Value Investor INSIGHT
The Leading Authority on Value Investing
August 25, 2006

Not-So-Ugly Ducklings

There are plenty of prosaic companies in his portfolio, but Bob Robotti's ability to unearth great values over the past 20 years is anything but dull.

INVESTOR INSIGHT

Robert Robotti
Robotti & Co.

Investment Focus: Seeks ignored or temporarily struggling small-cap companies with the potential to at least double their share price within three years.

As CFO of the then 12-person Gabelli & Co. in the early 1980s, Bob Robotti got plenty of exposure to the investment process – if not much input into the actual decisions made. "Let's just say Mario Gabelli didn't need me to pick stocks," he says.

Since starting his own investment firm in 1983, Robotti's record as a decision-maker has been superb. Focusing on unloved or unknown smaller-cap stocks, he's returned an average 17.4% annually to investors over the past 20 years, vs. 10.3% per year for the Russell 2000.

Great runs by the energy and small-cap companies on which he focuses haven't diminished his ability to find values, he says: "Volatility will likely be up, but we're finding plenty of things to buy." See page 12

Robotti & Company Advisors, LLC

Historical Performance, Small Cap Value Composite

ASSET-WEIGHTED ANNUAL RETURN

YEAR	GROSS	NET	GROWTH OF $1 MILLION INVESTED
			$1,000,000.00
1993	29.68%	29.53%	$1,295,300.00
1994	18.29%	17.55%	$1,522,625.00
1995	38.44%	38.07%	$2,102,289.00
1996	24.30%	23.78%	$2,602,021.00
1997	22.42%	21.69%	$3,166,630.00
1998	-14.14%	-14.83%	$2,697,021.00
1999	0.19%	-0.70%	$2,678,142.00
2000	19.59%	17.50%	$3,146,817.00
2001	18.37%	16.37%	$3,661,951.00
2002	-4.97%	-6.66%	$3,418,065.00
2003	33.65%	31.19%	$4,484,159.00
2004	30.80%	28.36%	$5,755,867.00
2005	26.39%	24.04%	$7,139,577.00
2006 *(Through August)*	18.03%	16.54%	$8,320,463.00

COMPOUNDED ANNUAL GROWTH RATE, THROUGH YEAR-END 2005

PERIOD	GROSS RETURN	NET RETURN	RUSSELL 2000
1 Year	26.39%	24.04%	4.55%
3 Year	30.25%	27.83%	22.13%
5 Year	19.97%	17.80%	8.22%
10 Year	14.55%	13.01%	9.26%

Inside this Issue

FEATURES

INVESTMENT HIGHLIGHTS

Other companies in this issue:
Acergy, Advanced Marketing Services, Apple Computer, CBS, Clear Channel, Comcast, First Data, Hewlett-Packard, McDonald's, Microsoft, NewMarket, News Corp., Ross Stores, Sears, Viacom, Wal-Mart, Wendy's, Williams, Yum Brands

Investor Insight: Robert Robotti

Robert Robotti of New York's Robotti & Co. explains which special situations most attract him, the parts of the energy sector he thinks have the brightest prospects, why tougher audits create opportunity and where he sees unrecognized value in Atwood Oceanics, Drew Industries, Zenith National and Pre-Paid Legal Services.

Your portfolio is a hodgepodge of less-than-glamorous stocks. Is there a common theme to your investing?

Bob Robotti: The first security I ever bought, which worked out very well, was a defaulted New York City Housing Authority bond at 36 cents on the dollar. When I set up my own firm in the early 1980s, we focused at the beginning mostly on pink-sheet, trade-by-appointment type stocks. So I've always been a bit attracted to distressed or messier situations.

Our general focus is on companies that attract little attention from Wall Street and/or are beaten up and out of favor. We usually invest in small- and micro-caps, where I still think there are more opportunities to find things that are truly inefficiently priced. I want to believe going in that things we buy can double in price within the next two or three years.

You're a big proponent of special-situations investing. What kinds of situations attract your attention?

BR: We've been successful with a variety of special situations, such as spin-offs, bankruptcies and rights offerings. With rights offerings, for example, these are usually done by companies under some stress and we're looking to see insiders step up as standby purchasers in the offering. You're basically looking for an insider trade, where people in a position to know the business better than the market might be telling you something.

One of our biggest wins ever was with Stolt Offshore, a deep-sea, oil-and-gas drilling contractor which is now called Acergy. It trades on the Oslo exchange and on Nasdaq [ACGY]. In May of 2004, the company did a rights offering as one of the final events in a long restructuring. The Oslo exchange has a rule that if you do a private placement of shares, you have to offer the same terms to public shareholders, which turned out to be an offering price of $2.20 per share.

The $2.20 share price valued the company at around $400 million. That was for a company with $1.5 billion in revenue, no net debt and fixed assets with replacement values far in excess of $400 million. New management had restructured the business and industry consolidation was improving contract terms and pricing. We bought 1.25 million shares in the offering, increasing our position by four to five times.

We didn't need energy prices to go up to do well on this, but when they did, demand for Stolt's services took off. Almost every piece of equipment they have is contracted out for the next two or three years. Today, the stock trades around $18.

Have you taken money off the table?

BR: We've sold very little. They now have $300 million in cash, no debt, around $2 billion in revenue and will earn $1.40 per share this year. The number of deep-water provinces where you can find and produce oil and gas is going to double over the next five years, as provinces open up in Australia, Malaysia, China and elsewhere. That's where people are looking now and that's going to be very good for Acergy's business. I think this can ultimately be a 25x-multiple stock when people recognize the strength of their business and how well positioned they are.

Do you pay attention to share buybacks?

BR: We often look at cases in which a company with significant insider ownership is aggressively buying back shares, but the insiders don't participate in the buyback. Again, that indicates that someone who may know more about the business

Robert Robotti

By the Books

Bob Robotti was "bitten by the investment bug" while serving on the audit team poring over the books of Tweedy, Browne Co. in the late 1970s. "It became quite clear to me that investing was far more interesting than the 'ticking and footing' of the auditing process," he says.

Robotti, however, has not turned his back on his accounting roots. "Bob is without peer in drawing insight about a company and its business from its financials," says Mario Cibelli (*VII*, June 30, 2006), who once worked for Robotti and now manages his own investment partnership. In fact, Robotti lets the numbers do much of the talking when analyzing a company. "I find that subjective judgments about management and the industry are tough to make until you've actually owned the shares for a while," he says, "We focus first on an objective look at the reported numbers."

The post-Enron shift toward tougher audits and board scrutiny of financial reporting has created new opportunity for sleuths like Robotti. One of his most fertile areas for ideas today? "Companies delinquent in filing their financial statements," he says. "It's a real growth area."

wants to own more at a particular price.

An example of that – which took a long time to play out – is the old Ethyl Corp., which does chemical additives for petroleum products and is now called NewMarket [NEU]. In the late 1990s, the controlling Gottwald family bought back 25% of the outstanding stock at $46.25 – adjusted for a 1-for-5 reverse split – and we began buying about a year later when it traded down to $35.

Unfortunately, the business deteriorated and the stock a few years ago got down to about $4, which was 1x trailing 12-month cash flow. We liked that the company was generating cash and paying down debt, and we thought the industry dynamics were finally changing for the better, so we bought a lot more. The business turned around beautifully and it's still a big position for us. [NewMarket shares closed recently around $61.]

We see that like any good value investor, you're not afraid of doubling down when something goes against you.

BR: You have to be willing to do that when you invest in the types of companies we invest in, where things often get worse well before they get better.

I don't want to leave you with the impression, however, that it always works. In the late 1990s I had about a 12% portfolio position in Superior National, a big player in California workers' compensation insurance. I increased my position in a rights offering and it got to as much as 20% of my portfolio. When the workers' comp business in California fell apart, the company turned out to be too leveraged and the shares went from $22 to zero.

Ouch.

BR: The lesson wasn't to not be aggressive, but to not be overweighted in anything that's so leveraged that it really has the risk of going to zero. Acergy is now about 13% of my portfolio, but it has no debt and $300 million in cash. The earnings might slow down, but there's no issue with the viability of the company.

Are there relatively new special situations you're seeing more of?

BR: One newer area is companies that are delinquent in filing financial statements. Up until 2002-2003, corporate audits were really commodity items and there was little value added. The value added, such as it was, was in distorting the economic reality to fit accounting rules and regulations. The world today is very different and auditors have come to rule the world. With long, drawn-out audits and conflicts over reporting, you see more and more companies fall behind in filing, getting de-listed or even choosing to de-register their shares to avoid filing requirements. Those things usually cause a dramatic repricing of the shares and may provide opportunity.

ON OIL-SERVICE COMPANIES:

Whether oil is $40 or $70 per barrel, I'd argue it's not going to have that much impact on demand for services.

Can you give a current example?

BR: We own Advanced Marketing Services [MKTS.PK], which trades in the pink sheets. The company distributes books, mainly to major wholesale-club retailers like Sam's Club, Costco and BJ's. In 2004, they discovered that the head of marketing was defrauding customers. They had to hire forensic accountants and lawyers to track the extent of the fraud and determine the restitution to customers, so they became delinquent in their filings with the SEC. As a result, they got kicked off the New York Stock Exchange in April of last year and the stock went from $7 to about $3.50, which is when we got interested.

There was enough information available that we thought the stock was trading for less than our $5-per-share estimate of what the restated, tangible book value would be. The balance sheet was mainly receivables and inventory – the receivables from blue-chip clients and the inventory was mostly books returnable to the publishers for full refund. The company was and is losing money, but it has in the past earned around $1 per share, which we believe should be achievable again.

Unfortunately, rather than get in compliance and resume their listing, the company now says they plan to de-register their shares. It will still trade in the pink sheets, but we're concerned about the information we're going to get going forward. The stock now trades around $3, and while the risk has increased, we still think there's value here.

You're a long-time investor in the energy business. Where do you stand on the question of whether things are "different this time" with respect to prices?

BR: Our portfolio is currently about 30% in energy, so it's the biggest industry exposure we have. Having invested in the business as long as I have, the one thing I know about energy prices is that whatever the consensus is about future price movements will be wrong. It always is.

The big increase in energy prices has added a lot more commodity risk to investing in the sector today. It's harder to be totally agnostic about the prevailing price levels. I do believe the energy market has fundamentally changed and there will be a new long-term, market-clearing price for energy that is higher than it has been. How much higher, I have no idea. The excess supply in the global industry actually started to be used up by the mid-1990s. Because this is a long lead-time, capital-intensive business that has gone through 20 years of underinvestment, it will take many years for responses on the supply and demand side to work their way through the system.

As that happens, what areas of the energy business do you consider most attractive?

BR: In general, I believe the service companies are more attractive than producers in the current environment. Whether oil is $40 per barrel or $70 per barrel, I'd argue it's not going to have that much impact on demand for services. Many of the big oil companies have declining reserves and will be desperate to add reserves. To do that, they've got to spend on finding and developing new production or getting more production out of what they already have. Well-positioned service companies will benefit from that trend for a long time.

As I mentioned earlier with Acergy, service companies involved in deep-water exploration should be particularly strong. Exploration success as the number of provinces expands will only breed more activity. At the same time, because of the expense and lead times on the capacity side, there's much less risk of oversupply than with land-based drilling.

Tell us about another of your favorite oil-service holdings, Atwood Oceanics [ATW].

BR: Atwood is a contractor of large offshore drilling rigs. Four of their rigs are semi-submersibles, which can drill in 3,000 to 5,000 feet of water, for which the leasing rate is now about $400,000 per day. The other rigs they own, which drill in shallower water, go for closer to $200,000 per day. There's huge operating leverage at current rates: operating costs are $45,000 per day on the semi-submersibles and $30,000 per day on the shallower-water "jack-ups."

From investing in energy for a long time, you develop an appreciation for smart managements that know how to operate in a cyclical business. They don't spend money on capacity when everyone else is and they add it on the cheap when no one else wants to.

From 1982 to 1991, Atwood didn't spend a penny on equipment because they thought the business was going to be oversupplied for years. Then in 1991 they bought an interest in three rigs for $6 million. They spent $10 million to refurbish the equipment and then in 1995 bought the remaining interest for another $16 million. So for $32 million, they owned equipment that had been built in the early 1980s for $240 million. They're very good capital allocators and understand how to build value.

Isn't the concern here that many in the industry won't be so prudent and too much capacity will be added?

BR: Exactly. There are currently around 200 deep-water rigs on the market – semi-submersibles and drill ships – and another 35 are under construction. Most of those rigs are not being built by the traditional industry players, but by speculators who are betting on day rates staying high.

Is that too much new capacity? As I said, I'm convinced demand for deep-water drilling is going to explode. So much so that I don't think the market will be able to meet the demand, even with the new capacity. The world just needs the production from these deep-water provinces.

How does this view play out in your earnings estimates for Atwood?

BR: Their full fleet is contracted out for next year and almost all contracted the following year. Based on contracted rates, the company should earn $5 per share next fiscal year and more like $9 in fiscal 2008. Given that some contracted rates are well below current rates and that they have a new rig coming on in 2008, we think sustainable earnings – at current market conditions – are more like $11-12 per share.

INVESTMENT SNAPSHOT

Atwood Oceanics
(NYSE: ATW)

Business: Houston-based contractor of large-scale offshore rigs used in the drilling of exploratory and developmental oil and gas wells around the world.

Share Information
(@ 8/23/06):

Price	**41.18**
52-Week Range	32.55 – 58.44
Dividend Yield	0.0%
Market Cap	$1.28 billion

Financials (TTM):

Revenue	$240.6 million
Operating Profit Margin	30.9%
Net Profit Margin	28.9%

Valuation Metrics
(Current Price vs. TTM):

	ATW	S&P 500
P/E	19.1	19.3
P/CF	13.8	13.7

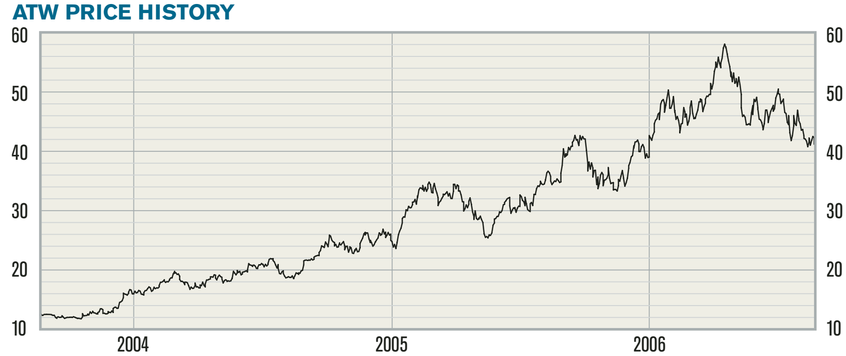
Largest Institutional Owners
(@6/30/06):

Company	% Owned
Columbia Wanger Asset Mgmt	7.2%
Trafelet & Co.	4.6%
Barclays Global Inv	4.1%
Mackenzie Financial	4.0%
Mellon Financial	3.6%

Short Interest (@ 7/10/06):

Shares Short/Float	9.6%

ATW PRICE HISTORY



THE BOTTOM LINE

Oil companies desperate to add energy reserves will fuel a long-lived explosion in demand for the deep-water drilling equipment the company provides, says Bob Robotti. Based on contracted day rates and the addition of new capacity, he believes the company's sustainable earnings are $11-12 per share, less than 4x today's share price.

Sources: Company reports, other publicly available information

Given our view on supply and demand, we believe that's sustainable for some time.

With the stock recently around $41, the market seems to disagree.

BR: Yes, given that the shares trade at less than 4x what we think the company is going to earn in three years, the sustainability of earnings is clearly where our view differs from the market.

The company will have no debt by the middle of next year, so their net earnings will be mostly cash earnings. So within three years, then, not only will they be earning at a very high level, but they will have accumulated $20 or so per share of cash. If that happens, it doesn't take very sophisticated math to arrive at a share price significantly above where it is today.

What if oil prices go down?

BR: Exploration to find a deep-water field costs $5-7 per barrel. Producing it then costs another $3-5 per barrel. So whether oil is at $75 or $40 won't make that much difference on demand.

What attracted you to your next pick, Drew Industries [DW]?

BR: This is a relatively straightforward story. Drew sells component parts – like windows, doors, chassis and axles – to manufacturers of recreational vehicles and manufactured homes. They do business with almost all manufacturers and probably have 50% market share in both businesses. The revenue mix is two-thirds RVs, one-third manufactured housing.

There are two main things that attracted us here. First, we're convinced they have an excellent model for growth. They've been very good at identifying products that will have broad appeal and then making small acquisitions to fill out their product line and leverage their relationships and sales infrastructure.

We're also big believers in the turnaround potential of the manufactured-housing industry – where Drew operates at maybe 50% of capacity and where they have historically earned higher margins.

Why do you think the manufactured housing business is set to improve?

BR: The industry has been beaten up for some time. In the late 1990s, the industry was selling 370,000 new homes per year, driven by very aggressive financing offers. Many of those loans blew up, dumping a lot of inventory on the market. At the same time, falling interest rates made stick-built homes a more affordable option for many people. As a result, sales of new manufactured homes fell to 130,000 per year and have stayed around that level.

We now think higher interest rates will refocus many low-end buyers' attention on the relative affordability of manufactured housing. Lending to the industry is now much stronger and default rates are way down. In fact, terms have gotten so rigid that legitimate potential buyers – who generally have lower FICO scores – can't get loans. We expect that all to adjust as time goes on. Clayton Homes is the biggest player in the industry and you can imagine one reason Berkshire Hathaway bought it was for the opportunity to lend money to help finance the industry's rebuilding.

Getting back to even 200,000 new manufactured homes sold per year, which is fully achievable, would result in tremendous upside for Drew. We think

INVESTMENT SNAPSHOT

Drew Industries
(NYSE: DW)

Business: Supplier of windows, doors, chassis and other components used in the manufacture of recreational vehicles and manufactured homes in the U.S.

Share Information
(@ 8/23/06):

Price	**24.95**
52-Week Range	20.95 – 38.90
Dividend Yield	0.0%
Market Cap	$537.2 million

Financials (TTM):

Revenue	$762.0 million
Operating Profit Margin	8.6%
Net Profit Margin	5.2%

Valuation Metrics
(Current Price vs. TTM):

	DW	S&P 500
P/E	14.0	19.3
P/CF	9.9	13.7

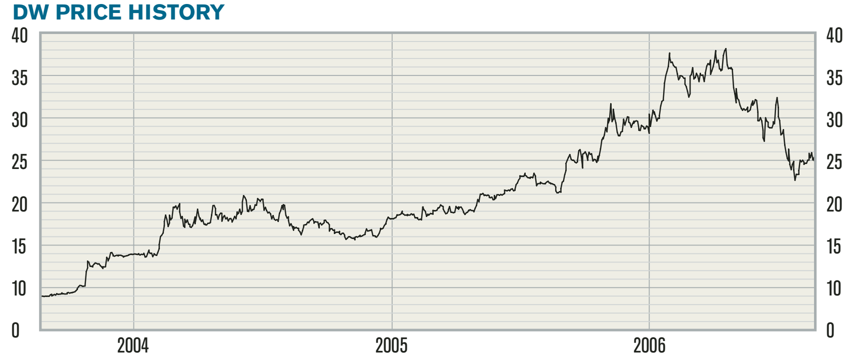
Largest Institutional Owners
(@6/30/06):

Company	% Owned
Fidelity Mgmt & Res	8.6%
Royce & Assoc	8.1%
Munder Capital	5.6%
Columbia Wanger Asset Mgmt	4.9%
Mellon Financial	3.9%

Short Interest (@ 7/10/06):

Shares Short/Float	8.8%

DW PRICE HISTORY



THE BOTTOM LINE

Earnings should increase at double-digit annual rates as the company capitalizes on add-on acquisitions and an expected turn in its business supplying the manufactured-housing industry, says Bob Robotti. He expects significant multiple expansion – of at least 50% from today's 12x forward earnings – to accompany that growth.

Sources: Company reports, other publicly available information

that business can double for them in the next few years.

With the stock currently trading just under $25, how are the shares valued?

BR: The stock currently trades at around 11-12x our estimate of next year's earnings. As they continue to add new products and the manufactured-housing business turns, we think earnings will increase at double-digit annual rates. With that kind of growth and the high-teens multiple we believe the business will then deserve within three years, you've got a lot of upside from today's price.

After your Superior National experience, we're surprised you still own a workers' comp company, Zenith National [ZNT].

BR: The California workers' comp market – where Zenith does about two-thirds of its business – is very large, very volatile and, as I learned firsthand, has historically destroyed a lot of capital.

It's important to give some history here about the market. In the early 1990s, the economy in California turned down and people were losing their jobs. When that happens, you see a big increase in workers' comp claims, because the benefits are generally much better than those provided by unemployment insurance. This was all facilitated by a significant number of less-than-ethical doctors and lawyers, who saw this as a great way to make a buck.

That led to regulatory reforms in 1993-1994 that were meant to address the increase in the number of claims and the resulting increase in the price of workers' comp insurance. They changed things like increasing how much of one's stress had to be related to their job to qualify for a claim. They also cracked down on doctor and lawyer mills generating bogus claims.

Wall Street then came into the picture and started to pour capital into workers' comp insurers in California. This too ended badly, because the companies were overly leveraged and thought they were transferring a lot of risk to undisciplined reinsurance companies who didn't know what they were doing. The result was that the market got very undisciplined and started to crack in the late 1990s. Fremont Insurance was seized by the state insurance department. Superior went bust.

Where was Zenith during all this?

BR: Stanley Zax, who has run Zenith for 30 years, is a very disciplined operator who has been through all the ups and downs of the business. He kept Zenith on track and relatively well reserved, so the company came out of the turmoil of the late 90s in a stronger position, as many of the dumb competitors went away.

Fast forward to today and you have a much healthier industry. The major players in the business are much better-run and new regulations, such as requiring a medical-review process for claims, have been instituted. That all plays particularly to Zenith's hand, because their focus and expertise is on smart underwriting and claims management.

What does the current rate environment look like in California?

BR: Rates are coming down, but that's because losses have come down. Given that, I don't think Zenith's margin of profitability comes down all that much over

INVESTMENT SNAPSHOT

Zenith National
(NYSE: ZNT)

Business: Insurance holding company primarily focused on the underwriting of workers' compensation insurance in California and Florida.

Share Information
(@ 8/23/06)):

Price	**37.19**
52-Week Range	36.14 – 55.30
Dividend Yield	2.9%
Market Cap	$1.38 billion

Financials (TTM):

Revenue	$1.19 billion
Operating Profit Margin	23.9%
Net Profit Margin	15.4%

Valuation Metrics
(Current Price vs. TTM):

	ZNT	S&P 500
P/E	7.7	19.3
P/CF	7.7	13.7

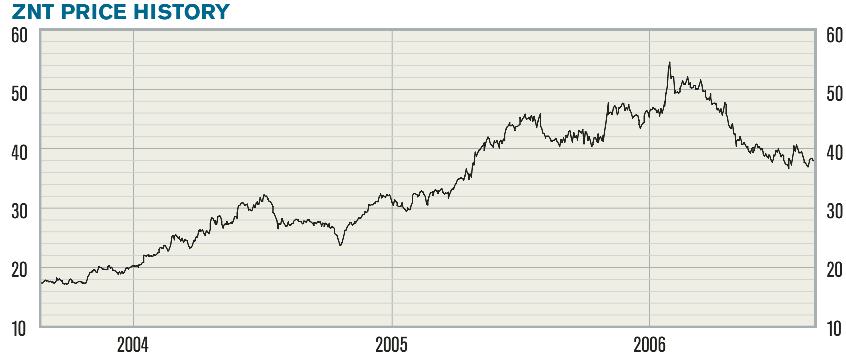
Largest Institutional Owners
(@6/30/06):

Company	% Owned
Gilder, Gagnon, Howe & Co	14.6%
Fidelity Mgmt & Res	6.1%
Barclays Global Inv	5.5%
American Century	4.5%
Vanguard Group	3.8%

Short Interest (@ 7/10/06):

Shares Short/Float	4.3%

ZNT PRICE HISTORY



THE BOTTOM LINE

Fears over the capital-destroying tendencies of the California workers' compensation insurance market are outdated, says Bob Robotti, and the healthier dynamics of the industry bode well for disciplined competitors like Zenith. At a more appropriate 10x multiple on normalized earnings, he believes that shares are worth $55-60 per share.

Sources: Company reports, other publicly available information

the next couple of years. I also think they'll be able to offset any rate decreases with both increases in investment income and adjustments from excess reserves they've put on the books in recent years.

Is there a growth story here?

BR: If there's a negative, it's that growth prospects – at least the way Stanley Zax runs the company – are limited. He sticks to what he knows and executes well, but he shows little aspiration for growing his policy count. Over time, then, the business will grow as payrolls in their markets grow.

What upside do you see for the shares, recently trading just about $37?

BR: Last year Zenith earned $4.25 per share, including a loss of about $1.30 per share from a reinsurance business they've since exited. So the stock is trading at only 6.8x the current earnings run rate of $5.50 or so per share.

The stock is so cheap because everybody still assumes workers' comp in California is a horrible business. We think if the market recognized the improved dynamics of the industry and gave Zenith full credit for running a disciplined, conservative business, a 10x multiple on normal earnings of $5.50 to $6 per share would be more reasonable.

We're curious, is Berkshire Hathaway getting more involved in the market?

BR: They actually bought a company recently, Applied Underwriters, which is a player in the workers' comp business. These are pretty smart capital allocators, so we obviously see that as a positive comment on the business. It hasn't happened so it probably never will, but we've actually thought Berkshire would be a logical acquirer of Zenith one day.

There no dearth of controversy around your last idea, Pre-Paid Legal Services [PPD].

BR: Our interest is primarily based on our conviction that they have a great product. For a monthly payment of around $25, you get access to certain legal services for free and to others at deeply discounted rates. We think that's an interesting product offer for $300 a year, with applicability to even more people in the U.S. than for the tax-prep services of H&R Block. The model is actually similar to H&R Block – providing a level of service most people need on a more cost-effective basis.

Describe how the service works.

BR: You're assigned a local law firm as your point of contact, which improves customer service. The first time I tried to use it was when I bought my co-op. The problem was they wouldn't get involved until I already had the co-op picked out, but in New York you have to have your attorney involved earlier in the search process to get access to certain information. So it didn't work there. Where it did work for us: we bought a $700 TV from Best Buy and it broke a month or two later and they wouldn't take it back. For no additional cost, the Pre-Paid lawyer wrote a letter for us and we received a refund shortly after.

A friend of mine, who also owns the stock, bought his house in Westchester County and used a Pre-Paid lawyer for his closing, paying less than half what every other lawyer wanted. He's even used one

INVESTMENT SNAPSHOT

Pre-Paid Legal Services
(NYSE: PPD)

Business: Provider of legal services to roughly 1.5 million U.S. families who purchase plan memberships carrying monthly fees of approximately $25.

Share Information
(@ 8/23/06):

Price	**36.77**
52-Week Range	32.15 – 48.40
Dividend Yield	3.3%
Market Cap	$533.7 million

Financials (TTM):

Revenue	$438.0 million
Operating Profit Margin	18.3%
Net Profit Margin	10.3%

Valuation Metrics
(Current Price vs. TTM):

	PPD	S&P 500
P/E	12.5	19.3
P/CF	10.0	13.7

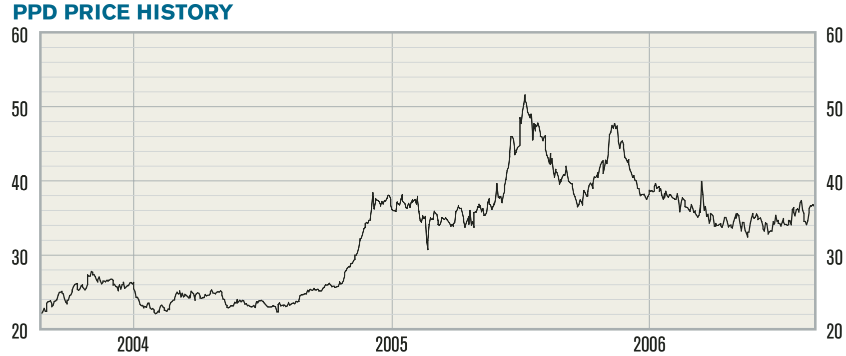
Largest Institutional Owners
(@6/30/06):

Company	% Owned
Thomas W. Smith	20.8%
Steadfast Capital Mgmt	5.6%
Goldman Sachs	5.0%
Wellington Mgmt Co	4.3%
Barclays Global Inv	3.9%

Short Interest (@ 7/10/06):

Shares Short/Float	54.3%

PPD PRICE HISTORY



THE BOTTOM LINE

More-traditional marketing of the company's proven and unique legal-services plan to a broader audience, combined with a heightened focus on customer retention, can unleash tremendous untapped revenue and earnings potential, says Bob Robotti. Success on both fronts, he says, would result in a "multiple" of today's share price.

Sources: Company reports, other publicly available information

of their lawyers for routine securities work, at one-fifth the cost I pay for the same work at my regular law firm.

Who is the target audience?

BR: The company says it's not the top 10% or bottom 10%, but the 80% in between. The reality is they reach mostly middle- to lower-income people, which I think is more a result of how they sell than of who might benefit from the product.

A dreaded multi-tiered marketing system?

BR: Yes, they use a system just like Amway's, which is one reason Wall Street hates the company. We agree that how it's sold is a limitation, but not based on any elitist view of what's appropriate.

The first problem is that by selling to people you know, who sell to people they know, they don't reach large parts of the population – namely higher income levels. The current system also isn't adequately educating people on how to use the product and what a great value it is. The more people use and take advantage of the services, the longer they remain customers.

We think there's great untapped potential in promoting to a broader population base through advertising and more traditional marketing. They also should enhance customer-service efforts to connect more often with paying customers.

The growth upside from doing both of these is tremendous – they win from dramatically increasing the customer base and from higher retention of the customers they already have.

The founder, Harland Stonecipher, still runs the business. What makes you think things will change?

BR: Management has been open to suggestions of certain long-time shareholders. Tom Smith, the managing partner of Prescott Investors, has been on Pre-Paid's board since 2004. I'm sure he's introduceing ideas that will continue to impact how they look at the business. We see it already in how they've started new programs to try to increase usage, in how they're looking more carefully at the lifetime value of a customer. They have more than enough resources to invest in better marketing, and we think they will.

We're also optimistic about the identity-theft product they launched in 2003 in a joint venture with Kroll. It's a relatively unique service that doesn't just monitor for problems with identity theft, but also has a restitution part if something goes wrong. Kroll is a part of Marsh & McLennan and the entire company is quite sophisticated in how they sell their products. I believe this relationship can open new doors to Pre-Paid.

ON CHANGING TIMES:

The particulars might change from time to time, but people drive the environment and human nature is pretty constant.

Is the competitive environment agreeable?

BR: The other main players – the Hyatt Legal Plans division of MetLife and a former Montgomery Ward business that's now owned by General Electric – operate mostly in the corporate market, offering plans as employee benefits. Pre-Paid is by far the market leader with consumers.

The short interest, nearly 55%, is about as high as it gets. Why do so many investors loathe the stock?

BR: There have been lawsuits against the company alleging various damages, usually amounting to no more than a few hundred dollars each. One case, in Mississippi, resulted in a punitive-damage award of $9.9 million, which is now on appeal. Many business people would not consider an early negative verdict from a Mississippi jury as great cause for concern, and we agree. The Connecticut Attorney General also announced he was looking into the company's sales practices, but nothing's come of that since it was announced with great fanfare a year ago.

There were accounting concerns, primarily over the company amortizing over three years commissions on new customer sales. Now those commissions are expensed immediately. Today, cash earnings slightly exceed reported EPS.

With all this, we come back to the fact that we believe in the product – that it's a proven, cost-effective service for consumers that has been around for 30 years. The "noise" has calmed down quite a bit, but sometimes a high short interest takes on a life of its own. As long as you're comfortable with your work, you just can't worry about that.

The stock has been stuck near its current level, around $37, since the beginning of 2005. Where do you think it can go?

BR: The shares currently trade for around 11x trailing earnings, if you adjust for the fact that the identity-theft earnings are temporarily lower because the start-up selling expenses are being expensed immediately. There's no capital spending, so the earnings translate to free cash flow. Protecting the downside is that they have no debt and they're using free cash flow to buy back stock. The company has gone from over 24 million shares outstanding to less than 15 million today, which has had a significant effect on EPS growth.

I can't give you a specific target number for the stock price. But if they can really get at the untapped potential I think this product has, the share price will be a multiple of what it is today.

You've been in the investment business for over 25 years. How would you say the business has changed?

BR: You know, the particulars might change from time to time, but people drive the environment and human nature is pretty constant. A year ago, NewMarket shares were at $15 and nobody wanted them and today it's at $61 and everybody wants to own it. Fundamentally, it was positioned a year ago to earn what it's earning today. Things like that are as likely to happen today as they were 25 years ago. VII

Robotti & Company Advisors, LLC

Notes:

At the time of this interview, Bob Robotti, Robotti & Company, LLC, Robotti & Company Advisors, LLC and its affiliates owned 1.6% of PPD's common stock and less than 1% of ATW, DW and ZNT's common stock.

The investment results of the Small Cap Value Composite are only for illustration purposes and it cannot be assumed that future results will be reflective of this past performance.

The Small Cap Value Composite has been defined and created to include all fee-paying, discretionary accounts over $100,000 that are managed according to the Small Cap Value investment strategy. The composite may include accounts that are no longer managed by Robotti & Company. The performance is computed using trade date accounting and generally accepted accounting principals. This strategy does not make use of derivatives or other leveraged instruments.

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Gross performance results are presented before deducting Robotti & Company Advisor's investment management fee, but after any custodial fees and trading commissions and expenses. Net performance results are presented after deducting Robotti & Company's investment management fees and any custodial fees and trading commissions and expenses. The standard fees charged, on an annual basis, are negotiable and generally up to a maximum of 2% of assets under management. Valuations and performance returns are stated in U.S. Dollars.

The Russell 2000 benchmark measures the performance of the 2,000 smallest companies in the Russell 3000 Index, which represents approximately 8% of the total market capitalization of the Russell 3000 Index.

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This composite was created in December 2001. No alteration of composites as presented here has occurred because of changes in personnel or other reasons at any time. A separate composite has been created for each investment strategy offered by Robotti & Company Advisors, LLC. A complete list of firm composites and performance results is available upon request.

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