

Annual Advisor's Report
August 31, 2006

Aegis Value Fund, Inc.

The Aegis Value Fund seeks to achieve long-term, above market returns while minimizing risk of capital loss. Our strategy is to invest in well-researched, small-cap equities trading at a fraction of their intrinsic worth. We believe the equity markets are often inefficient, and we are contrarian, bottom-up stock selectors. We generally buy stocks trading at low price-to-book and price-to-earnings ratios, a segment of the market where academic research shows historical returns to be significantly higher than the overall market. We look for indications of strong corporate governance and ethical stewardship as evidenced by high insider ownership, proper use of corporate profits including bargain-priced share repurchases, and appropriate executive salary and options levels. We tend to purchase companies when they are misunderstood, out of favor, or neglected, and hold these companies until share prices reach our estimates of intrinsic value.

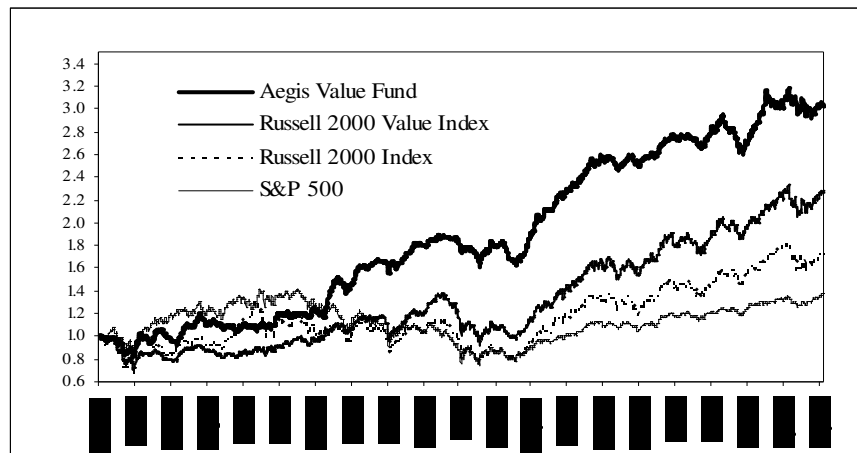
Advisor's Report

October 18, 2006

To the shareholders of the Aegis Value Fund:

We are pleased to present the Aegis Value Fund Advisor's Report for the fiscal year ended August 31, 2006. For the fiscal year the Fund has gained 7.3 percent versus a rise of 12.7 percent in the Russell 2000 Value Index. The Russell 2000 Index of small cap stocks returned 9.4 percent while the S&P 500 Index gained 8.9 percent. As can be seen in Figure 1, while recent performance has lagged the benchmark indices, performance since inception remains strong. The Fund has posted a cumulative gain of 201.5 percent from its inception on May 15, 1998 through September 30, 2006. This gain compares with cumulative gains of 125.5 percent in the Russell 2000 Value Index during this period, 70.7 percent for the Russell 2000 Index, and 37.3 percent for the S&P 500. *

Figure 1: Historical Investment Return



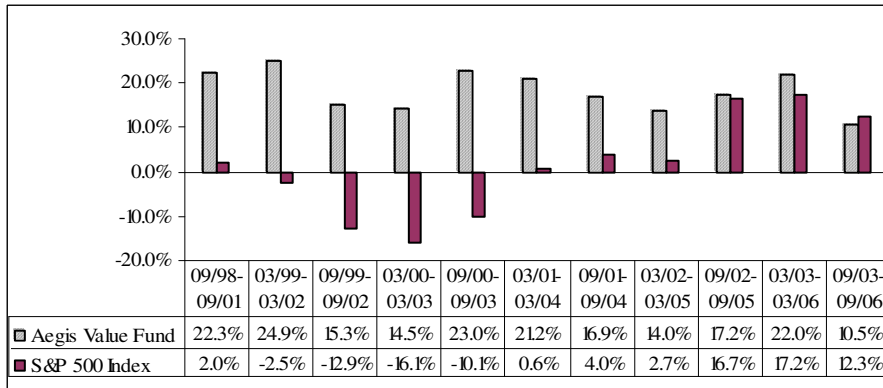
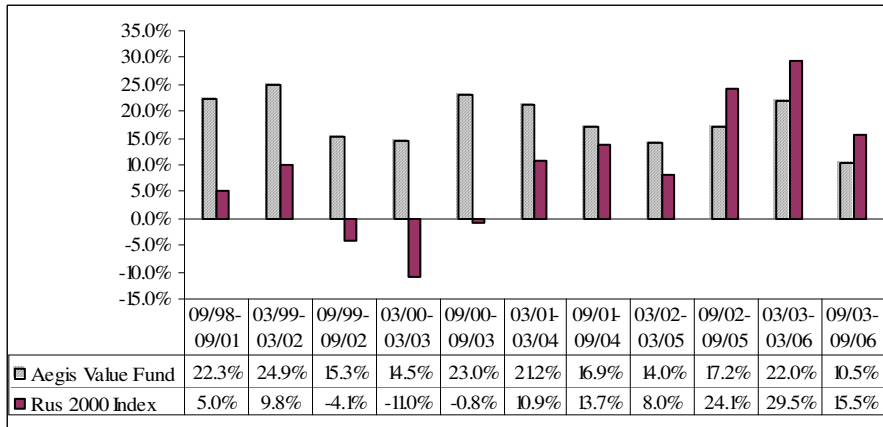
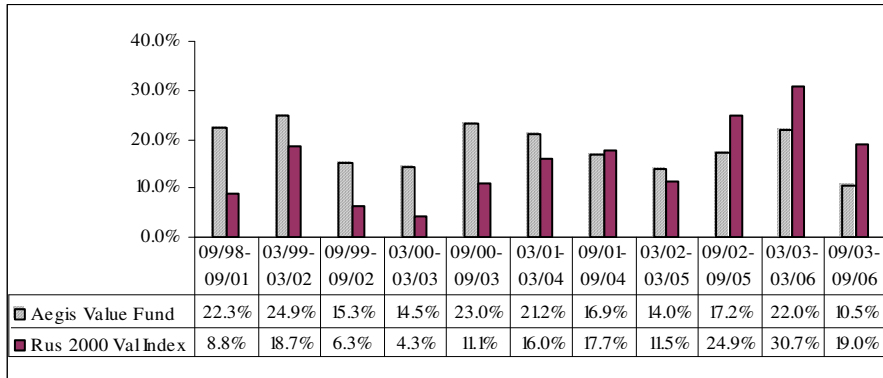
Source: Aegis Financial Corporation

* Aegis Value Fund's one-year, three-year, five-year, and since inception (5/15/1998) average annual returns for the period ending September 30, 2006 are 9.9%, 10.5%, 13.2%, and 14.1% respectively. Returns include reinvestment of dividends and capital gains. Russell 2000 Value Index one-year, three-year, five-year, and since inception (AVALX-5/15/1998) average annual returns for the period ending September 30, 2006 are 14.0%, 19.0%, 17.0%, and 10.2%. All historical performance returns shown in this shareholders' letter for the Aegis Value Fund Inc. are pre-tax returns. This report does not constitute an offer or solicitation of any transaction in any securities. The Aegis Value Fund is offered by prospectus only.

Figure 2 compares the performance of the Aegis Value Fund to the above three indices during rolling, three-year, semi-annual periods since inception in 1998. Figure 2 also shows that the volatility, or swings in performance in the rolling 3-year returns for all 3 benchmark indices are greater than for the Aegis Value Fund. In addition to the lower volatility, the Aegis Value Fund has an average of 3-year rolling returns for the 11 periods that is 2.9 percent higher than for the Russell 2000 Value Fund, 9.2 percent higher than for the Russell 2000, and 17.0 percent higher than for the S&P 500.

Figure 2: Aegis Value Fund Rolling 3-Year Performance Record

Period	09/98-09/01	03/99-03/02	09/99-09/02	03/00-03/03	09/00-09/03	03/01-03/04	09/01-09/04	03/02-03/05	09/02-09/05	03/03-03/06	09/03-09/06
% of Cash	7.4%	14.7%	22.3%	26.1%	30.1%	37.1%	42.0%	42.9%	41.2%	40.8%	40.9%



Performance data quoted represents past performance. Past performance does not guarantee future results. Investment return and principal value of an investment will fluctuate so that an investor's shares, when redeemed, may be worth more or less than their original cost. Current performance may be lower or higher than the performance data quoted. Please call us at 1-800-528-3780 to

Average daily cash levels of approximately 40.9 percent of Fund assets during the most recent 3-year period of strong stock returns did dampen our performance vis-à-vis the fully invested market indices. However, the cash position in the Fund had the positive effect of protecting assets against excessive risk while awaiting investment in a richly valued and unpredictable environment.

Portfolio Gainers and Losers

Each year out of a diversified portfolio of 60-80 stocks, the Fund will most likely have some investments that work out very well and others that detract substantially from overall results. In Tables 1 & 2 we have highlighted individual investments that had significant impacts on performance through the fiscal year.

Table 1 shows stock investments held by the Fund during the year that contributed gains in excess of 1% of the Fund's average daily net assets. (Because aver

Table 1: Significant Contributors to Net Gains in Fiscal Year

Investments Contributing Gains in Excess of 1% of Average Net Assets

Investment	Ticker	% of Net Assets 8-31-05	% of Net Assets 8-31-06	Annualized Investment IRR to Fund (9-1-05 through 8-31-06) **
Andersons Inc.	ANDE	1.4%	0.0%	238%
Books-a-Million	BAMM	1.4%	1.6%	78%
Dillard's Inc.	DDS	1.8%	3.4%	44%
Imperial Sugar Co.	IPSU	2.1%	3.3%	243%
Olympic Steel Inc.	ZEUS	1.2%	0.0%	187%
Pemstar Inc.	PMTR	0.5%	1.0%	309%
Ryerson Inc.	RYI	5.2%	0.0%	165%
SCPIE Holdings	SKP	2.0%	3.2%	96%

Table 2: Significant Detractors from Net Gains in Fiscal Year

Investments Contributing Losses in Excess of 1% of Average Net Assets

Investment	Ticker	For Fiscal Year (9/1/2005 – 8/31/2006)			
		Realized Gains (Losses)	Unrealized Gains (Losses)	Dividends	Total Gains (Losses)
Sea Containers	SCRA	(\$0.5M)	(\$17.2M)	-	(\$17.7M)
PXRE Group Ltd.	PXT	-	(\$15.4M)	\$0.1M	(\$15.3M)
Dominion Homes	DHOM	-	(\$9.5M)	-	(\$9.5M)

age net assets were \$497M during the year, the table shows any stocks that contributed greater than \$4.97M of gains in the period.) The second table shows investments that had losses in excess of 1% of the Fund's average net assets during the fiscal year.

Table 1 indicates that the Fund's performance benefited significantly from our investment in Imperial Sugar Co. through the year. Imperial Sugar Co. is a sugar refiner and marketer that we have discussed in past reports. The company benefited during the year from tight refining capacity and favorable commodity price spreads between refined sugar and raw sugar in the United States. As investors digested the impact of the wide commodity spreads on Imperial Sugar's cash flows from refining, the stock rose from about \$13.75 at the beginning of our fiscal year to hit highs above \$35 in April-May 2006 before settling at \$30.76 at the end of August. As Table 1 shows, a number of other investments also provided solid gains during the period.

Unfortunately not all investments will work out so well. Table 2 highlights stocks that detracted from performance during the year: Sea Containers and PXRE Group.

Sea Containers

Shortly after last-year's Annual Advisor Report, Sea Containers announced a restructuring of its ferries business, which was suffering under high fuel costs and increased competition from low-cost airlines. On November 10, 2005 the company reported that after restructuring charges on the ferries unit, calculated total book value per share was approximately \$21. At the time, the stock was trading at 57 percent of book value. Based partly on management's track record of selling assets at values in excess of stated book value, the discount to intrinsic value appeared attractive, especially if losses in the ferries unit could be curtailed in a restructuring.

The following spring, new information was released to the public. Effective Monday March 20, 2006, Sea Containers founder and CEO Jim Sherwood retired. The following Friday, the company announced it had decided to exit its ferries business and restructuring charges and write-downs were now anticipated to be \$500 million pre-tax rather than the \$157 million previously reported. This large revision reduced the book value per share from \$21 to approximately \$8. In the wake of this news, the stock fell from about \$12 a share to \$7.45 at the close of Friday's trading.

Beginning with the March 2006 conference call, new Sea Containers president Robert MacKenzie began voicing concerns that sales growth assumptions for its GNER rail division appeared to be challenging to achieve. The British government had recently degraded the value of GNER's franchise by allowing competition onto its routes. MacKenzie recently stated that GNER was no longer profitable. Just a few days ago, several Sea Containers units filed for Chapter 11 bankruptcy protection. As a result of troubles at its ferries division (a large portion of

which was recently sold) and rail division, the company has been unable to raise sufficient liquidity to make an October 15th debt principal repayment. The company made an effort to negotiate a resolution outside of bankruptcy with bondholders, but was unsuccessful.

There are many difficulties involved in trying to calculate the value the company may ultimately realize from its 50 percent stake in its GE SeaCo container leasing joint venture with GE. Some analysts believe the profitable GE SeaCo venture stake is under-valued in the Company's reported \$1.673 billion of assets, yet Sea Containers lacks the ability to extract cash from this venture without GE's approval. Although it is uncertain whether any value will remain for Sea Containers shareholders, we are currently holding our position in Sea Containers with the belief that a successful resolution of these issues can enhance the current value of our holdings, which are currently less than 1 percent of Fund assets.

PXRE Group Ltd.

PXRE is a Bermuda catastrophe reinsurer. In early 2003, we began purchasing shares of this insurer in the low \$20's per share, generally making our purchases at a slight premium to book value. The company had been generating very good returns on capital and claimed to employ a risk management approach that limited single-event exposures to major catastrophe losses. However, during the 2005 hurricane season, Katrina, Rita, and Wilma caused PXRE losses far in excess of what we expected in a worst case scenario.

When the company provided its first estimate of losses from Katrina and Rita late in 2005, the loss estimates indicated that book value had dropped from the low \$20's to a range of \$13-16 per share—a major capital loss, but one from which the company could recover. Given that insurance rates generally increase rapidly following significant natural disasters, the company appeared well positioned to participate in the strong insurance market of 2006. A public stock offering was made, and private capital was raised at \$11 per share in order to bolster PXRE's financial position.

We were not happy that this capital was raised at a dilutive price below stated book value, but we were optimistic that at least \$11 of value remained in the shares, especially when considering that major financial firms with PXRE Board representation had contributed new capital at this price. Following the new capital infusion, the company wrote 2006 policies during the key January renewal season. All signs were that these policies would deliver an excellent return on capital given a more normal hurricane season in 2006.

However, in February the company surprised its investors, customers, and ratings agencies with a revised estimate of losses from the 2005 storms. New estimates indicated an additional \$281 million to \$311 million of reserves were necessary to cover Katrina, Rita, and Wilma.

As a result of the revised 2005 loss estimates and PXRE's ratings downgrades,

many companies PXRE insured for 2006 cancelled their policies. Management recently announced that approximately 82% of the 2006 insurance book has been cancelled, limiting the company's ability to profit from the strong insurance market in 2006 that turned out to have few natural disasters.

Currently the company is still examining "strategic alternatives" a term generally meaning a sale or recapitalization. As of June 30, 2006 the company reported approximately \$7 of book value per share, a significant premium to the \$4 per share trading price. Given the valuation, we have continued to hold our shares pending a wind-down or sale of the business.

View from the Trenches

In the past, we have written about how movement of the various faultlines in the the economy can serve to unearth additional investment candidates. Sometimes an industry or market segment can face difficult operating conditions, causing valuations of companies exposed to these poor operating conditions to decline significantly: After Enron, utilities stocks declined. After September 11, the hotel and travel oriented issues came under significant pressure. Currently, housing-related and automotive supply industries are facing difficult conditions. Out of the 111 stocks currently on our primary low price-to-tangible book value investment screen, we recently counted 19 housing-related stocks and 8 automotive-related stocks. We are currently evaluating these sectors for potential investment.

Housing

Recent increases in interest rates have led to a correction in housing prices and a sharp decline in real-estate speculation. With the decline in speculation, a greater proportion of home-buyers are walking away from deposits, leaving the home-building industry with increasing inventories of partially built custom homes for which there is no certain buyer. As unoccupied homes add supply to the market, demand for new builds is reduced. Further, builders who have paid top dollar in the recent strong market for land, lumber, and labor are now facing increasing difficulties selling completed homes at reasonable margins in a softening home price environment. Some builders are coming under pressure to liquidate assets in order to reduce uncomfortably high debt levels. In this market, write-downs of the carrying value of the investments seem inevitable.

We already own one of the cheapest homebuilders on a price-to-book basis, Dominion Homes, which has recently traded at just 28% of its stated book value. While Dominion Homes is facing difficult market conditions in its Ohio and Kentucky regions, and may face write-downs as it works to liquidate assets, we believe that the current valuation levels more than discount the company's troubles.

We are currently contemplating other investments in the sector, but are remaining vigilant of the risk of homebuilder write-downs given valuation levels that

even with recent stock market declines remain near tangible book value, giving little margin for evaluation error.

Auto Suppliers

The auto suppliers to the North American auto makers have also been beaten down on a variety of concerns including market share losses to Asian competition, heavy pension and debt loads, labor unrest, and fear of a looming recession or consumer spending slowdown in 2007. Domestic automakers are also struggling with dealer relationships, as the relative oversupply of vehicles results in heavy discounts and incentives, which draw the most bargain-oriented shoppers. Automakers will also be adapting to their new relationship with rental companies, which are increasingly focused on profit maximization. New private equity investors in rental companies will be tougher customers, refusing to allow their fleets to become “dumping grounds” for excessive domestic auto production.

Because equipment in the industry is often special-purpose and difficult to move long distances, there is concern that if North American capacity for auto-making is too high, there certainly will be write-offs at North American auto industry suppliers. Also if North American plants are not cost competitive, parts makers are forced to invest in duplicative equipment overseas. This new overseas investment creates an additional capital burden on the suppliers. Collection of receivables from customers who may be credit risks can be cause for market concern. Several auto suppliers have already sought protection from creditors in bankruptcy, including Delphi. Others could follow if domestic automakers continue to perform poorly or if labor determines to strike.

On the liability side of the balance sheet, many companies in this sector are saddled with substantial pension and debt obligations, which can be significantly understated on the books. The threat of strike and the resulting cash drain from lost production is a liability neglected by standard accounting treatment. And the costs companies have to incur to reduce workforce is uncertain. When auto companies find themselves with excess capacity, there is a heavy price to pay not only in equipment write-downs but also in employee buyouts and “jobs banks” programs.

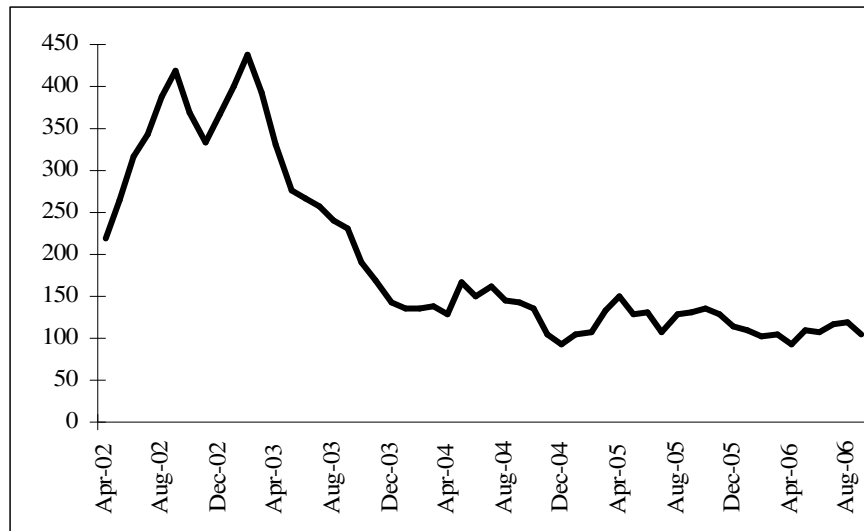
Auto makers have been conditioned over decades of falling commodity prices and rising worker productivity to expect regular year-over-year price cuts from the suppliers. Such price reductions have pressured the suppliers, who face inflationary pressures from rising commodity prices, rising global labor prices, and a flagging U.S. dollar.

Our only investment in the auto supply industry so far has been Superior Industries, which offers a solid balance sheet, a strategy for continuing diversification of its manufacturing base from North America, and a reputation as an excellent supplier to the majors. The stock is now trading near 78 percent of book value. Amongst all the wreckage in the industry, Superior stands out as an above-average prospect. As of June 30, 2006 the company reported roughly \$88 mil-

lion of cash and short-term investments on its balance sheet and no debt. Its exposure to unions is very limited. Its Mexican operations are globally cost competitive. Management has proved resilient and focused on maintaining costs in-line with business prospects.

Overall, Figure 3 continues to show the considerable interest the investment community still has in “value” securities selling above a \$70 million market cap. The investor having been tested during the busting of the technology bubble still has not moved to perceived greener pastures, and Figure 3 provides you with the latest update in this long-running saga of “slim pickings” in the small value arena. Nonetheless, during the last 12 months ended August 31, 2006 we were able to purchase \$68.2 million of stocks at prices we believe represent good values.

Figure 3: Number of Securities Selling at or Below Tangible Book Value (Greater than \$70 Million Market Cap)



Source: Aegis Financial Corporation and Stock Investor Pro Stock Screener

CF Industries

The largest purchase during the fiscal year was \$14.7 million invested in CF Industries. We wrote briefly about this leading fertilizer company in our earlier Semi-Annual Advisor’s Letter. Since then, our investment thesis has continued as we hoped. First, the domestic nitrogen fertilizer industry, and CF in particular has demonstrated it can successfully weather the storms of natural gas price volatility. This is critical because natural gas is the key input to the nitrogen fertilizer manufacturing process. Just as natural gas feedstock prices are declining in the U.S., they are rising for CF’s international rivals. Russia and Gazprom are continuing their efforts to obtain higher prices for gas, undoing faulty pricing mecha-

nisms that had become ingrained through decades of communist rule.

On the demand side, the outlook for CF is strong. Key users of nitrogen fertilizer in North America are Corn Belt farmers. The outlook for corn plantings has substantially improved this year. Chicago Board of Trade corn futures recently surged to over \$3 per bushel, the highest prices since the 8-year highs that were reached in the first half of 2004. While the 2006 corn crop looks set to be about 10.9 billion bushels, it is still falling short of estimated corn usage by a 1 billion bushel deficit. Massive new ethanol capacity investment is fueling strong demand for corn, as is demand for livestock feed as populous developing nations continue to eat more meat. A weaker dollar versus the Euro and the Brazilian Real also helps support healthy corn prices. Strong corn prices mean farmers will plant more acres and use fertilizer liberally to ensure maximum yields on the crop.

CF's assets used to serve the farmers are unique. The company owns ammonia fertilizer terminals in the Corn Belt and a massive, efficient, well-located, and flexible fertilizer manufacturing facility in Donaldsonville, Louisiana. The replacement value of these facilities is well in excess of book value. The company also holds a joint venture interest in a Canadian fertilizer producer that benefits from lower, steadier natural gas prices in Alberta. CF owns irreplaceable phosphate fertilizer assets in Florida. Finally the company has reported a healthy net cash position on its recent balance sheets.

Insiders at CF have purchased the stock over the year, and as we write this report, the domestic fertilizer business has recently attracted the interest of a number of Wall Street analysts. CF Industries is currently among the top three holdings of the Fund.

Canfor Corporation

Another company we have found attractive to purchase in the past six months is Canfor Corporation. We have invested \$4.5 million in this leading Canadian forest products company. The Canadian softwood lumber industry has been buffeted by a strong Canadian dollar, declining homebuilding activity in the U.S., and a larger than usual supply of lower-quality wood resulting from a mountain pine beetle infestation.

We believe the company has sufficient balance sheet strength and management capability to see its way through the current storm. The balance sheet strength will be bolstered substantially by the Softwood Lumber Agreement that is set to be finalized this quarter. Once effective, we estimate the company will receive close to C\$500 million after-tax in tariff refunds. The balance sheet as of June 30, 2006 did not reflect the vast majority of this C\$3.50 per share cash infusion. To put the size of this refund in perspective, the stock has recently been trading at about C\$11.50 per share. The Softwood Lumber Agreement is likely to improve margins at Canfor in the medium-term. However substantial margin improvement will only be achieved when lumber prices stabilize and the market more

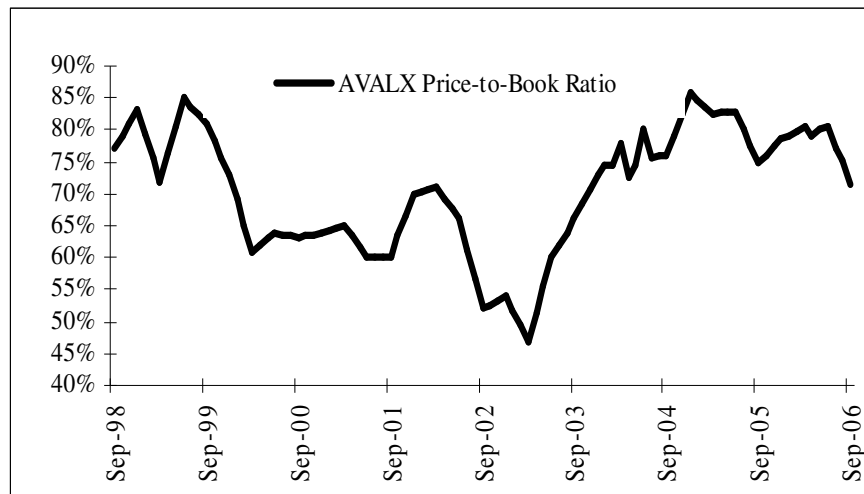
fully adjusts to recent events and higher Canadian exchange rates.

While the near-term conditions in the lumber market are challenging, Canfor's mills are relatively well-positioned and efficient. Its costs are lower than many of its Canadian competitors in Quebec, who have been first to shut capacity. Canfor is also diversified into U.S.-based production, providing some hedge against adverse Canadian conditions. We expect it may apply its strong balance sheet and tariff refunds partly to increase its proportion of U.S.-based production. The housing market downturn may provide some good buying opportunities in the U.S. While the next few quarters are likely to prove challenging, we believe the company maintains the ability to generate strong cash flows in coming years.

Stock Sales

In our effort to reduce risk of capital loss in the portfolio, we have continued to sell off holdings over the year when prices reach levels inconsistent with good value. Given the strong market in small-cap stocks, sales of equities have totaled \$224.5 million during the fiscal year, far in excess of the purchases noted above. The Fund realized a total of \$129.7 million of gains on sales during the fiscal year. Gains represented about 58 percent of the total amount of sales, demonstrating the substantial price appreciation that our successful investments have enjoyed. The Fund realized notable gains on its investments in Ryerson Inc. (\$24.5 million realized gains), Imperial Sugar (\$12.5 million realized gains), Lubys Inc. (\$12.5 million realized gains), Andersons Inc. (\$11.0 million realized gains), Olympic Steel (\$10.3 million realized gains), and Hanover Insurance (formerly Allmerica Insurance, \$8.7 million of realized gains). It should be noted that these sales were made solely based on valuation considerations and judgements to sell were not impacted by the levels of Fund redemptions.

Figure 4: Historical Price-to-Book Value - Aegis Value Fund



Source: Aegis Financial Corp.

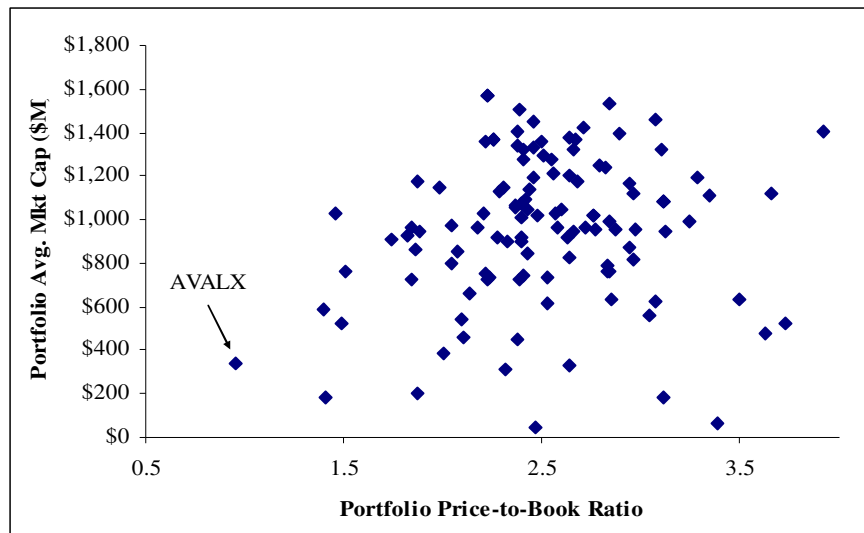
Taxable Distribution

While sales of portfolio holdings are important from the standpoint of reducing risk of future capital loss, one unavoidable side-effect is the tax impact of realizing capital gains. After several years of tax efficiency, as a result of portfolio sales, we will have a larger than usual taxable distribution per share this year, which will occur in mid-December. Our accountants are currently evaluating the distribution and developing estimates. As soon as these estimates are available, further information about the distribution will be available at 1-800-528-3780 and will also be posted for your convenience at www.aegisvaluefund.com.

Portfolio Valuation

Throughout the life of the Fund, investment risk has been reduced by keeping the Fund holdings to companies with valuations among the lowest in the market. As Figure 4 demonstrates, the Fund portfolio currently trades at 0.72 times book value and 0.26 times sales at September 30, 2006. Our price-to-book ratio remains very much in-line with the Fund's average historic valuation levels. As Figure 5 also shows, these statistics compare quite favorably with current valuation metrics for common benchmark indices. The Aegis Value Fund also continues to trade at valuation levels significantly lower than the vast majority of the Morningstar's small-cap value peer universe, as can be seen by Figure 5. Clearly not all value Funds are administered in the same way. Aegis is unique in its purpose of finding truly deep-value companies.

Figure 5: Aegis Trades Among Lowest Price-to-Book Value Funds in Morningstar's Small-Value Universe



Source: Morningstar, Aegis Financial Corporation

Fund Administrative Notes

As long-term shareholders know, we have often communicated with all of you our strategy with regards to holding cash balances in the Fund. That is, we have maintained a discipline of holding cash or cash-like instruments when we do not find investments that have a “better than cash” profile of risks and rewards. We have and will continue to treat the shares of the Fund as a vehicle in which we are very comfortable holding a substantial portion of our own assets. Employees of Aegis Financial Corporation and our families have substantial amounts invested in the Fund.

Fund Redemptions

During the fiscal year, Fund assets contracted from \$676 million to \$394 million due to net shareholder redemptions offset by positive investment performance. We believe that factors contributing to net shareholder redemptions included Fund closure for a portion of the year, limited availability of the Fund through Fidelity and Schwab platforms, and the rotation of some investors and advisors away from small-cap value stocks in anticipation of a more difficult near-term economic environment. We do not believe fund redemptions had any appreciable effect on the Fund’s investment performance. We began the year with a significant cash position, so cash on hand to manage redemptions has always remained adequate. Despite the redemptions, we continue to manage the Fund with a keen focus on minimizing risk and delivering value to our investors over the long-term.

In Closing

Please know that we take our fiduciary obligation to you very seriously and work diligently to ensure shareholders are treated properly and earn a good return on capital. We hope that those of you who have made use of the enhanced service capabilities of our new transfer agent have enjoyed a good experience. While we believe the new arrangement will provide more efficient shareholder servicing, you can continue to reach the offices of Aegis Financial Corporation through our direct line at (703) 528-7788. The overwhelming portion of our liquid assets continues to be invested either in the Fund, or in a similar manner, so we remain committed to our investment approach.

Aegis Financial Corporation

Scott L. Barbee, CFA
Managing Director, Portfolio Manager

** Notes: Aegis Value Fund's one-year, three-year, five-year, and since inception (5/15/1998) average annual returns for the period ending September 30, 2006 are 9.9%, 10.5%, 13.2%, and 14.1% respectively. Russell 2000 Value Index one-year, three-year, five-year, and since inception (AVALX-5/15/1998) average annual returns for the period ending September 30, 2006 are 14.0%, 19.0%, 17.0%, and 10.2%.. All historical performance returns shown in this Advisor's Report for the Aegis Value Fund are presented on a pre-tax basis. Returns include reinvestment of income and capital gains. Past performance is no guarantee of future results. Current performance may be lower or higher than the performance data quoted. The investment return and principal value will fluctuate so that upon redemption, an investor's shares may be worth more or less than their original cost. The Fund has an annualized expense ratio of 1.41%.*

This article refers to eleven stocks held by the Fund. As of August 31, 2006, the percentage of total assets of the Fund these stocks represent respectively is as follows: CF Industries Holdings, Inc. 3.81%, Dillard's, Inc. 3.39%, Imperial Sugar Co. 3.26%, SCPIE Holdings, Inc. 3.16%, Books-A-Million, Inc. 1.57%, Sea Containers Ltd. 1.24%, Dominion Homes, Inc. 1.18%, Pemstar, Inc. 0.99%, Canfor Corp. 0.915%, PXRE Group Ltd. 0.873%, and Luby's, Inc. 0.02%..

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