IronBridge
Capital Management, L.P.

October 2008

IronBridge Capital Management, L.P.
Third Quarter 2008 Small Cap Core Review

I woke up last night in a sweat... had a nightmare that I worked for... JPGoldmanStanleyAmericaWaLynchMuGroup, a wholly owned subsidiary of the United States Government.

- Anonymous Trader

Dear Fellow Investor,

This was certainly an historic quarter. Stock prices gyrated as the market continued to punish poor stewards of capital. Then, the U.S. Government intervened to save those who had been deemed "too big to fail." So far, our government has pledged over $800 billion of taxpayer money to attempt to manage an orderly unwinding of an overleveraged financial system.

The Russell 2000®[1] Index fell -1.11% while our Small Cap Core product fell approximately -4%[2] (gross of fees) during the quarter. As we alerted readers prior to this quarter, our portfolio is not positioned to benefit when one group of poor stewards of capital (government) bails out yet another group of poor stewards of capital (financial "Sinnovators"). As such, the portfolio underperformed for the quarter. While the quarterly performance disappoints, we think the forces driving the underperformance are temporary.

Year to date, the Small Cap Core product's performance is down approximately -8% gross of fees; but it is ahead of the Russell 2000 Index return of -10.38% and solidly ahead of most equity-based indices.

Third Quarter Performance Attribution

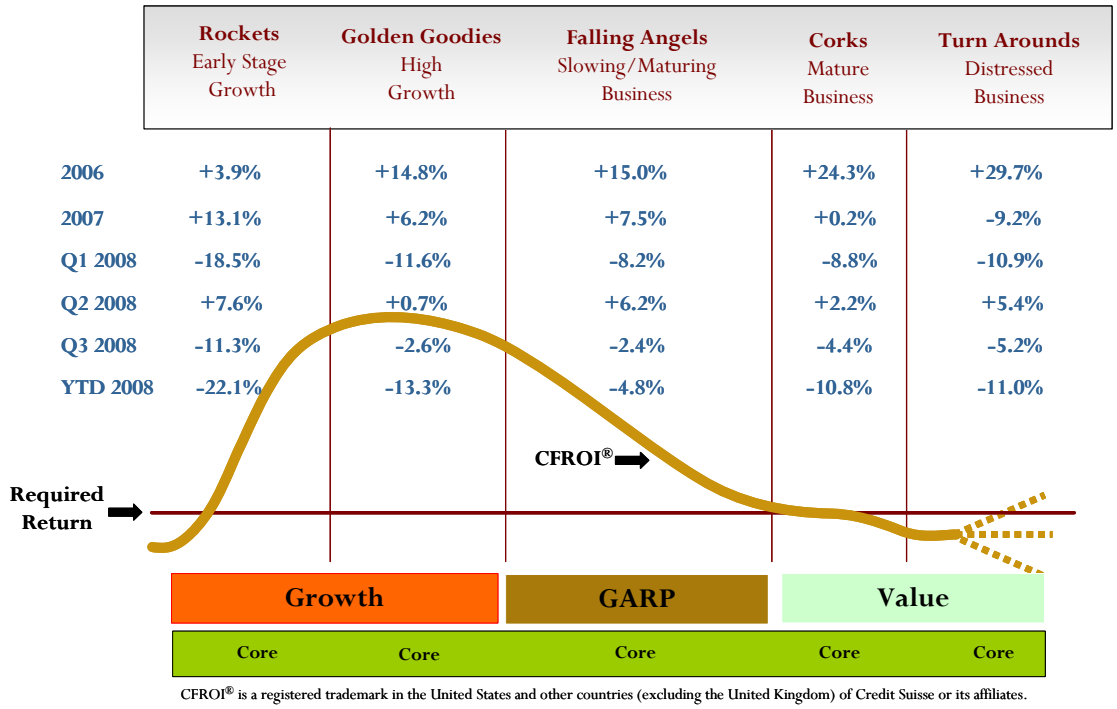
Stock selection was fairly strong among our consumer discretionary, financial, and information technology holdings, but weaker among our health care, material, and industrial holdings. Stock selection drove approximately 190 basis points of the underperformance. The sector allocation's contribution to relative performance was also negative, approximately -130 basis points due to the underweight in Financials and Consumer Staples, and the overweight in the Materials sector.

[1] Russell 2000® Index is either a registered trademark or tradename of Russell Investment Group in the U.S. and/or other countries. Indexes are unmanaged and cannot be invested in directly.
[2] Return is gross of fees. Past performance does not guarantee future results. Returns reflect reinvestment of dividends, gains, and other earnings.

IronBridge's Financials Analyst, Charlie Henness, called our attention to the fact that the most heavily shorted stocks in the Russell 2000 Index significantly outperformed the least shorted stocks by 572 basis points. This is highly unusual. We hypothesize that short sellers were forced to cover their short positions when the government intervened to curb short selling and, as hedge funds de-leveraged, by selling long positions, and used the proceeds to pay down debt.

From a Life Cycle perspective, Rockets fell -11.3% for the quarter, and -22.1% for the year. Please note that Rockets are the most sensitive to changes in the discount rate due to their high duration. Risk is highest at the tails of the Life Cycle. Investors are de-risking and heading toward middle ground as uncertainty reigns high.

Life Cycle Returns – Russell 2000® Constituents by Life Cycle



Source: IronBridge Capital Management, L.P.

Given what has happened, one may well ask, why dual diversification didn't protect the portfolio better? The benefits associated with dual diversification for managing the risks associated with macroeconomic shocks and duration risk (growth vs. value) are adequate in most market environments. But, in this case, dual diversification failed to insulate the portfolio against the risk of government intervention--where all the rules change. New short sale rules resulted in a spike in heavily shorted stocks; and government intervention boosted weak financial-related and homebuilding-related companies. To summarize, the portfolio did not keep up with the government-mandated, short covering rally among low quality, illiquid, smaller companies.

The Great Unwind Accelerates

The unwinding of financial "Sinnovation" accelerated this quarter, and resulted in the phenomenal collapses of IndyMac, Fannie Mae, Freddie Mac, Lehman Brothers, AIG, Merrill Lynch, Washington Mutual, Wachovia, and in the rapid erosion of the Wall Street investment banking model. These events exceeded even our fears when we wrote in our January letter, "It is clear to us that the self-correcting mechanism of capitalism has more work to do to clear out poor allocators of capital."

Additional victims include hedge funds, which have experienced a 79% decline in flows. According to The Wall Street Journal, many hedge funds have failed to live up to their promises, given that nine out of ten are not able to collect performance fees due to a lack of performance. Thirty-five hundred have closed year-to-date. Perhaps the most spectacular close came from Ospraie Management that lost 39% year-to-date. Even more spectacularly, Ospraie announced it would take "*at least three years to close its positions*." This situation serves to illustrate how providing leverage-based liquidity to illiquid assets significantly contributed to the current financial crisis.

The "Great Unwind" is driving a mass extinction of those who are guilty of financial sins and responsible for huge misallocations of capital. Their misallocations were based partially on (I.) a misunderstanding of the proper role of capital markets, further fueled by (II.) misguided government policy, and escalated by (III.) a general confusion about the concept of wealth creation versus wealth transfer, and an over-reliance on (IV.) flawed academic risk models.

The Elements of Financial Sinnovation – How the Market Got Here

I. A Misunderstanding of the Proper Role of Capital Markets

The market is not anyone's friend. It does not exist to serve investors. It does not exist to deliver investors a required return in order to fund their retirement or other liabilities.

The market serves as a clearing function, where buyers and sellers meet and transact. Market prices reflect the terms that balance the wants of buyers with the needs of sellers. Changes in market prices reflect changes in the balance of wants and needs.

Investors sell the use of their capital. Borrowers buy the use of that capital. Neither the buyer nor the seller can independently control the terms of exchange. Only through the joint interaction of many buyers and many sellers can true balance be found. As such, capital constantly flows (allocates itself) to where it can achieve its highest return.

Thus, the proper role of capital markets is to allocate capital to its most productive uses. If allowed to function freely, the market, through its use of price signals, is very good at this.

While there are always victims due to "creative destruction," along with winners and losers in the competition for capital, the net benefit to society of free and properly functioning markets is a rise in the standard of living driven by the benefits derived from innovation and productivity.

Some major principles that allow markets to function properly, that have been abandoned by many stewards of capital, are:

1) Participants must act with trust and integrity
   The widespread failure of multiple participants to act with trust and integrity contributed to the current crisis. Mortgage lenders originated massive amounts in massive numbers of loans to people who could not afford them. Many consumers fudged their income to qualify for loans and accepted irresponsible levels of debt. Investment bankers "re-packaged" the questionable loans into structured investment vehicles called (CDOs/SIVs) and represented them as investment grade credit to investors. Credit agencies advised the investment banks about how to obtain high-grade ratings for these opaque, questionable structures. Because the credit agencies could not understand nor analyze the quality of the assets in these structures, they advised investment banks to use the balance sheets of insurers (such as AIG) to attain the investment grade rating that was required to sell them to investors. Drawn by the illusion of higher returns with less risk, investors bought these structures, but failed to do due diligence to understand what they were buying. They simply relied on the credit ratings. Trust and integrity are the pillars of the free market process and cannot be compromised without risk to the entire system.

2) A level playing field where no players have an unfair advantage
   As mentioned, government intervention promotes a misallocation of capital when it favors one group over another. Under these circumstances, capital unnaturally flows where it should not due to tax policies, subsidies, redistribution programs, and other various government programs designed to appease political contributors, the voting public, and/or designed to try to hold back the creative destruction associated with free markets. Tax policies and regulatory rulings drove the creation of structured investment vehicles (SIVs) and collateralized debt obligations (CDOs) as a natural tax arbitrage[3] over traditional vehicles. The offshore, tax haven-based domicile avoided most corporate tax, which led to a subsequent decline in credit spreads. Declining credit spreads forced banks to transition from a *principal* to an *agency* model of lending where the risk horizon for the bank credit officer declined from the term of the loan (thirty years) to the sale of the loan (measured in days, weeks, or months). The decline in the credit horizon drove the decline in lending standards and credit quality. Tax policy drove the demand for housing beyond what normal market forces would have. Government policies drove a misallocation of capital into the wrong places.

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[3] Defined Terms
Arbitrage is attempting to profit by exploiting price differences of identical or similar financial instruments on different markets or in different forms.
Index Arbitrage is a strategy designed to profit from temporary discrepancies between the prices of the stocks comprising an index and the price of a derivative instrument designed to mirror that index. By buying either the stocks or the derivative and selling the other, an investor can sometimes exploit market inefficiency for a profit. Like all arbitrage opportunities, index arbitrage opportunities disappear rapidly once the opportunity becomes well-known and many investors act on it. Index arbitrage can involve large transaction costs because of the need to simultaneously buy and sell many different stocks and derivatives, and so only large financial institutions or hedge funds are usually able to profit from index arbitrage. In addition, sophisticated computer programs are needed to keep track of the large number of stocks and derivatives involved, which makes this a very difficult trading strategy for individuals.
Tax Arbitrage is trading that takes advantage of differences in tax rates across tax systems or for different taxable entities as the basis for profit.
Source: InvestorWords.com & TheCFDCentre.com

3) True price discovery as a mechanism to monitor feedback loops
Price discovery requires transparency. When poor credit was alchemized into quality credit, through the creation of SIVs/CDOs, price discovery was undermined; and regulators, or market participants, did not easily see the warning signals. Risk premiums disappeared, so participants had a false sense of security. When a driver approaches an intersection, he relies on a red, yellow, or green light to decide whether to stop, slow down, or go. However, SIVs/CDOs, backed by the financial strength of our strongest financial institutions, painted all the lights green so nobody could see yellow, no one slowed down, and the inevitable crash occurred. Those "innovative" financial products undermined the market price signaling and feedback loops required to direct the allocation of capital efficiently, until the entire financial system was at risk.

4) Independent analysis by market participants
"Investors" became enamored with the new products that Wall Street peddled to help them buy/sell/trade and manage risk rather than invest to own. Historical default rates became a substitute for old-fashioned credit analysis. Thematic baskets of stocks (ETFs and index funds) became a substitute for old-fashioned equity analysis. Lack of due diligence and analysis drove a massive misallocation of capital into investment structures that investors simply did not understand, but never the less invested in and borrowed against.

II. Misguided Government Policies

Investors price after tax net cash receipts. Every time the government tinkers with tax policy, they affect the price of various assets. This could be the subject of an entire book, which we may one day write; but for now, we will hit the four big government actions that created incentives for the huge misallocation of capital.

1) The Community Reinvestment Act of 1977 set the stage for deteriorating credit by setting a requirement that commercial banks lend to low-income people. However, banks never took the act too seriously, until 1995 when the Clinton Administration required stricter enforcement in order to remain in the good graces of regulators. Failure to comply with the act had significant negative consequences. The act was actually a mandate for banks to create bad loans. Circa 1996, Barney Frank pushed hard to require Fannie Mae and Freddie Mac to buy these high-risk loans; and that action put an implicit government guarantee on questionable credit. This opened the floodgate to all banks to allow low quality credit that could be purchased by Fannie Mae and Freddie Mac, all wrapped up in an implicit government guarantee.

2) The 1986 Tax Act did many good things in terms of generally lowering tax rates and eliminating most tax shelters. An important feature was the elimination of the tax deductibility of interest expense on credit cards, auto loans, and other consumer loans for individuals. But, a major inconsistency in the act was that it maintained the mortgage interest tax deductibility on primary residence real estate loans. This created an incentive to move consumer debt from all other sources of credit to home equity. In 1990, only 23% of banks offered home equity loans. By 2006, 100% of banks offered home equity loans.

Further, the act not only provided the tax incentive for homeowners to borrow against their homes, it encouraged renters to become homeowners.

3) The 1997 Tax Act eliminated capital gains tax on the primary residence for the first $500,000 of capital gain. At this point, residential homes became the first and only investment in history that allowed the average citizen to combine tax-deductible, financial leverage on a tax-exempt, capital gain asset. This drove the after-tax value of housing higher, and generated even more demand for housing. Homeowners continued to borrow against the illusion of increased wealth as home values began to appreciate.

4) Circa 1998, an IRS interpretation, and a little known insurance ruling, set the stage for an explosion in credit. First, the IRS blessed the offshore tax structure for CDOs and SIVs, which allowed investors to avoid a layer of corporate tax, with the effect of significantly lowering credit spreads. Remember, bank business models must have a spread; so it is hard to stay in business if the spread disappears. Therefore, banks rationally adjusted their business model to an agency model, which compensated them for their ability to originate debt rather than hold it. For example, they would originate loans at say 5% and repackage and sell them to a CDO/SIV at 4.5%, retain a servicing component, and book a gain on the sale of the loan. Since time horizons for credit officers were no longer 30 years, but instead measured in weeks or months, credit quality rapidly deteriorated. But, because these loans were sold off and wrapped into a highly rated CDO/SIV package, investors were misled by the illusion of safety.

How could questionable credit get alchemized into high-grade credit by the rating agency? A little known insurance ruling paved the way. Financial Security Assurance Inc. argued, and won approval from the New York state insurance regulator, to create a legal loophole that allowed bond insurers to issue credit default swaps (CDSs) through shell companies called transformers. Within a year, almost every other state followed New York's lead. The change allowed AIG, Ambac, MBIA and other monoline insurers to manage the risk of insuring these structures – and that paved the way for the credit rating agencies to grant investment grade ratings. By borrowing the balance sheet of our most highly rated insurers, investment banks could say they had created the "holy grail of finance," creating a product with below-average risk and above-average return. Demand exploded for these products, and more loans of deteriorating quality were needed to feed the machine.

In summary, tax policy and regulation unleveled the playing field and encouraged too much capital to go into housing, exotic debt structures, and derivatives that very few people actually understood.

III. Confusion over Wealth Creation vs. Wealth Transfer

Debt and equity are the primary markets that fund innovation and increases in productivity. Innovation and productivity increases are the roots of wealth creation. Investors participate in wealth creating activity through direct ownership of debt and/or equity in either the public or the private markets. Wealth creation drives higher standards of living for society.

Wealth transfer is a derivative of a wealth creation. Nobody funded a factory with a credit default swap or an oil future. Wealth transfer strategies are a zero sum game, minus agency costs, wherein one party wins, and another party loses. Derivatives are not actual debt or equity. Therefore, they do not have a direct claim on the cash flows of the entity, and do not participate in wealth creation. Derivatives participate in the wealth transfer process of managing risk or enacting arbitrage strategies.

Their appeal to "investors" is that their prices behave like the underlying debt or equity. This allows for the proliferation of arbitrage strategies employed by speculators, certain financial institutions, businesses, and many hedge funds, as they use various derivatives to exploit differences in price between an underlying real asset (debt, equity, commodity) and the "synthetically created" derivatives position. Derivatives are like parasites that require a host to live. Sometimes parasites can actually perform a valuable function to the host. It could be argued that the pursuit of arbitrage improves liquidity and pricing efficiency. However, parasites can also overwhelm and kill the host, which is Mr. Warren Buffet's concern when he said that, "derivatives are the financial equivalent of weapons of mass destruction."

Some wealth transfer strategies can act as the lubricant that allows capital to flow to its most productive uses. Think about wealth creation as the engine of economic growth and higher standards of living, and wealth transfer as the oil that keeps it running efficiently. There is a natural optimal mix of oil for an engine; too much, and the engine will gum up; too little, and it will freeze up. By definition, capital allocated to wealth transfer needs to be a tiny fraction of the capital allocated to strategies connected to wealth creation. Too many stewards of capital who lacked a total systems view of the world, over-allocated to wealth transfer strategies. Why?

Fiduciaries responded to concerns about over exposure to the primary markets of debt and equity after the collapse of the tech bubble. As they sought optimal risk-adjusted returns, they used sophisticated risk models to reach for the financial holy grail of higher returns with less risk. These models said, "Diversify, diversify, and diversify into everything less correlated with the primary markets of wealth creation." These models, and their proponents, recommended (and remarkably *still* do) increased allocations to less correlated strategies like hedge funds and other alternative investment vehicles.

Because alternative investment strategies, based on arbitrage, usually offer low expected rates of return, they require leverage to magnify the results. Other Wall Street innovations like ETFs and Libor/Equity Index swap contracts are engineered to bring easy, inexpensive exposure and liquidity to less correlated asset classes. These innovations were thought to provide a practical synthetic alternative to direct investment in asset classes that are too illiquid.

The Pension Protection Act of 2006 added additional fuel to the fire when it provided fiduciaries with a safe harbor if they allocated assets based on academically sound models of risk. Unfortunately, these academically sound models never incorporated real world liquidity constraints or counter party risk. The models assumed infinitely deep pools of liquidity, and did not account for how acting on the models would change the structure of risk moving forward, nor could they incorporate how systematic risk would change in response to government policies. They never incorporated these important real world factors, the hidden risks, or really

understood why they worked. And, therefore, they continued to allocate capital based on flawed risk models whose shortcomings are only now coming into full view.

IV. Flawed Risk Models

Somewhere along the way, modern finance lost its way, and viewed capital markets as existing to serve investors' desires to achieve the optimal, risk-adjusted return. We suspect that the adoption of FASB 87 paved the way. FASB 87 forced companies to quantify the funding status of their defined benefit plans and place any underfunded liability on the balance sheet. This required actuarial assumptions about the present value of future benefits, and the expected return of the plan assets. Expected return assumptions determined the size of the impact to the balance sheet and income statement of each company. This requirement drove the quest for the perfect, risk-adjusted, portfolio mix to justify assumptions that would minimize the detrimental impact of adoption.

Absent a crystal ball, finance looked backward, into the world of historical returns, volatility, and correlations. Diversification of uncorrelated investments based on *historical* price behavior drove a massive restructuring of global portfolios away from the highly liquid primary markets of wealth creation to the illiquid, less correlated, asset classes of commodities, real estate, emerging markets, and timberland; and toward wealth transfer strategies employed by many hedge funds, which rely on derivatives. Ignored were the real world issues associated with taxes and liquidity. Forgotten was the concept of forward-looking, net cash receipts. Misunderstood was the fact that diversification only works if the net cash receipts are uncorrelated. Not fully appreciated was the reality that historical prices do not mean anything because history never repeats, and because circumstances change.[4]

Backward looking finance relied on historical default rates for mortgage loans, and naively forecasted similar default rates into the future. Completely ignored was the fact that the structure of lending had completely changed from a principal model, where you collect interest and principal payment over the life of the loan, to an agency model, where you originate and then sell the loan to a CDO or SIV.

Basically, if you used the same type of model to drive your car from Chicago to California, it would be like trying to navigate with only the use of the rear view mirror. This might actually work through Illinois, Iowa, and Nebraska (straight flat roads); but somewhere in Colorado you would crash into, or off, a mountain. Further, with no price discovery or feedback loops, your speed would accelerate the entire time due to velocitization and you would have no idea of the danger you were in.

To summarize, financial Sinnovation has brought the global financial system to the brink of collapse by a collective abandonment of principles required for properly functioning markets by multiple stewards of capital, and that includes investors, lenders, credit agencies, borrowers, regulators, politicians, and academics. The self-correcting mechanism of capitalism is clearing

[4] For additional information, please reference our First Quarter 2007 Small Cap Core Review, in which we highlight lessons of the sand pile game.

out as many poor stewards as it can while the government is scrambling to save them in order to stem the decline.

Phase II of the "Great Unwind" – Government Intervention

I am reminded of the wisdom of Ronald Reagan when he said, "The nine most frightening words in the English language are: 'I'm with the government and I'm here to help.'"

This quarter, we witnessed the largest government intervention since the Great Depression's New Deal.

Consider the actions below:
- Approval of a major housing/mortgage bailout plan
- Massive injections of liquidity into the financial system through liberalization of "collateral" accepted at the Fed discount rate window
- A bailout of Fannie Mae, Freddie Mac, AIG
- A temporary (perhaps eventually permanent) ban on shorting of certain institutions deemed critical to the proper functioning of the U.S. financial system
- Twenty proposals to curb speculation in the commodities market
- Formation of a "Troubled Asset Relief Program" to the take over illiquid financial assets expected to run around $700 billion
- A SEC change to accounting for illiquid assets from mark-to-market to mark-to-model value, based on the present value of expected future net cash receipts

……more to follow?????

Boom, Bust, Intervention

The following case studies illustrate how government "help" initially drives a misallocation of capital causing a boom, which ultimately busts, and then government "helps" again to protect poor stewards of capital.

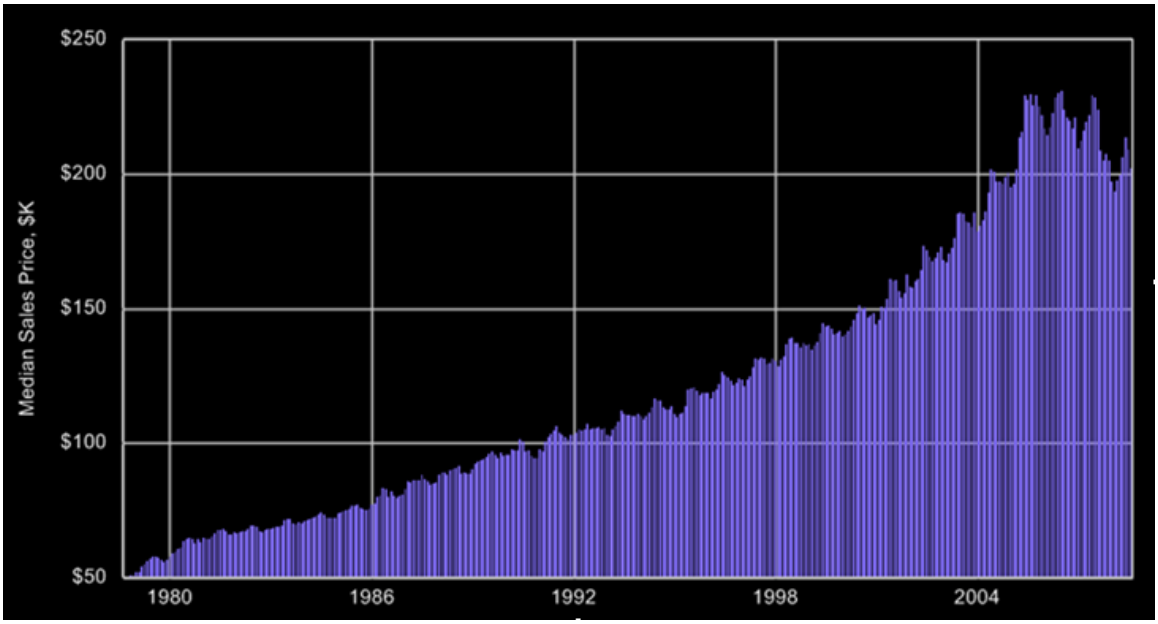
Case Study I – Hovnanian (a homebuilder)

Background: Hovnanian is a homebuilder. It designs, constructs, markets, and sells single-family detached homes, attached townhomes and condominiums, mid-rise and high-rise condominiums, urban infill, and active adult homes.[5]

Boom: The U.S. government wanted to help all its citizens achieve the American dream of home ownership. Noble as that is, government policies drove too much capital into the homebuilding sector with several tax reforms, regulations, and policies that "unleveled" the playing field in the competition for capital by favoring mortgage debt over all other debt. This drove an increase in the demand for home ownership and fed a speculative frenzy that sent home prices soaring.

[5] Refer to our Fourth Quarter 2007 Small Cap Core Review for additional information regarding Hovnanian.

Existing Single Family Homes – Median Sales Price, $K (1978-2008)



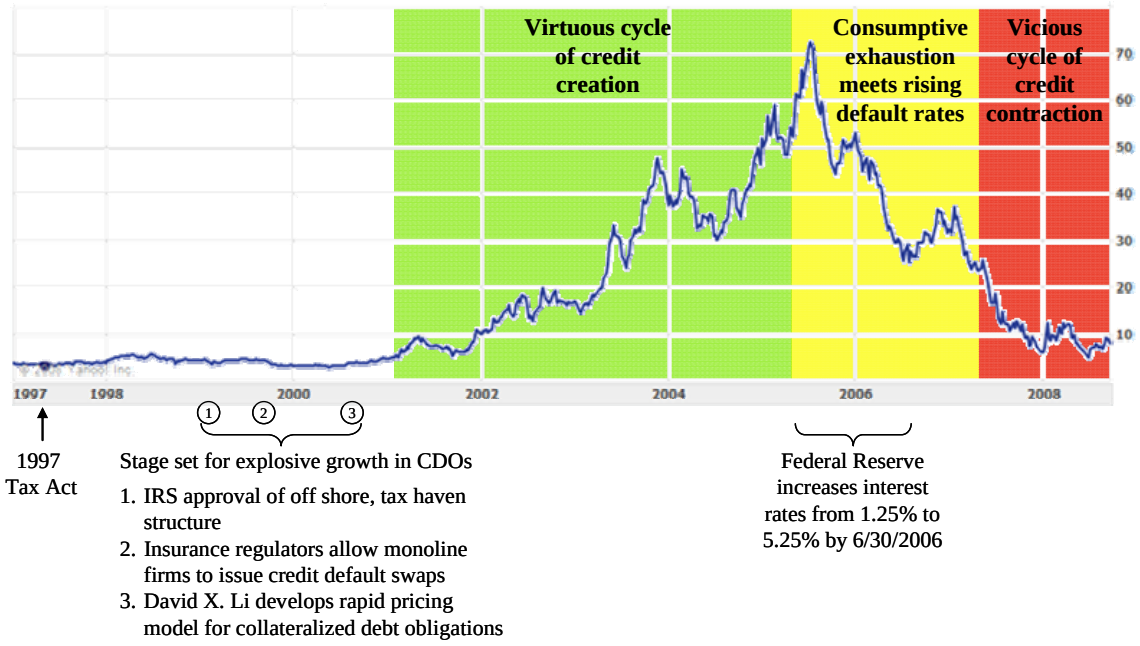
Source: Global Insight - National Association of Realtors

Meanwhile, Wall Street created CDOs and SIVs to capitalize on a tax arbitrage, which fueled even more demand as borrowing costs to homebuyers plummeted. Too much capital went into the housing sector, driving a boom in homebuilding, home values, and that fueled a consumption binge, driven by the illusion of wealth creation (higher home prices against which consumers borrowed). Home ownership increased from 62% in 1991 to 71% by 2006 as lower-quality borrowers had access to capital due to the deterioration in lending standards.

Bust: Eventually, consumptive exhaustion met rising default rates, at which point homebuilders, homeowners, lenders, and those that participated/benefited from the boom headed toward bust, triggering the current financial crisis.

Intervention: Hovnanian was headed toward bust, but the government passed The Hope for Homeowners Act of 2008 driving up the value of homebuilders and homebuilding-related companies (of which IronBridge is significantly underweight). Stocks like Hovnanian increased from $4 to $7.

Hovnanian Enterprises Inc. (HOV) – Boom, Bust, Intervention



Source: Yahoo Finance

Case Study II – Ambac (a monoline insurer)

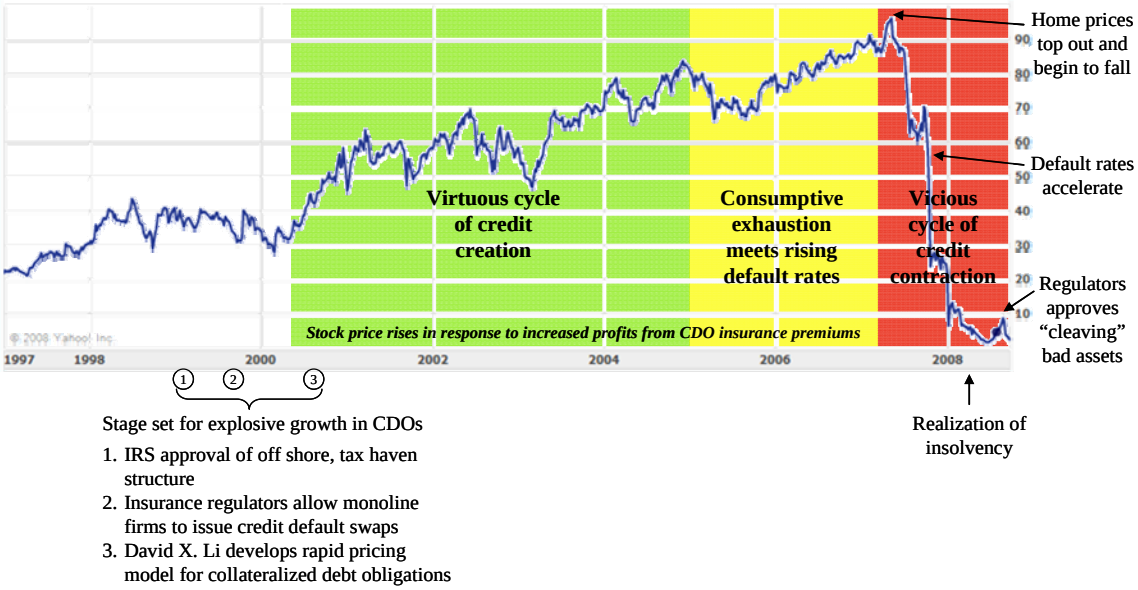
Background: Ambac is a monoline insurer. They insure municipal bond issuances. They backed municipal issuances with their AAA rated balance sheet, thus raising the issue's ratings, making the world a better place by lowering the cost of capital for municipalities.

Boom: Searching for higher returns, Ambac found them in insuring CDOs and SIVs, naively believing the Wall Street pitch of higher returns with no additional risk, and trusting Wall Street's quantitative risk models. By insuring/underwriting SIVs/CDOs, they got much higher premiums than in the muni market, and quickly became addicted to booming profits.

Bust: By the end of 2006, home prices topped out, and started to fall. Default rates rose above investment bank models' predictions. Radian, MGIC, and ACA backed bonds started to blow up; and it was clear that they were sitting on low quality debt, and solvency came into question. Equity valuation spiraled downward, and their credit rating got lowered. Management somehow raised $1.52B to re-capitalize the business; but it had no business without an AAA rating, and their stock fell to $1. The stock should have gone to $0, but government intervened.

Intervention: On July 7, 2008, Ambac asked for approval of an $850 million Connie Lee capitalization plan to focus only on muni finance and to "cleave" off its bad assets into bankruptcy. On September 3, 2008, regulators approved the Connie Lee plan, breathing new life into what should be a bankrupted company. Instead, its shares soared from $1 to $10 for a tenfold gain in three months.

Ambac Financial Group (ABK) – Boom, Bust, Intervention



Source: Yahoo Finance

The two case studies above highlight the fundamental challenge for the IronBridge portfolio as well as other active managers who follow the principles of finance, such as integrity and trust. Much of our significant outperformance from 2006 through the first half of 2008 was driven by our not owning businesses that were benefiting directly, or indirectly, from the housing bubble.

Our underperformance this quarter, and perhaps for the next few quarters, is being driven by the government intervening to save what we do not own, not what we do own. Government bailout beneficiaries and zombie stocks are leading the market as poor stewards of capital are being bailed out. Note that our portfolio underperformed by approximately 100 basis points on the very day the government passed The Hope for Homeowners Act of 2008. By the way, we outperformed by approximately 100 basis points the day Lehman Brothers went bust. Bailouts undermine the proper role of markets and trap unproductive capital in assets that could be better utilized elsewhere. How many times has United Airlines gone bankrupt now? Who is next to be bailed out? The auto industry? The airlines? Why stop there?

We are in an unprecedented time of government intervention. A period when the U.S. economy is shifting from a market-based process to a political one. We will not waiver in our belief that the best long-term financial strategy is to own companies with skilled managements, who truly understand legitimate long-term wealth creation. However, in the near term, this strategy may struggle as good stewards of capital suffer relatively more than the bailout beneficiaries. This is a challenge we must try to manage.

The IronBridge Outlook

While painful, the crisis serves an important role. It is punishing the misallocators of capital through the loss in equity valuations of homebuilders and those businesses tied to the homebuilding industry – the condo flippers, mortgage originators, banks and thrifts, Wall Street investment bankers, monoline insurers, and investors. It is punishing over-leveraged borrowers through rising foreclosures, and falling home values. It is punishing the U.S. government through falling tax revenue and potentially a lower dollar. It is punishing those who got us into this mess and now those who did not. It is truly hard to know the downside risk when the economic engine freezes. As a hedge, the U.S. government is stepping in because it is the only institution with a balance sheet big enough to re-start the engine. Let's hope this works, but more importantly, let's hope that those responsible for allocating capital will heed the lessons the market is teaching all of us.

This is a challenging time for all investors everywhere. Government intervention is changing the rules of the game daily and changing the expectations of future net cash receipts for entire industries. Market forces are being replaced by government forces, which are counter to how investors think and act. We have to first understand the changes, and then understand what those changes mean for the companies we both own, and do not own.

For certain, we are at a major crossroads in the United States, which we, as a nation, have yet to feel/understand the full impact. I think individuals and institutions will be reflecting about what went wrong, and will require that behavior be modified in ways that are positive and match our founding fathers values as we move forward. This will not be easy. "No pain, no gain." We are in the pain stage; and, while it is hard to imagine right now, the gain stage will surely follow -- when the market has cleansed the system. We will most likely get through this crisis as we always do, through innovation and the productivity this nation is known for. When we look back five or ten years from now, this moment may be seen as one of those "I wish I had money to invest back then" moments. We cannot predict what will pull us out of this crisis, though I am absolutely certain it is not government intervention.

Ultimately, the small business entrepreneurial spirit and the American people will find their way, spurred on by the human desire to improve their lot in life. Despite all the financial sins of "Sinnovators," outlined above, U.S. capital markets, property rights, and our economic freedom are among the soundest in the world. They will serve as the foundation to drive future wealth creation. IronBridge's mission is to participate fully in the next phase of wealth creation by investing your capital in companies with managers who are good stewards of capital and invest capital in wealth-creating activities.

Thank you for your continued support.

Best regards,

Christopher C. Faber
IronBridge Capital Management, L.P.

Small Cap Core Equity Composite

April 30, 1999 to December 31, 2007 — Assets & Returns in USD

Year	IronBridge Gross Return %	IronBridge Net Return %	Russell 2000® Return %	Number of Portfolios at End of Year	Composite Dispersion	Total Firm Assets End of Period $ Millions	Total Assets in Composite $ Millions
1999	19.50	18.70	17.67	<5	NA	7.9	4.9
2000	15.19	14.03	-3.02	<5	NA	16.0	11.8
2001	18.79	17.63	2.49	<5	NA	24.6	20.8
2002	-11.87	12.77	-20.48	<5	NA	61.0	50.6
2003	48.29	46.85	47.25	<5	NA	521.3	233.6
2004	19.84	18.68	18.33	22	0.36	1,878.0	1,112.2
2005	4.35	3.34	4.55	28	0.54	2,692.9	1,343.4
2006	16.36	15.22	18.37	25	0.35	3,696.4	1,221.9
2007	10.78	9.68	-1.57	24	0.48	4,429.0	1,169.6

IronBridge Capital Management, L.P. has prepared and presented this report in compliance with the Global Investment Performance Standards (GIPS®).

1 IronBridge Capital Management, L.P. is a dedicated equity manager, and an independent investment management firm that is not affiliated with any parent organization.

2 The benchmark is the Russell 2000. The annualized composite return since inception is 15.32% before management fees; 14.18% after fees; and the annualized benchmark return is 8.16%.

3 The composite includes all small cap portfolios, invested in companies with relatively small market capitalizations (i.e., generally under $2.5 billion), with both growth and value attributes. The composite excludes portfolios under $5 million, and portfolios that are tax-sensitive or have client-driven restrictions. The composite was created on March 31, 2002.

4 The inception date of the composite is April 30, 1999. The returns for 1999 for the composite and benchmark include May 1 through December 31 and are not annualized.

5 The standard management fee is 1.00% of assets. Net returns are computed by compounding monthly.

6 Gross of fees returns are presented after trading expenses, but before all other fees.

7 IronBridge uses equal-weighted standard deviation as the dispersion measure.

8 Accounts are removed from the composite when significant cash flows occur, for the month of the flow and the month after. Significant cash flows are defined as 50% or more of the account value. Prior to 2007, significant cash flows were defined as "50% of the account value or $15 million or other amounts IronBridge believes will materially affect performance." The change was made in order to ensure consistency in the application of the cash flow rules. Additional information regarding our cash flow policy is available upon request.

9 Derivative use within the composite is minimal and deemed immaterial.

10 A complete list and description of all IronBridge composites is available upon request.

11 Additional information regarding policies for calculating and reporting returns is available upon request.