



PIONEERS IN SMALL CAP INVESTING

SECOND QUARTER, 2008 COMMENTARY

MARKET REVIEW

Stock markets began the quarter by staging a recovery on hopes that the March rescue of Bear Stearns would mark the beginning of the end of the credit crisis. Shares rallied smartly in April, as Financials stabilized and signs of a bottom appeared. However, markets retreated in May as a combination of factors produced new worries of extended economic malaise. Unemployment data released in mid-May was higher than expected, and shortly thereafter, weaker-than-expected home price levels (Case-Shiller data) were announced. Oil prices continued to surge and gasoline prices surpassed \$4 per gallon nationwide. Not surprisingly, the major auto makers announced disappointing sales and projected new rounds of plant closings and layoffs.

Growth stocks outperformed Value stocks for the quarter, as investors' soured on Financial Services, real estate investment trusts (REITs), and consumer stocks, all of which are more prevalent in the Value indices. Energy stocks surged in the second quarter, rising 47% within the Russell 2000 and 17% within the S&P 500. Small Cap stocks outperformed Large Cap stocks for the quarter, eking out a small positive return while their larger brethren experienced declines. Table 1 below reviews the relative performance of the traditional asset classes.

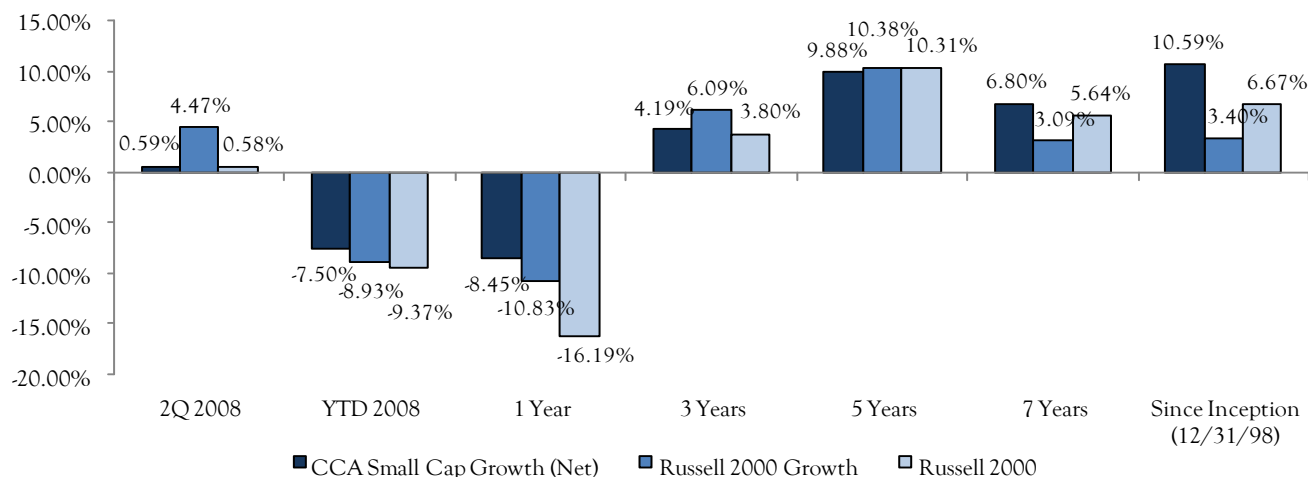
Table 1: Comparison of Asset Class Returns

| Market | Index | 2Q 2008 | One Year | Three Years * | Five Years * |
|------------------------|----------------------------|---------|----------|---------------|--------------|
| Cash | Citigroup 3 Month T- Bill | 0.40% | 3.32% | 4.11% | 3.06% |
| Bonds | Lehman Bros Aggregate Bond | -1.02 | 7.13 | 4.08 | 3.86 |
| Large Cap Stocks | S&P 500 | -2.73 | -13.12 | 4.41 | 7.58 |
| Small Cap Stocks | Russell 2000 | 0.58 | -16.19 | 3.79 | 10.29 |
| International Stocks | MSCI EAFE | -1.93 | -10.15 | 13.34 | 17.16 |
| Emerging Market Stocks | MSCI Emerging Markets | -0.80 | 4.89 | 27.52 | 30.15 |

OUTLOOK

Looking forward, the direction of the market in the second half of 2008 will clearly be dependent on the underlying company fundamentals (revenue and earnings growth) reported through the remainder of the year, as well as the macro concerns of inflation, credit availability, unemployment and GDP growth. Current Wall Street forecasts of revenue and earnings predict a strong recovery in the second half of 2008, with very favorable comparables to the year-earlier periods. While we are by no means market soothsayers, we do think a quick rebound is less likely. We do continue to believe that the Conestoga portfolio companies are well-positioned to produce sustained growth through an uncertain economy.

Please note: the specific securities identified and described in this report do not represent all of the securities purchased, sold or recommended for advisory clients, and you should not assume that investments in the securities identified and discussed will be profitable in the future. As you are aware, one cannot assume that past results are indicative of future performance.

PERFORMANCE - ANNUALIZED RETURNS VS. RUSSELL INDICES*

*Please see important disclosures at the end of this commentary.

PERFORMANCE REVIEW AND ATTRIBUTION

The Conestoga composite of accounts returned 0.59% net-of-fees during the second quarter, trailing the Russell 2000 Growth return of 4.47%, and in line with the Russell 2000 return of 0.58%. Year-to-date, the composite continues to hold a modest advantage to both benchmarks. (Please note that individual account performance will vary slightly due to slight individual issue weighting differences and specific individual client guidelines.)

ATTRIBUTION RELATIVE TO THE RUSSELL 2000 GROWTH:

The strategy's underperformance in the second quarter was largely due to stock selection. Of note, nearly all of the underperformance occurred in April when the market's rebound appeared to favor those companies most beaten down over prior quarters. For the remainder of the quarter, the strategy outperformed modestly. Sector allocations had little impact on overall performance, although the strategy's equal weighting in the Other Energy sector was critical to performance given the sector's 47% surge during the quarter.

Several stocks in the Consumer Discretionary and Technology sectors struggled this quarter. Within the Consumer Discretionary sector, Advisory Board Co. (ABCO) fell on concerns that a slower economy would dampen demand for their hospital consulting services. In similar fashion, brand royalty company Iconix (ICON) also fell on concerns about a cash-strapped consumer. In Technology, Rimage Corp. (RIMG), a maker of digital duplication and publishing systems, announced weaker-than-expected earnings and lowered guidance.

Energy related stocks Carbo Ceramics Inc. (CRR), St. Mary Land & Exploration Co. (SM) and Tesco Corp. (TESO) were among the strategy's best performers for the quarter. Within Health Care, we were pleased to see that Somanetics Corp. (SMTS) rallied and recovered after disappointing in March.

ATTRIBUTION RELATIVE TO THE RUSSELL 2000:

The strategy matched the return of the Russell 2000 Index for the second quarter, as advantageous sector allocations offset weak stock selection. The strategy underperformed in April's rally, but regained all of the lost ground in May and June with strong relative performance. An equal weight to the Index in the skyrocketing Other Energy sector was critical to keeping pace with the Index. Also, benefitting performance on a sector basis was the underweight to Financial Services and overweighting to Technology. An underweighting to Materials and Processing (which contains some very strong performing raw materials industries) detracted from portfolio returns.

Stock selection was strong in the Financial Services sector, where the strategy's modest exposure to banks and brokerage relative to the Index was very beneficial. World Acceptance Corp. (WRLD) continued to benefit from strong results and investors easing concerns that WRLD represented sub-prime exposure. Weak stock selection in Consumer Discretionary included Lo-Jack Corp. (LOJN), which fell on weaker results and fears that slowing automobile demand would reduce sales of LOJN's automobile theft recovery product. In Technology, Digi International Inc. (DGII) reported weaker results and lowered guidance for the full year, sending shares lower.

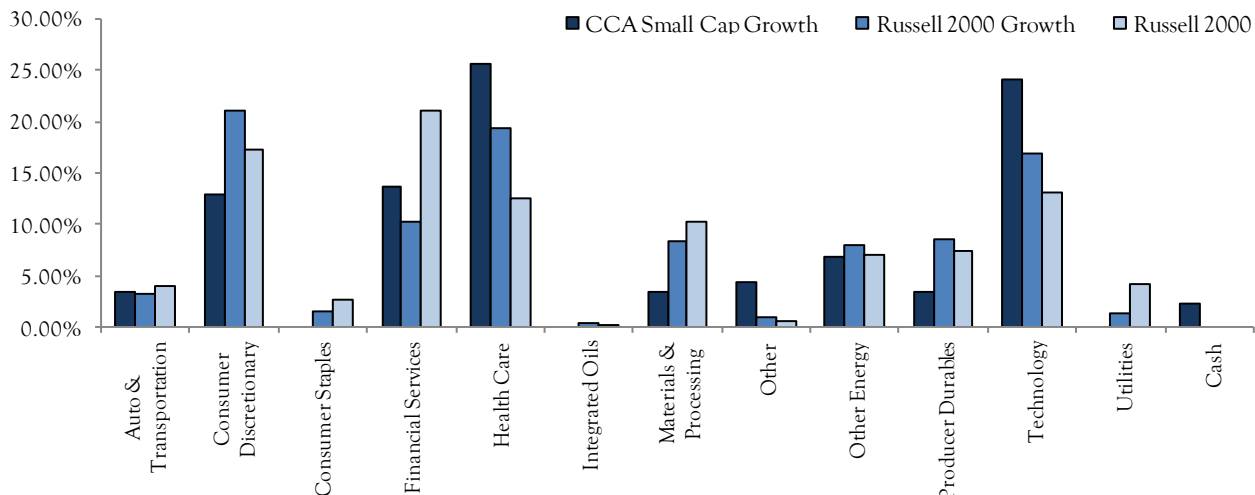
TOP 5 COMPOSITE LEADERS

1. **Carbo Ceramics Inc. (CRR):** A maker of ceramic propants that increase the efficiency of oil and gas wells, CRR benefitted from a solid earnings announcement in late April and investor enthusiasm for energy related stocks.
2. **St. Mary Land & Exploration (SM):** An oil exploration and development company with operations from the Gulf Coast to the Rocky Mountains, SM experienced very strong performance as investors clamored for energy companies. SM also benefitted from the announcement of expanded production expectations.
3. **Somanetics Corp. (SMTS):** A weak performer in the first quarter, SMTS rebounded sharply this quarter on better-than-expected results. The manufacturer of a medical device to measure blood oxygen levels in the brain during surgery reaffirmed its full year guidance and regained investor confidence. Of note, the strategy benefitted from the increased investment made after the shares declined in the first quarter.
4. **Ansys Inc. (ANSS):** This company announced the acquisition of another portfolio holding, Ansoft Corp. (ANST), at the end of the first quarter. This quarter, the company reported strong revenue and profit growth, and the merger with ANST was approved by the SEC. We expect ANSS to build on its successes in the engineering simulation software business.
5. **Tesco Corp. (TESO):** The portfolio's most recent addition within the Other Energy sector, this company designs and manufactures drilling and casing components that improve the efficiency of oil and gas extraction. As with the portfolio's other energy-related companies, TESO benefitted from investor demand for energy stocks.

BOTTOM 5 COMPOSITE LAGGARDS

1. **Advisory Board Co. (ABCO):** Focusing on the Health Care industry, ABCO provides management consulting services designed to provide companies with research and strategies for improving their businesses. In spite of a solid earnings report released in May, ABCO's stock price declined on fears that an economic slowdown would cause their client base to cut back on consulting projects and reduce future earnings.
2. **Rimage Corp. (RIMG):** This Minneapolis-based maker of digital duplication systems reported weaker-than-expected earnings in April, and then lowered guidance in June due to weaker spending by its distribution partners. The company has responded with a cost-cutting program which it believes will positively impact future quarters.
3. **Lo-Jack Corp. (LOJN):** Given expectations for lower vehicle sales and a weak consumer, this maker of stolen-vehicle recovery systems lowered guidance at the beginning of the quarter. This, coupled with a sell-side downgrade at quarter-end pushed the share price lower through the quarter.
4. **Innovative Solutions & Support Inc. (ISSC):** This Company, which makes OEM and retrofit cockpit instrumentation kits for aircraft, was dragged down by continued issues from its largest OEM customer. Also, the very weak outlook for the major air carriers that purchase retrofit kits weighed on the company's shares.
5. **Digi International Inc. (DGII):** A maker of networking systems for computer systems and devices, DGII reported flat sales and lower earnings during the quarter. Citing the economic slowdown as the cause of lower sales, DGII also reduced its full-year guidance.

SECTOR WEIGHTINGS



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SECOND QUARTER BUYS & SELLS

BUYS

1. **Capella Education Co. (CPLA)**: Part of the growing online education market, CPLA provides post-secondary education services.
2. **CoStar Group Inc. (CSGP)**: This company provides information services to commercial real estate brokers, owners, financial institutions and other parties.
3. **K-Tron International (KTII)**: A Producer Durables company that provides specialized handling and flow systems to a variety of industries, KTII was added to the Russell 2000 Index at the June 30 reconstitution.
4. **Moldflow Corp. (MFLO)**: An automation software services company for plastics manufacturers, MFLO was acquired at a modest premium by a larger competitor several weeks after our purchase.
5. **NVE Corp. (NVEC)**: This Technology company sells sensors and couplers that use electron spin rather than the traditional electron charge to store and transmit information.
6. **Sun Hydraulics Corp. (SNHY)**: Based in Sarasota, FL, this company designs and manufactures hydraulic cartridges and manifolds for fluid power systems.
7. **Westwood Holdings Group Inc. (WHG)**: A much larger player in the same industry as Conestoga, WHG is a publicly traded investment management firm that serves high net worth and institutional investors with assets under management of over \$7 billion.

SELLS

1. **Ansoft Corp. (ANST)**: This computer aided design firm was purchased by fellow portfolio holding Ansys Inc. (ANSS) during the quarter and sold as a result.
2. **Avocent Corp. (AVCT)**: We sold AVCT due to continuing execution issues and diminishing growth prospects due to competitor technologies. Also, a change in the firm's CEO was announced, which may foretell a long-term shift in strategy.
3. **Boston Private Financial Holdings Inc. (BPFH)**: The only financial services company in the portfolio to be severely damaged by the credit crisis, we sold the position mid-quarter on concerns that they had no attractive near- or mid-term solutions to improve their credit profile, and may be forced to raise additional capital.
4. **Moldflow Corp. (MFLO)**: Discussed under the Buys columns, MFLO was acquired by competitor Autodesk Inc. (ADSK) shortly after our purchase.
5. **Winnebago Industries (WGO)**: While remaining convinced that WGO was the premier manufacturer of recreational vehicles, we re-evaluated our expectations and determined that growth and earnings would not materialize as originally expected in the coming years.

In addition to the above new purchases, we added to positions in Abaxis Corp. (ABAX) and Advent Software, Inc. (ADVS). We also trimmed our weightings in II-VI, Inc. (IIVI) and Raven Industries, Inc. (RAVN).

STATISTICS VS. RUSSELL INDICES (AS OF 6/30/08)

| Portfolio Characteristics* | CCA Small Cap Growth | Russell 2000 Growth | Russell 2000 |
|--|----------------------|---------------------|--------------|
| Price/Earnings (1 Year Forward) | 22.1x | 18.0x | 14.6x |
| Earnings Growth | 19.0% | 21.4% | 16.4% |
| PEG Ratio | 1.16 | 0.84 | 0.89 |
| Weighted Average Market Capitalization | \$1,131 Mil | \$1,197 Mil | \$1,063 Mil |
| ROE | 17.9% | 9.5% | 8.6% |
| Long-term Debt/Capital | 12% | 26% | 30% |
| Dividend Yield | 0.94% | 0.72% | 1.93% |
| Trailing 12 Month Portfolio Turnover | 25% | N/A | N/A |

*Source: Factset Analytical System.

DISCLOSURES: Fully Compliant GIPS Presentation for the Period Ending June 30, 2008

| <u>Year Return</u> | <u>Conestoga Total Net Return</u> | <u>Russell 2000 Total Return</u> | <u>Russell 2000 Growth Return</u> | <u>No. of Accounts</u> | <u>Composite Dispersion</u> | <u>Total Assets at End of Period (mm)</u> | <u>% of Firm Assets</u> | <u>Total Firm Assets (mm)</u> |
|--------------------|-----------------------------------|----------------------------------|-----------------------------------|------------------------|-----------------------------|---|-------------------------|-------------------------------|
| YTD 2008 | - 7.50% | - 9.37% | - 8.93% | 87 | 0.40% | \$160.600 | 56% | \$284.900 |
| 2007 | 6.14% | - 1.57% | 7.05% | 96 | 0.59% | \$159.793 | 58% | \$275.368 |
| 2006 | 10.07% | 18.37% | 13.35% | 94 | 0.65% | \$164.069 | 60% | \$271.483 |
| 2005 | 4.60% | 4.55% | 4.15% | 70 | 0.93% | \$106.107 | 50% | \$211.667 |
| 2004 | 19.04% | 18.33% | 14.31% | 39 | 1.26% | \$55.718 | 34% | \$165.497 |
| 2003 | 30.96% | 47.25% | 48.54% | 37 | 2.35% | \$35.606 | 25% | \$140.624 |
| 2002 | - 15.29% | - 20.48% | - 30.26% | 17 | 2.67% | \$11.102 | 11% | \$96.392 |
| 2001 | 20.93% | 2.49% | - 9.23% | 17 | 4.95% | \$11.399 | 11% | \$103.627 |
| 2000 | 0.18% | - 3.02% | - 22.43% | 22 | 8.36% | \$14.404 | 1% | \$1,440.440 |
| 1999 | 43.52% | 21.26% | 43.09% | 18 | 9.38% | \$11.664 | 3% | \$388.133 |

Annualized Rate of Return for the Period Ending June 30, 2008

| <u>Time Period</u> | <u>Conestoga Return</u> | <u>Russell 2000 Total Return</u> | <u>Russell 2000 Growth</u> |
|----------------------------|-------------------------|----------------------------------|----------------------------|
| 1 Year | - 8.45% | - 16.19% | - 10.83% |
| 3 Years | 4.19% | 3.80% | 6.09% |
| 5 Years | 9.88% | 10.31% | 10.38% |
| 7 Years | 6.80% | 5.64% | 3.09% |
| Since Inception (12/31/98) | 10.59% | 6.67% | 3.40% |

*Conestoga Capital Advisors has prepared and presented this report in compliance with the Global Investment Performance Standards (GIPS). Conestoga Capital Advisors has been verified for the periods December 31, 1998 through March 31, 2002 by KPMG. Conestoga Capital Advisors has been verified for periods March 31, 2002 through March 31, 2007 by Briggs, Bunting and Dougherty. A copy of these verification reports is available upon request. Performance data after March 31, 2007 is in compliance with the GIPS standards but has not yet been examined by Briggs, Bunting and Dougherty.

- Past performance is not indicative of future results. The actual return and value of an account will fluctuate and at any point could be worth more or less than the amount invested. Individual account performance will vary according to individual investment objectives.
- Conestoga Capital Advisors is an independent investment management firm founded in 2001 that manages equity and balanced portfolios for primarily U.S. institutional and retail clients.
- There have not been any material changes in the personnel responsible for managing accounts during the time period. Performance results prior to June 30, 2001 have been achieved by Martindale Andres & Company, Inc., William Martindale and Robert Mitchell's prior investment advisory firm.
- The Russell 2000 measures the performance of the 2,000 smallest companies in the Russell 3000 Index, which represents approximately 8% of the total market capitalization of the Russell 3000 Index. The Russell 2000 Growth Index measures the performance of those Russell 2000 companies with higher price-to-book ratios and higher forecasted growth values. The Russell 3000 Index measures the performance of the 3,000 largest U.S. companies based on total market capitalization. The volatility of the Russell 2000 Index and Russell 2000 Growth Index may be materially different from that of the performance composite. In addition, the composite's holdings may differ significantly from the securities that comprise the Russell 2000 Index and Russell 2000 Growth Index. The Russell 2000 Index and Russell 2000 Growth Index have not been selected to represent an appropriate benchmark, but rather are disclosed to allow for comparison of the composite's performance to that of well-known and widely respected indices.
- Performance results for the full historical period are total return, time-weighted rates of return expressed in U.S. dollars. Portfolios are valued monthly and returns are weighted by using beginning-of-quarter market values plus weighted cash flows. Annual returns are calculated by geometrically linking the monthly returns. Computations assume the reinvestment of all dividends and capital gains.
- The dispersion of annual returns is measured by the standard deviation across equal-weighted portfolio returns represented within the composite for the full year.
- All composite accounts are managed without client imposed restrictions and are managed by Conestoga Capital Advisors for at least one full calendar quarter. Portfolios that are less than \$250,000 in size are not included in this composite. Prior to September 30, 2003, portfolios greater than \$100,000 were included in this composite.
- No leverage has been used in the accounts included in the composite.
- Trade date accounting is used for all periods.
- Performance results are presented after all management fees, custodial fees, commissions and other trading expenses. The current management fee schedule is as follows: **CURRENT FEE SCHEDULE:** Up to \$10,000,000 : 1.00%
Over \$10,000,000 : Negotiable
- The small cap composite includes all dedicated small cap equity portfolios as well as "carve-out" segments of portfolios that are managed to the firm's balanced strategy. Cash is allocated to the carve-out segment returns on a pro rata basis based upon the proportion of the small cap equity assets to total assets in each balanced portfolio. The pro rata percentage is predetermined by the client and reviewed on a quarterly basis. The percentage of carve-out assets to total small cap composite assets was 1.89% as of June 30, 2008.
- A complete list of composites and performance results are available upon request.

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