



PIONEERS IN SMALL CAP INVESTING

THIRD QUARTER, 2008 COMMENTARY

**MARKET REVIEW AND OUTLOOK**

September and October 2008 will long be remembered as two of the more traumatic months of the credit crisis that began in 2007. The de-leveraging spiral of the crisis claimed new victims including Lehman Brothers, the largest bankruptcy in U.S. history. Shortly thereafter, the Federal government scrambled to provide a rescue package for American International Group. The Federal Deposit Insurance Company seized Washington Mutual, the country's largest savings and loan, and turned the assets over to JP Morgan. Morgan Stanley and Goldman Sachs, the last remaining large investment banks, converted to commercial banks to avoid a short-term funding crisis, and Merrill Lynch hastily arranged a sale to Bank of America. As the quarter ended, Congress hurried to package a "bailout" bill to acquire toxic mortgage securities from financial firms weighed down by depressed prices and illiquidity.

The events of September overshadowed the strong performance of July and August, which featured a reversal of fortunes for the Energy and Financials sectors. After peaking at just over \$140 in early July, oil prices began a steady decline through the rest of the quarter. Meanwhile, the Financial sector managed a rebound as community banks saw their stocks recover after a disappointing twelve months.

The past year has been a true test of any investor's approach to the equity markets. We believe our investment approach is functioning as designed. Historically, our strategy has produced lower volatility and better downside protection than the small cap growth market as a whole. We seek companies with positive earnings, sustainable earnings growth rates, low debt levels, high returns on equity (ROE), and significant insider ownership. We believe these types of conservative growth companies are better positioned to weather economic uncertainties such as today's environment. Our returns for the periods ended September 30, 2008, are below:

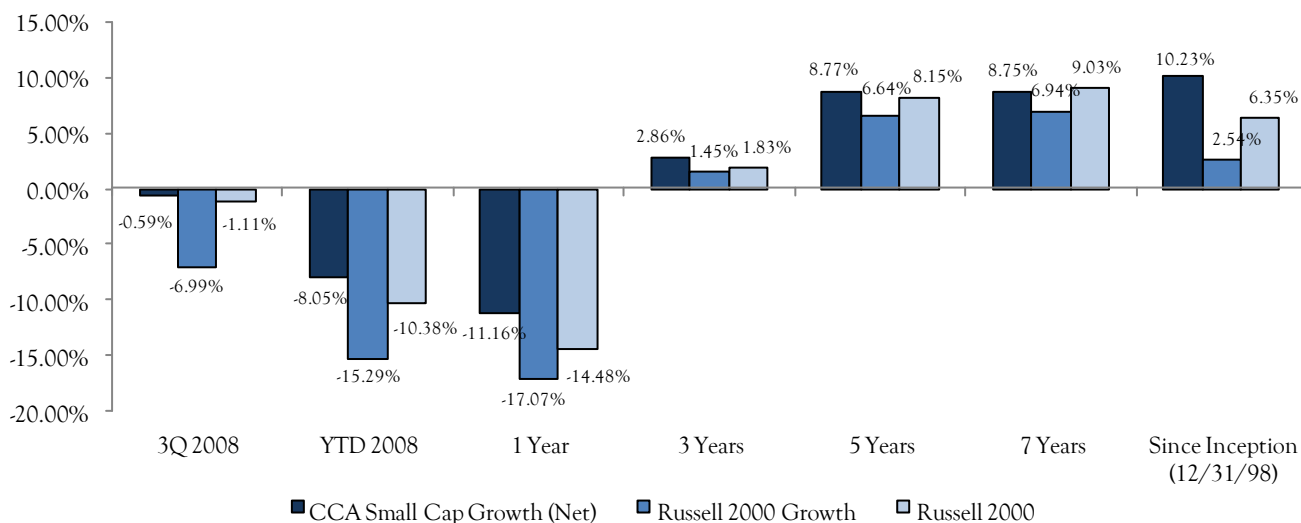
**Table 1: Annualized Returns vs. Russell Indices**

Returns as of Sep 30, 2008	3Q 2008	YTD	1 Year	3 Years	5 Years	Since Inception (12-31-98)
CCA Small Cap Composite	-0.59%	-8.05%	-11.16%	2.86%	8.77%	10.23%
Russell 2000 Growth	-6.99%	-15.29%	-17.07%	1.45%	6.64%	2.54%
Russell 2000 Index	-1.11%	-10.38%	-14.48%	1.83%	8.15%	6.35%

Markets have continued to decline sharply in October, and we can only speculate on the direction equity markets may take in the coming months. Financial sector stocks appear to be searching for a middle ground between de-leveraging and capital infusions. Consumer and Industrial sector stocks are dragged down by concerns about a looming recession. Earnings estimates for 2009 have begun to be revised downward and we expect that trend to continue. We believe that the current round of selling reflects public equity markets serving as the last bastion of liquidity for institutional and individual investors that must raise cash against the need to de-leverage and fund their operations.

In the short-term, we believe all stocks are driven more by market and economic factors, but over longer periods, all stocks are driven by their unique strengths and weaknesses. The current environment is as extraordinary as any we have seen in our years. However, we believe that looking out over the next three to five years, current valuations for high-quality small cap stocks may be presenting a significant buying opportunity. The portfolio of stocks we have built for our clients reflects our convictions on the best companies to produce long-term capital appreciation for our clients in the years ahead.

*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 fell -0.59% net-of-fees during the third quarter, outperforming the Russell 2000 Growth decline of -5.99% the Russell 2000 decline of -1.11%. The composite widened its advantage against both benchmarks for the year-to-date. (Please note that individual account performance will vary slightly due to slight individual issue weighting differences and specific individual client guidelines.)

**VERSUS THE RUSSELL 2000 GROWTH:**

The strategy strongly outperformed the Russell 2000 Growth, benefitting from both sector allocations and stock selection. The reversal of fortunes for the Other Energy and Financial sectors benefitted performance, as the strategy had reduced its Other Energy weightings at the end of the second quarter and avoided some of the decline due to falling oil prices. An overweight to Financial Services boosted returns. An overweight to Health Care, the largest sector represented in client portfolios, also added to return. An underweight to Consumer Discretionary detracted modestly from returns.

Stock selection was also strong versus the 2000 Growth, especially in the Technology sector. II-VI Inc. (IIVI), a CO<sub>2</sub> laser component manufacturer, delivered another strong quarter of sales and earnings growth. Similarly, Tyler Technologies Inc. (TYL) rose on strong earnings. Within Materials & Processing, the portfolio's sole position in Simpson Manufacturing Co. (SSD) delivered solid results, vastly outperforming the Index holdings. Stock selection was weak in Consumer Discretionary, led by declines from Capella Education Co. (CPLA) and Ritchie Bros. Auctioneers Inc. (RBA).

**VERSUS THE RUSSELL 2000:**

Outperformance relative to the Russell 2000 was less significant than versus the 2000 Growth. Sector allocations contributed positively to performance, while stock selection had no impact.

The Russell 2000 is much more heavily exposed to the Financial sector (over 20% of the Russell 2000), with significant weightings to community banks, savings & loans, and REITs. The Conestoga strategy was underweight the Financial sector and this detracted from returns as banks and S&Ls rallied. Offsetting this was very strong contribution from an overweight to the Health Care and Materials & Processing.

Stock selection was mixed relative to the Russell 2000, with strong selection effect in the Technology and Other Energy sectors. Weak stock selection in the Consumer Discretionary and Financial Services sectors acted as a drag on performance.

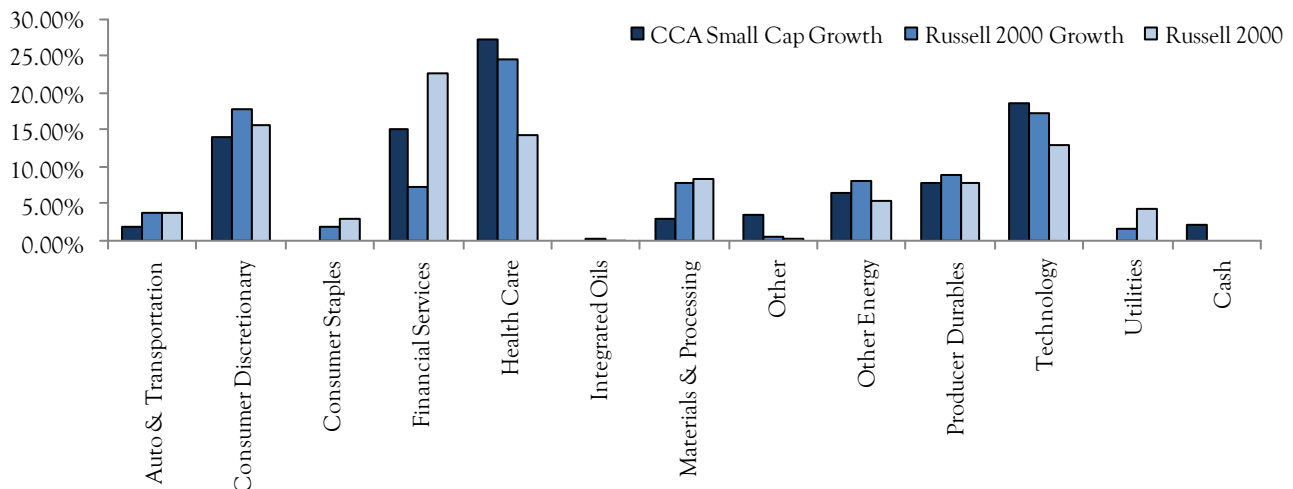
TOP 5 COMPOSITE LEADERS

1. **Quality Systems Inc. (QSII):** This Irvine, CA-based provider of information technology systems for physician and dental practices reported strong earnings and announced a special dividend. QSII is also among the best performing stocks in the portfolio year-to-date.
2. **Landauer Inc. (LDR):** Based in Chicago, this Health Care device company may be starting to benefit from a new management team that took the reins about three years ago. Earnings reported during the quarter continued a trend of solid results.
3. **Raven Industries Inc. (RAVN):** A mini-conglomerate with four divisions, this company saw solid gains in its agricultural geographic positioning systems (GPS) and engineered films divisions. We trimmed this position modestly during the quarter as a result of its strong relative performance.
4. **PrivateBancorp Inc. (PVTB):** This company is the only bank held in client portfolios. PVTB focuses its banking business on high net worth individuals and entrepreneurs, with branches in the Midwest and Atlanta. The company's significant hiring of ex-LaSalle bankers has resulted in strong loan growth over the last twelve months.
5. **Rollins Inc. (ROL):** Better known as the Orkin Pest Control Company, this Atlanta-based firm delivered strong results during the quarter. The acquisition of the Centex pest control division several quarters ago should continue to strengthen ROL's competitive edge.

BOTTOM 5 COMPOSITE LAGGARDS

1. **St. Mary Land & Exploration Co. (SM):** As noted in the Market Review on page one, stocks in the Energy sector retreated as oil prices fell during quarter. SM, an exploration and production firm with fields from the Rocky Mountains to the Gulf Coast, was not immune to the impact of falling prices.
2. **Tesco Corp. (TESO):** Another of the strategy's holdings in the Other Energy sector, TESO was also a victim of the sharp reversal in Energy prices. As noted in the Performance Attribution section on page two, Conestoga did benefit from being underweight the sector relative to the Indices as result of trimming client positions in the second quarter.
3. **SurModics Inc. (SRDX):** This Health Care company develops and provides "surface modification" coating technologies for devices such as stents via partnerships with other companies. During the third quarter, the company reported that a significant relationship with Merck Inc. (MRK) would be terminated. While disappointing in the short-term, we believe the company's long-term prospects remain solid.
4. **Capella Education Co. (CPLA):** An on-line education provider for post-secondary and graduate degrees, this Minneapolis-based company moved lower after announcing the resignation of the president and weaker enrollments. We believe the lower enrollments are related to a change of information technology platforms, and expect the company to recover in the coming quarters.
5. **Advisory Board Co. (ABCO):** This company continued to suffer from weaker-than-expected earnings during the quarter. ABCO is a provider of syndicated health care research to hospitals and health care systems. We visited with the company on-site during the quarter to review their plans and outlook, and will continue to monitor new developments very closely.

SECTOR WEIGHTINGS



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## SECOND QUARTER BUYS & SELLS

### BUYS

There were no Buys of new companies in the portfolio during the quarter

### SELLS

1. **Lo-Jack Corp. (LOJN):** This company is well-known for its proprietary automobile recovery technology, sold through dealers as part of a new car purchase. We believed the company could weather a decline in auto sales due to its high margin profitability for dealers, but earnings released earlier this year proved this theory wrong and we sold the position.
2. **Mentor Corp. (MNT):** This company serves as an excellent example of our long-term investment approach, having been held in most client portfolios for the entire nine and three-quarters years of our separate account composite. The company's primary product line is surgically implantable breast implants for plastic and reconstructive surgery. After nearly ten years of contribution to the portfolio returns, we sold MNT to reinvest in other companies within the portfolio and reduce our Health Care sector weighting

In addition, to the above sales, we also added to positions in: Advent Software Inc. (ADVS), Capella Education Co. (CPLA), K-Tron International Inc. (KTII), NVE Corp. (NVEC), and Sun Hydraulics Corp. (SNHY). We reduced portfolio holdings in Raven Industries Inc. (RAVN), Ansys Inc. (ANSS), and Ritchie Bros. Auctioneers Inc. (RBA). Raven Industries Inc. (RAVN), Ansys Inc. (ANSS), and Ritchie Bros. Auctioneers Inc. (RBA).

## TOP TEN EQUITY HOLDINGS (AS OF 9/30/08)

SYMBOL	COMPANY NAME	SECTOR	% OF ASSETS
LDR	Landauer, Inc.	Health Care	3.98%
ADVS	Advent Software, Inc.	Financial Services	3.95%
ROL	Rollins, Inc.	Consumer Discretionary	3.86%
SMTS	Somanetics Corp.	Health Care	3.71%
RAVN	Raven Industries, Inc.	Other	3.53%
QSII	Quality Systems, Inc.	Health Care	3.37%
CRR	Carbo Ceramics, Inc.	Other Energy	3.35%
BBBB	Blackboard, Inc.	Technology	3.23%
PVTB	PrivateBancorp, Inc.	Financial Services	3.23%
IIVI	IIVI, Inc.	Technology	3.10%
Total Weighting within Composite:			35.31%

## STATISTICS VS. RUSSELL INDICES (AS OF 9/30/08)

Portfolio Characteristics*	CCA Small Cap Growth	Russell 2000 Growth	Russell 2000
Price/Earnings (1 Year Forward)	20.7x	16.2x	14.4x
Earnings Growth	18.3%	20.3%	15.6%
PEG Ratio	1.13	0.80	0.92
Weighted Average Market Capitalization	\$983 Mil	\$1,106 Mil	\$1,033 Mil
ROE	17.9%	10.0%	8.4%
Long-term Debt/Capital	10%	26%	29%
Dividend Yield	0.89%	0.67%	1.75%
Trailing 12 Month Portfolio Turnover	30%	N/A	N/A

\*Source: Factset Analytical System.

**DISCLOSURES: Fully Compliant GIPS Presentation for the Period Ending September 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	- 8.05%	- 10.38%	- 15.29%	88	0.30%	\$172.997	60%	\$288.545
2007	6.14%	- 1.57%	7.05%	94	0.73%	\$159.284	58%	\$275.368
2006	10.07%	18.37%	13.35%	95	1.14%	\$163.521	60%	\$271.483
2005	4.60%	4.55%	4.15%	70	0.93%	\$105.755	50%	\$211.667
2004	19.04%	18.33%	14.31%	39	1.26%	\$55.559	34%	\$165.497
2003	30.96%	47.25%	48.54%	37	2.35%	\$35.554	25%	\$140.624
2002	- 15.29%	- 20.48%	- 30.26%	17	2.67%	\$11.176	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 September 30, 2008**

<u>Time Period</u>	<u>Conestoga Return</u>	<u>Russell 2000 Total Return</u>	<u>Russell 2000 Growth</u>
1 Year	- 11.16%	-14.48%	- 17.07%
3 Years	2.86%	1.83%	1.45%
5 Years	8.77%	8.15%	6.64%
7 Years	8.75%	9.03%	6.94%
Since Inception (12/31/98)	10.23%	6.35%	2.54%

\*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 1.80% as of September 30, 2008.
- A complete list of composites and performance results are available upon request.

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## CONESTOGA'S SMALL CAP TEAM

### **William C. Martindale, Jr.**

*Managing Partner, Portfolio Manager, Managing Member, Research Analyst*

Bill is a Co-Founder and Managing Partner of Conestoga Capital Advisors. He serves as Chief Investment Officer of the firm, with a focus on small cap equity securities, as well as overseeing the firm's strategic business development and finances.

Bill's investment career spans more than thirty-nine years, beginning at Dean Witter Reynolds where he acted as Vice President and Manager from 1969 through 1989. In 1989, Bill co-founded Martindale Andres & Company, Inc., where he acted as Chief Investment Officer. In this capacity, he was responsible for approximately \$1.0 Billion in equity securities that the firm managed for its individual and institutional clients. Bill was the Portfolio Manager of the Governor Aggressive Growth Fund, a small cap mutual fund, and the Governor Established Growth Fund, a large cap mutual fund.

Bill received a Bachelor of Arts from Gettysburg College in 1964.



### **Robert M. Mitchell**

*Managing Partner, Portfolio Manager, Research Analyst*

Bob is a Co-Founder and Managing Partner of Conestoga Capital Advisors. Bob is responsible for directing the firm's equity portfolio management process and employing the firm's fundamental research approach to selecting securities. His focus is on small capitalization companies. Bob also oversees the firm's operations.

Prior to Conestoga, Bob was a Portfolio Manager/Analyst and Director of Equity Research at Martindale Andres & Company. Bob's portfolio management and research expertise was focused on small capitalization companies. While at Martindale Andres & Co., he was responsible for \$100 Million in individual and institutional small cap accounts.

Before his employment at Martindale Andres, Bob worked with the U.S. Department of Justice Antitrust Division where he analyzed the economic and financial aspects of various industries for evidence of antitrust violations.

Bob received his M.B.A. from Indiana University's Kelley School of Business in 1995; in 1991, he received a B.A. from the University of Notre Dame.

