



Daruma Capital Management, LLC

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This brochure provides information about the qualifications and business practices of Daruma Capital Management, LLC. If you have any questions about the contents of this brochure, please contact us at (212) 869-4000 or by e-mail at clientservice@darumanyc.com.

The information in this brochure has not been approved or verified by the United States Securities and Exchange Commission or by any state securities authority.

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

Daruma Capital Management, LLC is registered as an investment adviser under the Investment Advisers Act of 1940, but such registration does not imply that Daruma or our personnel have a certain level of skill or training.

April 30, 2012

2. Material Changes

This is an other-than-annual update of Daruma's Form ADV brochure. Our last annual update was dated March 31, 2012. This brochure contains the following material changes:

- Daruma Capital Management, LLC has succeeded to the business operations of Daruma Asset Management, Inc. as of April 1, 2012. Details are on page 5.

In addition to the material changes listed above, there are revisions and other changes throughout this brochure, so please review it carefully even if you have read our previous brochure.

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4. Advisory Business

Overview

Daruma Capital Management, LLC (“Daruma LLC”) provides investment management services to public and corporate pension funds, endowments, foundations, other nonprofit organizations, corporations and high net worth individuals using a Small-cap strategy (07/28/95 inception) and a SMid-cap strategy (04/30/11 inception). Ms. Mariko O. Gordon, CFA, the firm’s founder, CEO and CIO, has been the sole Portfolio Manager since inception and is the majority owner.

Daruma LLC succeeded to the business of Daruma Asset Management, Inc. (“Daruma Inc.”) as of April 1, 2012. Daruma Inc. was founded under the name CastleRock Capital Management, Inc. in April 1995, and changed its name in March 1998.

Daruma has an affiliate involved in the management and operation of collective investment pools – Daruma Asset Management GP, LLC (“Daruma GP”). Daruma Inc. is also an affiliate, but has no current operations. In this brochure the terms “Daruma”, “we”, and “our” refer to all three entities, collectively.

Advisory Services

Daruma’s investment approach is defined by certain key beliefs:

- A concentrated portfolio compels truly active management
- In any market we can find 25 to 35 stocks with strong potential to outperform
- The best time to buy is not just when a stock offers good value, but when we can clearly define what will drive the price higher — in most cases better-than-expected sales, earnings or cash flow growth.

Our clients have a choice of two strategies: Small-cap equity and SMid-cap equity. Each strategy invests in equities of U.S. or non-U.S. companies listed on U.S. exchanges. The Small-cap strategy generally invests in companies with market capitalizations of approximately \$400 million to \$2 billion at the time of purchase. Our SMid-cap strategy includes companies that are below \$10 billion and above \$2 billion at purchase, as well as some of the larger and more liquid names we hold in our Small-cap product which may have market caps below \$2 billion. We own no REITs as we consider them a different asset class.

Clients can invest by either establishing an individually managed account or investing in a Daruma-sponsored collective investment pool (the “Daruma Funds”). The Daruma Funds are not registered under the *Investment Company Act of 1940*, nor is the offering of limited partnership interests in the Daruma Funds registered under the *Securities Act of 1933*. Therefore, interests in the Daruma Funds are privately offered only to investors that satisfy

eligibility requirements. *Information regarding the Daruma Funds contained in this brochure is provided only to satisfy Daruma's disclosure requirements; this is not an offer to sell interests in the Daruma Funds.*

Accounts, including the Daruma Funds, are managed based on a model portfolio, however, our services can be tailored to some extent for individual clients. For example, accounts generally have similar weightings in the same securities, but an account that is significantly smaller than other accounts in the same strategy may have somewhat different security weightings due to lot rounding. In addition, a client using an individually managed account may impose reasonable restrictions on investments in their account, but certain or too many restrictions could be disruptive to our investment style. Because of this we review all restrictions and guidelines a client wants to impose before accepting the account, and any agreed restrictions or guidelines (and any future changes) must be in writing and signed by Daruma.

Wrap Fee Programs

Daruma does not currently participate in any wrap-fee programs.

Assets Under Management

As of January 31, 2012 we had \$1,737,556,543 discretionary assets under management. Daruma does not manage any assets on a non-discretionary basis.

5. Fees and Compensation

Individual Managed Accounts

Management Fee

Daruma is generally paid a fee as a percentage of assets under management. The standard fee for individual managed accounts is 1% per annum, charged quarterly in arrears based on the value of the account at the end of the quarter. If an account terminates other than at the end of the quarter, fees are prorated. However, we have discretion over the fee we charge any client, and may agree to a lower fee, a different calculation methodology, or a different schedule for a particular client than we have agreed with comparable clients in the same investment strategy. We may also agree, in our sole discretion, to a fee that includes a performance-based fee, but only with clients that meet requisite eligibility requirements.

We bill our clients for our management fees, although some clients may authorize their custodian or a third party to pay us upon receipt of an invoice. Daruma does not deduct its fees from individual managed accounts.

The specific details of any client's fee, including rate, calculation methodology, payment schedule, etc. will be set forth in the client's investment management agreement.

Other Fees and Expenses

Clients will also bear the costs of maintaining and trading in their account, including custodial fees, brokerage commissions (see *Brokerage Practices*, below) and other securities transaction costs, wire transfer and electronic funds charges, and the fees of any third party the client hires, such as an auditor or consultant.

Collective Investment Pools

Each of the Daruma Funds has two series of limited partnership interest. The series differ only in the fees charged. Following is a summary of the fees and expenses paid by the Daruma Funds. Additional details are set forth in the offering documents for each fund.

Management Fee

The Series A interests carry a management fee of 1% per annum of each Series A capital account. The Series B interests carry a management fee of 0.75% per annum of Series B capital account, plus the incentive allocation described below. The management fee for each series is paid monthly in advance within 10 days after the first day of each month based on the net asset value of each capital account as of the first day of the month. Withdrawals

from the Daruma Funds are only permitted at the end of a month. Daruma may waive, modify or reduce the management fee for certain investors in its sole discretion.

Incentive Allocation

Daruma receives an incentive allocation with regard to the Series B interests for each fiscal year. The incentive allocation is 10% of the share of net profits, if any, allocated to a Series B capital account in excess of a non-cumulative Hurdle Rate. The “Hurdle Rate” is the amount of net profits or net losses, as the case may be, that would have been credited or debited to each Series B capital account for the fiscal year if the rate of return on that capital account had been equal to the total return of the Russell 2000 Index for the Small-cap strategy or the Russell 2500 Index for the SMid-cap strategy (in each case with dividends reinvested). For any period less than a year, the Hurdle Rate will be calculated based on the total return of the relevant index (with dividends reinvested) during such period. If an investor makes a withdrawal (in whole or in part) at any time other than the end of a fiscal year, the incentive allocation is charged at the time of withdrawal based on the return of the relevant index through the withdrawal date. In the case of a partial withdrawal, Daruma may, in its sole discretion, agree to delay the deduction of the incentive allocation until the end of the fiscal year. Daruma may waive, modify or reduce the incentive allocation for certain investors in its sole discretion. Each of the Daruma Funds has a fiscal year ending on December 31.

Despite the foregoing, Daruma will not receive an incentive allocation with regard to a capital account until any net loss previously allocated to that capital account has been offset by subsequent net profits. Any such loss carry-forward will be subject to reduction for withdrawals on a pro-rata basis.

Other Fees and Expenses

Each Daruma Fund also pays its own operating and trading expenses. These include third-party legal, audit and tax preparation fees, third-party fund administration expenses, brokerage commissions and other securities transaction costs, custodial fees, wire transfer and electronic funds charges.

Calculation and Payment

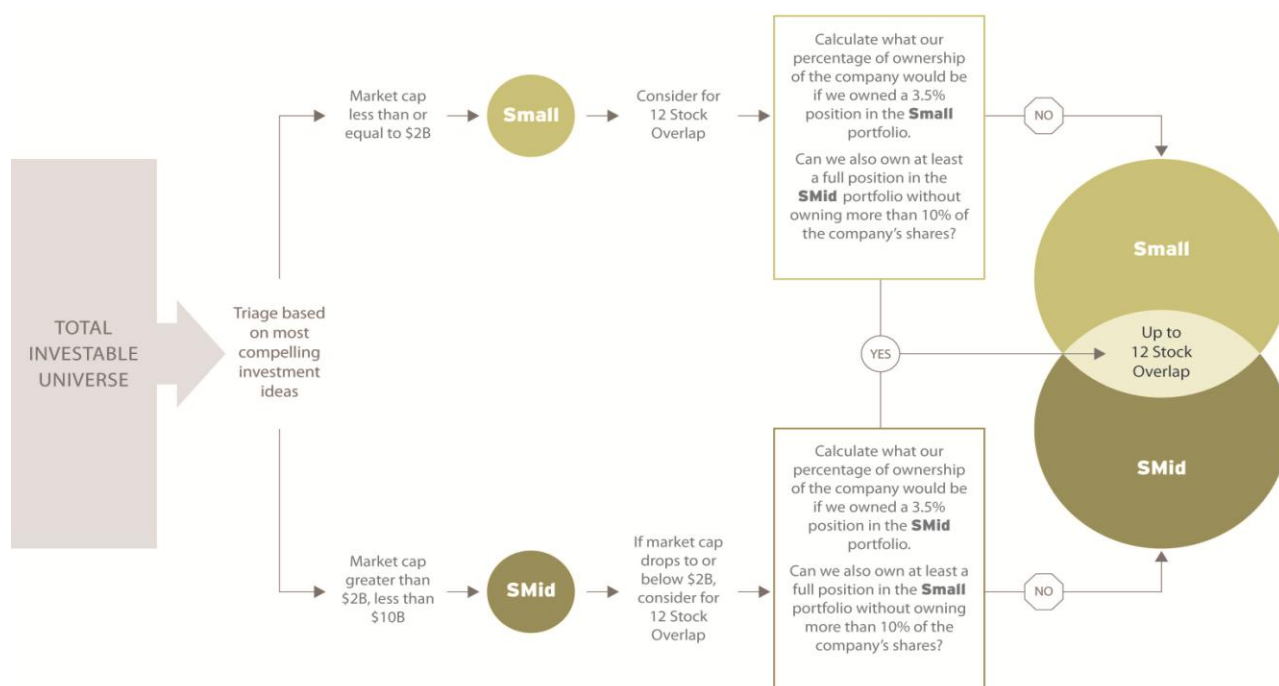
The administrator of the Daruma Funds calculates the Management Fee and Incentive Allocation, and we review the calculations. We then instruct the custodian to wire the appropriate amounts to our accounts. See *Custody – Daruma Funds* below for policies and procedures related to our ability to deduct fees from these accounts.

6. Performance-Based Fees and Side-by-Side Management

Daruma manages accounts with and without performance-based fees according to the same strategies. We also manage individually managed accounts and the Daruma Funds according to the same strategies (i.e., side-by-side management). These situations may create an incentive for us to favor accounts with higher fees, or to take risks in managing assets subject to a performance-based fee that we would not otherwise take.

Daruma has a duty to treat all client accounts fairly and equitably over time. We do this by managing all accounts in a particular strategy to the same model portfolio, except when this would conflict with a particular client's guidelines or restrictions. Trades are generally executed as a block (see *Brokerage Practices – Trading Allocation and Aggregation*, below, for more information). Our investment team also periodically reviews portfolio dispersion to verify that no account is getting preferential treatment over another.

Because our SMid-Cap strategy can hold some of the same securities as our Small-cap strategy, we have implemented a process to determine allocation of these securities between the strategies. We allow no more than a 12 stock overlap between the two products. The following decision tree illustrates the interaction between the two products and how new ideas are allocated between the two products.



7. Types of Clients

As described in Item 4, Daruma provides investment management services to public and corporate pension funds, endowments, foundations, other nonprofit organizations, corporations and high net worth individuals, as well as the Daruma Funds.

Conditions for Managing Accounts

As a general rule, we require a minimum investment of \$10 million for an individually managed account. An investment in the Daruma Funds requires a minimum of \$1 million. We may be waive or modify these minimums in our sole discretion.

Daruma generally requires a written agreement for each individually managed account. Additional documentation may be required in certain circumstances, such as with particular custodians. Investors in a Daruma Fund must complete a subscription document, and may be required to submit additional documentation as described in the funds' offering documents. Fund investors must also satisfy eligibility requirement established by the SEC before their investment will be accepted.

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

Investment Strategies

As described in *Advisory Business*, above, Daruma offers discretionary investment management services using U.S.-listed equities according to a Small-cap strategy and a SMid-cap strategy. These strategies follow the same investment philosophy and process, the only difference being the market capitalization of the companies in which the strategies invest (described in this section under *Methods of Analysis & Internal Guidelines*, below).

Investment Philosophy

Daruma's investment approach is defined by certain key beliefs:

- A concentrated portfolio compels truly active management
- In any market we can find 25 to 35 stocks with strong potential to outperform
- The best time to buy is not just when a stock offers good value, but when we can clearly define what will drive the price higher — in most cases better-than-expected sales, earnings or cash flow growth.

Methods of Analysis & Internal Guidelines

Daruma's investment process is based on bottom-up, fundamental analysis. We evaluate the classic valuation ratios used in financial statement analysis, although these may differ between sectors and industries. The most important factors to us are return on capital, free cash flow generation, growth in sales and profits, and quality of management and the business model. We look at specific firm metrics relative to both peers and relevant historic conditions.

Daruma's investment team delves into a portfolio candidate's past financial history to understand its business model. We conduct historical analysis using quarterly and annual financial filings. Understanding a company's past allows us to test our assumptions about the company's future. We read past earnings call transcripts, industry reports and other available research. We also spend time with management (often onsite), as well as suppliers, competitors and customers in order to better understand the drivers to the business model.

Our investment team looks to sell-side analysis to get some history and color on an industry or company, if the analyst has been covering that group or stock for a long time, and to gauge investor psychology. This helps us to better understand what's priced into a stock, and to clarify where our investment perspective differs from "the Street". The sell-side also provides us with research conferences and management meetings.

We do not spend time trying to identify macro trends, although we do spend time understanding the macro environment and psychology, as this has an impact on our portfolio holdings. The Portfolio Manager is responsible for monitoring the macro environment as it relates to our holdings.

Every holding is followed by a Senior Research Analyst, and the Portfolio Manager is responsible for monitoring the health of the entire portfolio by keeping an eye on aggregate risk. Investment team members meet weekly to review the portfolio, share fundamental news on their stocks, define a course of action and discuss progress on new ideas. They may also meet more frequently on an informal basis as developments occur.

We have also analyzed (and continue to track) every buy and sell decision we've made. This helps us avoid rewriting history or repeating the same mistakes, while allowing us to replicate our successes. As investors engaged in the imperfect art of predicting the future, we want to define through every possible means what we have done well and what we could have done better.

Our portfolio is constructed using the following guidelines:

- Equities listed in the U.S. with market capitalization, generally, of:
 - ↳ \$400 million to \$2 billion at purchase in our Small-cap strategy, and
 - ↳ below \$10 billion and above \$2 billion at purchase in our SMid-cap strategy, as well as some of the larger and more liquid names that would qualify for our Small-cap product.
- No more than a 12-stock overlap in holdings between Small-cap and SMid-cap. See *Performance-Based Fees and Side-by-Side Management*, above for the process we use to determine allocation of securities between our two strategies.
- No less than 25 and no more than 35 positions.
- Position sizes capped at 6% (in practice 5% is rare).
- Sectors capped at 25% or 2 times the benchmark weight, whichever is greater.
- No REITs as we consider them a different asset class.

Our liquidity criteria are:

- Average daily trading volume of \$3 million a day.
- The ability to own a minimum (2.2%) position in either strategy without owning more than 10% of a company's outstanding shares.

Investment Process

Our fundamentally-driven, bottom-up investment process for both the Small- and SMid-cap strategies consists of six steps:

Step One: Generate New Ideas Systematically

Daruma looks for companies that are inexpensive and changing for the better. We run quantitative screens looking for stocks that are pummeled, unwanted, cheap and changing. We run qualitative screens that look for unusual insider behavior, management changes, and inflection points in conference call transcripts.

New ideas also come from meetings with management teams onsite, at research and industry conferences and in our New York City office. Our research on existing holdings often leads to new positions in the same or a related industry. Daruma's best-ideas strategy means that we are often long-term holders of companies in our portfolio, and are viewed as desirable shareholders by company management.

Step Two: Understand the Past

Daruma delves into a portfolio candidate's past financial history to understand its business model. We conduct historical analysis using quarterly income statements, cash flow statements and balance sheets. Understanding a company's past allows us to test our assumptions about its future. Daruma reads earnings call transcripts, industry reports and other available research. We spend time with management (often on-site), as well as suppliers, competitors and customers in order to better understand the drivers to the business model.

Step Three: Weigh Future Outcomes

Incorporating all of our research, we weigh the probabilities of future outcomes. We at Daruma are agnostic as to the source of improving results, as different drivers have different risks and different rewards. Our job is to make sure that the upside of being right far outweighs the downside of being wrong.

For example, a sustained acceleration in sales will usually be rewarded more handsomely by investors than a small increase in profit margins. A business whose revenues become more predictable also generally becomes more valuable in the Street's eyes.

Much of our work focuses on where we believe investors are miscalculating growth or the predictability and/or sustainability of cash flow. We work to understand what will drive future results, and calculate a range of probable outcomes.

Step Four: Define the Investment Thesis

Next, we define on paper why we believe that the company is a good investment. Defining our investment milestones in writing assures process integrity, allowing us to understand over time why our ideas work or do not work. The investment thesis describes why we expect sales, profits or cash flow to improve, what we expect the company to earn, and the time frame within which we expect this to occur.

In developing the investment thesis, we work hard to find information that could derail our outlook, as opposed to searching for information that validates what we already think. It's important to spell out why our opinion is different from the consensus view.

Step Five: Valuation

We lay out the case of our upside and downside price targets. To justify a purchase, the upside potential to downside risk relationship must be three to one, and we need to make a case for appreciation of at least 50% over two years. This forces us to focus on only our most compelling ideas.

Step Six: Weekly Review and Sell Discipline

Every holding in the portfolio is subject to a weekly review of its valuation relative to its fundamentals. We live by the dictum, "Every stock must earn its keep." This belief guides every step of the investment process, especially the sell discipline.

We sell when:

- A stock becomes too expensive relative to its prospects, and its downside outweighs the upside
- A stock gets taken over
- New information contradicts our thesis
- Our investment thesis was right, and now we have fundamental risk (results start to decelerate), valuation risk (the downside outweighs the upside) or both
- We find a more compelling idea
- The position gets automatically trimmed at a 6% portfolio weight

Risks

Client account values will fluctuate daily, and may go down as well as up. Any investment in equities is subject to risk of loss, which clients must be prepared to accept. Although we continually strive to improve our investment decision-making skills, there are no guarantees

that specific results or positive returns will be achieved. Assets we manage are not insured or guaranteed by the Federal Deposit Insurance Corporation.

While there are numerous potential risks involved in investing, the following are some of the most significant risks our clients may face:

Small- & mid-cap company risk: The securities of smaller and mid-sized companies have historically exhibited more volatility and less liquidity than large companies. Some of the reasons for this are smaller revenue streams, narrower product lines, less management depth, smaller market share and fewer financial resources.

Non-diversification risk: Concentrated portfolios (those that invest in a relatively small number of securities, such as ours) may have more risk because of changes in the value of a single security or the impact of a single economic, political or regulatory occurrence may have a greater adverse impact on the strategy's performance.

Liquidity risk: If the volume of trading in a particular security is low we may not be able to purchase or sell at an advantageous time or price. This is often true of the small- and mid-cap stocks used in our strategies.

Sector/industry risk: With our concentrated approach, we deliberately do not mirror the benchmark or set specific sector or industry weightings. Although sectors are limited to between 0% and the greater of 25% or 2 times the benchmark, we may at any time have a significant investment concentration in one or two sectors. Concentration in a particular sector may result in more volatility than a strategy that is more evenly spread across sectors if a particular economic or market event affects that sector.

Equity securities risk: The price of any equity security can change dramatically due to changes in a company's financial condition or a single event at the company.

Market risk: A security may lose value due to a general downturn in stock markets even if the company that issued the security has not experienced a decline in its financial condition or other negative event.

Our position and sector caps and liquidity criteria (described above in this Item 8 under the subheading "*Methods of Analysis & Internal Guidelines*") provide some limit on certain of these potential risks. However, we don't look at traditional measures of risk because of our portfolio concentration. We primarily manage our risk by knowing what we own buying at what we think is a good price. An average holding period is two and a half years, which, when coupled with our concentration and relatively low turnover, means that our six-person investment team has the luxury of knowing our portfolio holdings well. Each Senior Research Analyst is intimate with company-specific risk. We track our holdings to explicit

milestones and look for evidence to disprove our investment thesis. Mariko Gordon monitors exposure rolled up to the portfolio level.

Because we purposely do not attempt to meet specific target weights in sectors or industries or to mirror a benchmark, we can select what we believe are companies with the best chance of appreciation. We believe our focus on long-term investing will ultimately allow business quality to be reflected in the stock price, whereas short-term returns may be more volatile and affected by market sentiment.

9. Disciplinary Information

There are no legal or disciplinary events related to Daruma or its personnel that we believe clients or prospective clients would consider material.

10. Other Financial Industry Activities and Affiliations

Daruma LLC has one affiliate – Daruma GP – that serves as the general partner of each Daruma Fund. Daruma Inc. holds a 1% interest in Daruma LLC, but has no other operations.

Daruma LLC, Daruma GP and Daruma Inc. all share the same office space and personnel.

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

Code of Ethics and Personal Trading

Because Daruma is a registered investment adviser, we have a fiduciary duty to our clients. For that reason, Daruma has adopted a Code of Ethics (the “Code”) that obligates our personnel to put the interests of our clients before their own interests and to act honestly and fairly in all respects in their dealings with clients. Our Code also puts restrictions on certain activities, such as personal trading, that might cause a conflict between our clients and our personnel. Key provisions of the Code are summarized below. A copy of our Code of Ethics is available upon request.

Most equity trades by our personnel for their own account must be pre-cleared by the Chief Compliance officer, who monitors employee trading activity. Trades will not be allowed in a security that is being currently traded or contemplated for client accounts. Certain trades are excepted from these requirements, such as trades in ETFs, mutual funds, and money market funds, as well as trades made pursuant to any automatic investment plan on in an account over which the employee has no influence or control (e.g., a blind trust, discretionary account managed by a third party). All personnel are required to provide quarterly reports and certifications regarding their personal securities transactions and annual reports regarding their personal securities holdings. The Chief Compliance Officer may grant an exception from pre-clearance, other trading restrictions, and certain reporting requirements on a case-by-case basis if she determines that the circumstances do not conflict with client interests.

Our Code also places restrictions on the receipt of gifts, travel, and entertainment opportunities by our personnel. Our personnel occasionally participate in entertainment opportunities that are for legitimate business purposes, subject to limitations set forth in the Code.

Insider Trading

We forbid all our personnel from trading on material non-public information. This restriction applied whether the trading is for a personal account, a client account or any other person. In addition, Daruma forbids personnel from communicating material non-public information to others in violation of the law. This conduct is frequently referred to as “insider trading”. Our Code contains guidelines for personnel to consider to determine whether they are in possession of material non-public information. Any person who believes they may have such information must report the matter promptly to the Chief Compliance Officer. If the Chief Compliance Officer determines that the information is material non-public information, she will determine appropriate steps to take, which may include restricting trading in the securities or establishing information barriers.

Participation or Interest in Client Transactions

Daruma is not a broker/dealer and does not generally trade money for its own account. However, our employees may invest money in the Daruma Funds or in accounts we manage. In addition, Daruma GP has an interest in each of the Daruma Funds, and receives the Incentive Allocation described in *Item 5. Fees and Compensation*. These situations might give us an incentive to favor the Daruma Funds or other accounts in which our employees invest. We have adopted procedures designed to prevent any such preferential treatment, which are described in “*Item 6. Performance-Based Fee and Side-by-Side Management*”.

Because many of our clients are institutions, we might have the opportunity to invest client assets in securities issued by one of our clients, or to contract for products and/or services from a company in which we invest client assets. A written investment thesis is prepared for each investment we make for client accounts. Should one of these situations arise, the Portfolio Manager and the Chief Compliance Officer will monitor the situation to verify that investment decisions are made solely based on the best interest of our clients.

12. Brokerage Practices

Generally, we are given discretion by our clients to select the broker/dealers we use to execute trades in client accounts. Some clients may limit our brokerage discretion by directing us to use a specific broker or type of broker to execute all or a portion of their securities transactions.

Brokerage Relationships

We use various brokers to execute client transactions, and we may have other relationships with these brokers. For example:

- We may invest client assets in securities issued by broker/dealers or their affiliates;
- We may provide investment management services to certain broker/dealers or their affiliates;
- Certain broker/dealers provide both internally generated and third-party research to us as part of trade executions that we place on behalf of our clients; and
- Family members of some of our personnel may be employed by broker/dealers and third-party research providers.

Daruma has a fiduciary duty to seek best execution for our clients, regardless of other relationships we may have with brokers. We have therefore implemented policies and procedures to monitor these transactions.

Best Execution

Daruma has a duty to obtain “best execution” in transacting securities for its clients’ accounts. In seeking best execution, we consider the full range of a broker’s services, including the value of research provided and execution capability, commission rate, financial responsibility and responsiveness.

In seeking best execution, Daruma will consider a number of factors including, but not limited to (i) the broker’s ability to efficiently execute, report, clear, and settle the order, (ii) familiarity with the markets for the types of securities in which we trade, (iii) the broker’s communications ability and history of timely and accurate communication with Daruma’s trader, (iv) the price at which the security is purchased or sold, viewed absolutely and in relation to the liquidity of the market for the security, (v) research products and services provided by the broker, (vi) commission rates, and (vii) the broker’s financial soundness and integrity.

Daruma's Portfolio Manager, with input from the investment team and the trader, establishes an annual broker budget, taking into account the research and brokerage services the broker provides. The investment team will provide input on the relative value of research provided by various brokers. The budget will be reviewed several times a year and adjusted as appropriate.

Use of Soft Dollars

Daruma may direct some transactions for execution to certain broker/dealers in recognition of brokerage and research services they provide. The practice of obtaining research in this manner is referred to as using "soft dollars." Soft dollar transactions may cause clients to pay a commission rate higher than would be charged for execution-only transactions. The products and services received through soft dollar transactions may be produced by the broker/dealer itself or obtained from other third-party providers.

Although we might have an incentive to select a broker/dealer based on the research products and services we receive from the broker/dealer, we obtain such services from brokers only after we determine, in good faith, that the broker's commission rates are reasonable in light of the services provided. All Daruma's soft dollar arrangements fall within the safe harbor of Section 28(e) of the Securities Exchange Act of 1934 and related guidance issued by SEC staff. Our Chief Compliance Officer will review all soft dollar arrangements to verify they fall within the 28(e) safe harbor. If a product or service is used both for purposes allowed under Section 28(e) and also for purposes that do not fall within the safe harbor, we will make a good-faith determination as to the relative proportion that is used for eligible versus non-eligible purposes. Only the portion of the cost that is eligible under 28(e) will be paid for with soft dollars. Daruma will pay the cost that is attributable to purposes not eligible with its own resources.

Monitoring Brokerage Transactions

Daruma's trader and CCO review information regarding new brokers (e.g., financial information, disciplinary history, any specialized expertise, execution & communication abilities) before a broker is approved for use. Thereafter, they will periodically review updated information on approved brokers.

Our trader reviews a quarterly trading analysis from Instinet that measures all trades we place through the Instinet trading platform. On a quarterly basis, our trader prepares a transaction cost analysis that uses VWAP (volume-weighted average price) data. Trades from the quarter are sampled and anomalies are reviewed. In addition, we do post-trade analysis of the quality of execution whenever there are significant cash flows (in or out). The CCO will also periodically review these reports.

Directed Brokerage

Some clients have directed use to use specific broker/dealers or types of broker/dealers (e.g., minority-owned firms) for at least a portion of portfolio transactions in their accounts. In such a case, Daruma is not obligated to, and will generally not, solicit competitive bids for each transaction or seek the lowest commission rates for the client. Since Daruma has not negotiated the commission rate and may not be able to obtain volume discounts, the commission rate charged by the specified broker may be higher than what we could obtain from another broker/dealer. In addition, the client may be unable to obtain the most favorable price because we can't aggregate/bunch the trades from this account with other client trades. In some situations, Daruma may not execute a client's securities transactions with its directed broker until non-directed brokerage orders are completed. Accordingly, clients who direct commissions to specified broker/dealers may not generate returns equal to clients that do not direct commissions. Clients who direct brokerage should understand that similar brokerage services may be available from other broker/dealers at lower costs and possibly with more favorable execution.

We will inform clients periodically if we believe there are circumstances negatively affecting best execution when using a directed broker, but clients directing brokerage will need to make the determination regarding continued use of such broker-dealer in light of all relevant factors, including the services and products the client may receive from such broker/dealer.

Daruma reserves the right to reject or limit client requests for directed brokerage if we do not believe we can reasonably execute our investment strategy in a client's accounts in light of the direction.

Trade Aggregation and Allocation

Daruma generally bunches trades in block orders to ensure all clients are treated equitably and all portfolios are invested proportionately in substantially the same manner. Total trades for the day in each security are average-priced by each broker, and underlying details of the transactions are kept for review. Shares are allocated by giving priority, first, to accounts that have not yet met position size targets, then to accounts with maximum cash level requirements. Thereafter (or if these circumstances don't exist), trades are allocated pro-rata using through our order management system. If we receive a partial fill of a trade order, we may allocate other than pro-rata to avoid excessive transaction costs to clients. Our goal is to allocate trades to accounts in a way that treats all our clients fairly and equitably over time.

Any accounts we manage that include investments from our personnel are allocated in accordance with the same policy. See *Performance-Based Fees and Side-By-Side Management*, above.

Cross Trades

Daruma does not engage in agency or principal cross trades. Nor do we cross trade between client accounts by instructing a custodian to move securities from one account to another. However, there may be times when we place buy and sell orders between client accounts on the same day, in the same stock, usually because of cash flows in one or more client accounts. Such transactions may give rise to potential conflicts of interest (where one client may receive a more favorable price than another). In an effort to mitigate any potential conflicts, these transactions are generally executed as market-on-close orders or in a manner that would not result in a market disadvantage to clients. If such transactions are deemed necessary, Daruma's trader consults with the Portfolio Manager and the Chief Compliance Officer.

Trade Errors

We bear the cost of correcting any trade error caused by our failure to place or process trades correctly. If the error results in a gain, the client account will keep the profits unless the client directs otherwise. If there is a direct financial loss to a client account, Daruma will reimburse the account. In the unlikely event a single account experiences more than one error due to related circumstances, we may offset losses against profits in that group of errors in determining the amount to be reimbursed or credited to the account. However, in no event will losses in one account be offset by profits in another account. In each case, our goal is to make clients whole for any losses suffered as a result of our errors.

13. Review of Accounts

Mariko Gordon is Daruma's Chief Investment Officer and sole Portfolio Manager, and is responsible for all account reviews. The portfolio is monitored daily, and the investment team meets formally once a week to review portfolio holdings. They may also meet more frequently on an informal basis to review client portfolios and company and industry developments.

Our operations team reconciles client account information on our systems to records of the custodians that actually hold the assets on a daily basis. If we find any discrepancies, our operations team works with the custodian to resolve the issue.

In addition, various reports are reviewed by the Portfolio Manager, the investment team, members of the operations team and/or the Chief Compliance Officer on a periodic basis, including, but not limited to, performance (both absolute and relative to the strategy's benchmark), dispersion across accounts following the same strategy, cash flows, distribution of holdings across sectors and market capitalization, and liquidity.

Daruma provides clients with quarterly reports regarding performance, market commentary, portfolio characteristics and portfolio activity. Performance is stated in absolute and relative returns for the quarter, year-to-date and since inception, and a GIPS-compliant composite for the relevant strategy is included. Monthly results are also provided if requested. Investors in the Daruma Funds receive a monthly account statement from the funds' administrator.

14. Client Referrals and other Compensation

Daruma does not currently use any third-party to solicit new business on behalf of our firm, although we have done so in the past. Under a contract that expired in December 1999, we continue to pay one third-party marketer compensation related to a client that was referred to Daruma during the term of the contract with this marketer. The compensation is based on a percentage of the advisory fees we receive from the referred client, and is paid from the firm's resources. There are no additional costs or fees to the client from this arrangement. If we enter into any solicitation arrangements in the future, they will be in accordance with rules under the Advisers Act applicable to the use of solicitors.

Many of our clients and prospective clients use investment consultants to advise them on the selection and review of investment managers, and we provide these consultants with information on accounts we manage for our clients who have directed us to do so. In addition, we may provide consultants with general information on our investment strategies and services. The consultants may use that information in connection with services to their clients, and may introduce prospective business to our firm, include us in searches they conduct for their clients, or make information about Daruma available to potential clients through online databases. We respond to requests for proposals from consultants in connection with new searches they conduct and from prospective clients introduced to Daruma by these consultants.

Daruma may have other interactions with consultants, such as:

- Inviting consultants to events or other entertainment hosted by our firm.
- Paying for the opportunity to participate, along with other investment managers, in conferences organized by consultants. These conferences provide us with the opportunity to discuss a broad variety of business topics with consultants, clients and prospective clients.
- We may manage proprietary accounts of consultants or their affiliates, or serve as advisor or sub-advisor to funds offered by consultants or their affiliates.

Upon request from a client, we provide information regarding our relationship with that client's consultant. However, we generally rely on each consultant to make appropriate disclosure to its clients of any conflict the consultant believes it has due to its relationship with our firm.

15. Custody

Individually Managed Accounts

We do not act as a custodian for assets in our clients individually managed accounts. Clients must make their own arrangements for custody of their assets with a broker/dealer, bank, trust company or other qualified institution. The custodian will usually provide the client with at least quarterly account statements and/or on-line access to their account information. Clients should carefully review the custodian statement (or information, if the client uses on-line access) to verify that it accurately reflects the activity and assets for the relevant period.

We also provide reports to clients at least quarterly regarding their holdings. We encourage clients to compare the information provided by their custodian to the information we provide. Please note that our reports may vary from custodian statements for reasons such as accounting procedures, different pricing sources, pending trades, corporate actions, payment of dividends or reporting dates. Any questions, concerns or discrepancies found between the information provided by the custodian and information provided by Daruma, should be promptly reported to both us and the custodian.

Daruma Funds

Because Daruma GP is the General Partner of each of the Daruma Funds and we deduct our fees from the funds, we are deemed to have custody of the assets in the Daruma Funds, however we do not have actual physical custody of any assets of the Daruma Funds. These assets are held by an independent qualified custodian. In addition, during the initial months after launch of the Daruma Funds, an investment could be made by means of a check mailed to the applicable fund at our shared office, and any such checks were forwarded promptly to the custodian. Investors receive monthly statements from the Daruma Funds that are prepared and sent by the funds independent administrator. The Daruma Funds are audited annually and investors receive a copy of the audited annual financial statements of the fund in which they are invested.

16. Investment Discretion

Our clients give Daruma discretionary authority by executing an investment management agreement and/or a separate power of attorney. As a result, we are authorized to make investment decisions and to direct the execution of all transactions for the client's account without consulting with the client in connection with each transaction. However, this discretion may be limited for a particular client by specific client objectives, guidelines or restrictions. Initial client account guidelines are established by agreement between us and the client. They are typically included as part of the investment management agreement, and may be amended from time to time with the consent of both Daruma and the client.

Securities Lending Arrangements

Daruma does not engage in securities lending for client accounts, however a client may enter into securities lending arrangements to defray custody or other client account costs or for other reasons. Daruma is not a party to such arrangements and may or may not be aware of their existence. We will to work with a client's custodian if we know there is a securities lending arrangement in place in order to determine whether securities we intend to sell are out on loan at the time. However, we cannot guarantee that a particular custodian will have on hand or be able to timely retrieve any securities it has lent that Daruma has instructed be sold. It is each client's responsibility to ensure that its custodian makes securities available for sale on a timely basis. Securities lending arrangements may also have an impact on our ability to vote proxies for clients who have delegated such authority to us. (See *Voting Client Securities*, below for more information.)

Class Action Suits and Other Legal Action

Our clients have the responsibility to initiate, consider or participate in any bankruptcy, class action or other litigation against or involving any issuer of securities currently or previously held in their accounts. We will not initiate, consider or participate in any such matters on behalf of any client. If a client decides to take action in any such matter, we will provide information in our possession regarding the account holdings and transactions upon request.

17. Voting Client Securities

Unless otherwise agreed with the client, Daruma will vote proxies in connection with all securities held in client accounts. In order for us to do this, the client's custodian must deliver the proxies in proper form and in a timely manner to our agent. We vote all proxies in the best interests of our clients as shareholders, and in a manner we believe will maximize the economic value of their holdings.

We have contracted with an independent third-party provider of proxy voting and corporate governance services ("proxy agent") which specializes in providing a variety of services related to proxy voting. Specifically, this proxy agent has been retained to conduct proxy research, execute proxy votes, and keep various records necessary for tracking proxy voting materials and proxy voting actions taken for the appropriate client account.

The Senior Research Analyst covering the security will review research provided by the proxy agent for each proposal, as well as any additional information he considers relevant, and will determine whether or not the proxy agent's recommended vote is appropriate. Generally, we follow management recommendations with regard to routine corporate housekeeping matters, such as the election of directors (where no corporate governance issues arise), selection of auditors and reasonable increases in or reclassification of common stock. We will usually vote against proposals that will make it more difficult to replace members of the issuer's board of directors (including proposals to stagger the board) cause management to be overrepresented on the board, introduce cumulative voting, introduce unequal voting rights, and/or create supermajority voting. However, these guidelines are not absolute; each proposal is evaluated on its merits before the Senior Research Analyst makes a determination.

The vote entered on a client's behalf with respect to a particular proposal may differ from the proxy voting guidelines and/or from the vote entered on behalf of another client in cases where a client has requested we follow particular guidelines for their account. If a client wishes to direct the voting of their securities with respect to a particular solicitation, they may do so by providing us with timely, written instructions. We only agree to this type of direction on a best efforts basis and to the extent consistent with our regulatory obligations.

If we have a material conflict of interest in voting any proposal, the Portfolio Manager will review the matter and determine how it should be voted. The Chief Compliance Officer will review any such decisions to verify that the basis for the decision reflects the best interests of our clients.

In some instances, we may not vote a proxy on behalf of one or more clients. For example, a proxy vote might not be entered because the securities involved have been lent out under a

client's securities lending program or because the proxy agent did not receive the proxy ballot in time.

For a copy of our proxy voting policies and procedures, or a copy of how we instructed your shares to be voted, please contact Daruma using the contact information on the Cover Page.

18. Financial Information

Daruma has no financial commitment that impairs its ability to meet contractual commitments.