# OAK VALUE FUND

## Investment Adviser's Review – Second Quarter 2008

***"The way to make money is to buy when blood is running in the streets."***

-John D. Rockefeller

Using the words of one of history's great monopolists as a call to arms amid runaway energy prices is more than a tad ironic, but now that we are officially in a bear market, Rockefeller's advice is as relevant as ever. While we would not characterize what's happening in the broader market as a total bloodbath, there are definitely some streets that could stand a scrubbing. A resurgence of fears regarding the health of a number of financial institutions coupled with the massive spike in energy prices made for a disappointing end to the second quarter, as these forces reached a crescendo in the closing days of June. Fear that the mighty consumer has finally rolled over seems to have supplanted credit concerns as the primary purveyor of pessimism in the overall market. Both of these factors are certainly valid concerns, but the very fact that the sources of discontent among investors are shifting reminds us that the forces that influence valuations in the short term are just that--short-term forces.

While the Oak Value Fund's (the "Fund") performance bested that of relevant value-style indices during the second quarter, it under-performed the broader market as measured by the S&P 500 Index. Higher energy prices and continued "credit crisis" concerns contributed to a period of extreme volatility. Energy stocks advanced more than 17% while financial stocks declined by more than 18%, on average. A simple analysis suggests that the underperformance of the Fund during the quarter is singularly attributable to our underweighting in the energy sector. In short, the outperformance of the Fund's holdings in the financial, consumer discretionary and healthcare sectors was just not enough to make up for the gale-force headwinds of rising energy prices and the shares of the companies who benefit from such.

Shares of first quarter Fund portfolio addition Praxair advanced more than 12% during the second quarter as the company continued to benefit from increased demand for its specialty gases by energy sector companies both domestically and abroad. Joining Praxair among the Fund portfolio top performers and positive contributors during the period were financials Aon and Willis Group, software provider Oracle, and medical device manufacturer Medtronic. Leading the detractor side of the equation was a ten percent decline in the share price of Berkshire Hathaway, which remains the largest holding in the Fund. Capital One, American Express, Ambac, and 3M rounded out the list of most notable detractors during the period.

**Quarter-End Performance For Periods Ended June 30, 2008**

| | 3 Month | 1 Year | 5 Year [1] | 10 Year [1] | Since Inception 01/18/93[1] |
|---|---|---|---|---|---|
| Oak Value Fund | -4.51% | -16.04% | 4.46% | 2.57% | 9.67% |
| S&P 500 Index | -2.73% | -13.12% | 7.58% | 2.88% | 9.25% |

*1) Annualized.*

*The performance information quoted above represents past performance and past performance does not guarantee future results. Investment return and principal value of an investment will fluctuate so that an investor's shares, when redeemed, may be worth more or less than their original cost. Current performance may be lower or higher than the performance data quoted. Performance data, current to the most recent month end, may be found at the Oak Value Fund ("Fund")'s website www.oakvaluefund.com. An investor should consider the Fund's investment objectives, risks, and charges and expenses carefully before investing. The Fund's prospectus contains this and other important information.* ***The Fund's annualized gross expense ratio as of fiscal year-end (06/30/08) was 1.37%.***

The Fund imposes a 2% redemption fee on shares redeemed within 90 days of their purchase date. See the Fund's current Prospectus for more information on the Fund's redemption fee. Please keep in mind the performance information above does not reflect the imposition of a 2% redemption fee. You may obtain a copy of the Fund's prospectus at www.oakvaluefund.com or by calling 1-800-622-2474. Please read the prospectus carefully before you invest or send money.

The macro-economic outlook for the next six to twelve months is as unclear as ever, though we believe the Fund is composed of businesses that should perform admirably through the course of the business cycle. *As long-term investors, we have seen these kinds of markets before and we will see them again.* We believe our philosophy of seeking good businesses that have sustainable advantages and buying them at attractive prices is as appropriate today as ever. We think that owning advantaged companies that not only perform well in good times, but that are also likely to emerge from difficult operating environments as even stronger competitors within their respective industries is a darn good way to make money, especially in a bear market.

| Top Ten Holdings As of June 30, 2008 | | |
|---|---|---|
| **Company** | **Primary Business** | **S&P Sector** |
| 3M | Manufacturing & Marketing Technology Products/Services | Industrials |
| Berkshire Hathaway | Insurance, Reinsurance & Capital Allocation | Financials |
| Cadbury | Confectioneries | Consumer Staples |
| Coach | Handbags & Accessories | Consumer Discretionary |
| DuPont | Chemicals | Materials |
| Diageo | Global Premium Alcohol Business | Consumer Staples |
| Medtronic | Medical Device Manufacturer | Health Care |
| Oracle | Database, Middleware, & Application Software | Information Technology |
| E.W. Scripps | Entertainment & Information/Media | Consumer Discretionary |
| Tiffany | Designer, Manufacturer, and Retailer of Fine Jewelry | Consumer Discretionary |

## *Update on Largest Holdings…*

**Berkshire Hathaway** – The shares of Berkshire Hathaway declined approximately ten percent during the quarter – less than the financials sector overall but far more than the broad market. Our long-term attraction for Berkshire's business model has been well documented and thoroughly vetted. The strength afforded by this model has manifested itself in the form of an ever increasing hoard of cash that until recently appeared to have a permanent place on the balance sheet of the company we have often called the "Fort Knox" of financial companies. It would now appear that the long-awaited period of "opportunity" for which this cash has been reserved has arrived. In recent months Berkshire has made significant investments across a broad spectrum of opportunities. For sure, this cash generating machine continues to pile it up, but Mr. Buffett's recent moves have certainly been shoveling it out the other side. More than $6 billion in equity and debt invested in Wrigley and around $4 billion in auction rate securities are just two examples. In our estimation, the value to be realized by each incremental allocation of capital only serves to further increase the intrinsic value of this company. Meanwhile, the decline in Berkshire's share price only serves to further increase the margin of safety implicit in the Fund's portfolio.

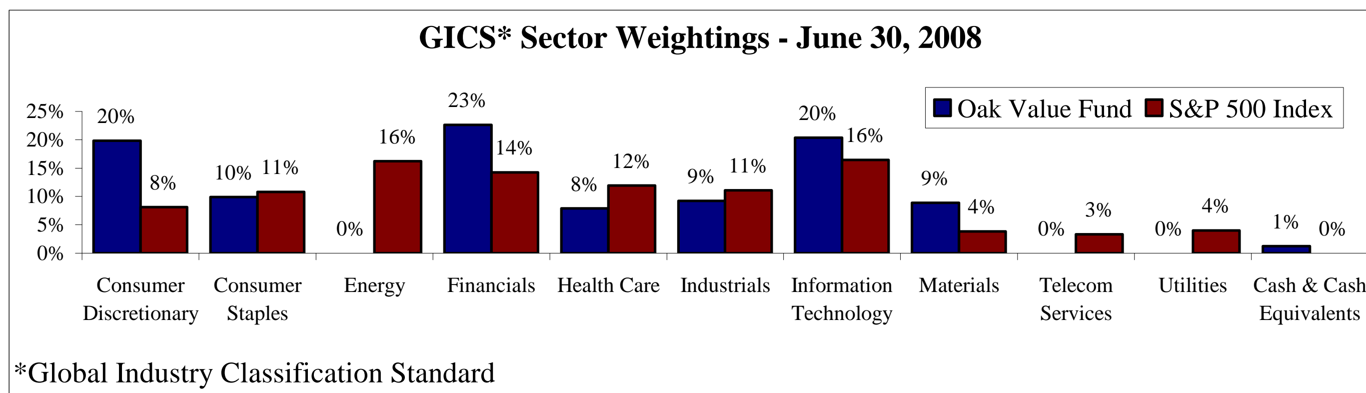
**Medtronic** – Our retention of Medtronic amongst the top holdings in the Fund continues to be based upon the belief that the market will assign a higher value to Medtronic's broad-based portfolio of medical technology products over time instead of focusing so myopically on the company's legacy cardiovascular platforms. Although we are starting to see those platforms return to more normalized growth rates, we believe the future value in this company will be more dependent on its broad product pipeline. Additionally, the company's leadership team is more vehemently embracing the necessity to run the business based on return on invested capital metrics and is extremely focused on gaining as much margin leverage as possible through cost reduction efforts across the company. Finally, we believe this management team is committed to returning value to company shareholders via large share buybacks and an increasing dividend. In spite of the fact that shares of Medtronic were among the better performers in the Fund during the quarter, we believe the company remains a good business with good management still available at an attractive price.

**Oracle** – Also among the top performers in the Fund during the quarter, Oracle has consistently delivered on the earnings growth trajectory that was a component of our original investment thesis. We believe the recurring nature of nearly half of the company's revenue stream along with the benefits of being the top software provider in many key verticals will extend the longevity of this strong earnings growth period. The business is global in nature, which desensitizes the fundamentals from U.S. market concerns. Oracle's track record of successful acquisitions continues to reinforce our belief that these have been good allocations of the company's excess cash flow. Additionally the company has been able to accelerate the cross-selling opportunities and expand its set of applications and technology

over a now larger installed customer base. While the shares of Oracle have performed admirably over the two year period since our original investment for the Fund, we believe the company's position as a sustainably advantaged business has further strengthened and that its shares continue to provide investors with an attractive margin of safety.

**Diageo** – Diageo is the world's leading premium drinks business with an outstanding collection of international brands across the spirits, wine and beer categories. We initiated a position during the quarter and took advantage of the market weakness to increase position size. This uncharacteristic move to build a full position in a relatively brief period of time is a reflection of our knowledge of the business and the industry, our understanding of its economics and the manner in which the company management views those economics, and the increasingly attractive opportunity represented by recent share price declines. The Fund has owned Diageo in prior periods and we have maintained our dialogue with the company in the interim. Our view is that while the company's profile is defensive in nature, it demonstrates an attractive opportunity for growth and earnings leverage at a time when excess cash flows are driving higher returns to company shareholders in the forms of share repurchases and increasing dividends. More importantly, we believe the trend toward premium brands in the spirits category will persist and that Diageo is well positioned to take advantage of this secular trend.

**Coach** – Shares of Coach have been volatile recently as concerns over the domestic consumer have intensified. Nonetheless, our investment in Coach is predicated on the thesis that the company has a great brand with a long runway to expand both domestically and internationally. In our opinion, Coach has the financials to match its brand. With gross profit margins in excess of 70% and operating profit margins in excess of 30%, the company generates significant free cash flow that it has utilized to expand its global opportunities while at the same time returning capital to its shareholders in the form of share repurchases. Coach's multi-national distribution network is a strong competitive advantage and minimizes the dependence on any single product, channel, or geographical market. This distribution system in itself is creating opportunities for growth. Importantly, we do not believe that the company's growth will come at the expense of excellent returns on capital. Moreover, we believe that the company will likely take advantage of its recently depressed stock price and further accelerate its own share repurchases. In our experience, it is only when short term concerns are of the "blood running" extreme that we as value investors are given the opportunity to invest in such high quality, growing businesses at very attractive valuations.




## *Recent Purchases*

**Apollo Group** - Our renewed investment in Apollo Group is based on our continued belief that the company has established itself as a leader in an industry that has high barriers to entry, solid growth potential, demonstrated pricing power, high profit margins, attractive returns on capital and significant cash flow generation. The company's business model leverages its size and scale in numerous operational capacities such as marketing and faculty support. Apollo Group is the largest private educational institution in the U.S. It was founded in 1973 with the purpose of serving the shifting marketplace in higher education towards a student population in which many were adults and working full time. Apollo Group has historically been a rapid grower, as the company led the way in the industry in the application of online delivery to the traditional university experience most notably through its flagship, the University of Phoenix.

We eliminated prior positions in the shares of Apollo Group just a few months ago as the shares had appreciated significantly and no longer provided us with the requisite margin of safety. In the months since, the shares have declined precipitously as industry concern over access to student lending and the increase in selling and marketing

costs have caused investors to worry of a possible disruption in the company's long term prospects. We continue to think Apollo Group has an excellent product offering, an attractive demographic profile and an outstanding business model. In our opinion, these forces should allow the company to produce attractive economics in even the most challenging of economic scenarios. Ironically, the company's recent acquisition of a lead-generating service and its accelerated investment in a larger staff of admissions counselors has given investors reason for pause. We view these moves as short term pain in exchange for long term gain. The ability to control the costs and functionality of the lead generation process through a captive service combined with a larger and more productive army of admissions counselors should help the company accelerate its growth and improve its student persistency. Over time, we expect Apollo Group to mine the prospects for international growth, which should enable the company to apply its core competency of online education to less mature markets. The company has recently announced one international acquisition and has launched a University in Canada. We expect that these will likely be only the first of many such moves.

Perhaps the most significant contributor to investor concern for this and all education related companies in recent months has been the impact of the credit crisis on the private student loan market. The news of the potential exposure of some industry participants to this risk has led to a veritable "throwing out the baby with the bath water." In the case of Apollo Group, we believe the exposure is negligible as less than five percent of its students are dependent on loans from such sources. In an interesting juxtaposition to this concern, the company recently announced a price increase for many of its programs as federal legislation was passed that actually increased the loan limits on Federal Title IV student loans.

Long-term sustainability is not necessarily reflected in short term predictability. Like many good businesses with good management, this company has a proven history of producing attractive returns for its shareholders. Over short term timeframes, the business results can and likely will be bumpy. Our propensity is to view such bumps as opportunities.

**Diageo** - Diageo is the world's leading premium drinks business with an outstanding collection of international brands across the spirits, wine and beer categories. Operating in some 180 countries around the world, the company has become truly global. Well known brands including Ketel One and Smirnoff vodkas, Johnny Walker Scotch Whiskies, Captain Morgan's rum, Bailey's Original Irish Cream liqueur, J&B Scotch Whiskey, Tanqueray gin, Crown Royal, Beaulieu Vineyard and Sterling wines, Bushmills Irish Whiskey, and Guinness stout populate the company's product portfolio. In addition, the company also has the distribution rights for the Jose Cuervo tequila brands in the United States and other countries.

Diageo is also a prior Fund holding and a company that we consistently monitor for the opportunity to buy its shares at an attractive price/value relationship. The company has been steadily adding brands to its portfolio and continuing to leverage local and regional brands in to create global franchises. On a parallel track, Diageo's management has been disciplined in its efforts to continually improve its cost structure throughout its brands and business lines.

Increased investor concern regarding a slowing U.S. consumer has contributed to the weakness of the company's shares as this geographic region represents about 30 percent of total sales. While we acknowledge Diageo's U.S. market position, it is not the dominance in this market that attracts us. Instead, we are more focused on the global nature of the overall company – the other 70 percent. As we have experienced with other portfolio companies with a similar international mix, we believe the international components will more than offset any further weakness in the U.S. markets. Additionally, we believe the trend seen over the last few years to premium spirits will continue, benefiting Diageo—which holds one of the largest premium portfolios in the global spirits business.

Put simply, we believe Diageo is a high quality business and that its shares are significantly undervalued. The company management's focus on improving returns on invested capital has served to only reinforce our attraction to this business.

**Zimmer Holdings** - Zimmer is a leading provider of reconstructive orthopedic implants – including hips, knees, dental, spinal, and trauma-related orthopedic surgical products. The company enjoys a leading worldwide market share position in both hips and knees, and collectively these two segments account for 75 percent of Zimmer's total revenue. Zimmer's emphasis is on delivering innovative technologies to the marketplace. Much of the company's effort in the reconstructive implant business is to expand its offerings in the application of minimally invasive surgical

techniques to orthopedic surgery. The benefits of this approach over total joint replacement include reduced rehabilitation and recovery time. We believe it is reasonable to expect that procedural volumes on a worldwide basis will continue to rise and will be driven by an aging global population as well as the effects of obesity and more active lifestyles.

One of the key investment considerations for a medical technology company is its ability to leverage its research and development investments by bringing new products to the market on a regular basis. The company spends approximately five percent of total revenues on research and development annually. The payback from this investment in research and development is evident in the fact that the company generates more than 25 percent of revenues from products introduced during the last three years. Medical device companies often state that the differentiator in market share is a function of technology and innovation. In our view, relationships with physicians are also important, as is maintaining enough product in the field as procedural volumes can have some seasonality embedded due to the elective nature of some procedures. Zimmer is a well-known name in the physician community, and it is our opinion that the company's current market share, along with new product launches across the knees, hips, dental, and spinal platforms will continue to drive above average revenue and earnings growth to shareholders.

With more than half of its hip sales and more than a third of its knee sales outside of the U.S., Zimmer's business fits a common theme among the Fund's holdings. Though based in the U.S., its business is increasingly global. This global expansion only serves to further leverage the brand and reputation the company has developed and to provide a larger population of customers over which to amortize its ongoing product development costs. We believe the company will be able to accomplish its continued global expansion while investing for the future in the areas of new products without diluting its economics. In addition to a pristine balance sheet, the company boasts operating profit margins in excess of 30 percent and converts nearly one fifth of each revenue dollar into free cash flow. With this excess cash flow, Zimmer has the flexibility to continue to fuel its future growth and take advantage of market dislocations to opportunistically return capital to its shareholders through aggressive share repurchases. We are pleased to have the opportunity to position the Fund in such a high quality business that still has a significant demographic tailwind on a global basis. A good business with good management, now finally available at an attractive price!

## *Recent Sales*

**Ambac** – The credit crisis in the U.S. began in earnest about a year ago. Its duration has been longer, its damage deeper, and its influence broader than any event we have seen in the financial markets in quite some time. For the most part, our positioning of the Fund in the financials sector has yielded above average returns during this period of extreme volatility. Unfortunately, Ambac is an exception. The investment thesis we espoused at the time of our initial purchases was, at its core, based on the belief that the company's exposure to the "toxic waste" of subprime collateralized debt obligations was finite and that the steps the company had taken in underwriting those risks would serve to protect its shareholders. As the depth and breadth of the crisis spread, so did the potential damage.

We believed the company had adequately managed its potential exposure to losses, and we had taken those estimates into full consideration in our analysis and decision making. Underlying our analysis was the belief that the "stress-case" valuation scenarios were reasonable, and that the market's inability to price the securities was more a function of a lack of liquidity than a long term diminution of value. As the company repeatedly indicated that it was comfortable with its exposures especially after it raised capital (which they suggested that they did not really need), we were braced for a prolonged period of volatility but comfortable with the cash flow outlook for the company. Ambac indicated their raising of capital was primarily to add cushion to make the regulatory and rating agencies more comfortable.

Within weeks of this capital raise the company disclosed that it was further increasing its loss estimates and that the impact of the credit market meltdown was beginning to spread to other areas of exposure as well as its investment portfolio. This outcome was far outside even the most dire of the scenarios we had considered. It was now obvious that the risks the company had assumed were greater than they had indicated and the impact was more severe than they or we had anticipated. We sold the position and took the loss.

**Dr. Pepper Snapple Group** – Cadbury completed the spin off of the Americas beverage division into an independent, separately traded public company named Dr. Pepper Snapple Group. As a result of the separation and size of the beverage company, the position became a very small position in the portfolio that we subsequently sold. We have

long contended that our focus and interest has been on the confectionery assets held by Cadbury and that the opportunity for growth in both gum and confections in emerging markets is much greater than the opportunity for growth in the Americas beverage segment. We continue to own Cadbury in the Fund.

**Harley-Davidson** – Harley-Davidson remains a solid company with good long-term prospects. Though its premium brand and solid balance sheet will surely sustain it through the months and perhaps years ahead, we eliminated the Fund's positions during the quarter. Our decision was based on our rising concerns about the potential impact of a slowing U.S. economy and its potential impact on Harley-Davidson's customer base. Indeed the company's international business continues to grow, but the reality is that a Harley carries a relatively high ticket price for a truly discretionary item. We will continue to watch the company closely as we believe it possesses an extraordinarily powerful brand and the ability to continue to grow the business on a long-term basis.

**Johnson & Johnson** – We sold Johnson & Johnson shares during the quarter. We have become increasingly concerned that Johnson & Johnson's pharmaceutical segment will continue to be challenged by generic offerings and will ultimately result in lower returns from the company's investment in research and development. Johnson & Johnson has delivered the drug pipeline within the timeframe they had projected, but the intensity and rapidity of competition from generics implies that the business model is not as resilient as it once was. Despite the acquisition of Pfizer's consumer business, the consumer segment is still the smallest contributor to overall sales and earnings at less than one quarter of the total. While the company continues to focus on creating growth avenues, the reality is that in the absence of foreign exchange benefits, the drag of the pharmaceutical segment on the company's overall organic growth rate has been more significant than acceptable to support our investment case.

**Willis Holdings** – Our rationale for leaving Willis during the quarter was due more to competition for the capital than it was any sort of shortcoming we found in our Willis investment thesis. We are still great admirers of the insurance brokerage industry and we maintain the Fund's position in Aon. Our opinion is that Aon has perhaps a clearer path to improved profitability over the near term and we decided to redeploy Willis capital in the Fund elsewhere.

## *In Closing…*

As long-term investors, we have been through these types of markets before and we will go through them again. While the near-term challenges facing the economy are real, we note that we have selected the businesses that generally compose the Fund because of our belief in the ability of those businesses to perform in both favorable and unfavorable economic environments. Our experience suggests that our philosophy of owning good businesses with durable competitive advantages and maintaining adequate margins of safety is especially appropriate in times such as these.

We thank you for your continued confidence in the Oak Value team.

## IMPORTANT INFORMATION

Authorized for distribution only if preceded or accompanied by a prospectus. Where shown or quoted, recent company returns (for example calendar quarter or trailing twelve months) are stock price changes only, and reflect neither dividends nor any fees as associated with an investment in the Oak Value Fund (the "Fund"). This Investment Adviser's Review seeks to describe the Fund managers' current views of the market and to highlight selected activity in the Fund. Any discussion of specific securities is intended to help shareholders understand the Fund's investment style, and should not be regarded as a recommendation of any security. Displays detailing a summary of holdings (e.g., Top Ten Holdings, GICS Sector Weightings, etc.) are based on the Fund's holdings on June 30, 2008. "Top Ten Holdings" do not include money market investments.

We do not attempt to address specifically how individual shareholders have fared, since shareholders also receive account statements showing their holdings and transactions. Information concerning the performance of the Fund and our recommendations over the last year are available upon request. Past performance is no indication of future performance. You should not assume that future recommendations will be as profitable or will equal the performance of past recommendations.

| Oak Value Fund Portfolio<br>Top Ten Holdings as of 06/30/08 | |
|---|---|
| **Security Description** | **% of Net Assets** |
| Berkshire Hathaway, Inc. (CL - A) | 9.26% |
| Medtronic, Inc. | 5.66% |
| Oracle Corp. | 5.64% |
| Diageo plc ADS | 5.28% |
| Coach Inc. | 4.91% |
| E.W. Scripps Co. | 4.86% |
| DuPont EI Nemours & Co. | 4.83% |
| 3M Co. | 4.82% |
| Tiffany & Co. | 4.76% |
| Cadbury plc ADR | 4.61% |

Statements referring to future actions or events, such as the future financial performance or ongoing business strategies of the companies in which the Fund invests, are based on the current expectations and projections about future events provided by various sources, including company management. These statements are not guarantees of future performance, and actual events and results may differ materially from those discussed herein. References to securities purchased or held are only as of the date of this communication to shareholders. Although the Fund's investment adviser (the "Adviser"), focuses on long-term investments, holdings are subject to change.

This Investment Adviser's Review may include statistical and other factual information obtained from third-party sources. We believe those sources to be accurate and reliable; however, we are not responsible for errors by them on which we reasonably rely. In addition, our comments are influenced by our analysis of information from a wide variety of sources and may contain syntheses, synopses, or excerpts of ideas from written or oral viewpoints provided to us by investment, industry, press and other public sources about various economic, political, central bank, and other suspected influences on investment markets.

Although our comments focus on the most recent calendar quarter, we use this perspective only because it reflects industry convention. The Fund and its Adviser do not subscribe to the notion that three-month calendar periods or other short-term periods are either appropriate for making judgments or useful in setting long-term expectations for returns from our, or any other, investment strategy. The Fund and its Adviser do not subscribe to any particular viewpoint about causes and effects of events in the broad capital markets, other than that they are not predictable in advance. Specifically, nothing contained in this Investment Adviser's Review should be construed as a forecast of overall market movements, either in the short or long-term.

Any hyperlinks and/or references to other web sites contained in this material are provided for your convenience and information. We do not assume any responsibility or liability for any information accessed via links to or referenced in third party web sites. The existence of these links and references is not an endorsement, approval or verification by us of any content available on any third party site. In providing access to other web sites, we are not recommending the purchase or sale of the stock issued by any company, nor are we endorsing products or services made available by the sponsor of any third party web site.

Comparisons to benchmark indices have limitations because benchmark indices have volatility and other material characteristics that may differ from open-end mutual funds. Because of these differences, benchmark indices should not be relied upon as an exact measure of comparison. Indices are unmanaged and do not reflect the payment of advisory fees and other expenses associated with open-end mutual funds. Investors cannot directly invest in an index, though index funds designed to replicate the performance of various indices are available. The S&P 500 Index is weighted by market value, and its performance is thought to be representative of the stock market as a whole. The S&P 500 Index was created in 1957, although it has been extrapolated backwards to several decades earlier for performance comparison purposes. This S&P 500 Index provides a broad snapshot of the overall U.S. equity market; in fact, over 70% of all U.S. Equity is tracked by it. The S&P 500 Index selects its companies based upon their market size, liquidity, and sector. Most of the companies in the S&P 500 Index are mid cap or large cap corporations. The S&P 500 Index referenced include the reinvestment of dividends.

Reference to "GICS Sectors" refers to the Global Industry Classification Standard. Descriptions or graphics related to "GICS Sector Weightings" are presented to illustrate the business and portfolio management operations of the Adviser or examples of representative groupings and securities in which the Fund may invest and are not to be considered recommendations by the Adviser. Categories and groupings in graphs detailing sectors are sourced from Standard & Poor's and Morgan Stanley Capital International "MSCI."

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