

THE LONDON COMPANY

INVESTMENT COUNSEL

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Dear Client:

The London Company welcomed the 2007 with optimism for continued success and growth for both the company and our clients. The first quarter of 2007 carried forward the momentum from the previous year, with growth a defining characteristic. The firm's assets under management rose to \$579.4 million as of March 31, 2007 from \$495 million as of December 31, 2006.

After our move to our new office on Bayberry Court last November, we were also looking to grow our staff. We are pleased to welcome two new members to our team, Mr. Wesley Haynes and Ms. Louise Swartz. Mr. Haynes, a recent graduate of the Virginia Military Institute (VMI), joins us as a research analyst. During his time at VMI, Mr. Haynes was a Lamar Presidential Scholar and an Institute Honors Cadet. He also worked as the Executive Officer of the Cadet Investment Group. Ms. Swartz, previously with a Commodity Trading Advisor in the Washington, DC area, joins us in marketing and client relations, while also serving as the new Chief Compliance Officer. Ms. Swartz is a 2003 graduate of the University of Virginia.

After a record performance in 2006, many of our top performing positions slowed their pace during the first quarter. These undervalued companies should resume leadership, however, over the next three to five years, based on our estimates of private market values. That being said, we ended the first quarter of 2007 slightly underperforming the S & P 500, while outperforming the Dow.

It is not unusual for our focused investment approach to underperform modestly in any given quarter. This is due to our belief that tracking exactly to a benchmark will lead to average returns, at best. We choose to target an absolute return with minimal risk. In fact, we have historically underperformed almost half of all quarters overall, but significantly outperformed over a full market cycle. This result stems from our excess return generated during those quarters in which we perform well. We believe

some tracking error, due to our concentration, is necessary to outperform over the long haul.

Our theme has not changed since our last quarterly letter; businesses are flushed with capital and have few reinvestment opportunities. With the economy slowing and interest rates relatively low, value creation will continue to be realized through releveraging of vastly underlevered balance sheets. As long as after-tax financing costs trade three hundred basis points or more below the equity earnings yield of the average public company, companies will be forced to re leverage through private buyouts, mergers, buybacks and significant dividend increases.

We have already seen a wave of acquisitions in the smaller capitalization companies, with activist shareholders and ample private capital sometimes pressing the issue with management. Our underlevered, high cash generation focus has led many of our companies to be natural targets, leading our small cap portfolio to top rankings over the past five years. In fact, our small cap portfolio was written up in the February 19, 2007 issue of *Pensions & Investments* as one of the top ten managers over the past one and five years for composite US stocks (please see attachment).

With \$300-\$400 billion, and growing, of private capital still seeking investment opportunities, we expect these targets will gravitate up the capitalization range to mid and large caps, where valuations are still very modest and balance sheets even more underlevered. Typically, a private buyer will lever each dollar of equity capital with three to four times the amount in debt capital, providing almost \$1.6 trillion dollars or more in purchasing power. So, as we have seen in recent quarters with companies in the \$20-\$40 billion dollar range being acquired at significant premiums, this level should continue into the foreseeable future.

Very few companies, no matter how large, will be immune to this pressure. Flat to sub par returns for mega-cap companies over this decade will leave few excuses for companies to continue to hoard capital for growth. Aggressive activist shareholders should force the issue, with the support of increasingly frustrated shareholders, to unlock value through recapitalizations, above average special dividends increases and premium merger buyouts. They will not be able to justify the 80's-90's mindset of capital retention for growth the longer their shareholders are not rewarded with expected appreciation.

All of the important ingredients are in place for a major releveraging of Corporate America: ample private capital, an increase in activist shareholders, lagging stock prices, underlevered balance sheets, low rates, a

slowing economy, an aging population biased towards higher dividends payouts and management incentives directed away from growth rewarded options to dividend rewarded restricted stock incentives.

Our investment process, focused on high cash flow, predictable business with underlevered balance sheets, will be the natural targets and primary beneficiaries of this trend. One way or another, our positions will be rewarded with the ample financial flexibility they have to reward shareholders with significant dividend increases, buybacks and premium merger offers.

Please feel free to contact us at any time to discuss your portfolio. We thank you for your continued loyalty.

Sincerely,



Stephen M. Goddard, CFA



Jonathan T. Moody

SMG:JTM:lms

Enclosure: *Pensions & Investments* Excerpt

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Absolute Return/ Alpha Conference

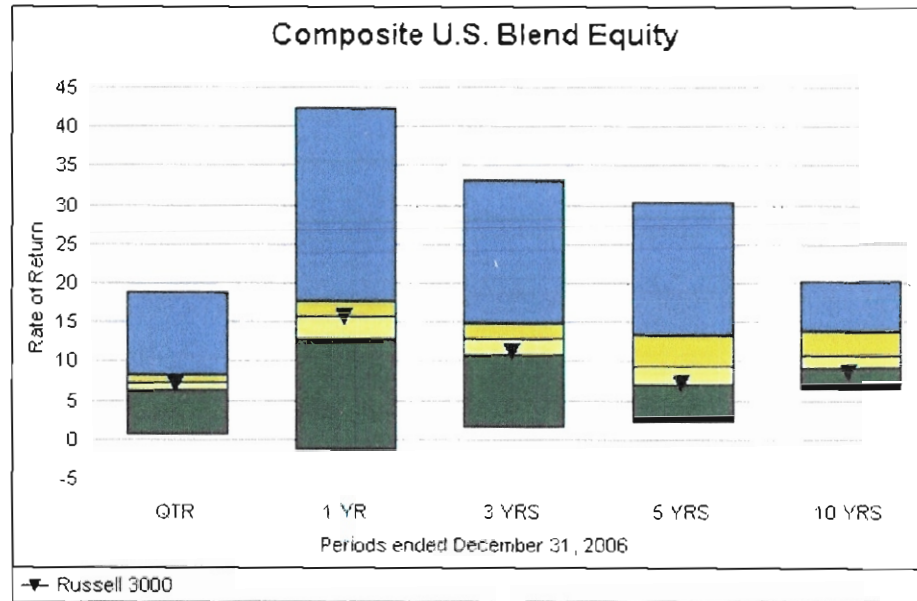


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**East Coast
Conference**
May 7-9, 2007
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**West Coast
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May 21-23, 2007
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Absolute Return/



TOP 10 MANAGERS - 1 YEAR

London Co. Sm.-Cap	42.26%
Boston Int'l Sm.-Cap	32.57%
Moloney Securities Gro.	31.32%
Lord Abbett Sm.-Mid Val.	30.99%
NWD U.S. Sm.-Cap Core	30.93%
Davidson Sm./Mid Cap	29.81%
TAMRO Sm.-Cap	29.53%
MFC Global U.S. Sm.-Cap Opp.	28.76%
Prudential Ret. MidCap Val.	27.35%
Gallatin Value Opp.	27.06%

TOP 10 MANAGERS - 5 YEARS

Boston Int'l Sm.-Cap	30.40%
Ativo Small Dynamic Portfolio	25.72%
RS Partners/Sm.-Cap Val.	24.39%
London Co. Sm.-Cap	23.18%
Lord Abbett Micro Cap Val.	22.26%
Advisory Res. Sm.-Mid Cap Val.	21.26%
Nicholas-Applegate Sys. Sm.-Cap	20.97%
TS&W Sm.-Cap Val.	20.92%
Westwood Smid Cap	20.72%
Rehmann Financial Alpha Quant	20.51%

Source: Morningstar Separate Account/Commingled Fund Database

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