

Item 1. Cover Page

Part 2A of Form ADV: Firm Brochure

PARADIGM ADVISORS, LLC

200 Crescent Court, Suite 1150
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June 1, 2011

This brochure provides information about the qualifications and business practices of Paradigm Advisors, LLC. If you have any questions about the contents of this brochure, please contact us at 214.756.6066 or email at pallc@paradv.com. The information in this brochure has not been approved or verified by the United States Securities and Exchange Commission (the "SEC") or by any state securities authority.

Additional information about Paradigm Advisors, LLC is also available on the SEC's website at www.adviserinfo.sec.gov.

The Advisor is registered as an investment adviser with the SEC. SEC registration does not imply a certain level of skill or training.

THIS BROCHURE SHALL NOT CONSTITUTE AN OFFER TO SELL OR THE SOLICITATION OF AN OFFER TO BUY ANY SECURITY.

Item 2. Material Changes

This brochure dated June 1, 2011 amends the Advisor's most recent annual update, dated March 31, 2011. The amendments primarily reflect the Advisor's engagement as sub-advisor to the Daedalus Funds, as further described herein.

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Item 4. Advisory Business

Paradigm Advisors, LLC (the “Advisor”) is a Texas limited liability company that was formed in December 1995. The Advisor serves as the general partner of Paradigm Investment Management, LP, a Texas limited Partnership (“PIM”), which in turn serves as the general partner of Paradigm Investors, LP and Paradigm Investors (QP), LP, both Texas limited partnerships (collectively, the “Domestic Funds”) and as the investment manager of Paradigm Investors Overseas Equity Fund, Ltd., a Cayman Islands exempted company (the “Offshore Fund” and together with the Domestic Funds, the “Paradigm Funds”). In addition, the Advisor has been retained by Osterweis Capital Management, LLC (“Osterweis”) to serve as a sub-advisor for a portion of the assets of each of Daedalus Partners, L.P., Daedalus Qualified Partners, L.P. (collectively, the “Daedalus Partnerships”) and Daedalus Offshore (together with the Daedalus Partnerships, the “Daedalus Funds” and, together with the Paradigm Funds, the “Funds”). Each of the Paradigm Funds and the Daedalus Funds is a pooled investment vehicle that is privately offered to high net worth individuals, institutions, funds of funds and pension and endowments plans, and is exempt from registration as an investment company in reliance upon Section 3(c)(1) or 3(c)(7) of the Investment Company Act of 1940, as amended. The Adviser is controlled by Michelle U. Gass and W. Kirk Dunk. References to the “Advisor” herein shall include PIM, where applicable.

The Advisor typically invests on behalf of the Paradigm Funds in the U.S. stock market, but may also invest in a wide variety of other securities including, among others, foreign securities, options, preferred stocks and publicly traded debt instruments. The Paradigm Funds sell securities short which the Advisor believes to be overvalued and purchase securities which the Advisor believes to be undervalued.

The Advisor tailors its investment advice for the Paradigm Funds in accordance with the investment objective and strategy of the applicable Paradigm Fund, as set forth in the applicable offering documents. There are no limits on the securities or types of securities that the Advisor may invest in on behalf of the Paradigm Funds.

The Advisor invests on behalf of the Daedalus Funds in accordance with the investments guidelines contained in its sub-advisory agreements with each of the Daedalus Funds. The Advisor is required to maintain a set percentage of short exposure, as determined by the investment guidelines of the sub-advisory agreement and in accordance with the periodic written instructions of Osterweis, and expects that it will primarily be responsible for acquiring short positions on behalf of the Daedalus Funds.

The Advisor does not tailor its advisory services to the needs of any particular investor in any of the Funds.

The Advisor does not currently provide investment advisory services to clients apart from the Funds and the Daedalus Funds, although it may do so in the future.

As of June 1, 2011, the Advisor manages approximately USD \$242,000,000 of client assets on a discretionary basis. The Advisor does not manage any client assets on a non-discretionary basis.

For a further discussion of these and related items, see *Item 7* (Types of Clients), *Item 8* (Methods of Analysis, Investment Strategies and Risk of Loss) and *Item 10* (Other Financial industry Activities and Affiliations).

Item 5. Fees and Compensation

PIM or its affiliates receive a quarterly management fee from each Paradigm Fund equal to 0.25% (1% per year) of the net assets of such Paradigm Fund (the “Management Fee”). The Management Fee is payable quarterly, in advance, at the beginning of each calendar quarter, based on the net asset value at

the beginning of each quarter. An investor that invests in a Paradigm Fund other than at the beginning of a calendar quarter will be charged a pro rata Management Fee for the initial calendar quarter. No portion of the prepaid quarterly Management Fee will be refunded should an investor in a Paradigm Fund make a withdrawal other than at the end of a quarter. PIM may waive or reduce its Management Fee attributable to the investments of certain investors, including, affiliates of PIM and its principals.

PIM or its affiliates also receive a performance based incentive fee from each of the Paradigm Funds. With regard to the Domestic Funds, PIM receives 15% of such Fund's net profits attributable to each Class A limited partner, on a quarterly basis, and 20% of such Fund's net profits attributable to each Class B limited partner, on an annual basis. With regard to the Offshore Fund, PIM receives 20% of any profits generated on an annual basis. The performance based incentive fee for all three Paradigm Funds is subject to a high water mark.

Each Paradigm Fund bears all costs and expenses directly related to its investment program, including brokerage commissions, custody fees, any withholding or transfer taxes and all expenses incurred in connection with locating, evaluating and implementing potential investments including research related expenses. Each Paradigm Fund also bears certain out-of-pocket costs of the administration of such Fund, including accounting, audit, administration, corporate secretarial and legal expenses, costs of any litigation or investigation involving Fund activities, and costs associated with reporting and providing information to existing and prospective investors.

With regard to the Daedalus Funds, Osterweis pays the Advisor an amount equal to: (i) thirty-five percent of the management fees and (ii) twenty-five percent of the performance based incentive fees/allocation that Osterweis receives from each of the Daedalus Funds; provided that on and after July 1, 2013, such percentages shall increase to (i) forty percent of such management fees and (ii) thirty-five percent of such incentive fees/allocation. Generally, the management fee payable by each Daedalus Partnership to Osterweis with regard to each investor is 1.00% per annum, payable quarterly, in advance, based on the net asset value of the capital account of each investor as of the first day of a fiscal quarter. The management fee payable by Daedalus Offshore to Osterweis with regard to each investor is generally 1.00% per annum, payable monthly, in arrears, based on the net asset value of the applicable shares as of the last business day of the month. An investor who withdraws capital on a date other than the last day of a fiscal quarter does not receive a refund of the management fee paid in advance for that fiscal quarter. Osterweis is also allocated, from each investor in a Daedalus Fund, an incentive fee or allocation, as applicable, equal to 20% of net profits (including both realized and unrealized gains and losses) otherwise allocable to that investor, subject to a high water mark. The incentive fee/allocation is accrued and is payable at the end of each fiscal year and upon an investor's withdrawal from the Daedalus Fund, with respect to the amount withdrawn.

For a further discussion of these and related items, see *Item 12* (Brokerage Practices).

Item 6. Performance Based Fees

The Advisor generally charges performance based fees or allocations. Please see *Item 5* (Fees and Compensation) above. The Advisor does not currently provide investment advisory services to any client that pays only a management fee. However, the Advisor may, in its discretion, manage other funds or accounts with higher or lower fees, and different fee structures, than the Paradigm Funds or the Daedalus Funds (including, without limitation, other privately-offered pooled alternative investment funds, some of which may have an investment strategy substantially similar to the Funds).

Performance based fees or allocations may create an incentive for the Advisor to make investments that are riskier or more speculative than would be the case in the absence of these and related items. Please see *Item 5* (Fees and Compensation).

The Advisor is required to act in a manner that it considers fair, reasonable and equitable in allocating investment opportunities to the Funds, but the Advisor and its affiliates are not otherwise subject to

any specific obligations or requirements concerning allocation of time, effort or investment opportunities, or any restrictions on the nature or timing of investments for the Funds.

Item 7. Types of Clients

The Advisor provides investment advice to the following three Funds:

Paradigm Investors, LP
Paradigm Investors (QP), LP
Paradigm Investors Overseas Equity Funds, Ltd.

In addition, the Advisor provides sub-advisory services to the following three Funds:

Daedalus Partners, L.P.
Daedalus Qualified Partners, L.P.
Daedalus Offshore

The Paradigm Funds and the Daedalus Funds are comprised of high net worth individuals, institutions, funds of funds and pension and endowments plans.

The Advisor or its affiliates may in the future provide investment advisory services to additional clients, either directly or through PIM or another entity, including, but not limited to, other pooled investment vehicles, trusts, institutions, high net worth individuals, investment companies, pension plans, sovereign wealth funds, family offices, foundations and endowments.

While there is no minimum investment requirement for the Paradigm Funds themselves, the minimum initial investment for an investor in the Paradigm Funds is \$500,000, although subscriptions of lesser amounts may be accepted in PIM's sole discretion. The minimum initial investment for an investor in the Daedalus Funds is also \$500,000, although subscriptions of lesser amounts may be accepted in Osterweis' sole discretion.

For a further discussion of these and related items, see Item 4 (Advisory Business) and Item 10 (Other Financial Industry Activities and Affiliations).

Item 8. Methods of Analysis, Investment Strategies and Risk of Loss

With regard to the Paradigm Funds, the Advisor focuses primarily on fundamental analysis in identifying both overvalued and undervalued situations. In evaluating the prospects of a particular investment, the Advisor utilizes its knowledge of accounting, extensive analysis of company fundamentals, past experience, and numerous discussions with industry sources and contacts. Attention is given to such factors as company debt levels, accounting practices, growth and earnings projections, competitive industry pressures and macroeconomic changes that may impact a company's stock price. Investment decisions are based on the merit of a given company and the potential for profit which would exist regardless of the "direction" of the market.

In engaging in long investments for the Paradigm Funds, the Advisor seeks to purchase securities of a company at a price which the Advisor believes to be less than the fair or intrinsic value of a company's assets or earning power. The philosophy is often "contrarian", as the Paradigm Funds may purchase securities that are ignored, or disliked, by the market. As part of its analysis, the Advisor may look at the quality of earnings, operating cash flow and underlying asset values. Those who subscribe to an asset value approach stress the relationship of current market prices to the company's book value and/or to a restated realizable value of the company's assets. Those who stress the quality of earnings are concerned with the relationship between the current price of a security and its earnings, cash flow, and prospects for growth in earnings. The quality of the company's management and the "franchise"

value of the company's products are also taken into consideration. Concentrated positions are sometimes established.

The Paradigm Funds also actively engage in short investing whereby they look for the absence of many of the qualities which they would seek in primarily long investing. The Advisor views short selling as an independent profit opportunity. The Paradigm Funds focus on companies which have negative cash flow, exceedingly high market values compared with assets, or exceedingly high prices compared with low earnings, or even deficits. The Paradigm Funds look for companies that may have a "faddish" product, deteriorating prospects and/or bloated inventories or receivables. Also, aggressive accounting practices which have artificially increased earnings attract the attention of the Paradigm Funds.

The Paradigm Funds have investments focused in the U.S. stock market, but may also include a wide variety of other securities including, among others, foreign securities, options, preferred stocks and publicly traded debt instruments. The Paradigm Funds sell securities short which the Advisor believes to be overvalued and purchase securities which the Advisor believes to be undervalued. The Advisor intends to continue to put particular emphasis on selling securities short, which does not preclude the Advisor from buying securities long or taking defensive positions by, for example, being invested substantially or entirely in cash or cash equivalents.

With regard to the Daedalus Funds, the Advisor focuses on short investing in the U.S. stock market. The Advisor may invest in securities and options on behalf of the Daedalus Funds. However, Osterweis may invest in a wide variety of other securities, on behalf of the Daedalus Funds, to which the Advisor is not privy.

General Risks

There are a number of general risks relating to the intended investment strategy of the Paradigm Funds and/or the Daedalus Funds, as applicable, including, but not necessarily limited to, the following:

Short Sales. The Funds sell securities short. Selling securities short risks losing an amount greater than the proceeds received. Theoretically, securities sold short are subject to unlimited risk of loss because there is no limit on the price that a security may appreciate before the short position is closed. In addition, the supply of securities that can be borrowed fluctuates from time to time. The Funds may be subject to losses if a security lender demands return of the lent security and an alternative lending source cannot be found or if they are otherwise unable to borrow securities which are necessary to cover the Funds' positions. Also, substantial amounts of short selling by the Funds may increase the possibility of litigation and regulatory scrutiny.

Investments in Undervalued Securities. The Paradigm Funds intend to invest in undervalued securities. The identification of investment opportunities in undervalued securities is a difficult task, and there are no assurances that such opportunities will be successfully recognized or acquired. While investments in undervalued securities offer the opportunities for above-average capital appreciation, these investments involve a high degree of financial risk and can result in substantial losses. Returns generated from the Paradigm Funds' investments may not adequately compensate for the business and financial risks assumed. The Paradigm Funds may make certain speculative investments in securities which the Advisor believes to be undervalued; however, there are no assurances that the securities purchased will in fact be undervalued. In addition, the Paradigm Funds may be required to hold such securities for a substantial period of time before realizing their anticipated value. During this period, a portion of the Paradigm Funds' funds would be committed to the securities purchased, thus possibly preventing the Paradigm Funds from investing in other opportunities.

Small Companies. The Paradigm Funds may invest a portion of its assets in small and/or unseasoned companies with small market capitalization. While smaller companies generally have potential for rapid growth, they often involve higher risks because they may lack the management experience, financial resources, product diversification, and competitive strength of larger companies. In addition,

in many instances, the frequency and volume of their trading may be substantially less than is typical of larger companies. As a result, the securities of smaller companies may be subject to wider price fluctuations. When making large sales, the Paradigm Funds may have to sell portfolio holdings at discounts from quoted prices or may have to make a series of small sales over an extended period of time due to the lower trading volume of smaller company securities.

High-Yield Securities. The Paradigm Funds may invest in high-yield securities. High-yield securities are rated below investments grade. High-yield securities are commonly known as “junk bonds”. Securities which are in the lower-grade categories generally offer a higher current yield than is offered by higher-grade securities of similar maturities, but they also generally involve greater risks, such as greater credit risk, greater market risk and volatility, and greater liquidity concerns.

Leverage. The Funds may employ leverage, including, without limitation, through the use of borrowed funds and/or through low margin and collateral deposits. Also, the Funds may engage in short sales, and may make investments in options, such as puts and calls, and warrants. While such strategies and techniques increase the opportunity to achieve higher returns on the amounts invested, they also increase the risk of loss. If the Funds use leverage with respect to a position, any losses would be more pronounced than if leverage were not used, and a relatively small price movement in a security may result in immediate and substantial losses to the Funds, including, without limitation, losses in excess of the amount invested. The level of interest rates generally, and the rates at which such funds may be borrowed in particular, could affect the operating results of the Funds. In addition, the lender or counterparty, as the case may be, may have a security interest in, or otherwise acquire, all or a portion of the Funds’ assets. In the event that a Fund defaults under any such arrangement, such lender or counterparty may have the right to become or remain the owner of all or that portion of such Fund’s assets secured pursuant to such arrangement. If such arrangement is terminated, the Fund’s ability to meet its investment objective may be adversely impaired. The Funds will bear all of the costs and expenses incurred in connection therewith, including, without limitation, any interest expense charged on funds borrowed or otherwise accessed.

Liquidity. Some of the investments that are made by the Funds may lack liquidity or be thinly traded. This could present a problem in realizing the prices quoted and in effectively trading the position(s). In certain situations, the Funds may invest in illiquid investments which could result in significant losses. In addition, the Funds could be exposed to substantial loss should the Advisor find it necessary to liquidate positions during periods of illiquidity.

Call Options. There are risks associated with the sale and purchase of call options. The seller (writer) of a call option which is covered (e.g., the writer holds the underlying security) assumes the risk of a decline in the market price of the underlying security below the purchase price of the underlying security offset by the gain by the premium received if the option expires out of the money, and gives up the opportunity for gain on the underlying security above the exercise price of the option. If the seller of the call option owns a call option covering an equivalent number of shares with an exercise price equal to or less than the exercise price of the call written, the position is “fully hedged” if the option owned expires at the same time or later than the option written. The seller of an uncovered, unheeded call option assumes the risk of a theoretically unlimited increase in the market price of the underlying security above the exercise price of the option. The buyer of a call option assumes the risk of losing its entire investment in the call option. If the buyer of the call sells short the underlying security, the loss on the call will be offset in whole or in part by any gain on the short sale of the underlying security (if the market price of the underlying security declines).

Put Options. There are risks associated with the sale and purchase of put options. The seller (writer) of a put option which is covered (e.g., the writer has a short position in the underlying security) assumes the risk of an increase in the market price of the underlying security above the sale price of the short position of the underlying security offset by the premium if the option expires out of the money, and thus the gain in the premium, and the option seller gives up the opportunity for gain on the underlying security below the exercise price of the option. If the seller of the put option owns a put option covering an equivalent number of shares with an exercise price equal to or greater than the

exercise price of the put written, the position is “fully hedged” if the option owned expires at the same time or later than the option written. The seller of an uncovered, unheeded put option assumes the risk of a decline in the market price of the underlying security to zero. The buyer of a put option assumes the risk of losing his entire investment in the put option. If the buyer of the put holds the underlying security, the loss on the put will be offset in whole or in part by any gain on the underlying security.

Forward Trading. The Funds may invest in forward contracts and options thereon, which, unlike futures contracts, are not traded on exchanges, and are not standardized; rather, banks and dealers act as principals in these markets, negotiating each transaction on an individual basis. Forward and “cash” trading is substantially unregulated; there is no limitation on daily price movements and speculative position limits are not applicable. For example, there are no requirements with respect to record keeping, financial responsibility or segregation of customer funds or positions. In contrast to exchange traded futures contracts, interbank traded instruments rely on the dealer or counterparty being contracted with to fulfill its contract. As a result, trading in interbank non-U.S. exchange contracts may be subject to more risks than futures or options trading on regulated exchanges, including, without limitation, the risk of default due to the failure of a counterparty with which the Funds have forward contracts. Although the Advisor seeks to trade with responsible counterparties, failure by a counterparty to fulfill its contractual obligation could expose the Funds to unanticipated losses. The principals who deal in the forward markets are not required to continue to make markets in the currencies or commodities they trade and these markets can experience periods of illiquidity, sometimes of significant duration. There have been periods during which certain participants in these markets have refused to quote prices for certain currencies or commodities or have quoted prices with an unusually wide spread between the price at which they were prepared to buy and that at which they were prepared to sell. Disruptions can occur in any market traded by the Funds due to unusually high or low trading volume, political intervention or other factors. The imposition of credit controls by government authorities might also limit such forward (and futures) trading to less than that which the Advisor would otherwise recommend, to the possible detriment of the Funds. Neither the CFTC nor banking authorities regulate forward currency trading through banks. In respect of such trading, the Funds would be subject to the risk of counterparty failure or the inability or refusal by a counterparty to perform with respect to such contracts. Market illiquidity or disruption could result in major losses to the Funds.

Swap Agreements. The Paradigm Funds may enter into swap agreements. Swap agreements can be individually negotiated and structured to include exposure to a variety of different types of investments or market factors. Depending on their structure, swap agreements may increase or decrease the Paradigm Funds’ exposure to long-term or short-term interest rates (in the United States or abroad), non-U.S. currency values, corporate borrowing rates, or other factors such as security prices, baskets of equity securities or inflation rates. Swap agreements can take many different forms and are known by a variety of names. The Paradigm Funds are not limited to any particular form of swap agreement if consistent with the Paradigm Funds’ investment objective and policies. Swap agreements tend to shift the Paradigm Funds’ investment exposure from one type of investment to another. For example, if the Paradigm Funds agree to exchange payments in dollars for payments in non-U.S. currency, the swap agreement would tend to decrease the Paradigm Funds’ exposure to U.S. interest rates and increase its exposure to non-U.S. currency and interest rates. Depending on how they are used, swap agreements may increase or decrease the overall volatility of the Paradigm Funds’ portfolio. The most significant factor in the performance of swap agreements is the change in the specific interest rate, currency, individual equity values or other factors that determine the amounts of payments due to and from the Paradigm Funds. If a swap agreement calls for payments by the Paradigm Funds, the Paradigm Funds must be prepared to make such payments when due. This is only true in default and not part of mark-to-market. In addition, if a counterparty’s creditworthiness declines, the value of swap agreements with such counterparty can be expected to decline, potentially resulting in losses by the Paradigm Funds.

Equity Swaps. The Paradigm Funds may make use of equity swaps. A swap is a contract under which two parties agree to make periodic payments to each other based on the value of a security, specified interest rates, an index or the value of some other instrument, applied to a stated or “notional” amount.

An equity swap is a customized derivative instrument that entitles the counterparty to certain payments on the gain or loss on the value of an underlying equity security. Equity swaps are subject to various types of risk, including, without limitation, market risk, liquidity risk, counterparty credit risk, legal risk and operations risk.

Other Derivative Instruments. The Paradigm Funds may take advantage of opportunities with respect to certain other derivative instruments that are not presently contemplated for use or that are currently not available, but that may be developed, to the extent such opportunities are both consistent with the investment objective of the Paradigm Funds and legally permissible. Special risks may apply to instruments that are invested in by the Paradigm Funds in the future that cannot be determined at this time or until such instruments are developed or invested in by the Paradigm Funds. Certain swaps, options and other derivative instruments may be subject to various types of risks, including, without limitation, market risk, liquidity risk, the risk of non-performance by the counterparty, including, without limitation, risks relating to the financial soundness and creditworthiness of the counterparty, legal risk and operations risk.

Securities of Distressed Companies. The Funds may invest in unrated stock traded on the “pink sheets” or “distressed” securities, *i.e.*, securities of companies that are experiencing significant financial or business difficulties, including companies involved in bankruptcy or other reorganization and liquidation proceedings. Among the problems involved in investments in such issuers is the fact that it frequently may be difficult to obtain information as to the conditions of such issuers. In general, the Funds will, in the case of a long position in a distressed security, attempt to make such investments when the Advisor believes it is reasonably likely that the issuer of the securities will successfully consummate a plan of reorganization or otherwise emerge as a viable company. However, there can be no assurance that such reorganization or other plans will be successfully completed or consummated. In addition, a significant period of time may pass between the time at which the Funds make their investment in distressed securities and the time that any such reorganization is completed. During this period, it is unlikely that the Funds will receive any dividend, interest or other disbursements on the distressed securities; the Funds will be subject to significant uncertainty as to such successful completion and the Funds may be required to bear certain expenses to protect its interest in the course of negotiations surrounding any potential reorganization. Furthermore, investments in distressed companies often have limited liquidity. Any securities received by the Funds upon completion of a reorganization or other plan may also be legally restricted as to resale. In addition, even if a reorganization or plan is completed, there can be no assurance that the securities or other assets received by the Funds as a result of the reorganization or other plan will not have a lower value or income potential than anticipated when the investment was made.

Successful investing in distressed companies involves substantial time, effort and expertise, as compared to other types of investments. Information necessary to properly evaluate a distress situation may be difficult to obtain or be unavailable and the risks attendant to a transaction may not necessarily be identifiable or susceptible of considered analysis at the time of investment. Optimal returns on distress situations may often require active participation in the transaction. While the Advisor may on occasion seek representation or an active role in such matters, its commitments to various advisory activities may preclude extensive involvement and it may be unsuccessful in obtaining significant influence as to particular distressed investments.

Event-Driven Investments. The Paradigm Funds may invest in companies involved in (or the target of) acquisition attempts or tender offers or in companies involved in or undergoing work-outs, liquidations, spin-offs, or other catalytic changes or similar transactions. Investing in the securities of such companies, as well as certain distressed securities, will be subject to so-called “event risk,” *i.e.*, the risk that the transaction in question will simply fail to conclude as contemplated or will be delayed or modified in a manner detrimental to the Paradigm Funds in the transaction. Numerous factors, including market or industry developments, economic factors, regulatory clearance requirements and management or workforce issues, can cause an announced transaction to be abandoned, delayed or modified.

Where a security to be issued in a proposed merger or exchange offer has been sold short by the Paradigm Funds in the expectation that the short position will be covered by delivery of such security when issued, failure of the merger or exchange offer to be consummated may force the Paradigm Funds to cover its short position in the market at a higher price than its short sale, resulting in a loss. These losses can be substantial. If a transaction is delayed significantly, the Paradigm Funds' capital may be committed to the transaction during the period of the delay and interest charges on Paradigm Funds borrowed to finance its investment in connection with the transaction may be incurred. These interest charges may be greater than the profit realized upon the disposition of the securities, in which case the Paradigm Funds would realize a loss on the transaction. In addition, "spreads" on some merger opportunities may be initially small or may be impacted in a manner that precludes investment or causes a position to be limited in profitability or become unprofitable. Merger strategies can also be adversely affected by costs of borrowed funds, hedging issues, including the ability or inability to hedge and the attendant costs, and the strength of competing investors in the marketplace.

Certain Other Special Situation Investments. The Paradigm Funds may invest, from time to time, in companies that have declared, or are about to declare bankruptcy, that may be subject to investigation by federal or state agencies, including, but not limited to, the SEC, or that have substandard financial or other controls. There are significant business risks associated with such investments due to the inherently speculative nature of such investments, including but not limited to, those described herein. Such companies may not provide regular financial results or other reports and as a result may not be compliant with the reporting requirements of the SEC, NASDAQ or securities exchanges. Such non-compliance could result in a company's securities being suspended or delisted from NASDAQ or a securities exchange, which would likely have a negative affect on the price and liquidity of such securities. Such companies may also become involved in litigation as a result of their bankruptcy, investigation or substandard controls. In addition, results with respect to such investments may fluctuate from period to period. Accordingly, the results of a particular period will not necessarily be indicative of results which may be expected in future periods. Furthermore, the securities of such companies may be subject to significant price volatility, including steep declines in price upon the announcement of a bankruptcy, an investigation or a litigation.

Counterparty Creditworthiness. The Funds may engage in transactions in securities and other financial instruments that involve counterparties, and no counterparty exposure limits have been imposed on these transactions. Under certain conditions, a counterparty to a transaction could default or the market for certain securities and/or financial instruments may become illiquid. In addition, the Funds could suffer losses if there were a default or bankruptcy by certain other third parties, including, without limitation, brokerage firms and banks with which the Funds do business, or to which securities have been entrusted for custodial purpose.

Currency Risk. The Paradigm Funds may make investments denominated in one or more currencies other than U.S. Dollars. The Advisor may, to the degree it deems appropriate, cause the Paradigm Funds to enter into arrangements in an attempt to hedge the Paradigm Funds' exposure to significant currency fluctuations between the U.S. Dollar and the applicable currency or currencies. However, price movements of currencies are difficult to predict accurately because they are influenced by, among other things, changing supply and demand relationships; governmental, trade, fiscal, monetary and exchange control programs and policies; national and international political and economic events; and changes in interest rates. Governments from time to time intervene in certain markets in order to influence prices directly. The Advisor cannot guarantee that it will be successful in accurately predicting currency price and interest rate movements. There can be no assurance that the hedging arrangements, if any, entered into on behalf of the Paradigm Funds will be sufficient to address all currency risks. More particularly, the profitability of the Paradigm Funds' portfolio depends, in part, upon, and the success of any hedging arrangements is subject to, the ability of the Advisor to correctly hedge against movements in the direction of currency rates. Therefore, while the Advisor may enter into such transactions to seek to reduce currency exchange rate risks, unanticipated changes in currency rates may result in a poorer overall performance for the Paradigm Funds than if the Advisor had not engaged in any such hedging transaction.

Non-U.S. Investments. The Paradigm Funds may trade securities on markets located outside the United States, including, without limitation, in emerging markets. Such investments require consideration of certain risks not typically associated with investing in securities traded in the United States, including, without limitation, unfavorable currency exchange rate developments, restrictions on repatriation of investment income and capital, imposition of exchange control regulation, confiscatory taxation and economic or political instability in foreign nations. Liquidity and trading costs can vary significantly over time and across markets, particularly in emerging market countries. Non-U.S. trading costs generally are higher than in the United States. Non-U.S. settlement procedures and trade regulations may involve certain risks (such as delay in payment or delivery of securities or in the recovery of assets held abroad) and expenses not present in the settlement of domestic investments. In addition, legal remedies available to investors in certain foreign countries may be more limited than those available to investors in the United States or in other foreign countries. The laws of some foreign countries may limit the ability to invest in, or repatriate investments in, non-U.S. currencies and securities. In addition, there may be less publicly available information about certain non-U.S. companies than would be the case for comparable companies in the United States, and certain non-U.S. companies may not be subject to accounting, auditing and financial reporting standards and requirements comparable to or as uniform as those of U.S. companies.

Maturity Risk. In certain situations, the Paradigm Funds may purchase a bond of a given maturity as an alternative to another bond of a different maturity. Ordinarily, under these circumstances, the Paradigm Funds will make an adjustment to account for the interest rate risk differential in the two bonds. This adjustment, however, makes an assumption about how the interest rates at different maturities will move. To the extent that the yield movements deviate from this assumption, there is a yield-curve or maturity risk. Another situation where yield-curve risk should be considered is in the analysis of bond swap transactions where the potential incremental returns are dependent entirely on the parallel shift assumption for the yield curve.

Item 9. Disciplinary Information

There are no legal or disciplinary events that are material to a client's or a prospective client's evaluation of the Advisor's business or the integrity of the Advisor's management.

Item 10. Other Financial Industry Activities and Affiliations

The Advisor currently serves as the general partner of Paradigm Investment Management, LP which in turn serves as the general partner of Paradigm Investors, LP and Paradigm Investors (QP), LP, and as the investment manager of Paradigm Investors Overseas Equity Fund, Ltd. The Advisor also serves as a sub-adviser for a portion of the assets of Daedalus Partners, L.P., Daedalus Qualified Partners, L.P. and Daedalus Offshore.

No management persons are registered, or have an application pending to register, as a broker-dealer or a registered representative of a broker-dealer.

No management persons are registered, or have an application pending to register, as a futures commission merchant, commodity pool operator, a commodity trading advisor, or an associated person of the foregoing entities.

The Advisor does not recommend or select other investment advisers for its client accounts.

Potential Conflicts of Interest

Neither the Advisor nor its affiliates are under any obligation to devote his, her or its full time to the business of the Funds, or any of them. They are only required to devote such time and attention to the affairs of the Funds as they may deem appropriate, in their sole and absolute discretion.

The Advisor and/or its affiliates, and the employees of such entities or individuals, may and do engage in, invest in, participate in or otherwise enter into other business ventures of any kind, nature or description, alone or with others, including, without limitation, the management of or investment in other investment entities or vehicles or securities, and brokerage and investment banking activities. Some of these activities may be conducted on behalf of certain clients of the Advisor and/or its affiliates. No investor in a Fund has any right to participate in any of these activities or to the income or profits derived from these activities.

The Advisor and/or its affiliates do, and may in the future, provide advice to other investment vehicles and manage other accounts for which they may be compensated, and such investment vehicles and/or accounts may have investment objectives and utilize strategies similar to the investment objective and strategies of the Funds (“Affiliated Funds”). The trades made by Affiliated Funds or other client accounts that may be managed by the Advisor and/or its affiliates in the future may compete with trades for the Funds’ account and the Advisor and/or its affiliates may decide to invest the funds of these accounts or clients rather than the assets of the Funds in a particular security or strategy. In addition, the Advisor and/or such other persons will determine the allocation of assets of the Funds and such Affiliated Funds, other accounts and clients on whatever basis they decide is appropriate or desirable, in their sole and absolute discretion. The records of these Affiliated Funds, other accounts and clients will not be made available to investors in the Funds.

Investors in the Funds may include taxable and tax-exempt entities and persons or entities resident of or organized in various jurisdictions. As a result, conflicts of interest may arise in connection with decisions made by the Advisor or its affiliates that may be more beneficial for one type of investor. In making such decisions, the Advisor and its affiliates intend to consider the investment objectives of each of the Funds as a whole, not the tax benefits/impact of any investor individually.

The Advisor and/or its affiliates may enter into agreements with third parties that may introduce potential investors to the Paradigm Funds. It is expected that such parties will not be related to the operations of the Paradigm Funds and any fee paid will be disclosed to the investors introduced by such third parties. Such commissions or fees will be the sole responsibility of the Advisor or such affiliates; the Paradigm Funds and investors will have no obligation with respect thereto.

The Advisor and/or its principals and/or other affiliates may make trades and investments for their own accounts. In these accounts, they may use trading and investment methods that are similar to, or substantially different from, the methods used by them to direct the Funds’ assets. The records of these personal accounts will not be made available to Limited Partners. Subject to internal compliance policies and approval procedures, the principals and/or employees of the Advisor and/or its affiliates may engage, from time to time, in personal trading of securities and other instruments, including, without limitation, securities and instruments in which the Funds may invest.

No agreements, contracts and arrangements between the Paradigm Funds, on the one hand, and the Advisor or its affiliates on the other hand, were or will be the result of arm’s-length negotiations. The attorneys, accountants and others who have performed services for the Paradigm Funds, and who will perform services for the Paradigm Funds in the future, have been and will be selected by the Advisor or its affiliates. No independent counsel has been retained to represent the interests of prospective or current investors, and such documents have not been reviewed by any attorney on their behalf. Each prospective investor should consult his, her or its own counsel as to the terms and provisions of the governing documents and all other related documents.

The Advisor will value the investments held by the Paradigm Funds in accordance with GAAP and the relevant Paradigm Fund documents. Any securities and instruments held by the Paradigm Funds for which there is no clear valuation (e.g. no quoted prices) are assigned a value determined by the Advisor. The Advisor has a conflict of interest in that it will receive a higher performance based incentive allocation and a higher Management Fee if the securities are given a favorable valuation.

While the Advisor will value the assets held in the sub-advisory accounts for the Daedalus Funds for its own records, Osterweis will value such assets for purposes of calculating the net asset value of the Daedalus Funds (and thus any fees and/or allocations based thereon).

The performance based incentive allocation may create an incentive for the Advisor to make investments on behalf of the Funds that are riskier or more speculative than would be the case in the absence of such an arrangement.

Please see *Item 8* (methods of Analysis, Investment Strategies and Risk of Loss), *Item 11* (Code of Ethics, Participation or Interest in Client Transactions and Personal Trading) and *Item 12* (Brokerage Practices).

Item 11. Code of Ethics, Participation or Interest in Client Transactions and Personal Trading

The Advisor has adopted a strict Code of Ethics which is detailed in the Compliance Manual distributed to each employee annually. Each year, every employee of the Advisor is required to review the Code of Ethics, along with the Compliance Manual in its entirety, and sign an agreement stating that (s)he will abide by the rules set forth in the document.

It is the Advisor's policy that all employees conduct themselves in accordance with the highest standards of integrity, honesty and fair dealing. The Code of Ethics is designed to remind each employee that his/her most important responsibility is to treat clients fairly and avoid any potential conflict of interest. It is the Advisor's duty to act solely in the best interest of the clients.

It should be noted that neither the Advisor nor its principals or employees are prohibited from buying or selling securities for their own accounts and may take investment positions different than or similar to those of advised clients. The Advisor maintains compliance policies and procedures, including personal trading policies, which are designed to reduce potential conflicts of interest. Among other things, the Advisor maintains a restricted securities list and requires preauthorization of all personal securities transactions with the exception of certain types of exempt transactions. Further, each employee is required to have copies of all personal investment statements sent to the chief compliance officer or her designee. These reports are reviewed on a regular basis by appropriate personnel to ensure that all non-exempt transactions have been preapproved and all holdings are within the guidelines set forth for employees. Each employee is required to sign a quarterly certification stating that he or she has adhered to the Advisor's trading guidelines and has provided copies of all personal investment statements to the chief compliance officer or her designee. Further, the Advisor maintains certain policies and procedures designed to prevent partners and employees from misusing material non-public information or trading the same security ahead of the Funds.

The Advisor will provide a copy of the Code to any client or prospective client upon request.

The Advisor and its related persons do not recommend to clients, or buy or sell for client accounts, securities in which the Advisor and its related persons have a material financial interest. Although the Advisor's principals and employees may buy and sell securities for their own accounts or the accounts of others, they may not buy securities from or sell securities to the Funds.

For a further discussion of these and related items, see *Item 8* (Methods of Analysis, Investment Strategies and Risk of Loss), *Item 10* (Other Financial Industry Activities and Affiliations) and *Item 12* (Brokerage Practices).

Item 12. Brokerage Practices

The Advisor seeks to fulfill its fiduciary duty to its clients by generally obtaining the best execution of client transactions under the circumstances of the particular transaction. Best execution is designed to facilitate the Advisor's execution of client transactions in such a manner that the client's total cost or

proceeds in each transaction is most favorable under the circumstances. All brokerage transactions for the Partnerships will be executed by brokers and dealers selected by the Advisor on the basis of obtaining the best overall terms available, which the Advisor will evaluate based on a variety of factors, including the following: the ability to achieve prompt and reliable executions at favorable prices; the operational efficiency with which transactions are effected; the financial strength, integrity and stability of the broker; the quality, comprehensiveness and frequency of available research and related services considered to be of value; and the competitiveness of commission rates in comparison with other brokers satisfying the Advisor's other selection criteria. Thus, as a matter of policy, broker-dealers will not be selected by the Advisor solely on the basis of price, but will be selected on the basis of an evaluation by the Advisor to determine overall value, quality of brokerage services, and research.

The Advisor periodically solicits the input of all of its investment professionals and traders to evaluate the quality of research services and execution of each broker. The Advisor evaluates and determines commissions paid based on the input of the investment professionals and the traders.

The Advisor uses soft dollars to pay for research related services that directly impact the investment decisions of the firm. The products and services available from brokers include both internally generated items (such as research reports prepared by employees of the broker) as well as items acquired by the broker from third parties (such as quotation equipment). Section 28(e) of the Securities Exchange Act of 1934, provides a "safe harbor" to investment managers who use soft dollars generated by their advised accounts to obtain investment research and brokerage services that provide lawful and appropriate assistance to them in the performance of investment decision-making responsibilities. The Advisor's brokerage practices shall be consistent with Section 28(e). In connection with soft dollar arrangements, the Advisor may cause clients to pay more than the lowest available commission rates. However, the Advisor uses soft dollars only to cover research related expenses believed to be of more value to the client than the difference in commission rates.

When the Advisor uses client brokerage commissions to obtain research or other products or services, the Advisor receives a benefit because it does not have to produce or pay for the research, products or services that it might otherwise have to pay for itself. The Advisor has an incentive to select or recommend a particular broker based on its interest in receiving the research or other products or services rather than its clients' interest in receiving the most favorable execution.

The Advisor does not recommend, request or require that a client direct them to execute transactions through a specified broker-dealer, and the Advisor does not permit clients to direct brokerage.

Aggregation of Transactions

The Advisor's policy is to require that all trades are allocated in a manner that treats each account fairly. If the Advisor has determined to invest in the same direction in the same security at the same time for more than one of its clients, it will generally place orders for all such accounts simultaneously. If all such orders are not filled at the same price, the Advisor will, to the greatest extent possible, allocate the trades such that the order for each account is filled at the same average price. Similarly, if an order on behalf of one or more accounts cannot be fully executed under prevailing market conditions, the Advisor will allocate the trades among the different accounts on a basis that it considers equitable.

For a further discussion of these and related items, see *Item 8* (Methods of Analysis, Investment Strategies and Risk of Loss), *Item 10* (Other Financial Industry Activities and Affiliations) and *Item 11* (Code of Ethics, Participation or Interest in Client Transactions and Personal Trading).

Item 13. Review of Accounts

Accounts will be actively monitored by the Advisor on at least a monthly basis. In monitoring the performance of the investments, the Advisor will perform various levels of review. Among other

items, the Advisor will consider short and long-term rates of return, investment diversification and risk allocations as part of its regular review. Michelle U. Gass and W. Kirk Dunk, the sole voting members of PIM, will be responsible for monitoring the accounts. With respect to accounting matters, the Advisor has engaged Deloitte & Touche to conduct an annual audit of the Paradigm Funds. Osterweis also monitors the Daedalus Funds, including the separate sub-advisory account managed by the Advisor, at least monthly.

The Advisor provides each investor in the Paradigm Funds with hardcopies of the audited annual reports and unaudited quarterly reports on the performance of the Funds in which it invests. In addition, the Advisor provides electronic copies of unaudited monthly performance reports and balances to each investor in the Paradigm Funds.

Item 14. Clients Referrals and Other Compensation

The Advisor does not provide an economic benefit to any person or entity for client referrals. Furthermore, except with regard to soft dollar benefits as discussed in *Item 12* above, the Advisor does not receive any economic benefit from any non-client person or entity for providing investment services or advice.

For a discussion of these and related items, see *Item 10* (Other Financial Industry Activities and Affiliations) and *Item 12* (Brokerage Practices).

Item 15. Custody

Because the Advisor has access to the Paradigm Funds' funds and has the authority to deduct fees and other expenses from their accounts, the Advisor is deemed to have custody of the Paradigm Funds' assets. The Advisor utilizes the services of prime brokers and banking institutions as qualified custodians of the Paradigm Funds' assets.

The Advisor does not use a qualified custodian to send quarterly account statements directly to the investors in the Paradigm Funds. The Paradigm Funds will distribute their annual audited financial statements to their investors within 120 days of their fiscal year-end.

The Advisor urges investors in the Paradigm Funds to carefully review the audited financial statements of the Funds in which they are invested.

The Advisor does not have custody over the assets of the Daedalus Funds.

Item 16. Investment Discretion

Pursuant to the investment advisory agreements and limited partnership agreements or memorandum and articles of association, as applicable, of each of the Paradigm Funds, PIM and its affiliates have discretionary authority to manage the Paradigm Funds. These agreements generally grant PIM an irrevocable special power of attorney. As such, PIM may carry out various administrative functions, as well as make investment decisions.

In addition, the Sub-Advisory Agreement between the Advisor and Osterweis with respect to each of the Daedalus Funds provides the Advisor with discretionary authority to manage that portion of the assets of each of the Daedalus Funds as may be determined by Osterweis from time to time. The Sub-Advisory Agreements grant the Advisor a power of attorney that terminates only with the termination of the Sub-Advisory Agreements.

There are no limitations on PIM's investment authority on behalf of the Paradigm Funds. The Advisor's investment authority on behalf of the Daedalus Funds is limited by the investment guidelines and periodic written instructions from Osterweis.

For a further discussion of these and related items, see *Item 4* (Advisory Business) and *Item 10* (Other Financial Industry Activities and Affiliations).

Item 17. Voting Client Securities

The Advisor votes, on behalf of the Paradigm Funds, proxy proposals, amendments, consents or resolutions in a manner that seeks to serve the best interests of the applicable Paradigm Fund. In general, the Advisor seeks to resolve any potential conflicts of interests associated with any proxy by promptly disclosing the conflict and obtaining written consent before exercising any proxy voting authority, or in the alternative, by applying the general policy of seeking to serve the best interests of the Paradigm Funds. The Advisor does not have authority to vote securities on behalf of the Daedalus Funds.

Generally, the Advisor will determine how to vote (or abstain from voting) proxies on a case-by-case basis. The Advisor's proxy voting policy does not mandate that it vote every proxy that it receives in regard to securities held in client accounts. There may be circumstances when refraining from voting a proxy is in a client's best interests, such as when and if the Advisor determines that the costs of voting the proxy exceed the expected benefit to the client (such costs include the value of the Advisor's time). The Funds cannot generally direct how the Advisor votes in a particular situation.

Upon request, a client may contact the Advisor during regular business hours, via email or telephone, to obtain (i) information on the Advisor's proxy voting history for the past 5 years and (ii) a copy of the Advisor's proxy voting policy.

Item 18. Financial Information

The Advisor does not require or solicit prepayment of more than \$1,200 in fees per client, six months or more in advance.

The Advisor is not aware of any financial condition that is reasonably likely to impair its ability to meet contractual commitments to clients.

The Advisor has not been the subject of a bankruptcy petition at any time during the past ten years.

Item 19. Requirements for State-Registered Advisors

The Advisor is not a registered with any State as an investment adviser.