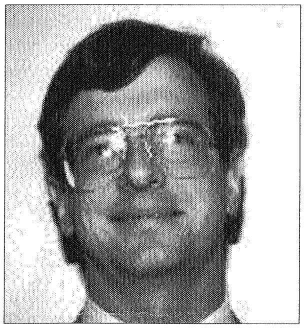
Deep Discount Value Investing

JOHN E. DEYSHER, BERTOLET CAPITAL LLC



JOHN E. DEYSHER is President of Bertolet Capital LLC, advisor to the Pinnacle Value Fund, a diversified, SEC registered mutual fund. He is responsible for the Fund's daily investment activities and has over 25 years' experience in the investment management business. From 1990 until late 2002, Mr. Deysher was a Portfolio Manager and Senior Analyst with Royce & Assoc., an investment firm specializing in the securities of small cap companies. Mr. Deysher began his investment career with Kidder Peabody in 1983 where he managed equity and fixed income portfolios for individuals and small institutions. He holds a Bachelor's degree from the Pennsylvania State University, and Master's degrees from Indiana University, Bloomington (Business) and University of California, Berkeley (Science). He is a Chartered Financial Analyst.

SECTOR – GENERAL INVESTING

(ZGP500) TWST: Would you start by telling us about the Pinnacle Value Fund and its investment philosophy?

Mr. Deysher: The Pinnacle Value Fund is an SEC-registered mutual fund launched on April 1, 2003, with a mandate to invest in securities of small and micro-cap companies that we feel are undervalued relative to earnings power or asset values. Many of these stocks are overlooked in the marketplace and trade below the radar screen of the big institutions. Our approach or philosophy is deep discount value and we seek the most compelling opportunities with the best risk and reward characteristics.

TWST: What has the investment climate been like for you in these recent turbulent times?

Mr. Deysher: The climate is becoming better. Up until mid-2007, it was very challenging because many small caps were making new highs and there weren't many bargains out there. But starting about a year ago, we're seeing more and more opportunities as the climate has become more negative from an economic standpoint. There's lots of bad news on the economy including rising unemployment, falling home values, high gasoline prices, consumers who are tapped out and lower consumer confidence. This led to a decline in the Russell 2000 Index and we're seeing more bargains, but not on a wholesale basis like we would like.

TWST: Do you think the investment climate for small cap value stocks is improving for the second half of the year?

Mr. Deysher: Yes, I think so. A lot will depend on how corporate earnings do. If they hold up, I think the market will probably hold up; if they are weaker or inflation worries accelerate, I think we will see a lot more opportunities.

TWST: What are the criteria that you're looking for in potential holdings?

Mr. Deysher: We like to tell people we look for good companies at great prices or great companies at good prices. Our purchases normally fall into one of four themes: 1) undervalued assets where the stock trades at a discount to liquidation or private market value; 2) turnarounds or

Highlights

John E. Deysher invests in small and micro-cap companies that are undervalued relative to earnings power or asset values. He has a deep discount value approach and seeks the most compelling opportunities with the best risk and reward characteristics. He generally invests in companies that are undervalued assets, where the stock trades at a discount to liquidation or private market value; turnarounds that are recovering from depressed operating results; businesses growing at a reasonable pace that can be acquired at reasonable multiples; and special situations like spin-offs, companies emerging from bankruptcy or liquidations. To avoid value traps, he looks for companies with a strong balance sheet, big insider ownership, capable management and good governance. He likes companies with a historical pattern of sales and profits and that are understandable and temporarily out of favor.

Companies include: Hanmi Financial (HAFC); Center Financial (CLFC); Haverty Furniture (HVT); Ethan Allen (ETH); Winnebago Industries (WGO); Nobility Homes (NOBH).

firms that are recovering from depressed operating results; 3) companies growing at a reasonable pace that can be acquired at reasonable multiples; and 4) special situations like spin-offs, companies emerging from bankruptcy or liquidations. All are fair game for us.

"Most recently we've been active in two Southern California ethnic banks, both Korean-American banks. Both have trade exposure to the Far East which continues to grow. One is Center Financial with a market cap of about $140 million and the other is Hanmi Financial Corporation with a $230 million market cap. They have maintained very strong balance sheets and have historically strong returns on assets and returns on equity. Center Financial is down from about $29 a share to $9, Hanmi is down from about $23 a share to $6."

1-Year Daily Chart of Hanmi Financial

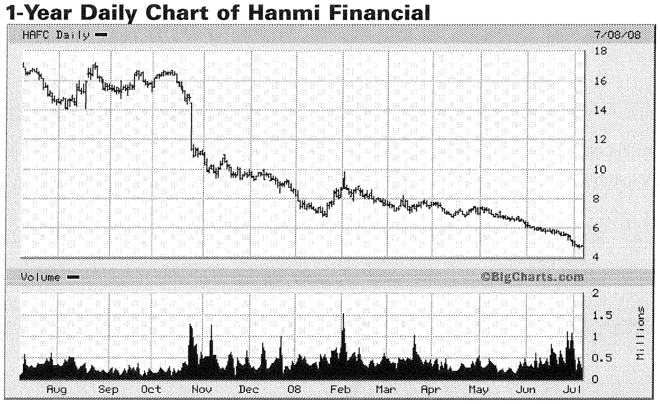


Chart provided by www.BigCharts.com

TWST: How do you do your research for these bargain stocks? Is it internal research?

Mr. Deysher: Yes. Very few of our companies have research coverage so we do all the research internally.

TWST: What are the qualitative aspects of the stocks that you look for to save you from cheap value traps?

Mr. Deysher: We try to avoid cheap value traps. We look for a few things. First and foremost is a strong balance sheet because when these stocks decline in price, normally something is wrong and that's why they're down. Something is out of whack, so they must have a strong balance sheet to provide the financial flexibility to recover and return to prosperity.

We look for companies with big insider ownership or key shareholders; we like someone else besides ourselves to have money on the line; that can either be the insiders or big shareholders, including activist investors. We look for capable managers who are honest, intelligent, energetic, and act as owner/operators, not caretakers. We look for good governance and we can talk more about that if you want. We look for businesses that are understandable and temporarily (not permanently) out of favor. We like a historical pattern of sales and profits; you won't find dream stocks or story stocks in our portfolio. Those are just some of the non-quantitative aspects that we look at.

TWST: Would you expand on the good governance that you mentioned?

Mr. Deysher: It's challenging for us to find a company that meets all of our other criteria and we want to avoid companies that will not treat their shareholders fairly. You can find the best management team in the best-run business in the best industry, but if the insiders are not going to treat the outside shareholders fairly, that's a problem. What do we mean? We rarely invest in companies with dual-class share structures. That's a structure where one class of shares is held by the outside shareholders and another class is held by the insiders and guess which class has the key votes — the insiders. We won't invest in companies that have a lot of related party transactions that are sweetheart deals between the company and insiders. We don't like a Board of Directors dominated by insiders or Compensation Committees on which insiders sit. We simply want companies that treat outside shareholders fairly.

TWST: It's been a difficult environment for deep discount value. Do you have cash positions in your portfolio?

Mr. Deysher: Yes, we have a large cash position, which we would like to deploy at appropriate prices. Even with the market as volatile as it's been lately, we're not seeing the level of bargains that we'd like. When the Russell 2000 declined 50% from 2001-2003, the landscape was littered with small cap values that were bargain priced. We're patient and believe there will be some bargains in the not too distant future.

TWST: How many stocks are in the Fund currently and how does the number fluctuate?

"We like Nobility Homes, which is Florida based and has a market cap of about $60 million, a dividend yield of about 3% and is solidly profitable. The stock is down from $30 to $15. We like manufactured housing because the number of units sold in 2007 was 96,000 units, down 75% from the 372,000 units sold a decade ago in 1998. We think that's going to change going forward because lenders are pulling back, requiring bigger down payments and stricter terms."

Mr. Deysher: The number of stocks in the portfolio is 41 and net assets are $66 million. That's been fairly consistent, normally between 40 and 45 stocks, with the top 10 representing about 30% of the Fund. If we have conviction on an idea we will make it a large position in the Fund.

TWST: What changes in emphasis have you made to the portfolio over the last 12 to 18 months?

Mr. Deysher: One area that's gotten cheaper, where we've been buying, is regional banks. They're front page news right now, people are worried about the loans they hold. One shift that's occurred is that we went from having a relatively small exposure there to having reasonable exposure to regional banks. So far we've been early and it's hurt our performance.

TWST: How have you been performing compared to your benchmark?

Mr. Deysher: Year to date through June 30, the Fund is down 9.5% while the Russell 2000 is down 9.4% including dividends.

TWST: How much in cash are you carrying?

Mr. Deysher: The Fund is about 53% cash.

TWST: What are some of the bargains that you purchased over the last year that fit your criteria and the reasons why you were attracted to them?

Mr. Deysher: Most recently we've been active in two Southern California ethnic banks, both Korean-American banks. Both have trade exposure to the Far East which continues to grow. One is **Center Financial** (CLFC) with a market cap of about $140 million and the other is **Hanmi Financial Corporation** (HAFC) with a $230 million market cap. We like them for a few reasons. They have maintained very strong balance sheets and have historically strong returns on assets and returns on equity. Both yield just over 2%, have strong insider ownership and are down in price. **Center Financial** is down from about $29 a share to $9, **Hanmi** is down from about $23 a share to $6. They're down because of concerns about their exposure to commercial real estate and construction loans in Southern California. This concerns us also, but the selling appears overdone and while nonperforming assets and charge-offs may continue to rise, their balance sheets should be strong enough to absorb the losses.

1-Year Daily Chart of Nobility Homes

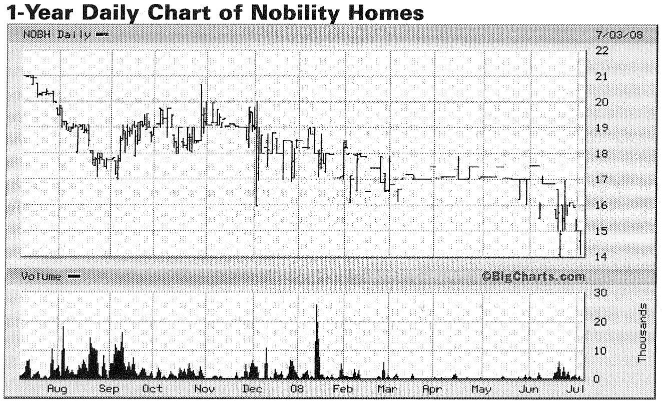


Chart provided by www.BigCharts.com

TWST: Were they relatively untouched by the subprime class and so on?

Mr. Deysher: They are relatively untouched by the subprime. They are being touched by bad construction loans and perhaps bad commercial real estate loans, there's no doubt about that. Their nonperformers are creeping up and clearly we are not through that issue yet, but we took a partial position in each of these and if they get cheaper, we may add to our position. These are clearly contrarian names but I think both represent good values.

"All factors are going against the RV makers right now and as a consequence, Winnebago, which has one of the strongest brands in the industry, has come down substantially in price. It's down from about $40 a share to $10 and has a $240 million market cap. It's a market leader, is still profitable, and pays a 4% dividend yield. Winnebago is a good way to have exposure to a cyclical rebound in the economy and you're paid while you wait."

TWST: Consumer stocks have been going down with the consumer confidence level dropping. Have you found anything attractive in that area?

Mr. Deysher: Yes, we are doing some work in a couple of areas, one of which is furniture retailers. As you know, housing activity has fallen and as a consequence people are not furnishing either existing homes or newly purchased homes as before. As a consequence, the furniture chains have come down and we're doing some work on two firms, **Haverty Furniture** (HVT) and **Ethan Allen** (ETH) with market caps of $220 million and $680 million respectively. Both have come down in price but are profitable and have strong brand names, big stores with wide assortments, and attractive dividend yields. This is one way to play the ultimate rebound in housing without the risk of owning a homebuilder or furniture maker which is vulnerable to imports.

TWST: What other areas of the economy are bringing up bargains?

Mr. Deysher: There are two other areas which represent value at this point in the cycle. The first is manufactured housing. As you know, Warren Buffett's **Berkshire Hathaway** (BRK.A) bought Clayton Homes a couple of years back. They are one of the leaders in manufactured housing. We like **Nobility Homes** (NOBH), which is Florida based and has a market cap of about $60 million, a dividend yield of about 3% and is solidly profitable. The stock is down from $30 to $15. We like manufactured housing because the number of units sold in 2007 was 96,000 units, down 75% from the 372,000 units sold a decade ago in 1998. Why did that happen? Because mortgage rates were so low that people could afford to buy conventional site-built homes instead of manufactured homes.

We think that's going to change going forward because lenders are pulling back, requiring bigger down payments and stricter terms. As a consequence, we think a lot of people are going to be shut out of the traditional site-built homes and a manufactured home will become a viable alternative. You can buy a manufactured home for about half the price per square foot of a traditional site-built home. For the right buyer they can be attractive. The quality has risen sharply in recent years, it's almost the equivalent of conventional homes. They must meet all the building codes that conventional homes do. We're at the right point in the cycle where manufactured homes are going to do quite well and **Nobility** is a good way to play that.

TWST: What about cyclical companies if there's a downturn in the cycle? Is that an area of interest?

Mr. Deysher: Yes, although we don't have many cyclical companies in the portfolio right now. One stock we're analyzing now that could be considered a cyclical stock is **Winnebago** (WGO). As you know, they make RVs, which are fairly cyclical. They're high priced discretionary items subject to consumer confidence, availability of financing and gasoline prices, which are up.

All of these factors are going against the RV makers right now and as a consequence, **Winnebago** which has one of the strongest brands in the industry has come down substantially in price. It's down from about $40 a share to $10 and has a $240 million market cap. It's a market leader, is still profitable, and pays a 4% dividend yield. They've been around since 1958 and survived 50 years of cycles and I think they will be around when the cycle turns. **Winnebago** is a good way to have exposure to a cyclical rebound in the economy and you're paid while you wait.

TWST: What are areas that you tend to avoid or underweight in your portfolio?

Mr. Deysher: The only things that we really avoid are areas beyond our circle of competence, for example technology or biotech where the pace of technological change is so rapid and the risk of obsolescence so high that we don't have time to become experts. There are other people a lot smarter in these areas than we are, so we leave those stocks to them. However, if there's a related industry that supplies components to these companies or distributes their products, they're fair game. A good example is an electronics distributor that doesn't have the technology exposure, but can benefit from growth in technology. If something is beyond our circle of competence we avoid it but we'll look for alternative ways to play it through related businesses or industries.

"We will see more Chapter 11 opportunities in another few years. The level of defaults and subsequent Chapter 11 reorganizations is fairly low right now but I think that is going to creep up. You will see reorganizations and new securities created that may be attractive. That's going to be a very fruitful marketplace for us in the not too distant future."

TWST: What is the outlook for M&A in the small cap arena going forward?

Mr. Deysher: We normally have about one or two stocks taken away from us each year through M&A activity. The outlook is mixed for two reasons. First, if small companies decline in price because of economic worries (which I think will happen), some are going to become takeover bait for strategic or financial buyers. That is the bull case. The bear case says this may be true, but if acquirers cannot obtain financing, it is a moot point. Credit is definitely tightening and you're seeing fewer and fewer deals being announced. Capital is just not as available as it was. There are probably going to be a lot more attractively priced bargains out there, but can the acquirers obtain financing?

"The furniture chains have come down and we're doing some work on two firms, Haverty Furniture and Ethan Allen with market caps of $220 million and $680 million respectively. Both have come down in price but are profitable and have strong brand names, big stores with wide assortments, and attractive dividend yields. This is one way to play the ultimate rebound in housing without the risk of owning a homebuilder or furniture maker which is vulnerable to imports."

1-Year Daily Chart of Winnebago Industries

Chart provided by www.BigCharts.com

TWST: Have you been seeing more special situations and broken IPOs or companies going into Chapter 11?

Mr. Deysher: We haven't seen a lot of broken IPOs that are attractive to us. We will see more Chapter 11 opportunities in another few years. The level of defaults and subsequent Chapter 11 reorganizations is fairly low right now but I think that is going to creep up. You will see reorganizations and new securities created that may be attractive. That's going to be a very fruitful marketplace for us in the not too distant future.

TWST: What triggers an exit from your portfolio and do you ever set price targets?

Mr. Deysher: We always set buy and sell triggers for our portfolio companies, a price at which we would like to buy a stock and a price at which we wish to sell. How do we decide when to sell? Generally we will sell when one of four things happens. First, the price target is met and we wish to take some money off the table. Second, if we're wrong in our analysis, reasoning or logic, we'll sell and take our loss. Third, we'll sell if the insiders are selling in a big way — they know the company better than anyone. Finally, if we're expecting a catalyst to appear and after two or three years it doesn't, we'll sell. But if the catalyst appears and the stock does nothing, we'll hold because eventually, the stock price catches up to reality.

"We're not afraid to take a contrarian position or go against the crowd if necessary. We look for absolute bargains, not just relative bargains. We do all of the detailed work ourselves since not many of our companies have Street coverage. Another differentiating factor would be that we're not required to be fully invested so we can hold a lot of cash in the absence of compelling ideas."

1-Year Daily Chart of Center Financial

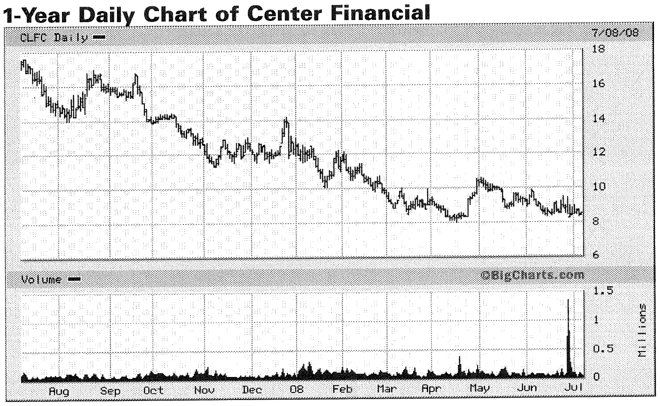


Chart provided by www.BigCharts.com

TWST: What about the turnover on average?

Mr. Deysher: In the last few years it has been 28%-30% indicating a typical holding period of three and a half years or so.

TWST: That is quite long term for a small cap.

Mr. Deysher: Yes. We're long-term investors. In most cases, we are willing to give a company two to four years to do what we think it's going to do. We don't like being too early or too late and generally two to four years is enough time for a company to perform the way we expect it to.

TWST: What about your risk management techniques? How do you attempt to control risk at the portfolio level and at the individual security level?

Mr. Deysher: At the portfolio level we try to be diversified across a lot of different companies and industries. However, we'll put more capital into high conviction ideas.

At the individual company level, we try to buy stocks that are absolutely cheap. We've done the homework, like the company, and like the management, but the question is price. At that point, we really want to buy stocks that are absolutely cheap relative to book value, cash flow, potential earnings, and to all the usual value metrics. Finally in terms of controlling risk, we're not afraid to go to cash in the absence of good ideas. Cash is safe and it earns 2% or 3% return, which is better than a capital loss from paying too much for a stock.

TWST: As a contrarian value player, how do you think that your investment approach to small cap stocks differentiates you from peer funds?

Mr. Deysher: There are a couple of things. First, we're not afraid to take a contrarian position or go against the crowd if necessary. Next, we look for absolute bargains, not just relative bargains. We do all of the detailed work ourselves since not many of our companies have Street coverage. Another differentiating factor would be that we're not required to be fully invested so we can hold a lot of cash in the absence of compelling ideas. The portfolio manager is the largest individual shareholder and comes to work every day trying to make money for all of the shareholders, including himself.

TWST: Looking ahead for the second half of this year, do you see any potential problem areas in the small cap arena that investors should be wary of?

Mr. Deysher: I think the primary issue is what happens to the economy because if the economy slows more than people expect, small caps are going to get whacked. It's the exact opposite of what happens in an expansion when small caps generally do better than large caps. The cloud on the horizon is what happens to the economy, what happens to small cap earnings, and what kind of multiple do investors put on that level of earnings.

There are many moving parts here, but that would be the one that I would be most concerned with because, let's face it, the small caps have had a great run since the fall of 2002. The small caps have outperformed the big ones and at some point that dynamic is going to change.

TWST: Is there anything that you would like to add?

Mr. Deysher: We make four promises to shareholders. Promise one is we will make mistakes and we'll try to keep the damage to a minimum. Promise two is we'll always invest on the basis of value and fundamentals, not popularity. Promise three is we'll be disciplined in both style and execution. Promise four is we'll always have a large personal investment in the Fund. We're eating our own cooking, so to speak.

TWST: Thank you. (PS)

Note: Opinions and recommendations are as of 7/3/08.

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