

THE LONDON COMPANY

INVESTMENT COUNSEL

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Dear Client:

Overall, we outperformed the difficult markets in the fourth quarter as the majority of our positions began to reach trough volatility levels or were insulated by stable fundamentals. With increased volatility and fears of an economic slowdown accelerating toward the end of the year, outflows of domestic equities continued to persist through the quarter, leading to declines in the majority of equity markets, particularly financials and cyclicals.

Although every economic and market downturn can be disconcerting, they are a healthy and normal part of market cycles. Since 1928, there have been 262 declines of 5-10% and 87 times it has dropped more than 10%. If you held stocks at least five years over the past twenty years, however, over ninety percent of the time returns would have been positive. Average returns would have generated 8.4% annually for any ten year rolling period. Over the recent bull market since March 2003, the market has generated over 100% returns, but approximately a 10% decline since it peaked in October. Like most declines, the prognosis is that the worst is yet to come and this time it's different. Historically, however, market declines have been the optimum time to invest. After each downturn since 1922, returns have averaged well above average over their subsequent five and ten year periods.

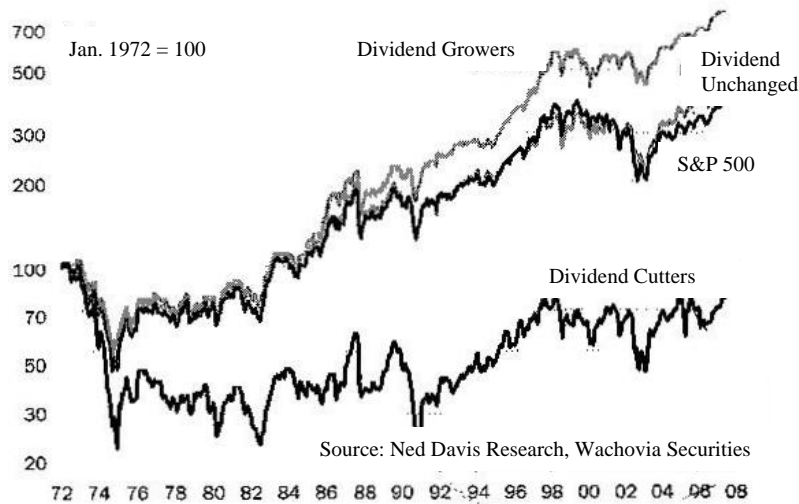
Another factor to take into consideration is the relative valuations of stocks to their prior market peaks. Today the market is trading at less than 15 times earnings, with many quality companies trading at 5 times their pretax cash flow. In prior market cycles, peak market valuations were normally well in excess of 20 times in far higher interest rate environments. The argument that prior market depressions ended at 8 times earnings were in environments where interest rates were significantly higher, justifying far lower equity multiples.

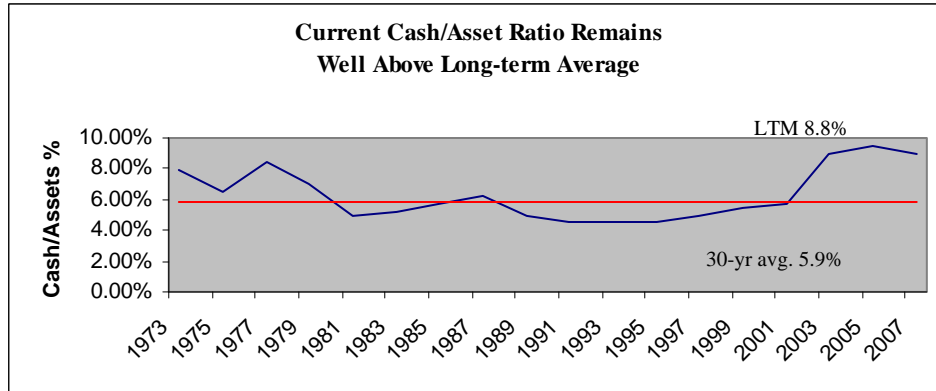
The positives in these situations that you do not hear are the majority of public companies are in their best financial shape in over fifty years, overcapitalized with little or no debt and abundant cash flows. Many are far more diversified in

growing overseas markets and have very efficient operating structures after years of streamlining.

While we believe top-line growth rates will slow over the next decade and that margins have peaked, higher valuations will be driven by the excess capital generated being reallocated to shareholders through large dividend increases, buybacks, and consolidation. In the past year alone, dividends increased nearly ten percent to \$246 billion for companies in the S&P 500. Stock repurchases increased 57% in the third quarter at an annualized pace of \$688 billion, almost three times the amount of dividends. Collectively, nearly \$934 billion of excess capital was returned to shareholders through dividends and buybacks. The buybacks could have just as easily been returned in the form of dividends, providing a dividend yield in excess of 7% for the S&P 500, 300 basis points over Treasuries. So despite recession fears, subprime junk credit illiquidity and other negative news dominating press coverage, the vast majority of companies are “throwing off” huge amounts of excess capital to support current valuations, with or without growth.

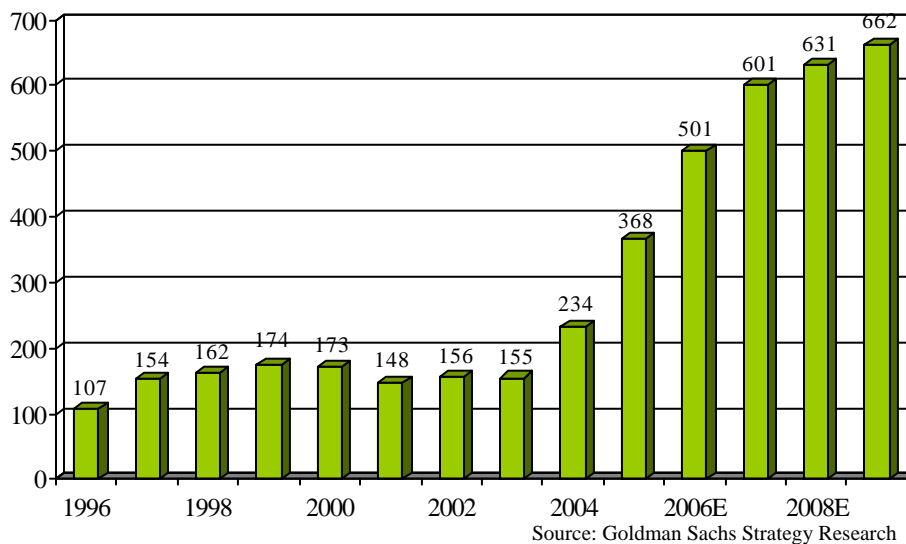
DIVIDEND POLICY MATTERS
S&P 500 Equal Weight Real Total
Return Indexes by dividend policy





Source: Goldman Sachs Strategy Research

Cash Spent on Buybacks Will Increase By 20% in 2007 to \$600 billion



Not only in the United States is excessive capital a problem, if you can call that a problem, but globally it is an accelerating trend, as well. With the dollar declining, the cash yield attractiveness of U.S. companies is more significant. Regardless of the degree of help from domestic private equity, foreign capital will continue to flow into the U.S., buying cheap U.S. assets and companies.


Long term, the stock market performance has ultimately been determined by the private valuations of the underlying businesses, which are currently significantly higher than the depressed market quotes of their publicly traded stock. Once this sentiment changes, and a few major acquisitions begin to occur at notable premiums, we suspect the gap will close quickly and returns in the market will rebound dramatically over the next three years.

We thank you for your continued trust and loyalty and we would welcome any calls to discuss your portfolio should you desire to do so.

Sincerely,



Stephen M. Goddard, CFA



Jonathan T. Moody



Wesley F. Haynes



Louise M. Swartz

SMG:JTM:WFH:LMS

Enclosure: 4Q07 Portfolio Statements