(703) 652-4613
(703) 738-6359 (fax)
http://www.tiddcapital.com

TIDD CAPITAL, LLC

1563 McNeer St.
McLean, VA 22101

Second Quarter 2007

Froth and Deals

The market has continued its ebullient trend throughout 2007, with the S&P 500 and Dow Jones Industrials indices hitting new all-time highs during Q2 2007. Business trends are almost uniformly positive, with corporate profitability at an all-time high and a generally favorable business climate. The market is also rife with takeovers by private equity firms that are showing robust appetite for deals of all sizes, firms with seemingly unlimited access to the funds to make these deals.

There appears to be "lots of money sloshing around" chasing both stocks and private equity deals. This results in very few bargains and a general positive trend in the market. This is good for holding stocks, but not necessarily for buying them, if you are seeking a discount price (as we are).

There is some concern that the current environment may be "too good", and that a bubble or period of overvaluation may be forming. While the stock market activity is frothy, corporate performance is generally also good, and by and large, market valuations are justified by strong fundamentals. While I don't see many bargains in the market, I also don't see many instances of stocks being wildly overvalued. While we are enjoying the positive performance, I am also cautious.

Long-Term View

When viewing market activity, it is essential to maintain a long-term view, since short-term trends are a meaningless distraction despite their apparent drama. This applies to the broad market, as well as individual portfolios and investments. I define "short-term" as anything less than 2-3 years, and encourage clients to have a target time frame of at least that long.

The last few quarters of Tidd Capital portfolio performance are noteworthy in this regard. Q4 2006 was by far the best in our history, while Q1 2007 was by far the worst. Q2 2007, currently about 2/3 completed, is looking pretty positive so far, and will probably end up being one of our best quarters depending on what transpires in June. Taking any one of these quarters and trying to extrapolate a trend is not meaningful, and all long-term clients will experience all of these quarters. Thus we need to maintain a multi-year outlook and resist drawing conclusions, positive or negative, from a single quarter.

Updates, and Share Buybacks

Share repurchases are generally great news for shareholders, as they give shareholders a tax-free boost in value that can last for years. Buybacks are common in our portfolio companies, because we generally **only** own companies that are oriented towards delivering value to their shareholders, run by management who are themselves shareholders. However, the buyback activity has been unusually high over the past couple of quarters, so I wanted to highlight it.

First Marblehead stock continued its roller coaster pattern with a sharp decline in April on the news that Sallie Mae is in talks to be acquired by a consortium including two of Marblehead's largest customers, JP Morgan Chase and Bank of America. I think that the market's concerns of an impact to

Marblehead are overblown, and I also think it is unlikely that the deal will get done as announced due to anti-trust concerns. Marblehead management seems to agree, and authorized the repurchase of a whopping 10.5% of the company's outstanding shares. Marblehead's business is self-funding and produces a lot of cash, and shortly will start to receive residual cash flows from their past deals, and this cash will support the buyback.

Long time holding Brookfield Asset Management in April surpassed all expectations with stunningly good 2006 results, including a hefty one-time gain from the disposal of non-core assets. The company followed up with announcing a repurchase of 10% of their stock. Brookfield has what I think is a unique (and wonderful) share ownership program, whereby top management is required to own stock valued at 5 times their annual salary. It is no wonder that the company is focused on delivering value to shareholders.

Acme United is a micro-cap company that manufactures scissors, rulers, first aid kits, pencil sharpeners, and other items. The next time you are in Staples, look at the scissor and ruler products, and you'll find that 100% of them are Acme's "Westcott" brand. In a nutshell, this "category monopoly" in a high-margin product with national distribution explains why we own this stock. The stock has been weak as they experience losses trying to take their formula to Europe, and the company has responded by buying back their stock, buying back 1% in Q1 with an authorization to buy back another 3%.

Access National Bank, a recent portfolio addition, announced the intention to buy back 4.5% of their stock, as well as buying back a tranche of trust preferred securities (essentially debt) that are available for repurchase in September 2007. 80% of Access National's employees are shareholders, and the average stake held by management is $3.2 million, so their focus on shareholders is clear.

Another way of delivering value to shareholders is by spinning off assets that were previously unrecognized by shareholders, something that is often termed “surfacing value”. Michael J. Smith, chairman of KHD Humboldt Wedag, prefers these spin-offs to share repurchases. We received shares in Mass Financial in early 2006 that were spun off from KHD Humboldt, and these shares have more than doubled and have added about $5 per share or 8% to our total return in that investment. In Q1 2007, KHD announced the intention to spin off a REIT holding about 800 acres of German real estate, which should happen in 2007. We can expect additional transactions along these lines as KHD continues to dispose of non-core assets and finds uses for its substantial cash surplus.

Brookfield Asset Management also announced the intention to spin off a new publicly traded partnership that will focus exclusively on global infrastructure investments. This provides an excellent segue into the topic of infrastructure investments.

The Global Infrastructure Boom

"Civilizations are built and sustained by the quality of their infrastructure", begins a recent report co-authored by the Urban Land Institute and Ernest and Young. According to the report, by the end of 2007, one out of every two people in the world will live in cities. This urbanization requires increases in infrastructure on a massive scale worldwide. Meanwhile, governments at all levels worldwide have the declining ability to fund and support these projects through their tax bases.

The result is a global trend towards private investment in "infrastructure" – assets such as roads, bridges, airports, pipelines, electricity generation and transmission, water distribution, large-scale real estate development, as well as natural assets such as timberlands and minerals. This also leads to increased demand for construction materials such as cement. This trend has provided enormous opportunities to companies who are in a position to capitalize on it.

Several of our investments are riding a strong tailwind from this global boom. While the investments have this trend in common, each was fond exclusively through "bottom-up" research and stands in its own merits.

KHD Humboldt is a leading global cement engineering firm that is enjoying tremendous revenue growth due in part to its strong position in emerging economies such as India, Russia, the Middle East, Africa and Eastern Europe. These countries have very strong demand for cement and related engineering services, and KHD's revenues are expected to grow an astonishing 60% from 2006 to 2007, after growing over 40% from 2005 to 2006.

This accelerating growth has been paired with improving margins and cash flows, driven by behind-the-scenes financial improvements orchestrated by KHD's brilliant Chairman, Michael Smith. The improvements in revenue, margins, and capital structure have combined to produce the "lollapalooza" effect that explains the outstanding performance of KHD's stock. On top of this very large cake is thick frosting in the form of repeated spin-offs of non-core assets that add additional shareholder value. Amazingly, KHD's balance sheet is made up almost entirely of cash, current assets, and non-core assets – the business produces cash virtually from thin air.

Brookfield Asset Management has their hands in numerous infrastructure assets worldwide, and the performance of, and demand for, these assets has given them a strong tailwind. For instance, Brookfield has a strong position in hydroelectric power plants in the northeastern US and Canada. These assets, purchased years ago when both energy prices and water levels were lower, were obtained at cheap prices and financed with very cheap equity and debt. The cost to operate these plants is largely fixed, while the price the energy fetches increases with global demand for energy, making for excellent recurring cash flows.

Posco is a South Korean steel company that has a dominant position in its own markets, and also sells a substantial amount of their product to China. They are building a new plant in India to support the demand there. Their success is part of the same trend – feeding the hyper-demand for infrastructure in emerging economies.

Another positive aspect of these infrastructure-oriented investments is that they tend to have a global focus, and operations that are denominated in currencies besides the US dollar. While I don't specifically hedge our portfolios from exposure to certain currencies, given the weakness of the US dollar and uncertainty about its future, I consider investments in companies that deliver earnings in non-US currencies to be a bonus.

Small Can Be Beautiful

But while our existing investments in these larger companies are on the run, I am looking for new investments in other waters. One of the advantages of not having an investment strategy defined by a certain asset class or industry is the freedom to search anywhere in the market for values. Currently I am finding opportunities in the micro-cap market, including some special situations. Two of the stocks in our portfolios have market capitalizations of less than $55 million, far too small for most institutional managers.

I received numerous calls from clients about new portfolio addition ECC Capital Corporation, which currently trades between $0.30 and $0.35 per share. "What is this penny stock doing in my portfolio!?" was the common refrain. I felt that a brief explanation was in order.

Warren Buffett famously said, "A cigar butt found on the street that has only one puff left in it may not offer much of a smoke, but the 'bargain purchase' will make that puff all profit.'" ECC Capital is a classic "cigar butt" investment. The company has the ignoble distinction of being one of the first publicly traded subprime lenders to fail when things got bad.

After the blow-up, Bear Stearns stepped in and purchased essentially all of ECC's operations and most of their assets. They left behind a residual interest in subprime mortgage backed securities that seem to have been written prior to 2006. The company, now a defunct stub, still has the rights to these securities. Based on exhaustive research of the industry (and some help from other like-minded analysts), I believe that the loans written prior to 2006 are generally performing fairly well, and ECC's interest in them may have substantial value.

The CEO appears to agree with us – shortly after the deal with Bear Stearns, the CEO bought 500,000 shares of stock from the company's Chairman at substantially higher than the current market price. He must believe that he can wring enough value from the company to make it worth his while. Puff puff!

Cinram

I wanted to provide a quick update on Cinram, which exited our portfolios recently, just soon after I mentioned that it was a good opportunity.

Cinram's business in flux, both due to a declining core business, and uncertainty about their security structure. They recently converted into a Canadian Income Trust security, which is similar to a REIT, requiring them to pay out substantially all of their earnings as a dividend.

The problem for individual US citizens that hold the security is the tax treatment of these dividends. The Canadian government withholds about 15% of these dividends, some of which can be reclaimed if the citizen has received taxable dividends in US corporations. Tax-deferred accounts such as IRA's can't reclaim these withholdings; so ironically, taxable accounts actually get a better tax treatment on these dividends. The tax treatment for accounts that are held by trusts or other entities is complex.

These rules are in flux as well, as the Canadian government is revisiting the issues after a change in administration. It is possible that this has put a damper on the attractiveness of the income trust

security, which Cinram just converted to (with much hassle and expense), raising the risk that they may have to convert again.

At its core, Cinram is a strong business that is in decline. They replicate media such as DVD's and CD's. They are a leader in this market, but the industry wide decline is almost certainly going to be prolonged and permanent. Unlike the demise of the 8-track tape, it isn't clear if another media will come along to replace DVD's – physical media itself may become obsolete in the distant future.

It is Cinram's challenge to get into other business areas and/or sensibly wind down the business to deliver value to shareholders. After seeing their 2006 annual results, I got a bit spooked that this decline may be happening faster than anticipated. Clearly products such as Apple's iPod and the ever-increasing trend of distributing movies over information networks are working against them. Generally, it is rare for businesses in decline to deliver long-term value to shareholders – even a business that doesn't grow has a positive terminal value.

Given all of these uncertainties, I felt that Cinram was no longer an attractive place for our money. In the short term, I've been proven wrong, as the stock has climbed 20% since our sale. We'll see what the long term reveals.

Closing

I appreciate the continued trust clients place in my firm. I hope that this letter has given you a better understanding of my investment process. If you have any questions or concerns, please feel free to contact me by phone or e-mail at any time.

Randall Tidd
President, Tidd Capital
703-652-4613
rtidd@tiddcapital.com