

Conestoga Capital Advisors celebrated its five-year anniversary on July 1, 2006, and through the ongoing support of our clients, assets under management have now grown to \$271 million. Assets in the Small Cap Growth strategy ended the year at \$201 million, with new fundings of Small Cap Growth accounts totaling \$38 million for the year. As in our past quarterly review, the following pages review performance, best and worst performers, and buys and sells; however, we would be remiss if we did not take this opportunity to thank our clients and friends for the growth of our business over the last year and since inception five years ago. We thank you for the trust and confidence you have placed with us and look forward to serving you in the years ahead.

Market Review

Equity markets surged in the fourth quarter of 2006, producing nearly double digit total returns. The run-up more than offset the weak returns of the summer, and produced excellent full-year returns for U.S. equities. Economic data appeared to moderate over the quarter and many forecasters spoke of the “Goldilocks” environment, an economy neither too hot nor too cold. Earnings for U.S. companies continued strong, and full-year 2006 earnings growth will likely exceed 15%. Small capitalization stocks outperformed large capitalization stocks for the quarter and the full year, and Value stocks strongly outperformed Growth stocks for the full year. Results for the broad sectors of the U.S. Equities markets are given below.

Table 1: Russell Indices Fourth Quarter and Full Year Returns

| | Index | Fourth Quarter 2006 | Full Year 2006 |
|------------------|---------------------------|---------------------|----------------|
| Small Cap Stocks | Russell 2000 Index | 8.90% | 18.37% |
| | Russell 2000 Growth Index | 8.77 | 13.35 |
| | Russell 2000 Value Index | 9.03 | 23.48 |
| Large Cap Stocks | Russell 1000 Index | 6.95 | 15.46 |
| | Russell 1000 Growth Index | 5.93 | 9.07 |
| | Russell 1000 Value Index | 8.00 | 22.25 |

Source: Frank Russell Co.

The rally in the fourth quarter and the year 2006 favored the more speculative asset classes which benefit from a lack of uncertainties and lower volatility. This can be seen in the strong performance of emerging market stocks, which rose 29.2% (MSCI EM index in US Dollar terms), and in the low credit spreads of high yield bonds relative to U.S. Treasury bonds. Within U.S. equities, the effects of the preference for more speculative issues were manifest in the stronger performance of low-quality companies. Standard & Poor’s, through their Quality Rankings, attempts to measure quality by analyzing the long-term growth and stability of a company’s earnings and dividends. As reported by Lehman Brothers using data from S&P and FactSet, the table below demonstrates how high quality companies failed to keep pace with low-quality companies during the fourth quarter and the full year.

Table 2: Performance of Russell 2000 Companies by S&P Quality Ranking

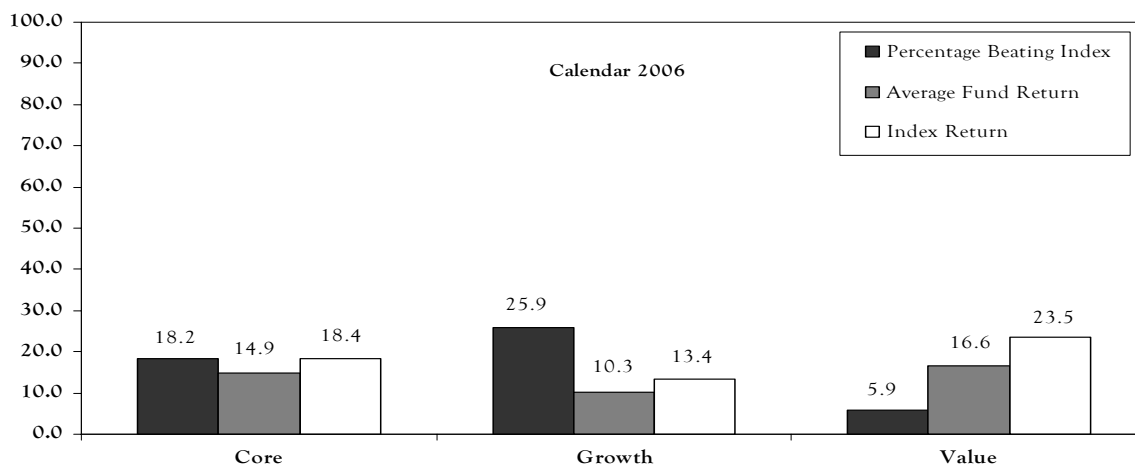
| Quality Level | S&P Ranking | Number of Companies | Fourth Qtr 2006 | Full Year 2006 |
|---------------------|-------------|---------------------|-----------------|----------------|
| High Quality Stocks | A+ | 21 | 5.1% | 11.1% |
| | A | 75 | 5.9 | 11.7 |
| | A- | 74 | 6.5 | 18.0 |
| | B+ | 209 | 9.5 | 17.6 |
| Low Quality Stocks | B | 264 | 9.7 | 18.3 |
| | B- | 342 | 11.0 | 24.3 |
| | C | 178 | 11.8 | 20.9 |
| | D | 1 | 49.3 | 110.6 |
| Unrated Stocks | N/A | 800 | 9.9 | 18.7 |

Source: Lehman Brothers.

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.

Significantly and broadly, many active management strategies failed to beat their benchmarks in 2006, as can be seen by the strong performance of the indices relative to mutual fund style groups. The table below, prepared by Prudential Equity Group LLC, reveals the weak relative performance of active management in 2006.

Chart 1: Small Cap Mutual Fund Performance in 2006



Source: Prudential Equity Group LLC, Lipper Analytical Services, Russell Investment Group

Naturally, the underperformance of active management leads to many questions about the causes, especially in the small cap sector, where active management has shown positive results over the long-term. One set of factors that may have affected many managers was the weaker relative performance of Technology and Healthcare versus the stronger performance of Financials (driven by community banks). Financials are a large part of the Russell 2000 Index (over 20%) and many managers were likely underweight, given the rising interest rate environment and concerns about residential housing. Also, the Financials sector includes real estate investment trusts (REITs), an industry many managers consistently underweight, which rose over 29% in 2006. In a strong positive return year, it is somewhat unusual for Financials (considered a more defensive sector) to outperform Technology and Healthcare (considered more aggressive sectors). Another possible factor affecting active managers may be the booming growth of exchange-traded funds (ETFs), many of which are passively managed against an index. Flows into ETFs were strong in the 2nd and 3rd quarters of 2006, while domestic equity funds experienced net outflows of funds (source: AMG Data). This may have caused better performance for the indices as ETFs spent their new dollars buying the index as a whole, while active mutual fund managers were selling their stocks to meet redemptions. Data for the fourth quarter fund flows has not been published as of the writing of this letter, but we will be curious to examine net flows for the full year.

As we begin 2007, our outlook for small capitalization stocks remains much in line with our past commentaries. Equities have continued to benefit from the economic recovery after the 2000-2002 bear market. Value stocks and low-quality companies have gained the most from this recovery, as earnings growth coupled with lower volatility and ample access to credit has created an environment in which weaker and lower-quality companies can succeed. Investors continue to seek higher returns to meet their long-term objectives, and the low volatility environment creates higher returns in more speculative investments (emerging markets, high yield bonds, etc.). Small capitalization companies are now operating at peak margins, and will need continued revenue growth to continue the multi-year run of ever expanding earnings. We do not believe small cap stocks are “priced for perfection”, but we do believe that an increase in economic or geo-political uncertainty, market volatility, or interest rates could prove difficult for many stocks. Our style, which has lagged the market since the recovery beginning in 2003, remains focused on higher-quality companies – companies with: (1) earnings, (2) sustainable earnings growth rates, (3) business models to capture the returns for shareholders, (4) low levels of debt, and (5) company managements that are also shareholders. This style feels a bit like the tortoise versus the hare in today’s environment, but we firmly believe that our clients’ portfolios will benefit from a long-term investment approach as we move through more uncertain economic times.

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Performance Review and Attribution

The Conestoga Capital Advisors strategy was able to hold a modest performance advantage relative to the Russell 2000 Growth after the first three quarters of 2006, but in the fourth quarter we encountered significant disappointments with three stocks (each is discussed below) which dragged performance below the Russell 2000 Growth for the full year. While each event was unique, it is especially frustrating to experience them simultaneously. We are disappointed in the performance results for the year, but we remain steadfast in our long-term investment philosophy and process, and our company research efforts continue to be the primary focus of our day-to-day activities.

2006 Annual Performance

For the calendar year 2006, the strategy underperformed both the Russell 2000 Growth and the Russell 2000 Indices. Sector weighting had a modestly negative impact, but the primary driver of underperformance was individual stock performance in the fourth quarter.

The strategy's position in Carbo Ceramics Inc. (CRR) was the poorest performing stock during 2006. During the second quarter, earnings at CCR fell short of expectations, and investors' confidence waned further as oil prices fell. The company makes a ceramic bead, called a proppant, which facilitates more efficient pumping of oil from wells. Another disappointing stock in 2006 was Computer Programs & Systems Inc. (CPSI), which fell over the summer on the news that its CEO would be retiring. We have owned CPSI since May 2002 initial public offering at a market capitalization of \$162 million, and the stock has grown to \$350 million in market capitalization. Select Comfort Corp. (SCSS) and Lo-Jack Corp. (LOJN) were two other key detractors from performance during the year, and they are discussed below under the fourth quarter review, as well as on the following page under the Laggards.

The strategy's best stocks in 2006 included World Acceptance Corp. (WRLD), a small-loan consumer finance company. WRLD rose steadily over the course of the year with revenue and earnings growth exceeding expectations. Trimble Navigation Ltd. (TRMB), a producer of GPS systems for agricultural and construction uses, was another top performer for the year on continued strong growth of earnings. Ansoft Corp. (ANST), was the best performer for the year, and is discussed in more detail below under the fourth quarter review.

While sector exposures were a very modest negative for the year, we should note that several sub-sector exposures did cause relative underperformance. Industries within the Financials sector, such as Commercial Banks and REITs, contributed significantly to the market's performance. Both are sectors we tend to underweight and this negatively impacted performance. Within Consumer Discretionary, the Retail and Restaurant industries performed well, and these were sectors we were underweight given their lower-quality characteristics and absence of long-term competitive advantage.

Fourth Quarter 2006 Performance

The fourth quarter proved to be the most difficult quarter of the year for Conestoga, as several stocks disappointed. Specifically, Select Comfort Corp. (SCSS), Lo-Jack Corp. (LOJN) and Raven Industries Inc. (RAVN) all produced disappointing results and dragged performance relative to the Russell 2000 Growth and the Russell 2000. SCSS announced lower than expected sales in September, and then lowered 4Q06 earnings guidance in December. LOJN came under pressure as the CEO resigned for personal reasons, and investors confidence was shaken. RAVN saw weaker sales and higher-than-expected capital expenditures reduce earnings. Each company is covered in more detail under the Laggards section on the following page.

The strong performance of the quarter's best performing stocks could not offset these weaker performer, although several stocks did produce outstanding performance during the quarter. Ansoft Corp. (ANST) continued to rise and became the best performing stock in the portfolio over the full year. FactSet Research Systems Inc. (FDS) announced better-than-expected earnings and also was one of the year's best performers. Blackbaud Inc. (BLKB), a new position in the third quarter, also contributed strongly to relative performance.

Sector allocations during the quarter were modestly negative. As mentioned in the above section discussing the full year's performance, several Industry level allocations including Commercial Banks, REITs, and Retail/Restaurants detracted from relative return.

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Top 5 Composite Leaders

1. FactSet Research Systems Inc. (FDS): A provider of software used by investment managers, investment banks and other financial firms to analyze securities and investment portfolios, FDS has a strong business model of recurring revenue. The company posted another strong quarter, reporting better-than-expected earnings. We trimmed the position towards the end of the quarter as its market capitalization moved towards the upper end of our capitalization range.

2. Simpson Manufacturing Co. (SSD): SSD designs and builds systems to strengthen a homes' ability to withstand earthquakes and high winds. The stock rebounded after a difficult summer when its price fell on concerns of a slowing housing market. While third quarter earnings declined on a year-over-year basis, the stock appreciated as the market sentiment improved. It appears that investors are anticipating an improvement in the housing sector which has not yet materialized in SSD's results.

3. Ansoft Corp. (ANST): This Pittsburgh-based company creates software used to aid in the design of technology devices such as cell phones, circuit boards, and networking systems. The company reported earnings in-line with expectations and guided for continued revenue growth of 10% to 15% and earnings growth of 25% for the remainder of its fiscal year. We reduced this position in mid-December to take some profits.

4. Blackbaud Inc. (BLKB): A new purchase in the third quarter, this company has created a software solution for use by not-for-profit entities to better manage their fund-raising efforts. The company demonstrated its strong business model with its third quarter results including income from operations growth of 28%, and revenue growth of 16%.

5. II-VI Inc. (IIVI): This maker of laser-related products followed its summer rally with another strong quarter. Earnings released during the quarter were in line with expectations and the company guided towards full-year earnings of \$1.10 to \$1.18. Purchased in the first quarter of 2006, this stock finished the year as one of the strategy's best performers.

Bottom 5 Composite Laggards

1. Select Comfort Corp. (SCSS): Select Comfort manufactures, markets and sells adjustable-firmness, a.k.a. air mattresses, in the United States and Canada. SCSS announced poor earnings for the third quarter in late October after weak September sales. Then, in late November, the company lowered guidance for its full-year earnings and the stock fell further. Despite the drops, SCSS is still expected to grow earnings at over 20% in the coming year, and we believe the stock's long-term potential remains intact.

2. Raven Industries (RAVN): This South Dakota-based maker of electronics, specialty sheeting, and flow controls announced earnings in mid-November that missed analyst expectations by two cents. Revenue growth year-over-year rose just over 6%, also weaker than expected. We believe the company's long-term growth prospects remain intact. On a positive note, the company celebrated its 50th anniversary in 2006 and was named to Forbes list of the 200 best small companies in October.

3. Lo-Jack Corp. (LOJN): This company announced lower-than-expected third quarter earnings and the resignation of its CEO in November. The announcements shook investor confidence and the stock traded down. Based in Westwood, MA, LoJack is the leader in wireless tracking and recovery systems for automobiles. We do not currently believe the sudden departure of the CEO indicates further problems to come, but we are closely watching developments at the company.

4. SurModics Inc. (SRDX): Based in Minneapolis, MN, SRDX is a medical device company specializing in surface modification and drug delivery systems. The company's largest relationship is with Johnson & Johnson's Cordis division for its Taxus stent. Concerns raised about the long-term health effects of coated stents and the announcement that Johnson & Johnson would acquire a competitor created volatility in the stock price.

5. PrivateBancorp Inc. (PVTB): This bank focuses on high net worth individuals in the Midwest. PVTB announced earnings growth of 24% for the quarter, but these were slightly weaker than expected, and the stock fell modestly before partially recovering towards the end of the quarter. The company also announced the acquisition of Piedmont Bancshares in the Atlanta area as part of its growth strategy.

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Fourth Quarter Buys

There were no new purchases into the strategy during the fourth quarter, however, we did add to three positions that we believe deserve a higher weighting. Specifically, A.S.V. Inc. (ASVI), Carbo Ceramics (CRR), and Blackboard Inc. (BBBB) were all increased to reflect our continued long-term conviction in the stocks after recent shortcomings. Also, Quality Systems Inc. (QSII), which was first purchased in the second quarter, was raised to a full weighting of 2%.

Fourth Quarter Sells

1. Matthews International Corp. (MATW): A multi-year holding for our strategy, this Pittsburgh-based producer of caskets and memorials has appreciated nicely since its original purchase. We have become concerned that its growth rate and profitability will be challenged by changes in the distribution economics of the casket industry.

2. Cherokee Corp. (CHKE): As the leading brand at Target Stores, Cherokee Corp. has enjoyed the success of Target's growth nationwide. Recently, however, their square footage within Target has declined and Target has used more brands from other companies to diversify their lines. While the company has many excellent fundamentals, we are concerned that their long-term growth may be challenged.

Several other companies were reduced in exposure this quarter. FactSet Research Systems (FDS) was trimmed as its market capitalization surpassed \$2.5 billion, and Ansoft Corp. (ANST) was trimmed modestly after its tremendous performance in 2006 caused it to become one of the larger positions in the strategy.