TOWLE & CO.

DEEP VALUE INVESTING

Contents

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Towle & Co. manages equity portfolios for investors seeking capital appreciation in excess of stock market returns. Our deep-value, investment discipline strives to identify, invest in and capitalize on significant discrepancies between stock market prices and the intrinsic, underlying value of publicly traded companies. This search for absolute value typically leads us to smaller capitalization stocks, a market segment where many investment firms overlook hundreds of well-seasoned, "main street" companies. For most investors, our strategy appreciably diversifies their scope of investment and complements larger capitalization, equity portfolios. Formed in 1981, Towle & Co. is registered with the Securities and Exchange Commission under the Investment Advisers Act of 1940.

WHO SHOULD INVEST WITH TOWLE & CO.?

Towle & Co. is appropriate for investors:

- Willing to accept stock market risk and the volatility of smaller capitalization equities.
- Possessing a minimum investment horizon of four years.
- Seeking above average (after tax) growth of capital without the need for current income.

INVESTMENT TENETS

Towle & Co. does not invest in tobacco, liquor, or gaming companies and is structured to serve investors who appreciate the following principles that govern our investment decisions and client service activities:

1. Capital formation is essential to the development of free enterprise, business expansion, and economic growth.
2. Common stock ownership represents financial participation in a variety of wealth- and job-creating activities.
3. Capital preservation takes precedence over investment risk.
4. A long-term investment outlook provides superior, after-tax results compared to short term performance expectations.
5. Clients are best served when their managed portfolios possess the same securities as those owned by the firm's principals.

DEEP VALUE INVESTMENT STRATEGY

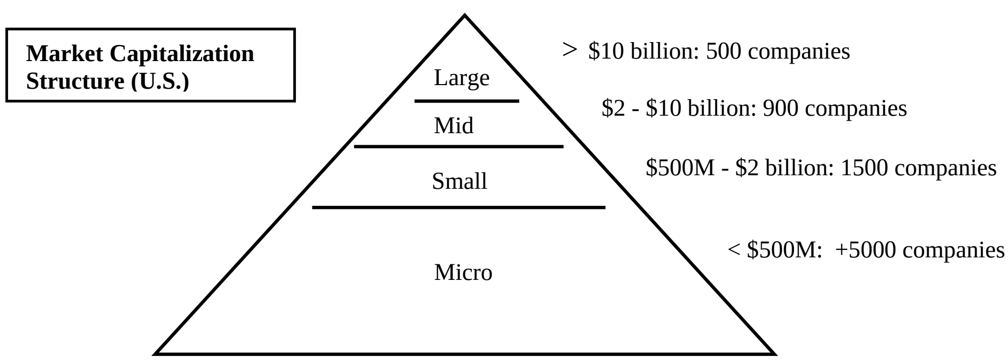
Towle & Co. executes a fundamental, bottom-up, value discipline that emphasizes the purchase of companies believed to be *significantly* undervalued relative to their private market value. We look for well-seasoned companies with strong market positions in industries such as financial services, manufacturing, consumer products, transportation, and energy. While our deep value approach may include large capitalization stocks, the search for absolute value usually leads to equities with market capitalizations under $2.0 billion, an area commonly referred to as micro-small cap. Our years of experience indicate that companies with the highest rate of appreciation potential are most often smaller companies.

Why do smaller companies emerge as attractive stock selection candidates?

- While 75+% of all publicly traded companies in the U.S. are designated micro-small cap, investment attention centers primarily on the well-known, highly liquid, large-cap companies where hundreds of billions in investment capital is concentrated. Due to this lack of interest, smaller companies can trade at substantial discounts not only to their private market values but also to the valuation multiples of larger-cap companies.

- Although there are thousands of companies from which to invest, multi-billion dollar investment managers generally avoid micro-small caps because it's a liquidity challenge to purchase and build meaningful stock positions.

- Perceived as carrying more risk than large companies, investors also find it difficult and labor intensive to conduct adequate research to invest in and monitor a portfolio of micro-small cap stocks.



Source: Marketguide

One of our methods for identifying value is estimating the amount an informed buyer would pay for the entire company, private market worth. Based on current and historical merger and acquisition activity, this approach provides a foundation for pricing equities and helps to form logical buy/sell targets. Since 1983, more than 75 companies held under management have been acquired or merged. Companies acquired may well receive a 50+% premium from our original purchase price, enhancing portfolio returns and validating our investment strategy.

Security Selection

Using a fundamental investment approach, we screen for companies that meet our well-defined purchase criteria. Investments are made in companies that exhibit many of the following characteristics:

- *Low price-to-book value*
- *Low price-to-earnings (current or potential)*
- *Low price-to-sales*
- *Selling at less than 6 times the total enterprise value to earnings before interest, taxes, depreciation, and amortization expense*
- *Total debt less than shareholders' equity*
- *Out-of-favor or consolidating industry*
- *Market position or technological leadership*
- *Stagnating or declining stock price*
- *No tobacco, gaming or liquor industry investments*

Candidates for inclusion in the portfolio will trade at a significant discount to our estimate of their private market value. To guard against the risk of loss, portfolio candidates must exhibit the ability to prudently finance their on-going business activities.

To determine a company's upside potential and downside risk, we perform a financial review that includes an analysis of historical and current profitability, liquidity, leverage, and asset management. The financial analysis is supported by an examination of industry prospects and the firm's competitive position. In addition, we may contact management regarding their willingness to consider value-enhancing activities, including merger and acquisition transactions.

Next, we project the company's earnings power, cash flow generating capability, and financial condition. Private market transaction values and profitability characteristics of comparable companies are utilized to determine the company's fundamental earnings potential over the next three years. **For inclusion in the portfolio, a company's three-year earnings potential must provide a minimum return on market value of fifteen percent (for example, earnings potential of $1.50 per share on a stock with a current market value of $10).**

Sell targets are assigned to each company in the portfolio that typically represent a 50 to 100 percent increase from the market value at the time of initial purchase. An estimate of the future market value of a company is determined by assigning a conservative multiple (8-13x) to the company's earnings potential in the third year of ownership. These sell targets are continuously monitored and periodically adjusted as business and investment conditions change. Periodic reviews may produce an upward or downward adjustment of the sell target or result in a decision to remove the position from the portfolio.

Why We Sell Investments

The decision to sell a company's stock prior to achieving the established sell target is based on certain events or conditions that no longer make the investment attractive. Reasons for selling early include:

- Change in a company's strategic direction (e.g., acquisition, spin-off, new business activity, etc.)
- Erosion of fundamentals (e.g., deteriorating financial position, declining margins, weakening revenues)
- A more compelling alternative investment
- Tax considerations

When the current market value of a portfolio company declines 30 percent or more, we thoroughly review the original investment premise and contact company management. If a company's fundamentals continue to satisfy our security selection criteria and we reaffirm management's ability to execute its plan, we will maintain or increase the position. Companies that fail this secondary review will be sold.

Portfolio Management

Initial portfolio positions are equally weighted in dollars at 1.5 to 2% of total portfolio value. A fully invested position is ordinarily maintained. However, unfavorable economic conditions may dictate allocating a portion of assets to cash. Every effort is made to maintain similar sector weightings for all portfolios under management. It is anticipated that at any given time portfolios will hold 1% to 7% of assets in each of 30 to 50 companies although market conditions may dictate holding fewer positions.

Tax Efficiency

The bulk of our managed assets are taxable. Consequently, we are sensitive to the tax consequences of our investment decisions. The following techniques and strategies are used to mitigate our clients' tax burden:

- Maintain low portfolio turnover (typically 25-35% per year).
- Emphasize long-term realized gains.
- Use tax lot accounting.
- Take losses when appropriate.
- Communicate with clients during the tax year to be sure the amount of realized gains is consistent with their needs and circumstances.

Benchmarks

Towle & Co. makes no attempt to manage portfolios against a specific benchmark. Our decision to invest in particular sectors or industries is a function of where we find the greatest value. Compared to the Russell 2000, Towle & Co. invests in companies with lower multiples to book value, sales, earnings, and cash flow.

INVESTMENT RISKS

History shows that Towle & Co.'s deep value investment strategy and asset composite can under-perform market benchmarks during periods of stock market disruption. Managed portfolios and individual stocks may decline in market value if the following occurs:

- The overall stock market goes down. A normal stock market correction could result in a 25-30% decline in portfolio value.
- The market favors growth stocks over value stocks or favors large capitalization companies over small capitalization.
- An adverse event, such as an unfavorable earnings report or restructuring announcement, temporarily weakens a particular company's investment profile.
- Our judgment about the attractiveness, value and potential appreciation of a stock proves to be incorrect.

ADMINISTRATION

Please contact us for information about our investment program.

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BIOGRAPHICAL INFORMATION

J. Ellwood Towle
Chief Executive Officer

Woody has researched and invested in publicly traded micro-small cap companies for 30+ years. During his investment career, Towle & Co. has owned over 80 companies that have been acquired from the company's portfolio. His cumulative knowledge of and experience in the micro-small cap universe provides the foundation for Towle & Co.'s investment management process. Before starting Towle & Co. in 1981, Woody worked for nine years at Brown Group, Inc. as Manager of Corporate Development. In this capacity, he was lastly involved in the implementation of the firm's merger and acquisition strategy including the identification, due diligence and analysis of acquisition candidates. Woody received his B.A. in history and business administration from Principia College in Elsah, Illinois in 1965 and an MBA from the University of Missouri - Columbia in 1967.

Christopher D. Towle
President

Chris joined Towle & Co. in 1994 and has been instrumental in all aspects of the firm’s growth and development. As an integral member of the investment team, he shares responsibility for the investment management process including portfolio management, trading, and research. Prior to 1994, he served as a General Manager of H. H. Brown Shoe Co., Inc., an operating subsidiary of Berkshire Hathaway, with full line responsibility for a division of the company. He started his professional career as a Senior Credit Analyst at Manufacturers Hanover Trust in New York City. Chris graduated from Williams College in Williamstown, MA with a B.A. in history in 1990 and received an MBA from Washington University in St. Louis in 1998.

Peter J. Lewis, CFA
Director of Research

Peter joined Towle & Co. in 2001 and is a key member of the investment team. Previously, he was President of Principle Research, Inc. From 1991 to 1998, Peter was a partner and department leader at Edward Jones & Co., where he developed a seven-person research team responsible for determining the suitability of all products sold by the company. Before 1991, he worked as a Senior Credit Analyst for three years at the Bank of New York. More recently, he served as a visiting professor of Economics at Principia College in Elsah, Illinois and professor of Finance at Webster University, in St. Louis, Missouri. Peter graduated from Principia College with a B.A. in chemistry and business administration in 1987 and received an MBA with concentrations in accounting and finance from Washington University in St. Louis in 1993. Peter holds the distinction of Chartered Financial Analyst.

FREQUENTLY ASKED QUESTIONS

Why does Towle & Co. emphasize a company's balance sheet?

A strong balance sheet gives a company strength and financial flexibility when faced with a temporary problem. Analysis of the balance sheet goes a long way toward determining downside risk.

Why does Towle & Co. invest in micro-small cap stocks?

Everything we do is a function of value. Throughout our +20-year history we have found the greatest value in micro-small cap stocks. In the short term, the stock market can be very inefficient with the widest discrepancies in value occurring among smaller capitalization companies. Micro-small capitalization stocks are more sensitive to a loss of confidence and market volatility providing opportunity to capture value on a regular basis.

What's the usual catalyst that drives your stocks to the upside?

A number of factors can drive stock prices upward. As bull markets always follow bear markets, a market upturn can dramatically increase prices as investor confidence is restored. Similarly, improved investment perception of a particular industry can increase valuation. However, the primary driver of upward pricing is earnings improvement. Ideally, a company that meets our security selection requirements should be purchased at the inflection point of earnings expansion.

Many of Towle & Co.'s stocks are from old-line industries. What do you find appealing about these companies?

Basic manufacturing, transportation, consumer products, and financial service companies are simple to understand and generally have seasoned management teams. They can trade at deep discounts to their private market transaction value and at low multiples to sales, cash flow, book value, and earnings power. Strong market leadership and heavy insider ownership are other compelling features of many old-line companies.

When a stock's valuation becomes attractive, do you buy it as it is falling or wait for it to stabilize?

We cannot predict where or when a stock bottoms. As it can be time-consuming to build a full portfolio position, Towle & Co. will not hesitate to buy when a stock hits our purchase price. If the market drives the stock lower, we may use the opportunity to buy more.