

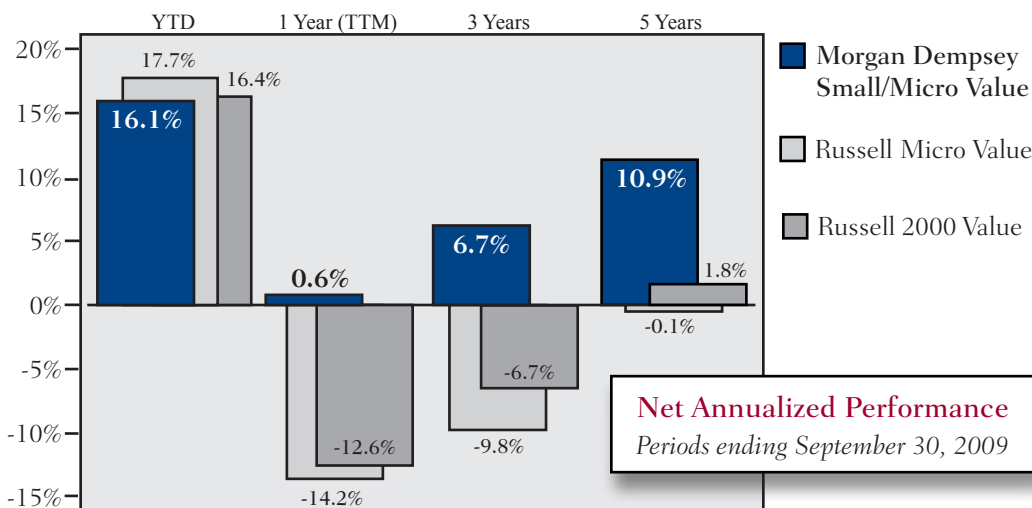
Morgan Dempsey Small/Micro-Cap Value - Third Quarter Commentary

## Dollars & Sense

The summer doldrums and the saw-tooth tepid market we expected for 2009 instead manifested itself in a resurrection of “animal spirits”. In the third quarter, cyclical manufacture, construction, materials and energy were out distanced by technology, financial services and health care sectors. Foreign emerging BRIC equities (Brazil, Russia, India, and China), zero-earnings power stocks and companies paying zero cash dividends all generated robust returns.

The Investor’s Business Daily menu of the IBD Top 100 momentum stocks tracked for U.S. Investors list 9 of the top 20 stocks domiciled in China which signals the froth in speculation given the dubious accounting. According to Bank of America analyst Steven DeSanctis, CFA, the rally from March 9, 2009 has fostered a low quality mix. The lowest ROE % stocks gained +136.51% and the lowest quintile price stocks were +129.03%. Standard and Poor’s reported for Q3 2009 that only 191 of 7,000 public common stocks hiked their cash dividend, the worst third quarter since 1925.

Since 1987, there have been 10 cycles where low quality, negative earnings stocks have outpaced cash flow positive stocks that have generated high quality earnings. These periods lasted an average of 7 months with only 2 periods of 18 and 16 months in 1998-2000 and 2002-2004. Since the November 12-13, 2008 lows, the current cycle is 10 months and appears from volume trading to be aging as trade volume deteriorates.



Disclosures: Please see important investment performance disclosures on following page.

### Performance Summary

	Morgan Dempsey Small-Cap (Net)	Russell 2000 Value
July	5.50%	11.56%
Aug	2.62%	4.73%
Sep	4.46%	5.02%
Q3	13.08%	22.70%
YTD	16.07%	16.36%

### Account Information

Management Fee: 1.00%  
Minimum Investment: \$1,000,000  
No lockup period or redemption restrictions

### Manager Information

Brian G. Rafn  
Director of Research/Portfolio Manager

Mr. Rafn joined Morgan Dempsey in October of 2003. He has over 20 years of experience in securities analysis, portfolio management, trading and trust accounting. Brian additionally has degrees in Finance, Accounting and Economics.

### Portfolio Information

Top 10 holdings as of 9/30/09

5.8% - Jos. A. Bank Clothiers, Inc.	JOSB
5.4% - Aptar Group, Inc.	ATR
5.3% - National Presto Ind.	NPK
4.8% - J&J Snack Foods Corp.	JJSF
4.5% - Utah Medical Products, Inc.	UTMD
4.4% - Granite Construction, Inc.	GVA
4.3% - Gorman Rupp Co.	GRC
2.8% - L.B Foster Co.	FSTR
2.4% - Flower Foods, Inc	FLO
2.2% - Ladish Company, Inc.	LDSH

Total Number of Holdings: 70  
1 year turnover: 21%  
Median Market-Cap: \$486 million  
Weighted Market-Cap: \$724 million

### Contact Information

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Our portfolio has done a superb job in maintaining pace with the small and micro-cap value indices given the low credit rally which paid negligible concern for fortress balance sheets and positive earnings. YTD our holdings are up 16.1% compared to 16.4% for the Russell 2000 Value index. In an environment that is typically one of the toughest relatively for our portfolio, we are extremely pleased to not surrender any of the significant out performance we achieved in 2007 and 2008 in which we outperformed our index by +20% and +15% respectively. As an added benefit, our returns this year have been a bit easier on our investor's nerves as quarterly swings for the index have ranged -20% to +23% compared to -10% to +15% for MDCM.

As of September 30, 2009 our small/micro-capitalization value portfolios were constructed with a 56% exposure to small capitalization (>\$500 million market cap) and 44% allocated to micro-cap issues (<\$500 million market cap). The levitation in equity price shifted about 11% of the market capitalization from micro to small during the 3rd quarter leaving us with a median market capitalization of \$486 million and an average weighted market capitalization of \$723 million. The tilt in our equity portfolio, the "Locomotive 7", approximated 34% of the holdings while our top 10 holdings accounted for 42%. The portfolio holdings of our 70 common stocks generated a 1.03% dividend yield which historically approximates a normal level.

The quarter registered several major gains with KMG Chemicals Inc. +52.7%, Unit Corporation +49.6%, Monarch Casino & Resorts Inc. +47.4%, MKS Instruments Inc. +46.8%, Brush Engineered Materials, Inc. +39.1%, and Sun Hydraulics Corporation +30.2%.

The value portfolio additionally posted a few losses in the 3rd quarter with Marten Transport Ltd. -17.8%,

Sanderson Farms Inc. -16.4%, Koss Corporation -10.4% and Granite Construction Inc. -7.0%.

We surveyed our portfolio in the Value Line Ratings Reports: Small/Mid-Cap 1700 edition with the following top 100 screens for value companies:

**High Yield % Equity:**

Espey Manufacture & Electronics, Inc. #81  
L.S. Starrett Cos #88

**High ROIC %:**

Unit Corporation #77  
Monarch Casino & Resorts #95

**Deep Discount Bargain Equity:**

L.S. Starrett Cos #6  
Lakeland Industries Inc. #15  
Key Technology Inc. #31  
Eagle Materials, Inc. #38

**High Free Cash Flow Generators:**

Graham Corporation #33  
Belchem Inc. #85  
KMG Chemicals Inc. #90

**Book Value Discount Equity:**

L.S. Starrett Cos #85

**A Company Perspective:**

At the individual company level, we have witnessed extraordinary performance in the ability of our business models to navigate the abyss during November 2008 and March 2009. The focus on fortress balance sheet solvency and paternalistic founder/owner/operator cultures created a near impregnable margin-of-safety hedge against capital loss in 2008.

We highlight this quarter with a couple of stock holdings where we most recently hosted on-site meetings with senior management in Milwaukee.

## **JOSB**

Joseph A. Banks Clothiers Inc. (JOSB), our top holding at 5.62% of the portfolio, has operated a men's apparel business with Swiss watch precision during the worst of 2007-09 financial panic. The company was the poster boy of naked short sales arbitrage with an inept SEC allowing a 21,335,000 short sale position on a 16,703,000 float in 2007, (finally abated with SHO regulation enforcement).

True to our deep value and contrarian roots, their (higher profit?) suit business has expanded from 24%-27% of sales during 2001-2005 to the current 32%. This result is due to the counter intuitive reality that suits and dress codes distinguish a business during economic recessions or foster a necessity for unemployed interview candidates.

The company provides investors a true "fortress balance sheet" as it is debt free (self funding) with \$126 million in cash and securities accounting for 25% of assets. Growth has remained strong exhibited by a +6.2% organic same store comp sales in 2Q 2009.

The company operates 474 store chains (89% of sales) with catalog and internet (11% of sales) providing 365 day X 24 hour shopping convenience. The product lineup provides a high/low price strategy with 50-55 events annually.

A classic fashion style dominates the product line (66% of 41,000 SKU ) which affords multiple luxury levels, 3-4 year lifespan, broad assortment and depth (S-XXL) and technology innovation with respect to anti-stain, anti-wrinkle, color test anti-shrinkage and thermal cooling (outlast™).

The company founded in 1905, (public IPO in 1994) and has generated consistent and phenomenal earnings power. Since the initial 1994 split-adjusted \$.14 EPS, the business exhibited

earnings per share growth rates of +21.61% for the period of 1994-2009 (IPO to present), +35.62% for the period of 1996-2009 (since women's apparel was divested), and most recently +31.79% from 1999-2009 under the Wildrick/Black/Ullman management team (profit growth in 31 of 32 past quarters).

The company is a traffic driver and "destination shopping" retailer for malls, strip power centers and lifestyle centers which has afforded JOSB an average \$225,000 land lord rebate vs. the \$100 per square foot or \$450,000 lease hold improvement costs per store. The company has been an apparel innovator with the thermal absorbent summer suit line and the Traveler™ line of anti-wrinkle, anti-stain, color fast anti-shrinkage and no iron apparel.

The conservative real estate management coupled with measured store chain growth reflects the under appreciated skill set of the operators. The common trades near \$45.00 with our internal estimate of 9.9X \$4.55 EPS and 5.5X \$8.12 EBITDA based on January 31, 2011 fundamentals. This stock is tailored for growth and is valued at our calculated intrinsic value of \$95 for 2011.

## **MCRI**

We hosted a company visit from Monarch Casino & Resorts Inc. in August 2009 with David Farahi, of the Farahi family, which owns the Atlantis Casino & Resort in Reno, Nevada. The common stock declined from \$32.97 on May 10, 2006 to \$3.59 on March 6, 2009 and we have availed our portfolio to the repurchase of shares as the economy rebounds.

Located 16 miles northeast of Lake Tahoe in arid sparks county, the company is finishing a \$73 million phase upgrade of their 3 tower, 61,000 ft casino which features 10 restaurants and a deli, a sports media lounge and world class 40,000

square foot spa and gym providing salon services offered at only 12-15 sites in the U.S. The hotel complex features a stratified level of luxury with motel rooms allowing pets at \$49.99 to suites at \$299.99 and offers the only skywalk link to the Sparks Convention Center in downtown Reno.

Monarch Casino exemplifies many of the characteristics we look for in a potential holding. The business model focuses on the acquisition of undercapitalized or older casino and hotel resort properties located in Nevada requiring major capital renovation. They operate as a debt adverse casino and have invested \$1.89 in PP&E capital expenditures for each \$1.00 in depreciation and amortization over the past 22 years, a phenomenal level.

As a paternalistic employer, the Farahi family has refused to eliminate or fire employees during recessions and recently upgraded the 401k match for employees from 25% to 50%. The company controls a margin-of-safety reserve in real estate holdings with contiguous properties at 15.8 acres, 2.3 acres and 2.5 acres to the 8 acre casino for future expansion.

The common stock trades near \$10.15 per share and sports a +26.6% 16 year EPS growth rate with only 2 negligible negative earnings years, \$(-.03) 1999 and \$(-.04) 1994. With gross margins above 50%-60% and free cash flow of 20% - 58% of gross EBITDA in 11 of 17 years (1992-2008), the stock is capitalized at 14.9 X \$4.66 2010E on a P/E multiple basis and 6.2X \$1.61 2010 E on a P/EBITDA multiple. We like the bet on MCRI and feel comfortable rolling the dice with this balance sheet.

### **Economics from 30,000':**

As we navigate into the 4th quarter of 2009, our macro-economic and political concerns focus on several trends that could affect our portfolio.

1. The mounting political rhetoric about the substitution of the U.S. dollar as the world reserve for a basket currency from the United Nations, China or Russia which follows the devaluation of the U.S. dollar of (-21)% vs. traded weighted currencies since 2001, 9/11.

2. The September 30, 2009 Federal budget ended with an early estimated Office of Management and Budget figure from Peter S. Orszag of \$1.85 trillion or 13% of GDP, moreover the 2010 budget deficit is forecast to be \$1.47 trillion. This habitual lack of fiscal discipline argues to the core of the inelastic viewpoint the current administration holds toward sovereign credit quality.

3. The equity markets have levitated as a function of monetary accommodation and stimulus on a global basis, with the concern over the timing and magnitude of the central banks removal of excess reserves and liquidity.

4. The factors which propel stock values: productivity, sales and earnings growth, inventory restocking, international trade stimulus, tax liability reduction and capital expenditure budgets have been less evident in the summer 2009 rally.

5. The Universal Healthcare Reform which targets insurance for some 27-47 million uninsured Americans paid for by savings from the elimination of waste, fraud and abuse sounds hollow. This echoes a haunting reprise of the Community Reinvestment Act of 1977 which crusaded for affordable housing and resulted in a 14 year 1991-2005 mortgage mania ultimately causing global banks \$1.89 trillion in write-offs.

6. Top-line corporate sales revenue growth has generated benign levels with profitability flowing primarily from cost/productivity and SGIA expense control. Unit volumes we expect to reflate first with an inevitable deflation in inventory pipeline building.



The macro-economic landscape continues the guarded and tepid rebound despite Washington policies of negligible accelerated depreciation schedules, higher minimum wages, Free-Choice-Check-Card union elections and corporate tax rates approaching 48-51%.

Real GDP growth exhibited 4 sequential negative quarters; 3Q 2008 (-2.68%), 4Q 2008 (-5.37%), 1Q 2009 (-6.43%) and 2Q 2009 (-0.74%) with consumption spending declining from 71% of GDP in 2007 to 66%. The deflationary paranoia is exhibited by the PPI wholesale inflation measures peaking at +6.2% in 2007 and swinging to (-7.3%) in 2009.

The 30 year U.S. Treasury TIPS spread, however, has expanded from 23 bp to 192-224 bp, from a 265-275 bp spread prior to the mortgage crisis in July 2007. The output gap of idled capacity and latent productivity expanded as capacity utilization % declined from 82% in 2006 to 68% in 2009.

The monetary aggregates exhibit a cessation to expansion, albeit holding at expanded levels with the Adjusted Monetary Base (currency circulation + bank deposits) at \$1.83 trillion as of September 12th vs. the \$877 billion run rate from 2006-2007. The level of gross financial debt in the U.S. economy in 3Q 2009, amounted to \$33.9 trillion, which has expanded at +5.9% to +9.5%, since 2001. The federal U.S. Treasury debt of \$11.9 trillion accounts for 35.13% of gross debt but a more ominous 84.28% of GDP vs. 37.24% as of September 30, 1977, 32 years ago under President Carter.

As evident in general economic expansion cycles, normalized market based indicators exhibit signals of recovery. The spot price of gold at year end 2008 was \$883.17/troy ounce and crossed \$1,000 in early September 2009, real Fed Funds rate traded (-2.0%) and positive yield curve of +398 bp U.S. Treasury 3 month – 30 year all signal reflation of economic commerce.

### Wisdom of the Ages:

At this juncture, our company holdings have traversed the credit abyss in superb fashion although we continue to hold a guarded optimism for the stock market, as the corporate sector exhibits the balance sheet austerity and cost/expense diet which the government and consumers should adapt.

The debt leverage risk in the U.S., which was the elixir of 25 years of conspicuous consumption, faces several choices. Debt is repaid, renegotiated, defaulted on, converted to or swapped to equity or allowed to stabilize to allow the GDP growth to lower the debt ratio.

We reiterate again our grave concern for the free-fall of the U.S. dollar which allows U.S. assets fire-sale exposure to foreigners, J-curve effect import inflation and the loss of the reserve currency status. A weak dollar policy, while of some benefit to trade commerce for goods and services, is toxic to capital flows of investment which dwarf trade and are the foundation of wealth creation by a sovereign nation.

World investors view the arc of U.S. economic policy through a skeptical lens, which currently is exhibiting confiscatory taxation on capital, undaunted entitlement welfare growth, anti-trust re-regulation, labor unionization, trade protectionism and a weaker global U.S. superpower. Ronald Reagan spoke of America as a “shining city on a hill” and Madeline Albright commented that the U.S. is the “indispensable nation”. It is a lonely, bone chilling sentry duty upon the wall of liberty which America strides, where the costs of freedom for the world are borne by 4% (U.S. taxpayers) of the globe's population. As the theme of capitalism wavers, if borrowing be necessitated, it should be with the fiscal austerity of our grandparents.

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and description of firm composites is available upon request. 7. Total firm assets represent total discretionary assets managed by MDCM. The number of portfolios in the composite is as of year end. The quarterly standard deviation is calculated as the average dispersion from the mean return of all accounts included in the Composite for the quarter. The annual standard deviation is the calculated average dispersion of accounts in the Composite for the full year. Note 1:n/a (<5 portfolios). During 2002 and the first quarter of 2003 results relate to one account and the account used was not the same from year to year. 8. The above table reflects past performance. Past performance does not guarantee future results. A client's investment return may be lower or higher than the performance shown above. Clients may suffer an investment loss. Returns reflect the reinvestment of dividends and other earnings. 9. Gross performance result calculations include the deduction of securities transaction charges but not investment advisory fees. The results include the reinvestment of all dividends and other income. Actual portfolio returns are reduced by the amount of such fees. Over time, the deduction of fees reduce the value of a portfolio on a compounded basis. 10. Net performance result calculations include the deduction of securities transaction charges and investment advisory fees. The results include the reinvestment of all dividends and other income. 11. Historical net performance numbers are calculated using the highest management fee charged by MDCM. (1.00%). 12. Fees: Standard management fees for the composite are as follows: first \$10,000,000=1.00% MDCM will negotiate fees for a structured small account program. MDCM will negotiate fees for accounts of substantial size. 13. Percentage of composite represented by non-fee paying accounts = 0.00%. 14. One-on-One Presentation: This report is used exclusively for one-on-one presentations to qualified individuals, pension funds, universities and other institutions. 15. The information herein is for informational use only. Under no circumstances does this information represent a recommendation to buy or

Year	# of Portfolios	Composite Assets	Firm Assets	Composite Dispersion	Composite Gross of Fees	Composite Net of Fees	Benchmark Performance
2003	1	363,200	137,315,376	0.00%	32.87%	31.68%	46.03%
2004	3	2,225,425	72,707,427	0.00%	23.82%	22.59%	22.25%
2005	6	3,140,055	68,492,815	0.95%	16.60%	15.47%	4.71%
2006	7	3,904,553	190,286,996	0.20%	19.73%	18.55%	23.48%
2007	8	4,556,445	186,950,509	0.43%	11.94%	10.83%	-9.78%
2008	10	4,642,480	145,295,212	2.37%	-13.11%	-13.99%	-28.93%
9/30/09	12	6,376,662	167,883,458	0.40%	16.93%	16.07%	16.36%

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