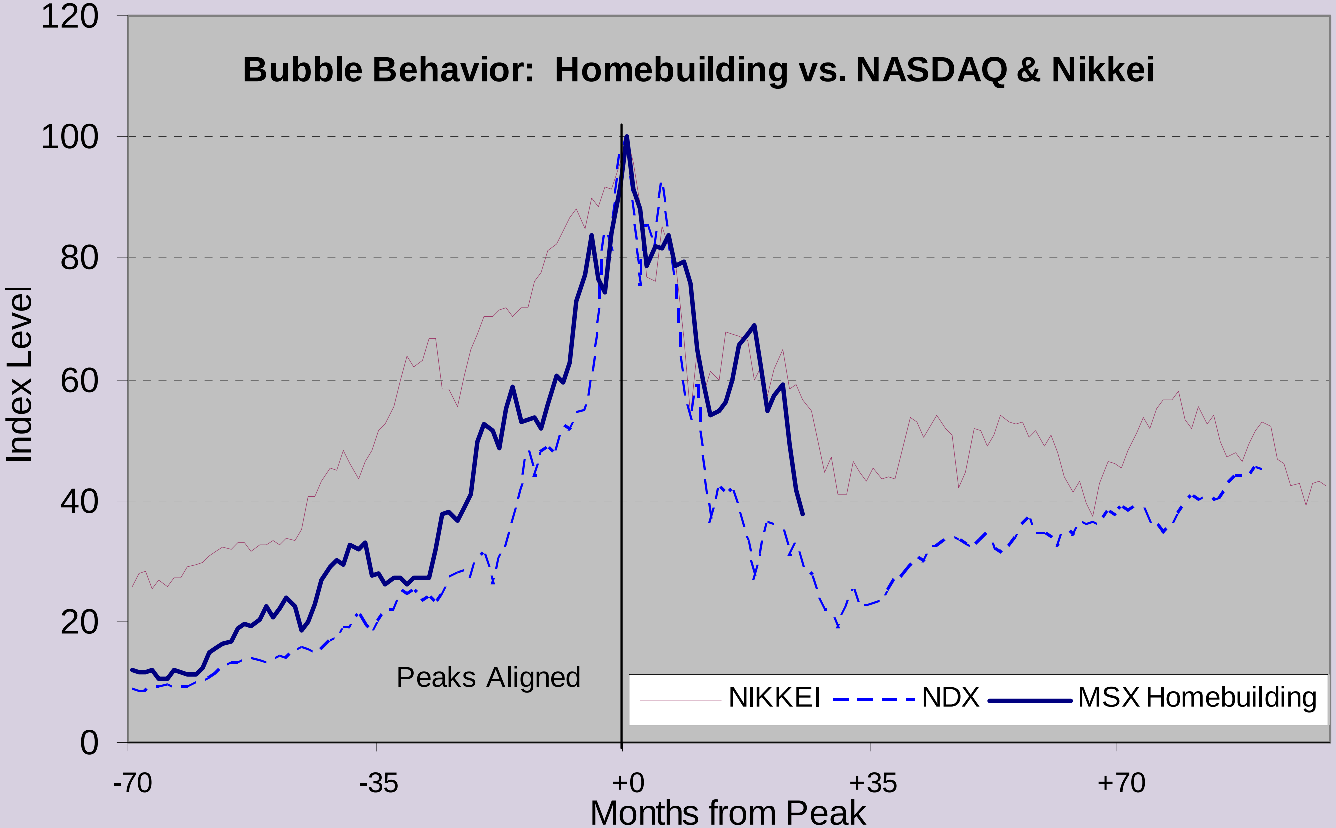
CIRRUS RESEARCH

Homebuilders: Deep Value or Dead Money?



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Key Themes

- **Focus on Subprime:** Will Consumer shares face the pain witnessed among Financials and Housing groups?
- **Catch-22 of Banks -** Depressed forecasts vs. Fed Easing. Who is left to hate the banks?
- **Relative Value Trade:** Banks beat REITs
- **Exogenous Shocks do NOT Force a change in Leadership.** Small Cap Super Cycle likely to run further.
- **Credit Contraction Cycles and the Size Trade:** Smaller Stocks appear to lead 12-months post a credit contraction phase.

The Subprime Ten

Home Related	Finance Related	Consumer Related
Homebuilders	Banks	Home Furnishings
Building Products	Consumer Finance	Auto Parts
Construction Materials	Mortgage REITs	Restaurants
		Household Appliances

Consumer segments least affected in Subprime wake; Financials and Housing groups more battered

Expectations

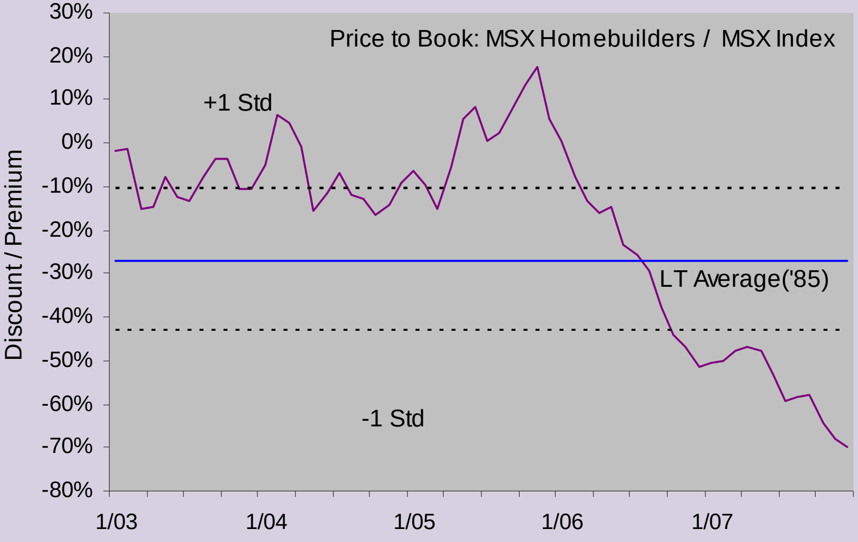
Valuations

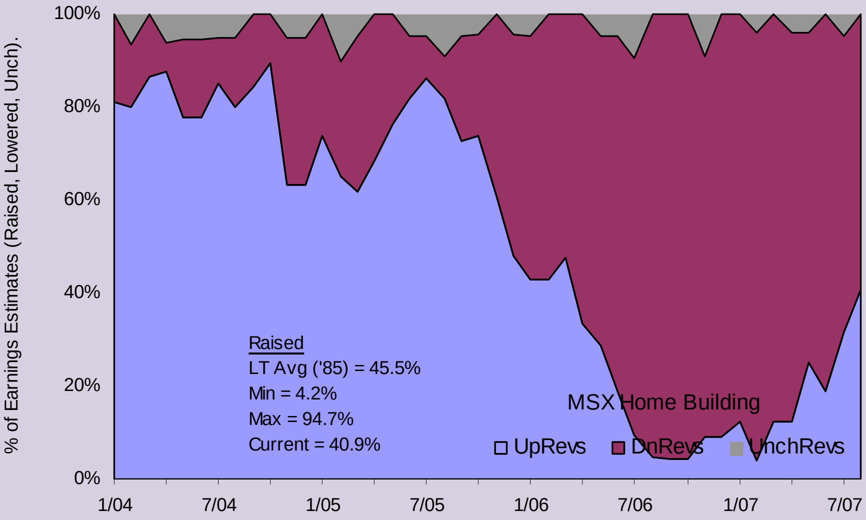
	Overly Pessimistic		Overly Optimistic
Attractively Priced	Homebuilders Consumer Finance Home Furnishings		
	Building Products Banks	Auto Parts	Household Appliances
Expensive		Restaurants	Construction Materials Mortgage REITs

Homebuilders: Inevitable bounce or dead money?

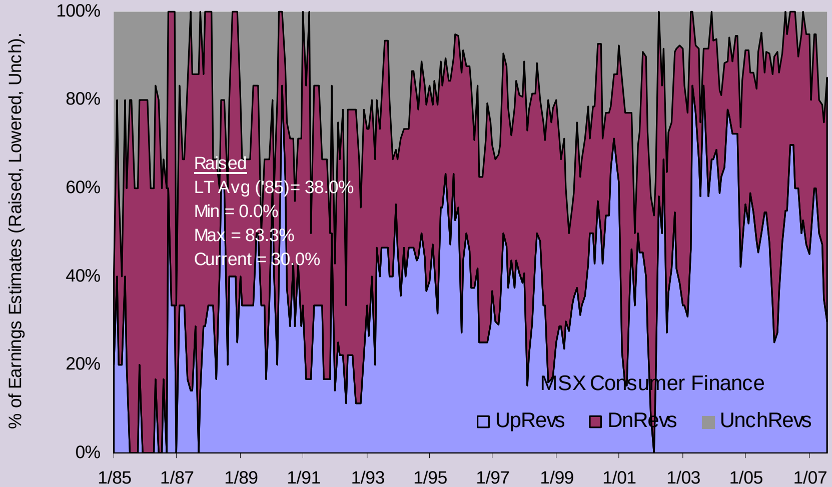
- **Relative Price-to-Book Value: Homebuilders appear cheap, but if you believe that, I've got a bridge to sell you.**

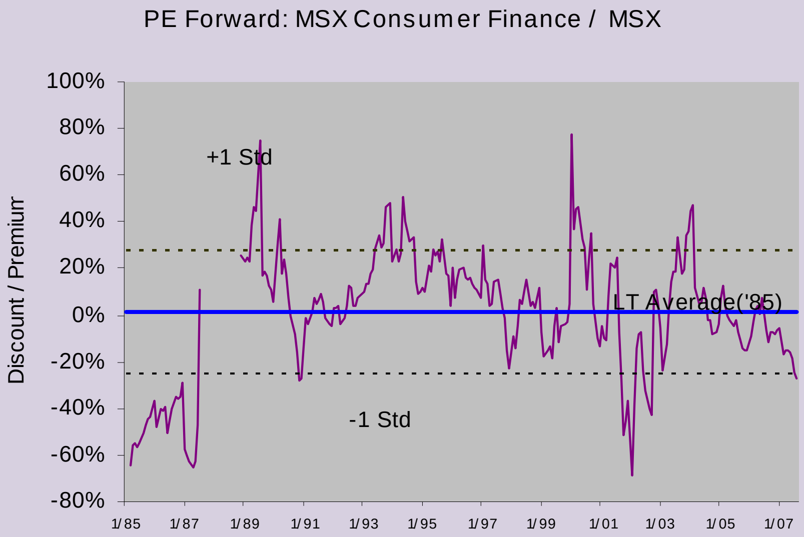
- **Earnings Diffusion: Analysts have been ratcheting earnings expectations lower since 2005; recent optimism on earnings belies the truth that book values for homebuilders are really in question.**





Consumer Finance Near-term Earnings Expectations Diffusions vs. Forward PE





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Cirrus Research Subprime-related Industry Performance

As of 18 September	Valuation			Performance					Other	
Housing Exposures	P/S	P/B	Fwd P/E	1 Mo	3 Mo	6 Mo	12 Mo	YTD	Count	Weight
Building Products (Large)	0.8	2.23	15.33	0.50%	-8.10%	-4.60%	-4.60%	-12.50%	1	0.10%
Building Products (MSX)	0.66	5.09	16.87	-1.00%	-11.20%	-4.80%	14.60%	2.10%	21	0.60%
Construction Materials (Large)	---	---	---	---	---	---	---	---	---	---
Construction Materials (MSX)	2.28	3.99	18.8	-2.10%	-17.70%	-13.30%	31.40%	11.30%	9	0.50%
Home Building (Large)	---	---	---	---	---	---	---	---	---	---
Home Building (MSX)	0.33	0.78	-10.72	-0.20%	-23.80%	-31.20%	-33.40%	-44.40%	28	0.80%
Financial Exposures										
Banks (Large)	1.72	1.8	11.54	2.70%	-1.90%	-2.60%	-3.50%	-7.50%	21	9.10%
Banks (MSX)	2.13	1.65	15.3	3.30%	-3.20%	-7.00%	-8.00%	-11.40%	413	5.50%
Consumer Finance (Large)	2.09	3.41	16.71	3.00%	-6.30%	5.00%	0.60%	-2.60%	3	0.90%
Consumer Finance (MSX)	1.43	2.13	10.04	6.90%	-13.30%	-10.10%	-11.80%	-20.40%	22	0.40%
Mortgage REITs (Large)	---	---	---	---	---	---	---	---	---	---
Mortgage REITs (MSX)	1.5	1.14	17.33	6.40%	-22.80%	-29.10%	-32.80%	-36.10%	32	0.50%
Consumer Exposures										
Auto Parts & Equipment (Large)	0.68	3.02	18.44	2.60%	0.20%	22.60%	61.70%	35.00%	1	0.20%
Auto Parts & Equipment (MSX)	0.32	3.93	21.33	1.00%	-8.80%	1.00%	27.10%	9.90%	35	1.00%
Home Furnishings (Large)	---	---	---	---	---	---	---	---	---	---
Home Furnishings (MSX)	0.72	1.73	15.31	1.80%	-6.40%	-0.90%	4.10%	3.10%	13	0.30%
Household Appliances (Large)	---	---	---	---	---	---	---	---	---	---
Household Appliances (MSX)	0.53	2.65	12.1	-2.10%	-10.90%	7.40%	10.60%	9.30%	4	0.30%
Restaurants (Large)	2.49	5.4	21.51	7.70%	6.80%	12.60%	21.30%	9.70%	3	0.70%
Restaurants (MSX)	0.96	3.68	20.52	1.20%	-2.70%	-2.70%	6.80%	0.70%	49	1.10%

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Small Cap Subprime Highlights

- **Banks:** Only 17 of 100 have gained ground YTD. Merger activity continues to drive the small bank equity market. Take-out acquisitions and in-market consolidations feature prominently. Reports of the absence of subprime exposure still move bank stocks.

- **Building Products:** Goodman Global (GGL) and Ameron International (AMN) are up on improved earnings. GGL hired an investment banker and might be pursuing a sale of the company.

- **Auto Parts:** Cooper Tire (CTB) and Gentex (GNTX) strong earnings have boosted prices, distinguishing them from stocks such as Delphi which continues to suffer setbacks in bankruptcy.

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Bucking the Trend

	Banks	Mkt Cap	MTD	YTD
FRC	First Republic Bank (Ca.) *	1,730.2	2.4	43.0
UMBF	UMB Financial Corp.	1,932.6	3.6	25.7
FCTR	First Charter Corp. *	1,048.2	1.0	22.8
SBNY	Signature Bank	1,081.5	5.5	17.7
	Cirrus MSX Banks			-11.4

	Building Products	Mkt Cap	MTD	YTD
GGL	Goodman Global Inc.	1,606.0	-0.4	35.5
AMN	Ameron International Corp.	911.3	4.7	30.9
LII	Lennox International Inc.	2,286.2	-6.1	10.4
	Cirrus MSX Building Products			2.1

	Auto Parts	Mkt Cap	MTD	YTD
CTB	Cooper Tire & Rubber Co.	1,532.1	0.4	71.6
LKQX	LKQ Corp.	1,816.5	9.2	47.2
GNTX	Gentex Corp.	2,918.0	1.3	30.5
TEN	Tenneco Inc.	1,421.8	-3.6	23.8
	Cirrus MSX Auto Parts			9.9

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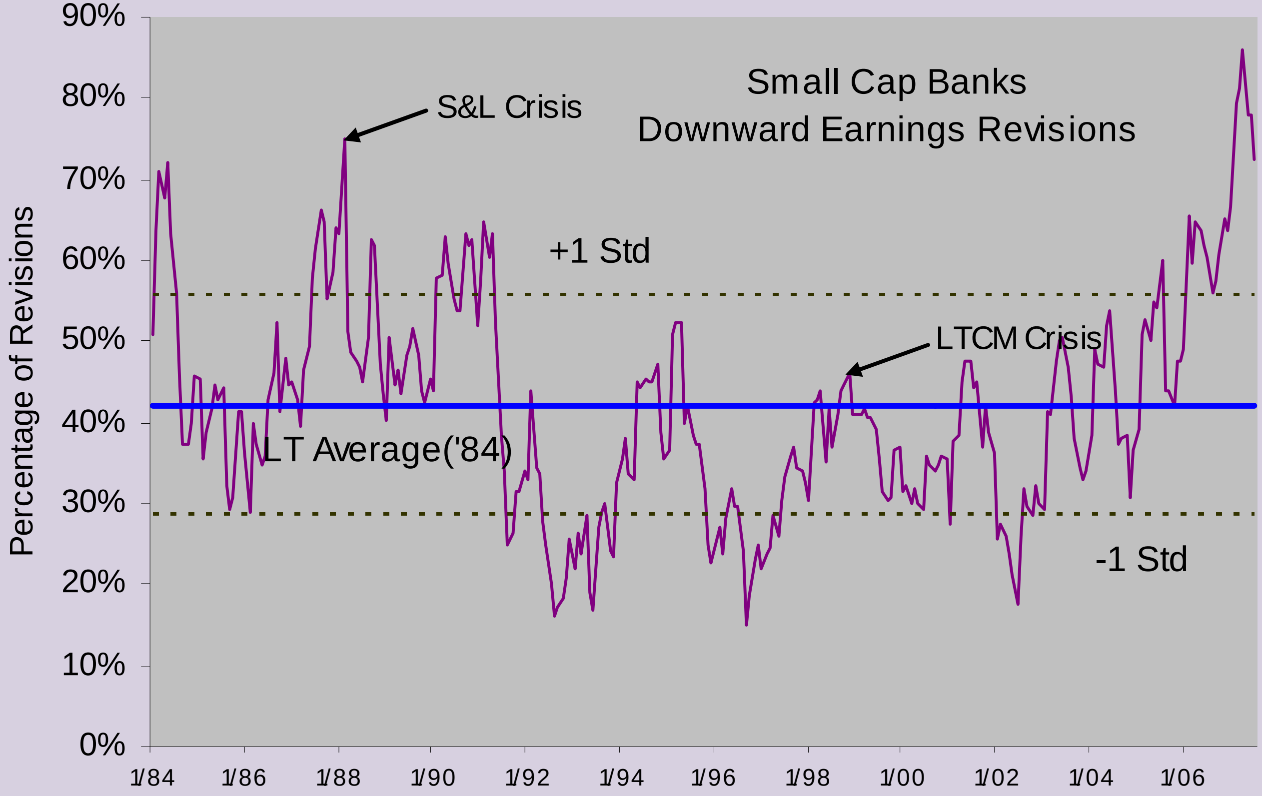
Is the summer of 2007 worse than the S&L Crisis of 1989? Sell-side analyst estimates are making such a claim.

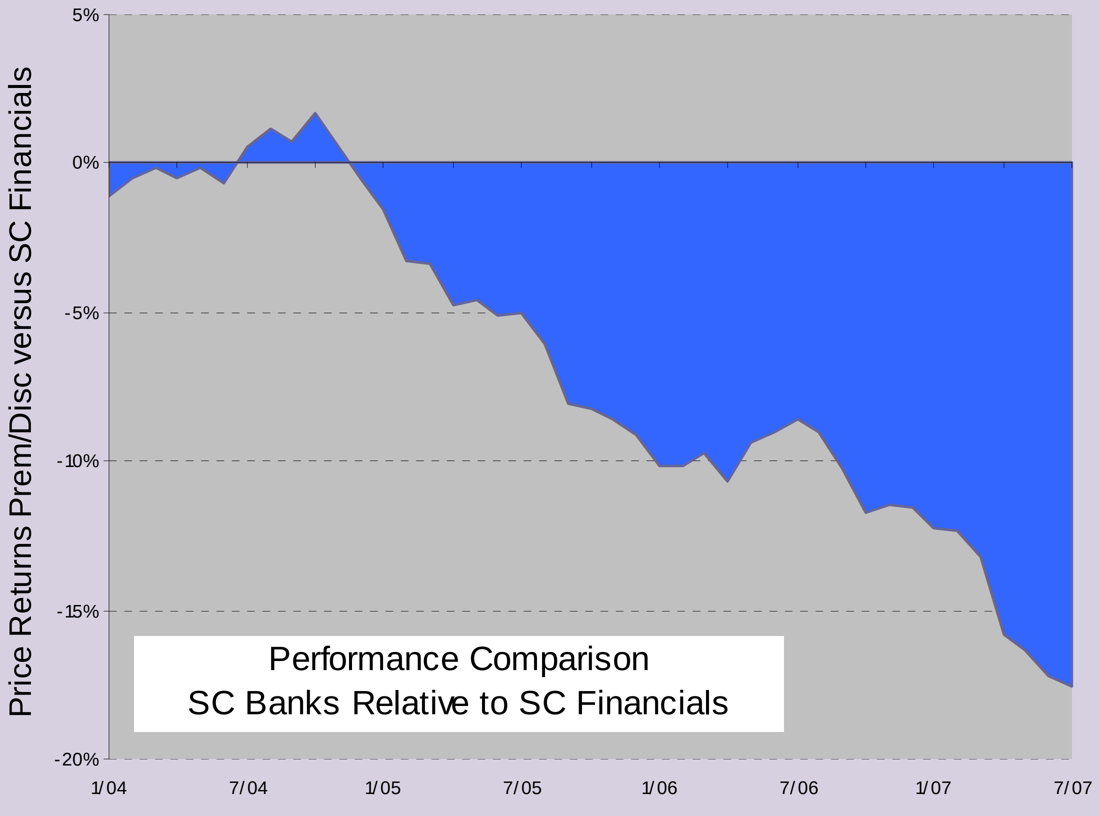


Earnings expectations at such extremes that potential for lower Fed Funds rate juxtaposed to depressed sell-side forecasts are the Catch-22 for Banks.

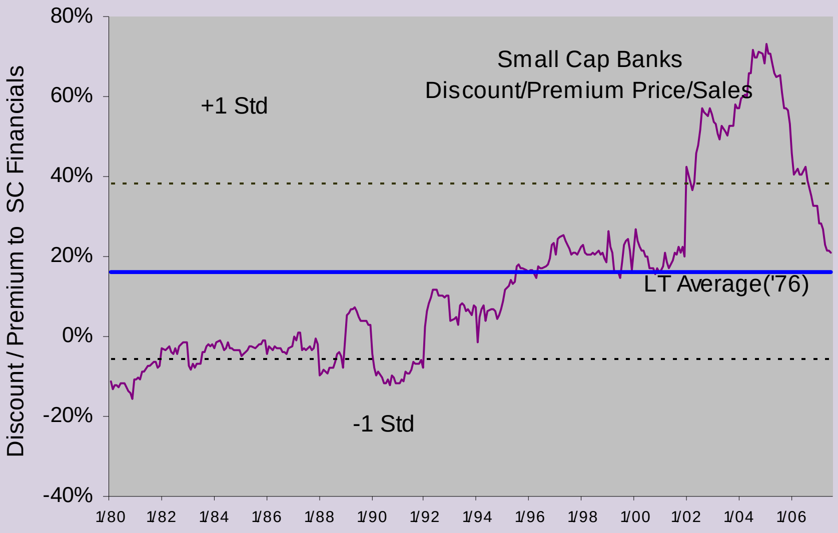
Non-performing loan ratios are low and expected to rise, but loan loss provisions have been increasing over the past 2+ years.

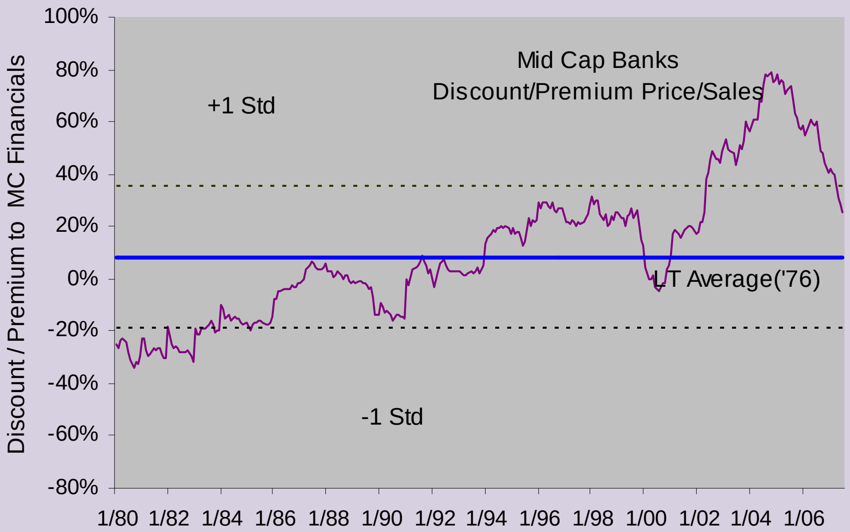
Bank valuation levels have not traced fading expectations. Regional Banks were more severely discounted to the financials and large cap banks by the S&L Crisis back in 1989/90.

Earnings revisions within Financial sector likely to break. Do quant factors reverse again? The second order effect--as earnings cuts become too severe stocks again could act contrary to expectations.



Bank leadership ended as the Yield Curve peaked in late 2004





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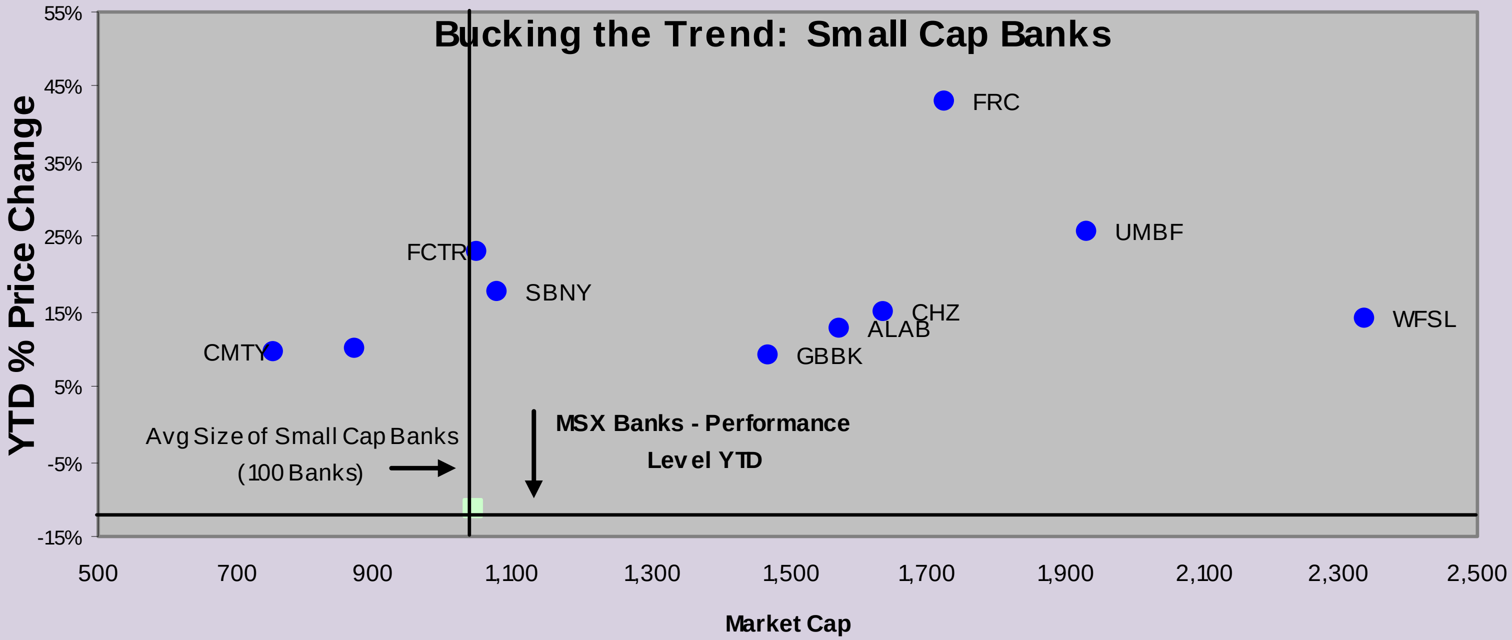
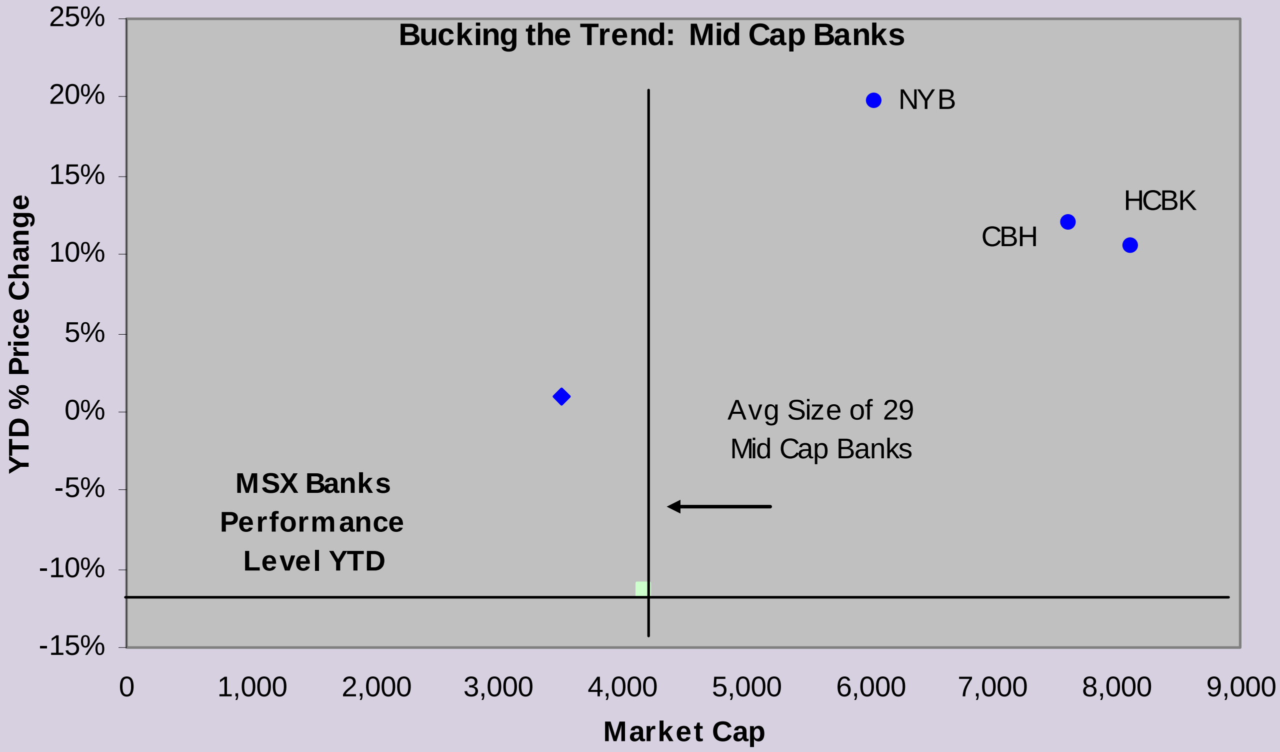
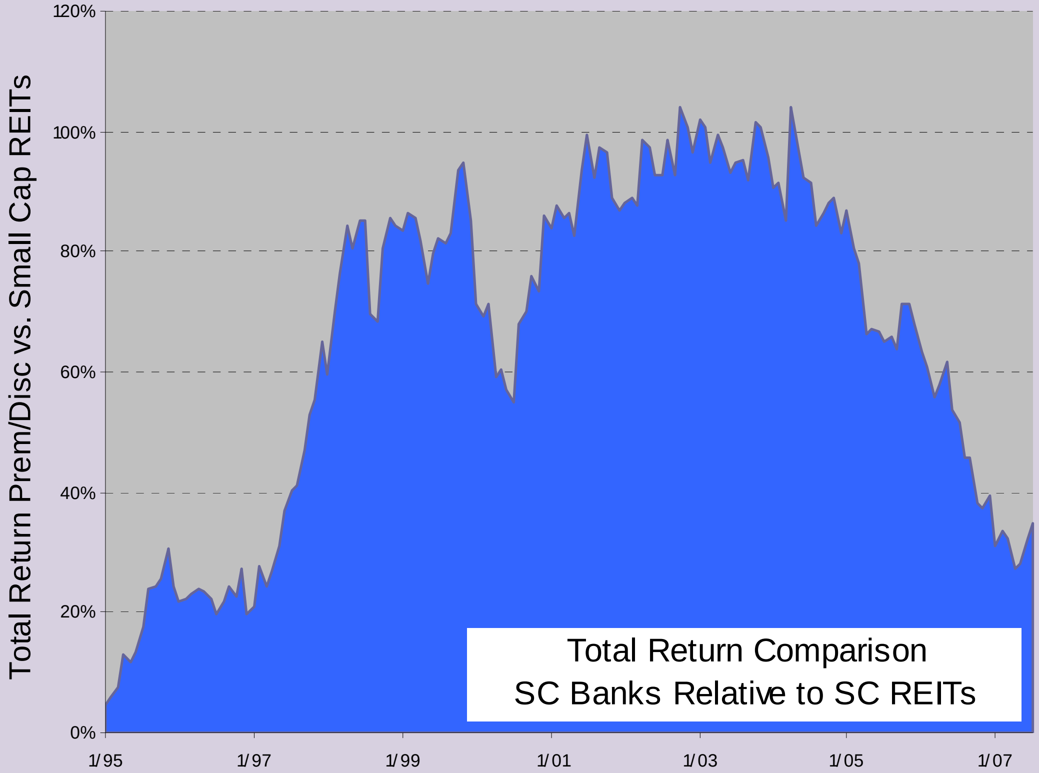
Small Cap Banks returned between +42% to -68% YTD



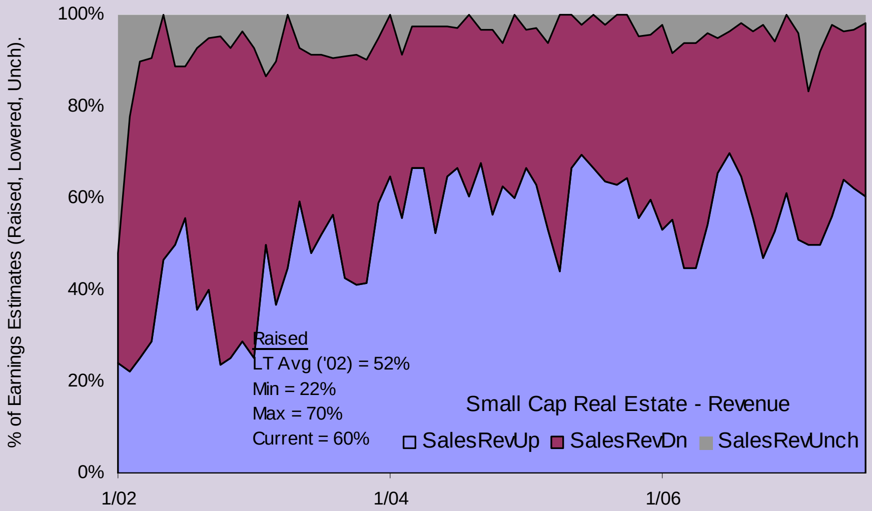
Mid Cap Mortgage REITs that Bucked the Trend

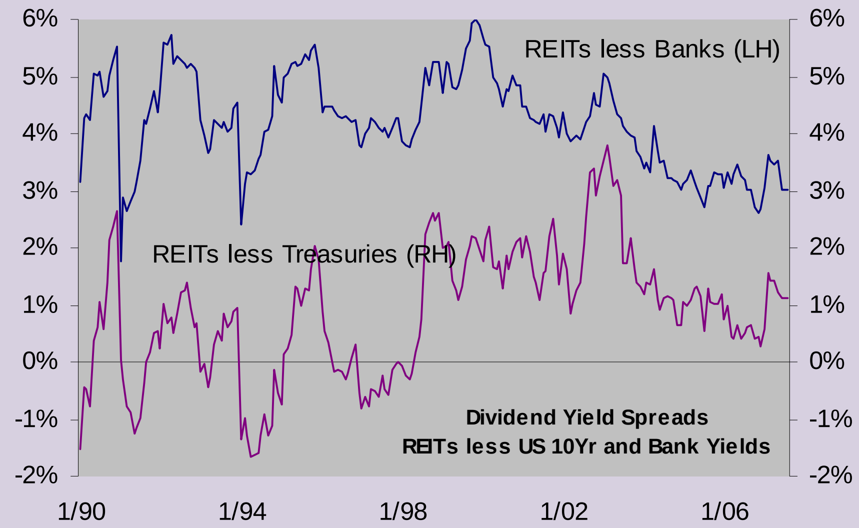


Banks have severely underperformed REITs in the past few years



Revenue expectations have not come under apparent scrutiny for REITs as yet. Yield Spreads for REITs are adjusting but far from signaling value.





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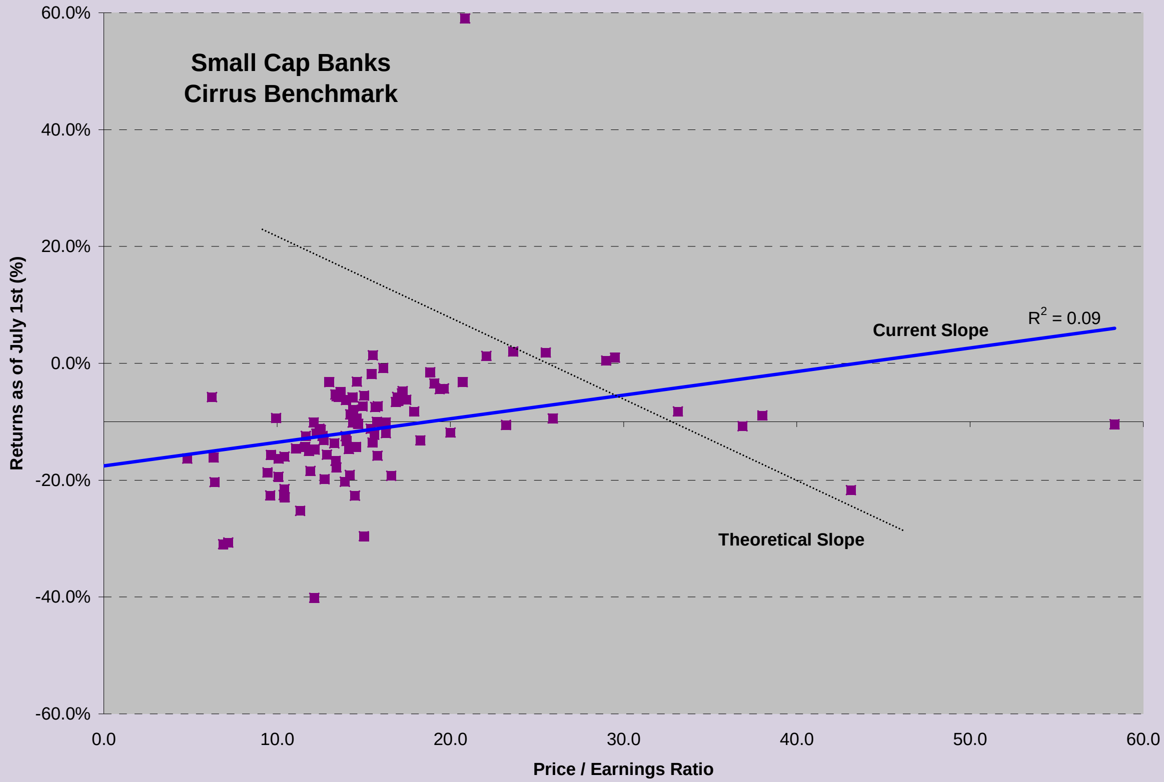
Mid Cap Financial and Real Estate Sector / Industry Performance

As of 24 August	Valuation			Performance					Other	
Cirrus Finance Industries	**P/S**	**P/B**	**Div Yld**	**1 Mo**	**3 Mo**	**6 Mo**	**12 Mo**	**YTD**	**Count**	**Weight**
Banks	2.3	1.7	2.70%	10.87%	-5.05%	-7.92%	-9.54%	-12.75%	100	6.80%
Specialized Finance	2.9	3	1.30%	-0.51%	-6.08%	7.82%	14.06%	7.54%	8	0.70%
Consumer Finance	1	2	1.20%	-3.56%	-23.66%	-13.86%	-13.24%	-24.97%	11	0.70%
Asset Mgmt. & Custody Banks	2.2	4.2	6.60%	1.60%	-14.06%	-8.04%	5.26%	-9.55%	9	0.60%
Investment Banking & Brokerage	2	2.1	1.10%	1.02%	-12.77%	-9.43%	-2.88%	-14.97%	8	0.70%
Insurance Brokers	1.9	2.7	1.3	6.98%	6.31%	5.84%	23.30%	12.84%	2	0.20%
Life & Health Insurance	0.9	1.2	0.90%	4.95%	-2.61%	0.96%	7.35%	-1.25%	9	0.70%
Multi-Line Insurance	1	1.5	2.10%	11.89%	-10.62%	-1.43%	8.66%	-1.24%	1	0.10%
Property & Casualty Insurance	1	1.5	1.70%	4.95%	-5.85%	1.23%	9.99%	0.58%	22	1.90%
Reinsurance	1.8	1	1.40%	2.50%	-8.94%	-2.85%	3.94%	-5.03%	2	0.30%
Business Development Corps.	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
Cirrus Real Estate Industries										
Diversified REITs	4.5	1.9	8.40%	6.12%	-8.99%	-8.92%	-6.42%	-10.42%	11	1.10%
Mortgage REITs	1.3	0.9	17.50%	-2.34%	-39.34%	-41.98%	-45.85%	-50.18%	16	0.80%
Office REITs	3.7	1.7	4.90%	5.92%	-15.20%	-18.36%	-15.40%	-17.13%	7	0.70%
Residential REITs	4.2	2.3	5.20%	3.11%	-15.70%	-12.46%	-14.78%	-11.93%	5	0.40%
Retail REITs	5.1	2.7	4.60%	7.53%	-11.20%	-9.21%	6.23%	-5.70%	12	0.90%
Specialized REITs	2.5	2	5.80%	4.88%	-12.28%	-11.31%	-0.93%	-9.29%	21	1.70%
Real Estate Mgmt & Development	3.5	2.5	4.40%	1.97%	-10.12%	-1.78%	17.17%	-0.17%	3	0.20%
Cirrus Research Benchmarks										
Finance Sector: Large Cap	1.5	1.9	2.50%	4.22%	-6.88%	-1.72%	5.35%	-4.90%	64	20.50%
Finance Sector: Mid Cap	1.7	1.8	2.50%	1.29%	-10.54%	-5.35%	4.00%	-5.14%	91	13.90%
Finance Sector: Small Cap	1.7	1.7	2.40%	7.03%	-7.00%	-5.50%	-3.69%	-9.64%	172	12.60%
Finance Sector: Micro Cap	1.6	1.6	2.10%	4.86%	-6.79%	-8.51%	-7.25%	-12.33%	377	18.80%
Real Estate Sector: Large Cap	5.4	3.2	3.10%	4.37%	-13.21%	-14.40%	4.94%	-7.29%	12	1.30%
Real Estate Sector: Mid Cap	3.9	2.7	4.30%	3.77%	-12.96%	-15.61%	-2.01%	-11.18%	39	5.00%
Real Estate Sector: Small Cap	3	1.8	7.00%	4.53%	-16.00%	-15.88%	-10.84%	-17.02%	75	5.90%
Real Estate Sector: Micro Cap	1.6	1.4	5.30%	-2.24%	-14.21%	-13.02%	-4.11%	-12.83%	57	3.50%

Quant Hedge Fund Conundrum

Lower multiples were supposed to protect on the downside, not amplify the pain. The performance of Regional Banks valuations underscores the conundrum facing active quantitative positions.



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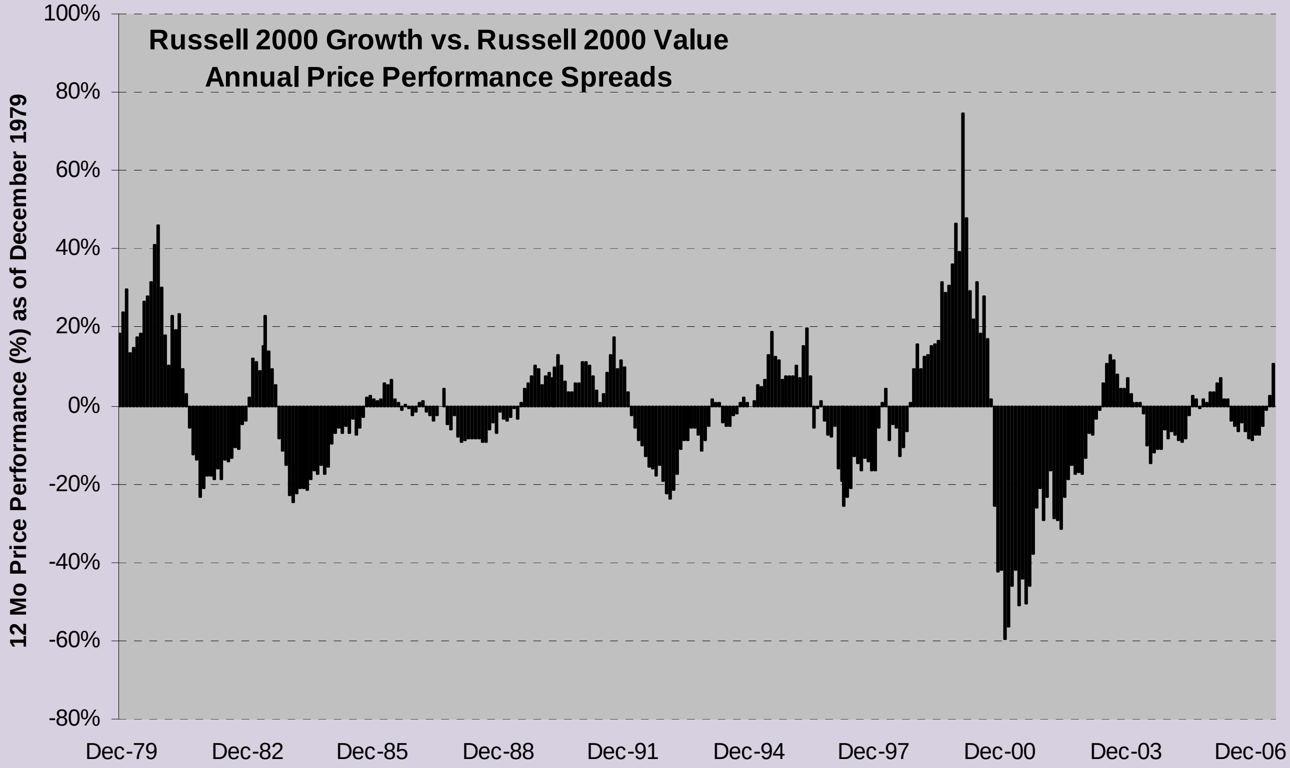
Russell 2000 Growth vs. Russell 2000 Value: Double-digit spreads have been broached many times over past 20 years.



Clustered Holdings among Sizable Quantitative Hedge Funds

As of 30 June

	High Small Cap Concentration Among Top 10 Quant Funds				
			Mkt Cap ($mn)	3Q Price Perf.	Est. % Conc.
Materials	OLN	Olin Corp.	1542.3	-13.8	15.7
	NXG	Northgate Minerals	815.8	5.5	11.4
Industrials	HEI	Heico Corp.	1028.9	12.3	13.5
	RAIL	FreightCar America	579.3	-9.2	18.5
Transport	PACR	Pacer Intl Inc.	810.6	-15.9	12.9
Consumer Discretionary	ARO	Aeropostale Inc.	1968.1	-22.4	11.9
	MOV	Movado Group Inc.	731.9	-13.3	10.8
Consumer Staples	THS	TreeHouse Foods Inc.	699.2	-17.3	10.2
	SAM	Boston Beer Co. (Cl A)	583.2	11.5	18.1
Consumer Services	CBRL	CBRL Group Inc.	947	-14.9	18.1
	CDL	Citadel Broadcasting	564.2	-29.8	11.6
Health Care	MOGN	MGI Pharma Inc.	1995.8	2.9	11.2
	AGP	AMERIGROUP Corp.	1451.2	10.3	10.6
Financial	RLI	RLI Corp.	1389.7	4.2	14.5

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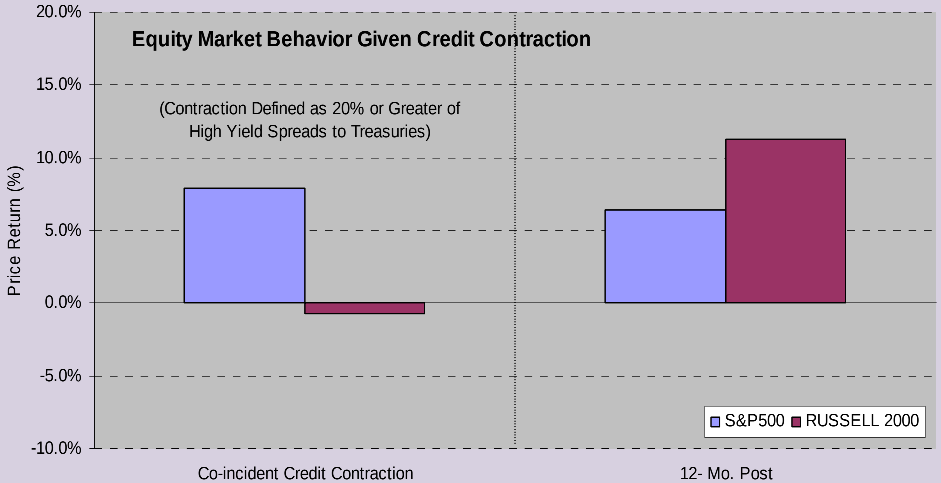
Credit contractions point to a greater selloff in riskier assets. Conversely, the subsequent 12 months point to reversal of fortunes.

- Is Summer 2007 another Perfect Storm? Lessons from Spring 2002, or the post-WorldCom/Enron debacle: Equities corrected into that storm and then bounced sharply. The Russell 2000 jumped 41% the subsequent 12 months.
- Strategic factors such as Valuation levels and Expected Growth point to a broader leadership. After eight years of outperformance smaller stocks are only at long-term average valuations. Markets rarely revert to long-term averages; they typically overshoot on both extremes.
- Access to capital likely to remain more flexible as investors face limited organic growth choices. Expected growth rates among Titan-50 (the largest 50 companies) still too high. Leadership unlikely to narrow.



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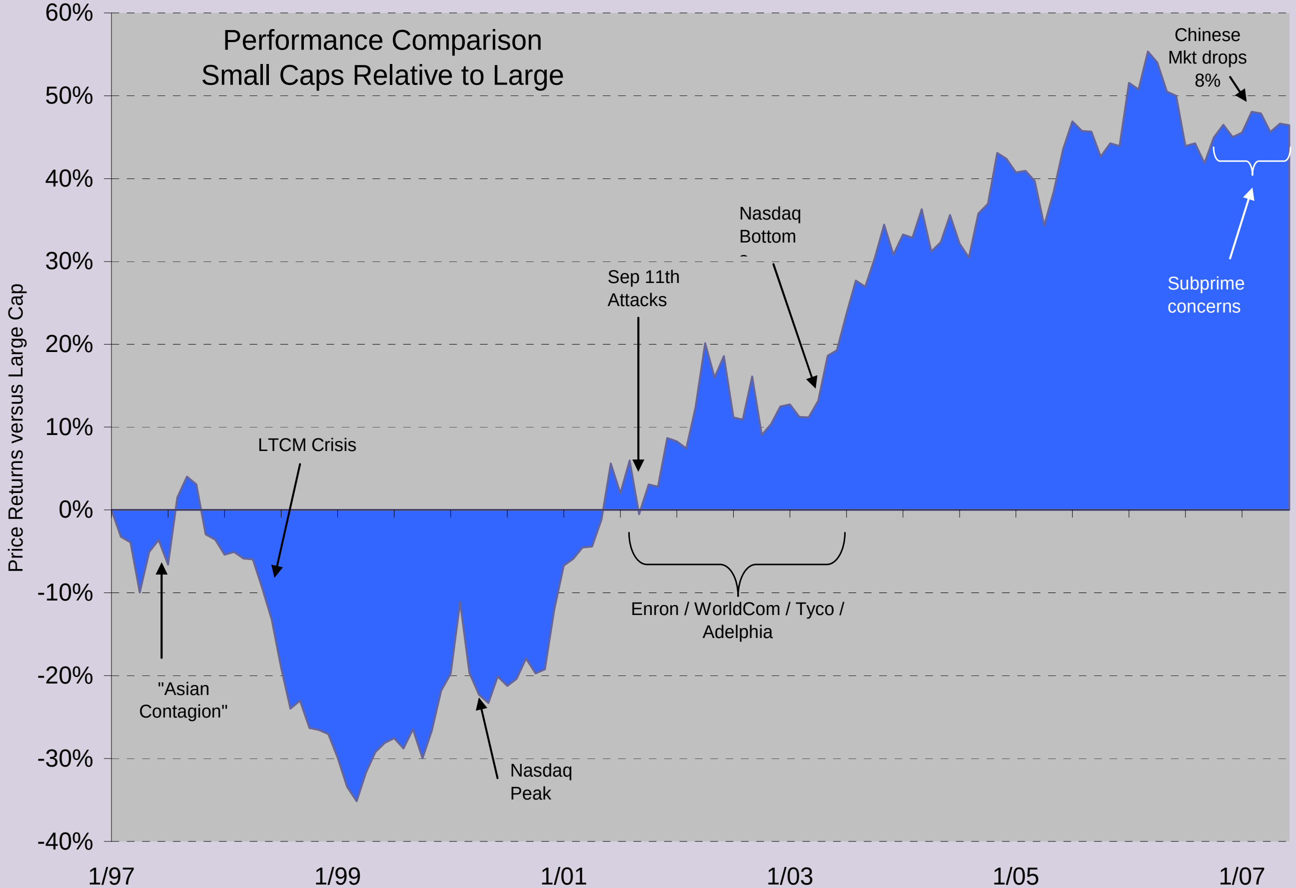
Current Small Cap Super Cycle is marked by many reversals



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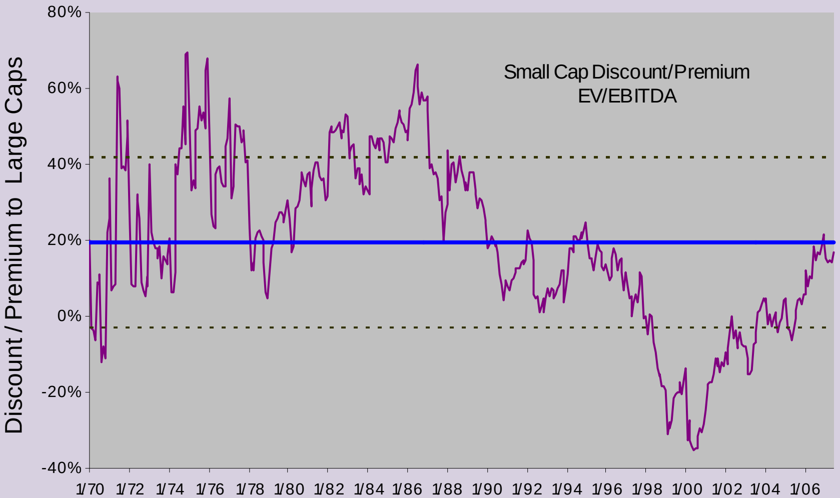
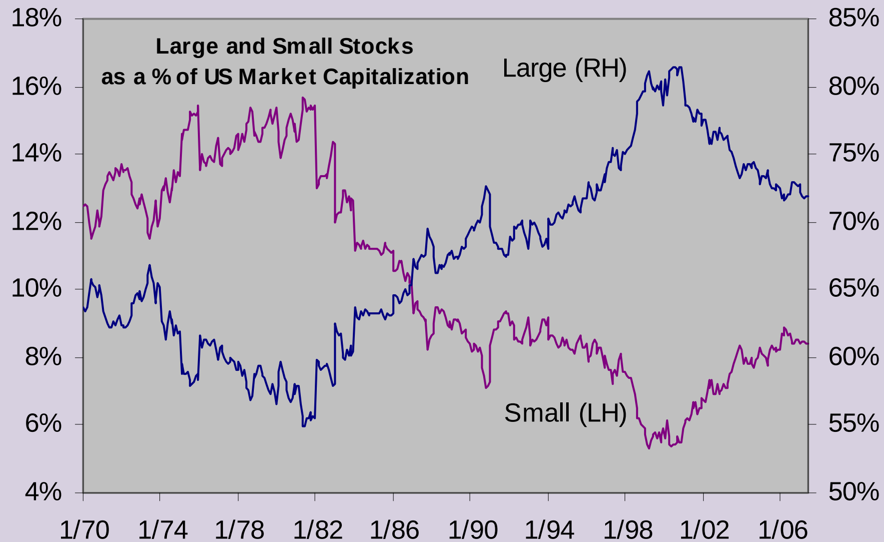
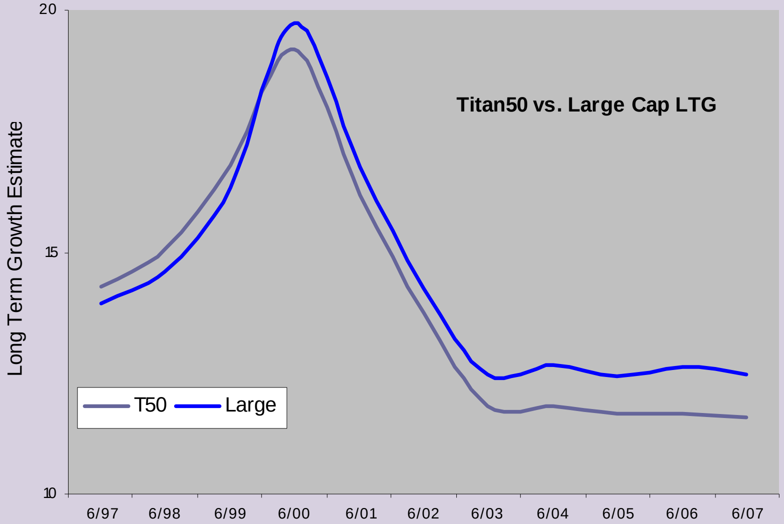
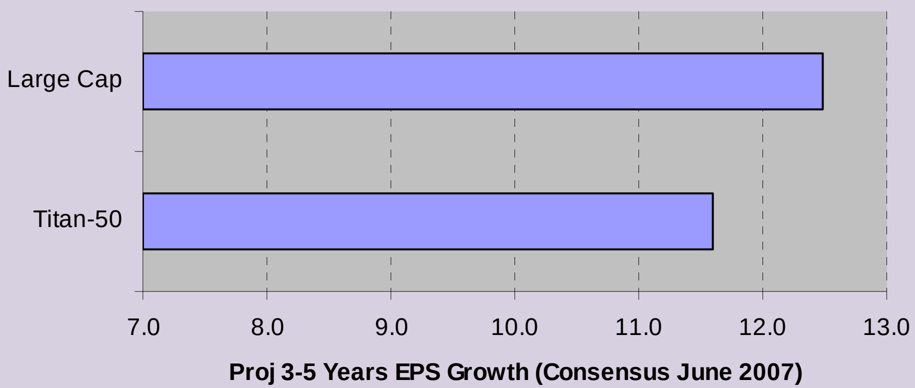
- **Most measures, including Firm Value (EV) to EBITDA, confirm valuations levels among smaller firms not excessive**
- **Large Firms Still Significant Chunk of Equity.**





Expected growth rates among Titan-50 still too high. Access to capital likely to continue as investors face limited organic growth choices. Leadership unlikely to narrow.





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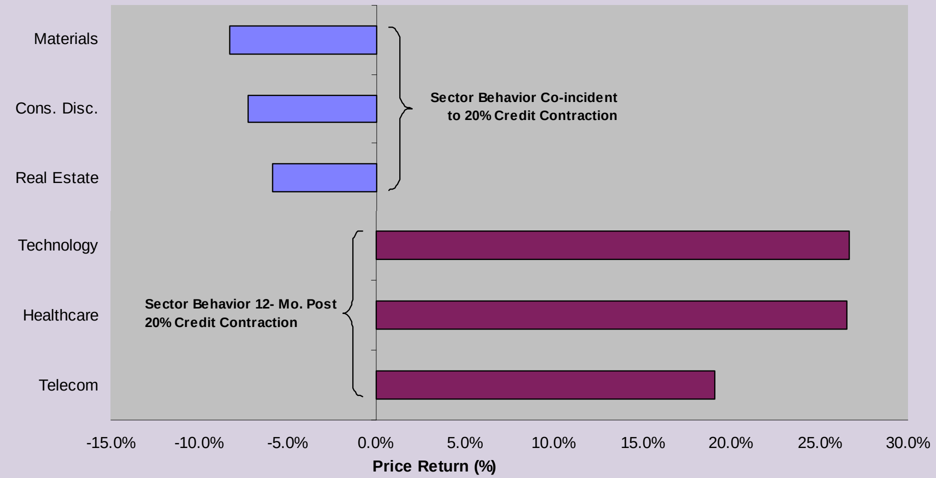
- **Materials, Consumer Discretionary and Real Estate typically hardest hit leading into a credit contraction. Tech, Healthcare and Telecom show strong historical leadership one year later.**
- **Small Cap Super Cycle should continue. Strategic factors, ie, Valuation levels and Expected Growth, point to broad leadership. Despite 8 years of outperformance, Small Caps still at LT-avg relative valuation levels. Valuations expected to overshoot rather than mean revert.**
- **Access to capital likely to remain flexible as investors face limited organic growth choices. Expected growth rates among Titan-50 still too high. Leadership unlikely to narrow.**

Small Cap: Worst/Best Sector Performance Pre/Post 20% Credit Contraction



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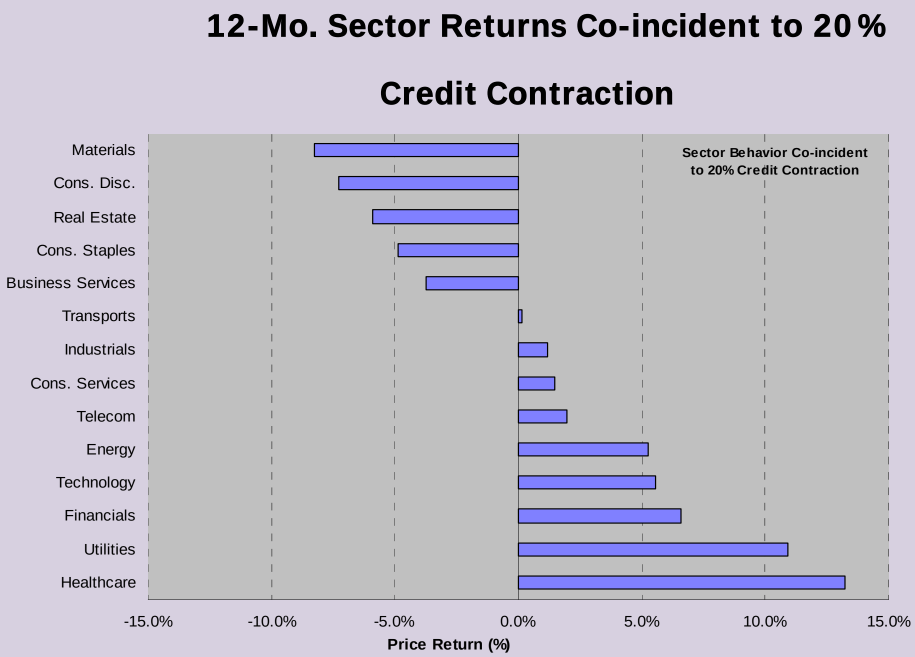
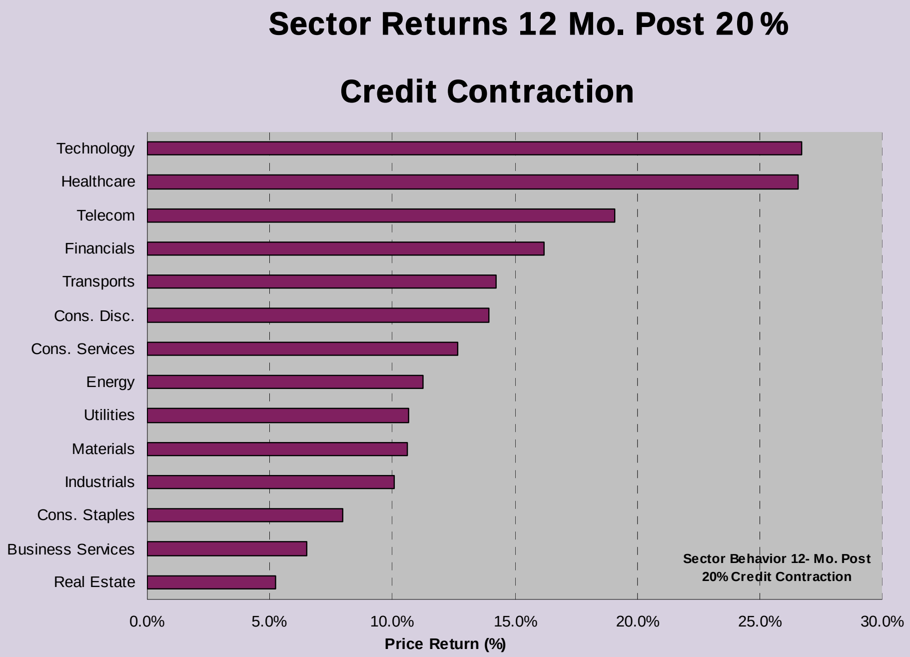
Small Cap Leaders and Laggards given an adverse swing in credit spreads.





Above benchmark and sector returns are based on periods in which credit spreads widened by more than 20% dating back to 1989.

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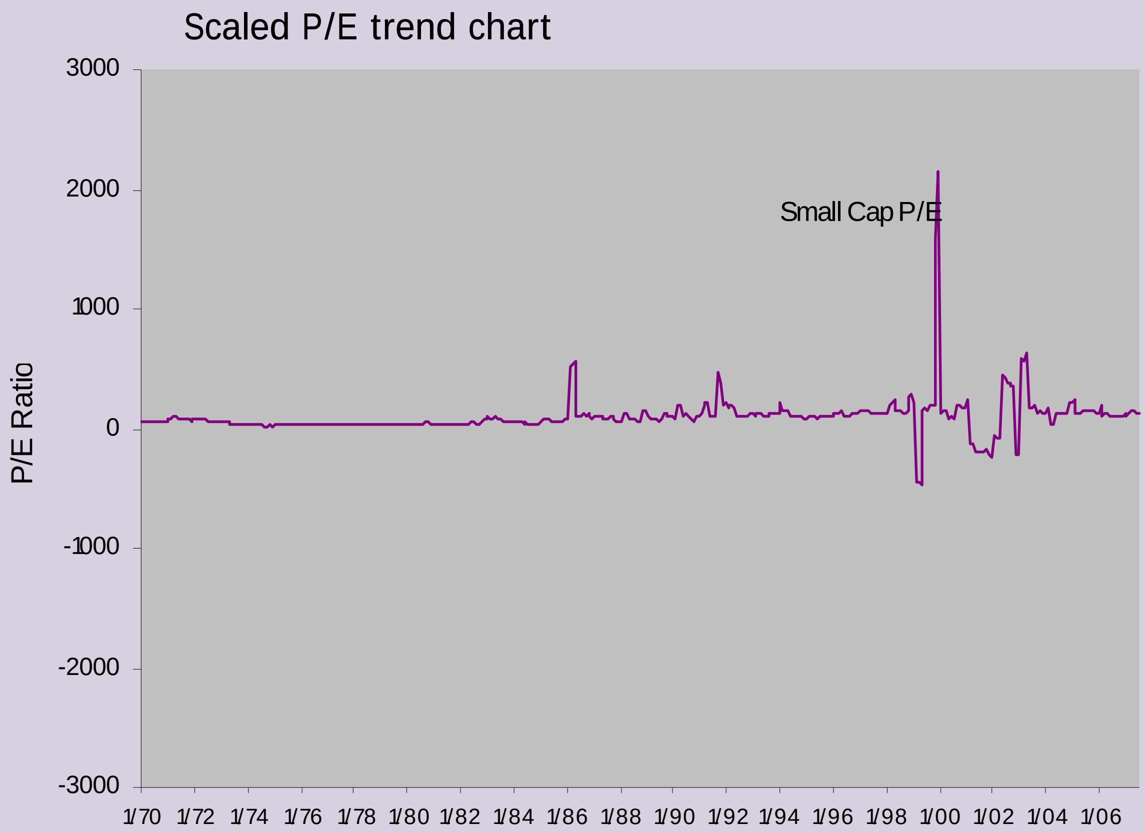
The P/E fallacy in valuing smaller firms



- **Cirrus Benchmarks**
  - Dynamic ranking of all companies; Sorted by size percentile, recalibrated annually
    - **Large Cap** **$10 billion +**
    - **Mid Cap** **$2.4 billion - $10 billion**
    - **Small Cap** **$600 million - $2.4 billion**
    - **Micro Cap** **$100 million - $600 million**
    - **Nano Cap** **$10 million - $100 million**

- **Cirrus MSX Index**
  - Our MSX Index comprises companies with market capitalizations ranging from $100 mn to $10 bn as of 1 January 2007. Cirrus MSX industry benchmarks comprise index constituents in the respective industry.

Satya D. Pradhuman
CEO & Director of Research

- 20 years in Equity Research at E.F. Hutton, Lehman Brothers and Merrill Lynch
- Founded Small Cap Research department at Merrill Lynch in 1994
- Created proprietary tools for timing small and large cap performance cycles in US and across regions, growth and value cycles, volatility swings and capital access trends
- Linked private equity markets to public markets via the small cap sector
- *Institutional Investor* ranked for 11 straight years
- Authored *Small Cap Dynamics* (Bloomberg Press, 2000); Contributed “The Presence of Value in Small-Cap Equities” in *Equity Style Management* (Klein and Lederman, Irwin, 1995)
- BS/Math and Computer Science, Union College; MBA/Finance, NYU Stern School of Business

Eric Fernandez, Senior Strategist

- Decade+ of analytical, advisory and transaction experience
- M&A, acquisition finance, debt restructuring and impact modeling of merger, IPO and spin-offs
- Cross-industry experience: real estate, energy, manufacturing, software, communications, IT services and consumer products
- Global client base and transactions
- Previously at Salomon Smith Barney, Kleinwort Benson and Oppenheimer
- Personal interest in options/futures research and trading and real estate development
- MBA/Finance, The Wharton School; BSBA/Finance, University of Florida
- Chartered Financial Analyst

Mitchell Hew, Analyst – Research

- Began career in research and trading at Rothschild Recovery Fund in 1999
- Joined Wilbur Ross, Jr. and Rothschild team forming WL Ross & Co., a leader in restructuring, private equity and alternative investments
- As System Administrator and CIO, oversaw telecommunications, network security and portfolio management/accounting system design
- BA, Yale University

William O'Herron, Analyst – Client Service

- Background in sales, trade execution, risk and money management, and client service
- Management positions in fixed income futures/options research sales at Salomon Brothers and Refco
- At Refco helped build the industry's third largest global commodities and futures/options trading desk
- Co-managed the global macro hedge fund division at Winchester Asset Management in London
- Recently Sales Director at StreetAccount, LLC, the leading independent equity commentary firm
- BA, Middlebury College; MS, Columbia University's School of Social Work; Licensed Clinical Social Worker

Thirza T. Moran, Office Manager

- Executive administrative support in marketing, communications and investor relations
- Previously at Bessemer Trust Company, Bradford Equities Management and Horizon Organic Holding Corporation
- Experience in project/event coordination, database administration, report and collateral materials creation, vendor management
- BA, Denison University

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