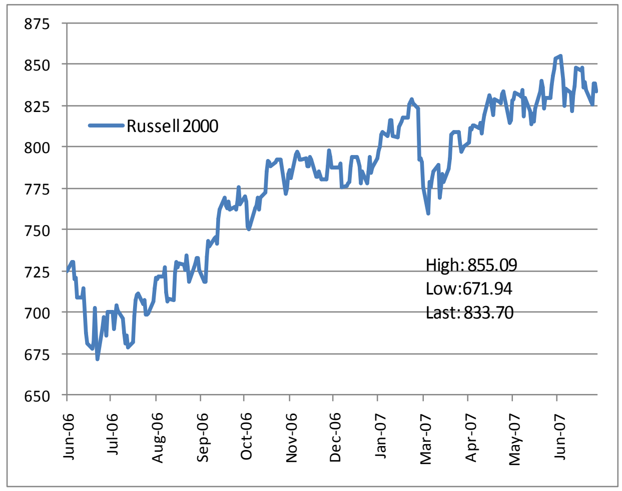
CONESTOGA
CAPITAL ADVISORS

Second Quarter 2007 Commentary

Market Review

U.S. equities continued their upward advance, with many indices reaching new highs during the quarter. The advance did not come without some uncertainty, and volatility increased modestly. While corporate earnings generally met forecasts, issues at a macro-economic level caused unease. Investors seemed particularly worried about further weakness in the housing market and sub-prime lending. Further, there was increased concern about inflation and whether the Federal Reserve would next raise or lower interest rates. Yields on the 10-year Treasury bond reached 5.25% before retreating modestly at quarter-end. Higher interest rates may cause a slowdown in the private equity buyout binge that has lent support to the market. The strength of the small cap market over the past one and ten years is shown at right (Charts 1 and 2).

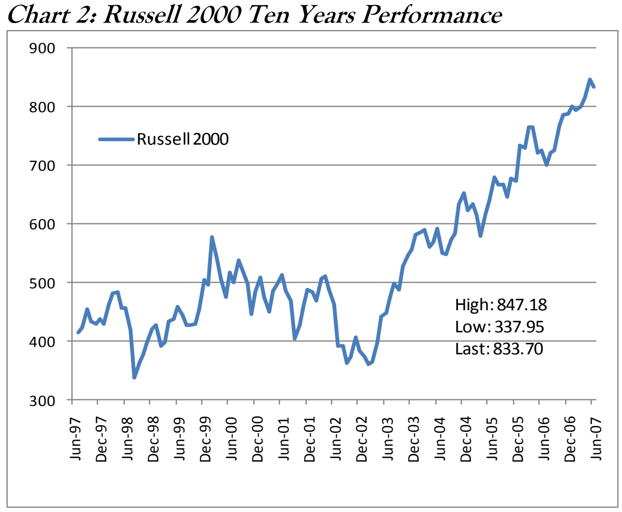
Chart 1: Russell 2000 One Year Performance



Sources: FactSet Research Systems; Russell Investment Group

Growth stocks, which have significantly lagged Value stocks over this decade, outperformed for the second consecutive quarter. Within the Small Cap market, it was interesting that the traditional Growth sectors (Tech and Healthcare) did not lead the outperformance. Rather, two more typically Value oriented sectors (Materials and Processing, Producer Durables) within the Growth market were the key contributors.

Chart 2: Russell 2000 Ten Years Performance



Sources: FactSet Research Systems; Russell Investment Group

While dissatisfied with the strategy's recent performance, we remain confident in our investment philosophy and research process. In two of the past three quarters, stock selection has been uncharacteristically weak. A number of companies have experienced what we perceive as short-term bumps in the road (i.e., AMCOL International (ACO) and II-VI Inc. (IIVI)) while others have experienced more difficult challenges (Select Comfort Corp. (SCSS) and Kensey Nash (KNSY). We have carefully evaluated each of these situations and have made adjustments to the portfolio. We believe the portfolio's positions in higher quality companies are well positioned for an eventual increase in volatility.

Table 1: Russell Indices Performance

Index	2Q 2007	One Year	Three Years*	Five Years*	Ten Years*
Russell 2000 Index	4.42%	16.43%	13.45%	13.88%	9.06%
Russell 2000 Growth Index	6.69	16.83	11.76	13.08	5.28
Russell 2000 Value Index	2.30	16.05	15.02	14.62	12.14

Source: *Frank Russell Co.* * *Annualized.*

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Performance Review and Attribution

In the second quarter, the Conestoga Capital Advisors' strategy posted returns exceeding the Russell 2000 Index but trailing the Russell 2000 Growth Index. Sector allocations benefitted performance relative to the Russell 2000 but detracted from returns relative to the Russell 2000 Growth. Stock selection detracted from returns, and was particularly challenging in April as several companies disappointed investors' earnings expectations. As a result, stock selection acted as a drag on relative returns for the quarter.

Attribution Relative to the Russell 2000 Growth

The strategy's relative underperformance versus the Russell 2000 Growth was a combination of sector allocation and stock selection. The strategy maintained a modest overweight in Financial Services (about 12% versus 10% for the Russell 2000 Growth) during quarter, which detracted from performance. Also, several industries within the Producer Durables and Materials Processing sectors (such as Steel and Gold) produced stronger returns for the benchmark. Finally, the 2% cash position held in the strategy detracted from relative performance as it will in any strong positive quarter such as 2Q 2007.

Stock selection detracted from returns in several sectors, including Technology, Financial Services and Other Energy. Within Technology, II-VI Inc. (IIVI), a maker of laser and crystal technology and one of the strategy's largest positioned disappointed on production issues and was the strategy's weakest performer. PrivateBancorp Inc. (PVTB) and Boston Private Financial Holdings Inc. (BPFH), both within the Financial Services sector, underperformed and detracted from returns. Several stocks within the Technology sector were strong contributors, including: Blackboard Inc. (BBBB), Digi International (DIGI), Rimage Corp. (RIMG) and Trimble Navigation Ltd. (TRMB).

Attribution Relative to the Russell 2000

Sector weightings relative to the Russell 2000 added to returns for the quarter, allowing for modest outperformance of the benchmark. The strategy's underweighting to the weak performing Financial Services sector was the key driver of sector relative performance. The strategy also benefitted from a zero weighting in the Utilities sector, which was another weak performer within the Russell 2000.

Stock selection partially offset some of the benefits of the strategy's sector weightings. In addition to the weaker performers described above under the 2000 Growth Attribution section, Carbo Ceramics Inc. (CRR) and St. Mary's Land & Exploration, both within the Other Energy sector, suffered from weakness. One notable factor within stock selection that we believe reveals the current impact of the merger and acquisition boom was the impact of Microsoft's (MSFT) purchase of Aquantive Corp. (AQNT) at an 85% premium to its market value. The buyout created a significant contribution to the Russell indices, and our performance attribution estimates reveal a roughly 30 basis point impact by not holding AQNT within the strategy.

Tactical Trading Analysis – A Review of our Trading Activities

As part of our quarterly internal performance reviews, this quarter we examined the impact of the tactical increases and decreases in stocks over the past two and one half years. We were pleased to find that the majority (about 75%) of our decisions have contributed to performance. That has held true in 2007, as the continued due diligence review of portfolio holdings has led to some incremental performance improvements. A recent example is the review and re-weighting of Raven Industries Inc. (RAVN), which we visited on-site in Sioux Falls, SD. While the stock has been a strong performer since first purchased in 2004, it fell steadily over the last three quarter of 2006 due to disappointing earnings results. The focus of this quarter's visit was the company's Flow Controls unit, which generated the weaker results last year. Our visit re-confirmed our belief in the long-term growth prospects and we increased the weighting in client portfolios. Earnings released towards quarter-end were above expectations, and the stock was one of the top 5 leaders this quarter. One of the goals of our continuous reviews of holdings is to add return by exploiting the myopic focus of so many market participants.

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Top 5 Composite Leaders

1. Raven Industries Inc. (RAVN): After being one of the strategy's weaker performers during 2006, RAVN recovered strongly in mid-May. Stronger-than-expected earnings which were boosted by the company's Flow Controls division renewed investor confidence in the longer-term outlook for this South Dakota-based mini-conglomerate.

2. Blackboard Inc. (BBBB): This company continued its trend of meeting or beating earnings expectations, with strong 1Q profit growth announced in early May. The education management software maker also raised guidance for the 2Q and full-year periods.

3. SurModics Inc. (SRDX): Based in Minneapolis, SRDX is a medical device maker with a broad product suite serving a variety of healthcare companies. At the end of the quarter, the company announced a significant licensing agreement with Merck Inc. (MRK) to provide its technology for an implant device targeting the ophthalmic (eye) market.

4. Computer Programs & Systems Inc. (CPSI): This company's stock rebounded strongly in early April with news of thirteen new client contracts and confirmation that the dividend would be unchanged at $0.36 per quarter. Weaker new business generation and concerns over the safety of this company's dividend had weighed down this software provider to rural hospitals.

5. Lo-Jack Corp. (LOJN): Widely known for their stolen automobile recovery systems, LOJN recovered the performance that was lost during the fourth quarter of 2006 when the CEO resigned and earnings estimates were lowered. Investors have regained confidence in the long-term outlook for LOJN and the new management.

Bottom 5 Composite Laggards

1. II-VI Inc. (IIVI): This maker of laser-related products lowered guidance for the full year as a result of manufacturing problems with their crystal production. The company's attempts to increase crystal yield through a different production method did not perform as expected, causing weaker results for the quarter. In our opinion the stock was overly punished for the weak results, and we added to our position as a result.

2. PrivateBancorp Inc. (PVTB): Increasing consumer debt concerns and a flat yield curve caused the Financial Services sector to be one of the market's weaker performers during the quarter. PVTB fit this profile as it raised its loan loss reserves. Also, increased hiring costs related to hirings in the company's de novo Kansas City location pushed at profitability.

3. Winnebago Industries Inc. (WGO): After surging in March on better-than-expected results, the best known maker of recreation vehicles saw its stock price fall slowly and steadily though the quarter. Earnings results were a bit weak, and concerns about higher gas prices and the lack of any big new product launches at a Las Vegas trade show dampened investor enthusiasm.

4. Blackbaud Inc. (BLKB): The company, which provides customer relationship software to non-profits, had an up and down quarter. BLKB surged higher in early May on strong quarterly results and increased guidance for full-year earnings. Through the rest of the quarter, the stock fell steadily without any major news events, giving up the gains made on better earnings. We continue to believe in the long-term outlook for BLKB.

5. AMCOL International Corp. (ACO): This Chicago-based maker of specialty mineral products announced weaker-than-expected results for the first quarter. Investors also seemed to become more concerned about slower organic growth and higher financial leverage.

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Second Quarter Buys

1. Meridian Bioscience Inc. (VIVO): Based in Cincinnati, this company develops, manufactures and sells diagnostic kits to the hospital and healthcare industries. Kits include tests for respiratory, viral and gastrointestinal diseases. The company has demonstrated strong revenue and earnings growth over the past five years. After an on-site visit to the company's headquarters by both portfolio managers, the stock was purchased into client portfolios.

2. Somanetics Corp. (SMTS): Initially brought to our attention several years ago by a client who is a physician, this company manufactures a monitoring device for measuring oxygen flow to the brain during surgery. The device allows for more accurate delivery of anesthesia, which in turn quickens patient recovery and shortens hospital stays. The stock rose sharply after our first review in 2005, but has recently retreated to valuation levels that we think makes it a compelling long-term growth opportunity.

3. Neogen Corp. (NEOG): Similar to Meridian Bioscience above, NEOG manufactures diagnostic kits for use in detecting fungal diseases such as E. coli, as well as toxins in both food and animal feed. Based in East Lansing , MI, we believe the company will continue to see in increased demand for its products on rising concerns over food safety. It should be noted that NEOG is a less liquid security, and that at the end of the second quarter, not all client portfolios had established a full position in the stock.

4. Tesco Corp. (TESO): Tesco's product offerings facilitate more efficient drilling and extraction of oil and natural gas by drillers. The company has a history of innovative product offerings that have created efficiencies and cost savings to their customers. Based in Houston, the company's stock is listed on the Toronto and NASDAQ exchanges.

Second Quarter Sells

While no holdings were sold in their entirety during the quarter, we did trim two names in the portfolio. Kensey Nash (KNSY) and Select Comfort Corp. (SCSS) were both reduced in weighting due to decreased confidence in each company's near-term outlook. With KNSY, we are concerned that the company's investment in marketing and sales in the embolic protection market is not paying off. SCSS has been under very close scrutiny since disappointing in the fourth quarter of 2006. We have met with management on two occasions, and remain skeptical on the near-term outlook for the company's revamped marketing strategy. We will be visiting with the company again in August for further insight into their plans.

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