CARDINAL CONNECTION

Investor Letter – First Quarter 2010

Small Cap Value Equity Strategy

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Recent Investment Environment

Small and large cap equity indices rose 8.9% and 5.7%, respectively, during the first quarter of 2010 as more evidence emerged that the economy was on a steady track for improvement and the Federal Reserve appeared in no hurry to raise interest rates. The greater risk appetite evident for much of 2009 also reasserted itself in the quarter as low quality stocks led the stock market higher. Within the Russell 2000, the value index increased 10.0% while the growth index rose 7.6% for the quarter. The performance of the value index exceeded that of the growth index due to the relative strength of financial services, specifically banks and finance companies, which have a significantly greater weight in the value index. Within the small cap value universe, the return on consumer discretionary stocks far outpaced other sectors' performance as consumer spending was expected to rebound from very depressed levels last year. The large financial services sector, which is under-owned by active managers, and the consumer discretionary sector were the only sectors whose performance exceeded the overall value index return for the first quarter, thus making it difficult for active managers to beat this benchmark.

The U.S. economy moved further down the path to recovery in the first quarter. With corporate revenues starting to improve, business confidence rose. As a result, retailers, whose inventories remain lean, increased orders for the latter half of the year. At industrial companies, strength in orders expanded backlogs and drove up various input prices. Improvement in credit conditions and strong equity markets also built confidence. Although employment remained anemic, March data showed the first monthly increase in jobs since 2007. Despite economic progress, the Federal Reserve retained its accommodative interest rate policy as its members remained concerned about rising foreclosure rates, high unemployment and collateral damage from the decline in commercial real estate values. Although the underlying profitability of businesses seems to be recovering nicely, reported profit growth is being slowed by higher pension expense, the restoration of benefits and discretionary compensation, higher interest expense despite low Treasury rates, and currency headwinds. In addition, although most companies have yet to quantify the impact of healthcare reform, several have announced significant charges as they will no longer be able to deduct the cost of retiree drug benefits for income tax purposes.

Performance Commentary

Net of Fees As of 3/31/10	Cardinal Small Cap Value Composite (%)	Russell 2000 Value Index (%)	Russell 2000 Index (%)
1st Quarter	9.2	10.0	8.9
1 Year	51.0	65.0	62.8
3 Year	-4.9	-5.7	-4.0
5 Year	2.7	2.8	3.4
10 Year	10.1	8.9	3.7
Inception (7/1/92)	12.7	11.1	9.0

The first quarter performance for Cardinal's Small Cap Value composite of 9.2%, net of fees, slightly trailed the Russell 2000 Value Index return of 10.0%. Our return was a little lower than the benchmark's because of stock selection in the consumer discretionary, energy and financial services sectors, our lower weighting in financial services and the drag from residual cash in a rising market. Within consumer discretionary, Speedway Motorsports was the main detractor on weaker than expected profit guidance. Arena Resources, an energy stock, declined 20% as recurring problems at a gas gathering facility temporarily reduced the oil and gas company's production and reported reserves. We added to our holdings after the stock price fell, and shortly thereafter, Arena agreed to be acquired by Sandridge for a 17% premium. In

financials, Investment Technology Group lagged as equity trading volumes remained depressed. Our agency mortgage REITs were also weak as the market fretted about higher interest rates and the impact of Fannie Mae and Freddie Mac's repurchase of significantly delinquent mortgages. In addition, we owned fewer banking stocks than did the index, where banks rose 12.9%.

Mitigating the impact of these factors on our performance were the absence of poorly performing utilities in the portfolio and better stock picking in the healthcare, consumer staples and industrial sectors. In healthcare, Chemed was the primary contributor as 2010 guidance was stronger than expected on higher hospice margins. Our two consumer staples investments, B&G Foods and Ralcorp Holdings, both rose by mid-teens percentages. B&G improved its capital structure and had solid operating results while Ralcorp had better than expected earnings in the quarter, which alleviated concerns over its Post acquisition. In industrials, Atlas Air and Argon ST were the standouts. Atlas benefitted from the sharp rebound in international airfreight and resilient military demand. Argon, one of two defense companies solely focused on intelligence, reconnaissance and surveillance related technologies and services, announced that it was exploring strategic alternatives.

The annualized net return of Cardinal's Small Cap Value composite since inception (July 1, 1992) is 12.7% versus 11.1% for the Russell 2000 Value Index and 9.0% for the Russell 2000 Index. Cardinal managed $1.2 billion in small, small-to-mid and mid cap value assets as of March 31, 2010.

Highlighted Investments

At Cardinal, we focus on finding companies with solid fundamentals at opportunistic valuations. For example, Atlas Air Worldwide provides airfreight charter services to a diverse group of major international airlines and the U.S. military. More than half of Atlas' revenues are locked in for three to five years through take-or-pay contracts. The company specializes in servicing a customer's base load rather than incremental demand, which fluctuates with the business cycle. This business model makes Atlas' financial results more consistent and less volatile than that of the airfreight market and generates meaningfully positive free cash flow. Cardinal became interested in the company in late 2008 as a low risk way to profit from the international freighter shortage expected to emerge as older freighters and passenger aircraft with the ability to carry freight are retired much faster than new freighters enter service. We built our position in Atlas as the economy turned down and a hedge fund sold its 40% ownership stake in the stock. We made it a significant position in the portfolio in 2009 when the U.S. troop and equipment commitment to Afghanistan needed to rise dramatically while at the same time the stock price discounted the unlikely loss of several long-term contracts. Our conviction in Atlas' fundamentals remains high as the international airfreight market strengthens in a traditionally weak period, spot market rates are up dramatically, and the company sees more opportunities to sign new long-term contracts. In addition, better credit markets have lowered the financing cost for the company's upcoming deliveries of new, larger and more fuel efficient freighters. As Atlas delivers solid financial results and the international freight market tightens, we believe the company's valuation will rise to more fully reflect the value of its assets and business.

Chemed has two very unrelated but dominant service businesses. Roto-Rooter is the leading provider of plumbing and drain-cleaning services in North America. Through 110 company-owned and over 500 franchise territories, it serves residential, business, and municipal customers in most of the U.S. and much of Canada. Established in the 1930's, Roto-Rooter was part of WR Grace until it went public in 1985. Despite a modest 15% market share, Roto-Rooter has become synonymous with drain cleaning. Financially, the strong Roto-Rooter brand has translated into pricing power and revenue growth. The company has also generated steady free cash flow as the business is logistics-driven with relatively little capital required. In contrast, Vitas Healthcare is the nation's largest provider of hospice services. Originally a venture investment, Chemed acquired control in 2003. Through 45 operating programs in 15 states, the company uses a standardized model of care intended to maximize quality and enhance patient satisfaction. Vitas' revenues have grown rapidly over the last decade with increasing hospice admissions and geographic expansion. Profitability has also improved as cost controls have allowed the company to increase operating margins and free cash flow. Despite modest reimbursement cuts, Vitas should be able to maintain its profit margins through cost controls and efficiencies. With a valuation that does not fully reflect the attractive cash flow characteristics of its business franchises, Chemed should see its share price rise as Roto-Rooter volumes turn positive and the company redeploys its growing excess capital.

Investment Outlook

Our outlook for the stock market for the balance of 2010 remains optimistic. Despite the sharp recovery in equity prices over the last twelve months, greater confidence in the sustainability of the economic recovery, improving credit conditions and positive earnings comparisons should allay valuation concerns. Although very low short-term interest rates and better credit availability continue to have a salutary effect on the economy, the Federal Reserve will eventually have to signal that interest rates are going to rise. This announcement will be the first real test of the current rally in equities. In the interim, equity prices are likely to rise as the better macroeconomic environment, increased mergers and acquisitions activity, and positive fund flows from fixed income into equities increase investors' appetite for risk.

Although the economy is starting to improve, the investing environment continues to be challenging as many corporations have yet to see a meaningful improvement in business. In this regard, Cardinal's established approach of opportunistically buying high quality, free cash flow generating businesses at attractive valuations should prove timely. The rebound in mergers and acquisition activity also bodes well for our portfolio's future success as three portfolio companies have already received acquisition offers and two others are exploring strategic alternatives. Although our portfolio company managements are guardedly optimistic, many are still building cash in order to maintain financial flexibility. Nonetheless, we remain confident that they are poised to take advantage of attractive business opportunities that arise.

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