

## Fourth Quarter 2006 Investment Update

As Evercore Asset Management was coming together at the end of 2005 we tried to lay out a thoughtful, yet aggressive, multi-year strategic plan. It called for assets under management of \$125 million at year-end 2006 and assumed meaningful investments in people and systems. We're pleased to report that, on both accounts, we have exceeded our plan.

On the fundraising front, we began managing three new accounts this quarter, with assets totaling \$130 million. FMC Technologies hired us to manage a small-cap value mandate, Genworth Financial selected us to advise on a concentrated value portfolio and we launched a long/short equity strategy. The key to this strategy is that it allows us to short stocks that may *look* cheap on traditional value metrics, but that we believe are value traps. All told, assets under management at the end of December are \$157 million, and we are in active discussions for several additional opportunities.

Regarding personnel, we are pleased to have added a fourth research analyst this quarter. Our firm is now 13 people strong.

It's often said that an investment firm is nothing more than a collection of individuals. While on the surface that may be true, we are working hard to develop a culture that encourages teamwork, camaraderie and open communication. We look for smart people with skills and interests that are complementary and additive, people who want to work in an entrepreneurial environment with the opportunity to impact the growth of our firm. And we look for people we will enjoy working with. This quarter we hired another such person. Jeff Johnson, who joined the analyst team in December, worked with Andrew Moloff at Citigroup as an equity analyst and portfolio manager.

Looking ahead, our top priorities for 2007 are:

1. Achieving strong investment returns in Small- and SMID-Cap Value.
2. Opportunistically growing our employee base.
3. Initial marketing of a couple of alternative small/smids-cap value strategies — offshoots of our core investment services.

### *Our Philosophy*

As deep value investors, our view is that opportunities arise from emotional investors who are more concerned with market risk than business risk. We believe that short-term price movements are typically driven by hope or hype – reactions to recent news or events that are often irrelevant to a company's long-term prospects. This price volatility is largely unrelated to volatility in the cash flows of the underlying investments. And so, over time, as investors react – and often overreact – to news, a company's stock price often becomes disconnected from its underlying fundamentals. This creates opportunities for value investors. Our strict focus on the fundamentals – the operating environment, earnings and free cash flow – identifies companies whose stock prices have become cheap relative to their long-term normalized earnings power. Our portfolios consist only of companies that we believe have an outsized opportunity to appreciate in value.

## Portfolio Overview

For the quarter ended 12/31/06, Small-Cap Value returned 9.1% and SMID-Cap Value returned 8.3%, net of fees.

By year end, Small-Cap Value returned -1.8% net of fees for the nine months from its April 1 inception date. SMID-Cap Value returned 8.8% net of fees over the same time period. But the story doesn't stop there, of course. We take a long-term approach towards investing and we are very excited about the prospects of the companies we own.

As a part of our commitment to those who invest with us, we aim, vis-à-vis the investment update, to reinforce our philosophy and examine the factors that have the most relevance to the long-term outlook of our portfolio. Below are selected holdings that experienced an event, or reported news this past quarter that we think impacts their prospects, for better or worse, and our thoughts on how it relates to our thesis and affects our point of view.

**Hasbro Inc. – HAS**

*(SMID-Cap Value)*

**JAKKS Pacific, Inc. – JAKK**

*(Small-Cap Value)*

**Mattel Inc. – MAT**

*(SMID-Cap Value)*

Toys were a stronger seller this year than other popular categories, led by brand-rich Mattel, Hasbro and JAKKS Pacific. With long track records of successfully reinvesting capital into a diversified portfolio of valuable licenses and trademarks, we believe that each of these companies is in a position to improve the intrinsic value of its business.

No. 2 Hasbro, with brands such as G.I. Joe, Tonka, Milton Bradley and Parker Brothers, has licensed its Play-Doh brand to REEBOK which will make toddler footwear branded with the Play-Doh name and has another licensing deal, with Marvel, involving the Spiderman toy. Hasbro also has Transformers, which could see stronger sales following the release of a related movie due out later this year.

JAKKS, a designer and marketer of toys and consumer products, reported strong third-quarter earnings. The company had been under pressure since late 2004 following a lawsuit brought by World Wrestling Entertainment (WWE). WWE-related toys and video games represent an estimated 17% of pretax income. In April 2006, however, two of the three federal claims brought against the company were dismissed and our research showed significant fundamental strength. JAKKS has successfully diversified its sales base through a significant portfolio of "evergreen" brands, which the company believes are less susceptible to market fads. Principal licenses include Nickelodeon, Dora the Explorer, Hello Kitty and Rugrats. Additionally, the company has strong distribution through important retailers such as Wal-Mart, Target and Toys "R" Us. JAKKS further expanded its portfolio this quarter through licensing agreements with MGA Entertainment (BRATZ) and Church & Dwight Co., Inc., where it will develop pet products based on its Arm & Hammer® brand.

Mattel is the No. 1 toymaker in the world, with product lines such as Barbie, Fisher-Price, Hot Wheels, Matchbox and American Girl. Mattel reported strong earnings growth for the third quarter and showed strong sales this quarter across a broad array of product lines including a turnaround in Barbie toys for the third consecutive quarter, "CARS"-branded items based on the Disney film and an updated Elmo, marking its 10-year anniversary, whose sales were stronger than expected.

## **RadioShack – RSH**

*(SMID-Cap Value)*

Despite recording a third quarter loss, RadioShack has made meaningful progress in its turnaround. The new management team is in place, led by Julian Day who has had success at other notable retailers, inventory is being reduced, poor performing stores are being closed and the company's cash position is improving – it ended the third quarter with \$276 million – through better working capital management and streamlining costs. We believe that management has taken the appropriate first steps to return to a profitable and growing franchise, but our thesis also hinges on the company's ability to leverage its strong distribution network by concentrating on finding the right product mix to improve store profitability.

## **Universal Corp. – UVV**

*(Small-Cap Value and SMID-Cap Value)*

Headquartered in Richmond, Virginia, Universal is one of the world's leading tobacco merchants and processors and conducts business in more than 35 countries. The company also has an agri-products business. In December, Universal announced plans to sell its remaining non-tobacco business within the next six to 12 months in order to focus on its core tobacco business. Divesting these businesses (which reported an operating loss of about \$6 million in fiscal 2006) and using the proceeds to improve its balance sheet was part of our initial investment thesis.

## **Transactions**

Significant additions to our portfolios this quarter included the purchase of Axcelis Technologies, Inc., CSS Industries, Inc. and Royal Caribbean Cruises LTD.

## **Axcelis Technologies – ACLS**

*(Small-Cap Value)*

Axcelis designs, manufactures and services high price-point capital equipment for the semiconductor manufacturing industry. Axcelis has a strong market position in most of its key ion implantation product lines: #2 in high current with 31% share (versus #1 Varian at 38%); #1 in high energy at 95% share; #3 in medium current at 18% share. ACLS has lost market share to its key competitor over the past year because it was late to market with the next generation of high current ion implantation devices leading to significantly lower financial results. Additionally, ACLS has historically had relatively higher overhead costs and higher R&D expenses than competitors. Our research shows that ACLS's new generation of high current devices, which were recently introduced to the market, will allow the company to regain lost market share and improve financial results. Additionally, the company has made significant progress in its cost reduction efforts and has a strong balance sheet.

## **CSS Industries – CSS**

*(Small-Cap Value)*

CSS is a small, largely overlooked producer of gift wrapping and related merchandise, as well as other seasonal products such as Easter egg dye and Halloween costumes. Earnings took a dip because of higher raw material, energy and transportation costs, but CSS has a strong market position and a long history of generating steady profitability and growth.

## **Royal Caribbean – RCL**

*(SMID-Cap Value)*

Founded in 1968, Royal Caribbean is the world's second largest cruise line, and holds 36% of North American passenger market share. RCL operates under two brands — Royal Caribbean International and Celebrity Cruises. Market concern over the impact of new capacity on pricing, and sensitivity of industry profitability to an economic downturn has put pressure on the stock. Our research suggests that industry consolidation should help support pricing and lead to capital spending discipline. We also see secular improvements in industry profitability related to an increase in direct bookings.

We sold Cabot Corp. and the last remnant of our position in Bunge; both of these reached our fair value target.

## **Portfolio Characteristics**

	<b>Small-Cap Value</b>	<b>SMID-Cap Value</b>
P/E (ex. negative earnings)	17.5x	16.2x
P/B	1.5x	1.8x
Dividend Yield	1.6%	1.8%

- 1. The Small-Cap Value and SMID-Cap Value composites comprise discretionary accounts with no material investment restrictions and that invest primarily in equity securities. Net of fee performance results reflect the deduction of advisory fees and brokerage commissions. The results also include the reinvestment of all interest, dividends and capital gains and were computed on a trade date (as opposed to settlement date) basis. Accounts in the composite were included on the first day of the month after being fully invested. Weighted performance measures the average performance of all portfolios in the composite weighted by size. The performance returns reflect the deduction of fees according to the applicable investment advisory fee schedule. Performance results for individual accounts vary due to the timing of investments, additions/withdrawals, length of relationship, fee schedule and size of positions, among other reasons. Past performance is no guarantee of future results. All investments involve risk including the loss of principal.*
- 2. The securities discussed above were holdings during the quarter ended December 31, 2006. They do not represent all of the securities purchased, sold or recommended by the advisor, and the reader should not assume that investments in the securities identified and discussed were or will be profitable. All information is provided for informational purposes only and should not be deemed a recommendation to buy the securities mentioned.*
- 3. All information provided in this presentation is for informational purposes only and should not be deemed as a recommendation to buy or sell the securities mentioned. We believe this is a balanced presentation of the performance of the portfolio, including a general summary of certain investments effected by the services that have both over and under performed the expectations of our portfolio managers. Past performance is not necessarily indicative of future results. Evercore Asset Management closely monitors the securities held in the portfolios. If a company's underlying fundamentals or valuation measures change, Evercore Asset Management will reevaluate its position and may sell part or all of its holdings.*