First Annual Letter to Clients
(for Year ending December 2003)

From: The Ridgewood Group
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February 10, 2004

To our valued clients:

We have attracted a number of new clients in the last half of 2003 and assets under management have, thanks to all of you, increased to over $10 million. Last year was our first full year as an operating investment advisor. Interestingly enough, $10 million was the first milestone that we set for ourselves when we established the firm as an investment advisor in late 2002. It is not a large figure from the perspective of either our long-term goals for the firm or what many other managers manage today. However, it is always the first few steps that are the most difficult and we are encouraged that it took less than 18 months to increase assets under management from less than $1 million to over $10 million. Consequently, we are grateful to each of you for your support and faith in helping us get to this important mile marker.

As we will discuss in more depth later, 2003 was an unusual year from the perspective of both our own performance as well as that of the market. This performance is telling both in itself and also for its potential implications for the near future.

Given the number of new clients that joined the firm in 2003, it may make sense to explain why we write these letters to you. Consistent with the practice that we began with out first letter in August 2003 (which you can find on our website at www.ridgewoodgrp.com), we will write occasional letters to you, our current clients and others on our subscriber list. Our current plan is to send you two of these letters per year, the first at the midway point to be distributed in August and the second (and likely longer) annual letter to be distributed in February. Our plan is to discuss and communicate some of the items that may be relevant (or perhaps irrelevant depending on your point of view) to you in our role as your investment advisor, and more generally, discuss those topics that, hopefully, shed some light on the principles of intelligent investing that we follow and implement on your behalf at The Ridgewood Group.

Our purpose in writing these letters is several-fold:

- we want these letters to contribute to our ongoing dialogue with you, our valued clients, to better communicate both the specific facts (including past performance) and how we think about those facts

- we hope to assist you to continue to develop a better understanding of what we do, how we operate, and the philosophies and guidelines that we follow

- we view these letters as a way to help you gain insight into our thoughts (such as they are) regarding the current environment for investing

- we hope these letters will be a useful tool in our ongoing campaign to charm, cajole, embarrass, or otherwise entice you to refer any of your family, friends, acquaintances, and even complete strangers that could benefit from our brand of intelligent advice (and have cash just lazing around waiting for a home)

- we will also discuss topics that are more broadly interesting or relevant (at least to investophiles like us) to our goal of investing your (and our own) money intelligently

As you read these letters, we hope that you will think about the contents and, if the spirit moves you, share your feedback with us on any aspect contained in or provoked by these letters. We welcome your reactions, criticisms, compliments or suggestions (but please hold the tomatoes).

2003 Performance

2003 was an extraordinary year from a performance point of view. In short, everything in sight appreciated and in many ways the lower quality investments increased the most. To some extent, this "flight to garbage" was a somewhat predictable reaction to the panic selling of everything, and especially technology, over the last few years. One of the key catalysts for this reversal has been the massive fiscal and monetary stimulus engineered by Chairman Greenspan and President Bush. The image that immediately comes to mind is of an individual that having nearly choked to death and deprived of air, gasps for multiple breaths and as much air as possible when he resuscitates and is hooked up to supercharged oxygen. The 8.2% Q3 2003 GDP number is one statistic that quantitatively captures this effect. Since the U.S. is the world's largest economy at approximately $11 trillion in GDP and is a mature developed market, normal circumstances would not dictate growth at this rate, even for a quarter.

Unfortunately, many of the highest fliers in 2003 were not the type of quality businesses that we seek, and those that were of such quality weren't attractively priced for much of 2003. Of course back in late 2002 and the first quarter of 2003, there were a number of companies, especially in the tech and telecom areas, that were, especially with the benefit of hindsight, attractive "cigar butts" with enough cash and a real enough business such that they were far too cheap (for the uninitiated, a "cigar butt" in value investor speak is a not so great company that is cheap enough to offer a reasonable money making opportunity, like a free used cigar that you find that still has "one last puff" remaining. Early 2003 examples that come to mind are companies like Register.com). Largely, however, we passed on most of these investments or were still thinking about them when the market took off on its tear.

Normally, when the market makes such a broad advance, especially with a significant portion of lower quality companies rising rapidly, I would expect to have to report at year end that we underperformed the market (as measured by the S&P500)[1]. So I am pleased to report that not only did we not underperform the S&P500 this past year, but by a number of metrics, the performance of the Ridgewood Group Core Composite for the year ending December 31, 2003 was quite extraordinary.

Specifically, the composite of the accounts managed according to the Core approach by The Ridgewood Group advanced 36.9%[2] from December 31, 2002 to December 31, 2003. In contrast, the S&P500 advanced 26.4% during that same period of time. If you included reinvestment of dividends on the S&P500, the performance of the S&P was closer to 28.7%. The above difference is significant in that the Ridgewood Core Composite outperformed the S&P500 by approximately 8.2% in 2003.

This is probably a good time for a major caveat: one year is too short a period to get too excited. We prefer that you think of measuring performance like we do - in terms of average annual compounding of our money over rolling three to five year periods. Nevertheless, the above performance is still surprising since, over the longer-term, we aim to outperform the S&P by 3% to 5% net of fees. In summary, the 2003 results were above the long term average that we hope to achieve for the Ridgewood Core Composite. The absolute return of nearly 37% was also higher than the 12% to 15% absolute return we target.

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[1] As implied above, we measure the market and our own performance primarily against the S&P500. While there have been a proliferation of indices and subindices over the last few decades, we still view the S&P500 as the best yardstick for our clients for a variety of reasons. First, it is well known, easily accessible, and frequently reported. Second, it is broadly representative of the economy. Third, it is the index that most investors commonly invest in and is probably the proximate alternative for most clients.

[2] Per industry norms, performance is reported using a methodology known as Time-Weighted Return on Investment which is determined by calculating a geometric average of a series of monthly returns. This process effectively weights each subperiod return equally regardless of the money being managed during any one subperiod. This methodology was developed to allow for a more apples to apples comparison between different managers without the problem of having the performance figures biased by different amounts under management at different points in the cycle. Of course, individual clients care about the actual Internal Rate of Return (also called the Dollar Weighted Return on Investment) that they experience. We will be providing individual reports to clients at each semi-annual and annual period summarizing these figures for each individual account. The Ridgewood Core Composite is defined as all accounts we manage (over $50,000 in size) that are managed according to the Core style. In our Core portfolios, we seek the best opportunities that meet our investment criteria regardless of industry sector or market capitalization. Additional information about the makeup and performance of our Core Composite is available upon request.

The magnitude of this outperformance is even more pronounced when you know some of the details behind how our Core Composite was managed last year. For example, the above performance was achieved without holding any significant exposure to technology stocks, one of the strongest components of the market in percentage terms. As you may be aware, the NASDAQ was up 50% in 2003.

Before you get too excited about the above returns for either NASDAQ or the S&P remember that is it the average performance over three to five years that we consider more indicative. By these measures, the news is far more sobering. After the 50% rise in the NASDAQ in calendar year 2003, that index was still down a cumulative 18.9% in the three years ended December 31, 2003 and down 8.6% over the last five years. The S&P500 was down a cumulative 15.8% over the last three years and down a cumulative 9.5% over the last five years ending December 31, 2003. By contrast, the personal accounts that I managed prior to forming the Ridgewood Group are up meaningfully over each of those time periods because we followed (though with much less time and focus than we do now) the principles of intelligent investing.

Looking at and remembering the above performance going back three to five years is important because it provides context to the 2003 numbers which by themselves are misleading. There are a number of tendencies in human nature that make it hard for most to follow the lessons of intelligent investors. In recent days, at least two tendencies come to mind. First, people tend to forget or marginalize the unpleasant past in favor or things that are more pleasant or less threatening. In addition, most of us tend to overweight recent experience which is fresh in our minds. Due to these and other factors, many investors seem to have unlearned (or perhaps they never learned in the first place) the lessons of the recent past. As is often said, those who do not know history are doomed to repeat it.

Another reason to look at the longer term track record of both the S&P and the NASDAQ is that it is probably more representative of the average investor's experience than the more recent rise. Those moved primarily by the alternating tides of fear and greed (read most investors) tend to have an almost uncanny ability to make exactly the wrong move at precisely the wrong time. My own exposure suggests that average investors and advisors were more fully invested in equities at the peak in 2000 and were more weighted towards cash at the lows in 2003. Like a tragic straight man to the market's comic, the average investor always ends up with the pie in the face (though mostly through their own avoidable missteps).

It is not surprising then that the indexing approach of just throwing in the towel and accepting that average is the best that is possible has, for many good reasons, extraordinary appeal to the average investor. Implementing a plan to have a legitimate chance to do better than average would require focus, ability, discipline, time and the right framework. The average investor probably has a greater chance of being struck by lightning. Nevertheless, for the smaller group of investors who have access to a more intelligent alternative, implementing a prudent and risk minimizing strategy to seek better performance through long-term ownership of quality businesses is an undeniably attractive option. In our case, our clients effectively outsource the management of their funds to us because, on their behalf, we bring the focus, ability, discipline, time and framework necessary to achieve our joint goals.

Going back to the details of our own performance in 2003, the Ridgewood Core Composite had a significant exposure to cash which did significantly limit (essentially to zero in the current short term interest rate environment) the gains on that portion of the Composite. The Composite's cash portion was probably in the neighborhood of 20% weighted over the entire year. This proportion was as high as it was for a couple of key reasons: 1.) our inherent conservatism and 2.) the previously mentioned growth in client assets - new assets are mostly in cash until we find the opportunities over time to put the money to work. Another way to understand the impact of this cash is that if more of the cash had been put to work in our ideas, the returns would have been even higher.

On the other hand, the cash component partly explains why the Beta, the volatility relative to the S&P500, of the Ridgewood Core Composite was lower than the market. Still, we thought it extraordinary that the Beta of our Core Composite was only 0.55 or almost half that of the market. In combination with the above outperformance, the Alpha (or the excess return achieved after adjusting for the relative volatility) was nearly 20% in 2003. To put this figure into some context, most managers would be extremely happy with an Alpha of 1% to 3%, and an alpha of 5% (especially over time) is considered excellent. Like most good investors, we do not think that you should overly emphasis these statistics because there are a number of other factors that can be as or more important in understanding the quality of and the risks associated with our investments. Nevertheless, these numbers are relevant in that they do tell part of the picture for our results in 2003.

One thing that seems certain is that the above magnitude of excess performance as measured by absolute, relative, and volatility adjusted returns is extremely unlikely to continue over the long term. Nevertheless, we would obviously rather outperform than the other alternative. Our Composite portfolios today have a significant cash component because it is harder to put the money to work in places that meet our criteria for quality and value. While having cash earning extremely low rates is never pleasant, good investors know that they have to wait for the right opportunities which tend to arise on an unpredictable schedule. We think of cash as an option with which to participate in future opportunities if and when they arise, and believe that over a cycle this approach will help us achieve our stated objectives.

Ideally this first year of performance is indicative of something more fundamental that will hopefully become increasingly clear over the long-term, i.e. that The Ridgewood Group can achieve its objectives of providing a greater return, net of fees, with less risk than the market. If so, we will accomplish our goal of compounding your and our own money at a satisfactory rate over time.

How We Invested in 2003

As with any other phenomenon in life, the important thing is not just to know "What" happened, but also to ask "How?" and "Why?" By asking and delving into these important follow up questions, you often obtain much more insight into what may really be going on. Finally, after asking and answering these follow up questions, the next step is to think about what the answers imply for what the future may hold, recognizing that in investing as in life itself, there are no certainties, only probabilities. As most of our clients know, we at The Ridgewood Group pride ourselves on eating our own cooking. Consequently, we both ask and answer these questions below with respect to our own 2003 performance.

Now a brief review: those of you for whom The Ridgewood Group is handling your money know that we have a pretty simple strategy towards investing. In essence, we like to own a handful of quality businesses whose prospects we feel we understand, with good management teams, and which we can purchase at favorable or at least reasonable prices. Most importantly, we do not want to <u>overpay</u>. As stated above, our goal in our portfolios is to compound your and our funds in excess of the market benchmark (generally the S&P 500 over rolling 3 to 5 year periods of measurement) such that net of fees to the Ridgewood Group, you will come out ahead of the game.

Another way to say it is that we want to see our money double from compounding every five to six years in our Ridgewood Core Composite. This means that we try to find individual opportunities that we believe will each grow <u>*on average*</u> in value (including dividends) of between 12 to 15% (or better) per year. Now it would be nice if we could have no fluctuations and get a steady linear increase towards our goal of doubling your money in five or six years. Experience, history, and common sense all tell us that the actual journey will be far less predictable and much more "exciting." Nevertheless, we will accept uncertainty and fluctuations in the short and intermediate term if we can thereby achieve our longer term objective without taking on the significant risk that we always try hard to avoid: permanent losses of capital over the long term.

Given our objectives, we tend to hold ownership interests in a handful of businesses (generally 10 to 30 securities) at any one time. Most of our investments will, at least in our own analysis, offer the prospect of compounding our capital invested at the above rates over a multi-year period (though as explained above, not necessarily or usually in a straight line).

To summarize "How" the above performance was achieved, you must simply understand that in 2003, we did what we always attempt to do - we bought a collection of good business that we could purchase at good prices. In many of these investments, we expected to do well but thought that this value creation would play out over the next three to five years. The big surprise in 2003 was that for many of our investments, it did not take three to five years to double. Rather, a reasonable number of our companies increased by 50% or more, often less than one year after we made the investment.

Now on to the "Why" - while the market and some of our investments achieved extraordinary performance in 2003, some important portion of these gains probably occurred by accelerating gains that might otherwise have occurred in 2004, 2005, and in some cases even 2006. Before you start counting all the money we will have if we only linearly extrapolate last year's gains, we face the sobering likelihood that, like so many government actions involving favorable results, we have perhaps borrowed against the future.

As a side note, the 2003 market advance seems to have been far more broadly based with most, if not all, sectors of the market participating. Back in 1999, by contrast, the sometimes crazy gains were quite concentrated in technology, telecom, and recognized large capitalization growth companies. Due to this concentration of speculative interest, there were a number of bargains in most others areas of the market. Today, however, a recently rising tide has lifted (almost) all boats and those that are still available at good prices are more often dinghies than yachts. So in the near term, our job has become more difficult. For all of the above reasons, odds are good that future years will bring some normalization or regression in our results towards a more reasonable long term rate of return.

Our Clients and Other Developments

I am pleased with the current early composition of our clients. Many of you are in fascinating fields and doing great things. I look forward to hearing from each of you in the course of this coming year. Our plan is that next year (i.e. probably in March 2005) we will organize and invite each of our clients to attend the first annual gathering of clients (location to be determined). Those who attend will have to suffer through a presentation by yours truly, but before you send in your cancellation, you should know that this will be somewhat offset by the complimentary dinner at a good restaurant.

Our hope is that, over time, you will view your relationship with us as much more than a commercial relationship. Rather we hope that you will consider your status as that of a member in a special club of talented and successfully individuals and families. The club will be built around our common interest in intelligent investing as a means to achieve the freedom to pursue those activities that give your life meaning. In time, we hope and expect that some of you will get to know each other through your shared association with The Ridgewood Group and that we will all enjoy the resulting friendships and opportunities that arise.

While I assume primary responsibility for managing our collective investments, I welcome thoughts about companies or opportunities that you encounter in the course of your professional or personal lives. In this regard, I would rely on you to do the initial sanity check. If you find an established and profitable company with a management team or product that really impresses you and one that you think could enjoy success for sometime to come (think three to five years or more), then send me an email or give me a call. I promise to put it on my list of companies to take a look at and if the homework comes back positive, your idea could find its way into your portfolio (and maybe play a role in making us all a bit richer over time).

Ridgewood Investments and the Partnerships

As some of you are aware, The Ridgewood Group has a sister company called Ridgewood Investments, Inc. which I also own. Ridgewood Investments is the general partner of two limited partnerships that I manage and which are described below:

- The first partnership is the Ridgewood Managers Fund LP which is a focused and value oriented fund of funds. The Managers Fund accepted its first outside limited partners on August 1, 2003. I and several other partners have significant stakes in this partnership and we are pleased that results to date have been excellent (well in excess, on an annualized basis, of the Ridgewood Core Composite discussed above). The Ridgewood Managers Fund offers focused access to private funds and managers that I consider to be excellent and whom I also respect. Each of these managers has a thorough understanding of the value oriented intelligent investing principles that we follow. The partnership is managed to offer its limited partners access to these exceptional partnerships with lower minimums and some diversification.

- The other partnership managed by Ridgewood Investments is the Ridgewood Investment Fund LP. This partnership will begin accepting its first limited partners this month. As principal of Ridgewood Investments, I will be managing the Ridgewood Investment Fund.

Each of the above partnerships is grounded in the same principles of investing that underlie all of our activities, so I view my role as a manager, through Ridgewood Investments, of these partnerships as complementary to my position as manager of the separate accounts through The Ridgewood Group. However, these entities have different objectives and utilize additional techniques to achieve their objectives. Specifically, the goal of both of these partnerships is more ambitious in that they seek to compound money in excess of 20% to 30% per year over time. Unlike the Ridgewood Core Composite accounts, these partnerships are free to use leverage, make short sales, utilize options, and hold more concentrated positions.

Both partnerships are still open, but only to accredited investors (individuals with joint income over $300,000 and/or net worth of over $1 million). These partnerships may involve additional risks. If you have questions about the above partnerships or how they relate to our activities as manager of your funds in the form of separate accounts, please let us know.

The Power of Referrals

Now, time for a shameless commercial appeal. As is already the case, word of mouth is our single greatest source of clients. So if you know anyone that may need assistance or guidance with handling their investments a bit more intelligently, please let us know. Last year, several of our existing clients were instrumental in introducing us to other clients that joined us later in the year. In good measure thanks to these referrals, we achieved the above growth in assets under management to over the $10 million mark. Our goals for the next few years are even more ambitious and we will only be able to achieve them with your help. So please continue to tell people you know about The Ridgewood Group's approach and if possible put us in touch with the appropriate individuals.

To make it even more interesting, we are going to keep track of referrals. Next year at our first annual meeting for clients, we plan to present two surprise prizes. One prize will go to the individual or family that introduced us to the most qualified individuals in the prior year, regardless of what happened as a result of these introductions. The other prize will go to the individual or family whose referrals lead to the largest increase in our assets under management from clients that they referred. By having two separate measures, we hope to recognize the value of all referrals and create a level playing field for all of our clients that are kind enough to take the time to introduce us to their friends and contacts. Since there may be some correlation between the two, we will make sure that the prizes can also correlate very nicely. Let the games begin!

The Ridgewood Book Tour

As a final note, you may or may not be aware that The Ridgewood Group has received some press coverage in the last two months or so. Articles have been written in several niche publications including *the South Orange/Maplewood News Record*, the *India Tribune*, *India Abroad*, *India Post*, and the *Economic Times of India*. This media feeding frenzy resulted from our selection as one of fifty leading "Business Mentors" by Mission Publishing. Thanks to Mika Kalapatapu, whose firm ably assists the Ridgewood Group with media relations, a number of these publications followed up with informative articles and interviews highlighting The Ridgewood Group's message.

We want to thank Darwin Gillett - a friend and expert consultant to companies on enlightened management technologies – who nominated us for the above recognition. As a result of Darwin's nomination, we had the opportunity to be selected from about 2000 other individuals. We were also invited to write a chapter in a forthcoming book called "Create the Business Breakthrough You Want – Secrets and Strategies from the World's Greatest Mentors" that will be published by Mission Publishing. My own contribution is entitled "The Four Timeless Principles of Intelligent Investing." As clients, you will receive a complimentary copy of the book once it is published this Spring. The book will also contain insights from a number of other individuals, including notable mentors like Mark Victor Hansen (Chicken Soup series), Robert Allen and Brian Tracy. We hope you will enjoy it.

In conjunction with the publication of this book, we have been invited to speak to several groups and organizations regarding intelligent investing and other business topics. So if you are part of such a group, and think that other members would appreciate the musings of a moderately engaging speaker standing between them and dinner, please let us know.

As you may also have noted by the new contact information at the beginning of this letter, our mailing address and contact numbers have recently changed. Please make a note of our new address in Short Hills, NJ. Our new phone number is 973-409-9764 and the new fax number is 973-544-4026.

As always, we welcome your questions and comments. With that, I would like to invite each of you to visit (or revisit) our site (at www.ridgewoodgrp.com). If you have not seen it, check out our "Food for Thought" section, which many visitors seem to particularly enjoy. Better yet, if you are going to be in or near northern NJ, please let us know. We look forward to seeing you and working with you in 2004!

Warm Regards,

Kaushal

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Email: info@ridgewoodgrp.com
(Note: clients also have access to my personal email which has not changed)

For more information on The Ridgewood Group and our approach to intelligent investing, please visit our website at www.ridgewoodgrp.com