with the highest integrity, based on our measures, made the list.

I looked at their returns to test my theory that since high integrity is a measure of reduced risk (i.e., less uncertainty), and risk during this period was widely ignored by investors, these companies would perform no better than the overall market.

Much to my surprise, the 100 Most Trustworthy Companies had an equally weighted return of 7.25%, compared to an equally weighted Russell 2000 return of 3.18% for the six-month period ending June 30, 2007 – an excess return of over 400 basis points. Not an insignificant difference!

The fact that trustworthy companies substantially outperformed less trustworthy companies reinforces a phenomenon that we have observed over the last ten years: over time, trustworthy companies earn a return premium. This return premium has been fairly consistent, independent of market cycles (2003 being the only exception).

Return Spread by Calendar Year*



Given very recent events, it would not surprise me to see return spreads widen even further between the white hats (companies with high integrity) and black hats (companies with low integrity). We shouldn’t be surprised or disappointed if the value of integrity continues to provide a nice, steady return premium over time.

James A. Kaplan
Chairman



*Median yearly return spreads between highest rated and lowest rated companies as determined by the Audit Integrity Equity Risk Model. Returns are split and dividend adjusted, on publicly traded companies with market capitalization of \$50 million or higher.

100 Most Trustworthy Companies

Company	Ticker	Industry	Market Cap (\$mm)	6-Month % Return 1/1/07 - 6/30/07
21st Century Insurance Group	TW	Insurance (Prop. & Casualty)	1,921.15	25.71
AAON, Inc.	AAON	Misc. Capital Goods	399.288	22.039
Alberto-Culver Company	ACV	Personal & Household Prods.	2,319.35	11.103
Alexandria Real Estate Equities, Inc.	ARE	Real Estate Operations	2,922.94	-2.092
AllianceBernstein Holding LP	AB	Investment Services	7,495.00	11.168
Allied Waste Industries, Inc.	AW	Waste Management Services	5,053.97	9.52
AmSurg Corp.	AMSG	Healthcare Facilities	748.518	4.957
ATMI, Inc.	ATMI	Semiconductors	1,079.18	-1.736
Avaya Inc.	AV	Communications Equipment	7,562.16	20.458
AVX Corporation	AVX	Electronic Instr. & Controls	2,875.71	13.718
Baldor Electric Company	BEZ	Electronic Instr. & Controls	2,246.19	48.712
Bemis Company, Inc.	BMS	Containers & Packaging	3,380.50	-1.139
BJ's Wholesale Club, Inc.	BJ	Retail (Specialty)	2,391.59	15.815
Bob Evans Farms, Inc.	BOBE	Restaurants	1,304.02	8.496
BP Prudhoe Bay Royalty Trust	BPT	Misc. Financial Services	1,514.26	-0.856
Buffalo Wild Wings	BWLD	Restaurants	735.513	56.353
Capital Southwest Corporation	CSWC	Misc. Financial Services	624.411	23.555
CDI Corp.	CDI	Business Services	660.199	30.27
Charming Shoppes, Inc.	CHRS	Retail (Apparel)	1,427.53	-19.956
Computer Programs & Systems, Inc.	CPSI	Business Services	347.473	-6.666
CONN'S, INC.	CONN	Retail (Technology)	689.271	22.733
Costco Wholesale Corporation	COST	Retail (Specialty)	25,566.89	11.241
Curtiss-Wright Corp.	CW	Aerospace & Defense	2,081.75	25.895
Dollar Financial Corp.	DLLR	Money Center Banks	684.786	2.297
Dollar Thrifty Automotive Group, Inc.	DTG	Rental & Leasing	971.735	-10.458
Dollar Tree Stores, Inc.	DLTR	Retail (Department & Discount)	4,368.33	44.684
Donegal Group Inc.	DGICA	Insurance (Prop. & Casualty)	383.397	-23.153
Dover Corporation	DOV	Conglomerates	10,488.54	5.135
Entercom Communications Corp.	ETM	Broadcasting & Cable TV	974.612	-9.129
Entergy Corporation	ETR	Electric Utilities	21,140.88	17.456
FMC Technologies, Inc.	FTI	Oil Well Services & Equipment	5,064.94	28.541
FNB Corporation VA	FBNBP	Regional Banks	259.067	-12.544
Franklin Resources, Inc.	BEN	Investment Services	33,325.72	20.528
Fred's, Inc.	FRED	Retail (Specialty)	552.738	11.444
Goodrich Corporation	GR	Aerospace & Defense	7,309.70	31.736
Granite Construction Inc.	GVA	Construction Services	2,747.21	27.967
H.J. Heinz Company	HNZ	Food Processing	15,196.64	7.119
Hearst-Argyle Television, Inc.	HTV	Broadcasting & Cable TV	2,226.37	-4.99
Hythiam Inc.	HYTM	Healthcare Facilities	386.06	-6.385
ICT Group, Inc.	ICTG	Business Services	291.976	-40.772
Independent Bank Corp. (MA)	INDB	Regional Banks	433.889	-17.114
InterNAP Network Services	INAP	Communications Services	653.128	-27.428
Kansas City Life Insurance Company	KCLI	Insurance (Life)	540.598	-2.117
Lennox International Inc.	LII	Misc. Capital Goods	2,309.22	12.665
Lincoln Electric Holdings, Inc.	LECO	Misc. Capital Goods	3,140.12	23.698
Mattel, Inc.	MAT	Recreational Products	9,951.51	11.606
Medical Action Industries	MDCI	Medical Equipment & Supplies	293.632	-15.974
Mercury General Corporation	MCY	Insurance (Prop. & Casualty)	3,007.60	6.574
Midwest Air Group, Inc.	MEH	Airline	365.308	30.609

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(cont.)

Company	Ticker	Industry	Market Cap (\$mm)	6-Month % Return 1/1/07 - 6/30/07
Mission West Properties, Inc.	MSW	Real Estate Operations	284.585	8.807
Mueller Industries, Inc.	MLI	Misc. Fabricated Products	1,263.58	9.322
National HealthCare Corporation	NHC	Healthcare Facilities	649.987	-5.812
Nationwide Financial Services, Inc.	NFS	Insurance (Life)	8,919.72	17.695
Nationwide Health Properties Inc.	NHP	Real Estate Operations	2,442.66	-7.754
NBT Bancorp Inc.	NBTB	Regional Banks	778.873	-10.035
NetScout Systems, Inc.	NTCT	Computer Networks	280.704	4.458
North Pittsburgh Systems	NPSI	Communications Services	329.66	-10.334
OPNET Technologies, Inc.	OPNT	Software & Programming	234.279	-20.346
Option Care, Inc.	OPTN	Healthcare Facilities	533.141	8.386
Palm Harbor Homes, Inc.	PHHM	Construction Services	332.951	0.927
PC Connection, Inc.	PCCC	Retail (Catalog & Mail Order)	355.659	-10.722
Perry Ellis International, Inc.	PERY	Apparel/Accessories	455.668	17.695
Playboy Enterprises, Inc.	PLA	Printing & Publishing	380.297	-1.134
Provident Financial Services, Inc.	PFS	S&Ls/Savings Banks	1,078.37	-12.076
Respironics, Inc.	RESP	Medical Equipment & Supplies	3,483.21	12.821
RPC, Inc.	RES	Oil Well Services & Equipment	1,685.99	1.543
Sabine Royalty Trust	SBR	Misc. Financial Services	608.542	3.601
Sandy Spring Bancorp Inc	SASR	Regional Banks	515.192	-16.474
Saul Centers, Inc.	BFS	Real Estate Operations	804.66	-16.52
Semafo Inc.	SMF	Gold & Silver	284.818	16.455
Sherwin-Williams Company	SHW	Retail (Home Improvement)	8,736.35	5.533
Shoe Carnival, Inc.	SCVL	Retail (Apparel)	355.715	-13.006
Solectron Corporation	SLR	Electronic Instr. & Controls	3,464.10	14.286
Spartan Motors, Inc.	SPAR	Auto & Truck Manufacturers	592.291	68.603
Spherion Corporation	SFN	Business Services	540.798	26.38
Stepan Company	SCL	Chemical Manufacturing	285.272	-3.05
Tennant Company	TNC	Misc. Capital Goods	699.478	26.801
The Gap Inc.	GPS	Retail (Apparel)	15,739.20	-1.607
The Gorman-Rupp Company	GRC	Misc. Capital Goods	429.925	-13.241
The Washington Post Company	WPO	Printing & Publishing	7,384.09	4.659
Transatlantic Holdings, Inc.	TRH	Insurance (Accident & Health)	4,705.38	14.992
Tredegar Corporation	TG	Fabricated Plastic & Rubber	832.106	-5.448
Tyler Technologies, Inc.	TYL	Computer Services	474.731	-11.735
United Fire & Casualty	UFCS	Insurance (Prop. & Casualty)	991.371	1.104
United Natural Foods, Inc.	UNFI	Food Processing	1,161.58	-26.002
Universal Electronics Inc	UEIC	Audio & Video Equipment	541.314	72.788
Viad Corp	VVI	Business Services	900.915	4.067
Vicor Corporation	VICR	Electronic Instr. & Controls	555.736	21.051
Vignette Corporation	VIGN	Software & Programming	534.947	12.244
Village Super Market, Inc.	VLGEA	Retail (Grocery)	320.876	12.278
W.W. Grainger, Inc.	GWW	Misc. Capital Goods	7,799.50	34.097
ZOLL Medical Corporation	ZOLL	Medical Equipment & Supplies	420.054	-23.386