SMALL CAP CLIENT NEWSLETTER

Fourth Quarter 2016

Cardinal Capital
MANAGEMENT, L.L.C.

IN THIS ISSUE

- Market Commentary
- Performance Review
- Market and Portfolio Outlook

Market Commentary

Small and large cap indices, as represented by the Russell 2000 and 1000 indices rose 8.8% and 3.8%, respectively, in the fourth quarter, and returned 21.3% and 12.1% for the full year 2016. Within the Russell 2000, the value and growth indices increased 14.1% and 3.6%, respectively, for the quarter, and 31.7% and 11.3% for the year. For the quarter, the value index rose more than its growth counterpart due to a significantly larger weighting in the better performing bank stocks, a smaller weighting in the poorly performing health care sector and better performance in the technology sector. For the year, the value index rose more than the growth index for the same reasons as well as due to better performance in the real estate, utilities and materials sectors. From an economic perspective, the performance of small cap stocks during the quarter and year is best described as cyclical with notable strength in the financials (banks), energy, materials, and industrials sectors while the health care sector was particularly weak. In addition, the stocks with the smallest market caps as well as those with highest price to earnings ratios provided the highest returns. Investor behavior was consistent with a more optimistic view of the economy and equities, particularly following the U.S. Presidential election.

Domestic economic data was mixed during the quarter, although better than most developed economies. After GDP grew at a 3.5% annualized rate in the third quarter of 2016, fourth quarter employment growth slowed and industrial production ticked down slightly as the U.S. dollar strengthened and commodity prices rose. While the unemployment rate fell, wage growth remained modest. The Federal Reserve increased short-term interest rates by 25 basis points during the quarter and suggested a slightly faster pace of future rate increases than previously communicated, though it remains data dependent. Consumer price inflation ex-food and energy remained modest, rising 2.1% annualized during the quarter. U.S. corporate profits grew 5.2% year over year, the first increase since late 2014, as the headwinds from lower commodity prices ended. M&A activity fell from last year's record pace but still remains healthy. Equity valuations are high on a historical basis but still attractive relative to bonds.

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FIRM OVERVIEW

- Experienced Value Investors
- 23+ Year Track Record
- Research-Driven Process
- FCF-Based Valuations
- Consensus Decisions
- Owned by Current & Former PMs
- $2.5 Billion Discretionary AUM

OBJECTIVES

- Superior Risk Adjusted Returns
- Preservation of Capital

HOW WE SEEK TO ADD VALUE

- Intensive fundamental research
- Detailed DCF-based valuation analysis
- Opportunistic stock selection balancing risk and return
- Aim to identify good businesses whose stocks are temporarily out-of-favor in structurally inefficient market niches
- Our annual return objective has always been 20%, making our valuations more conservative
- Our discipline is similar to that used by companies and private equity investors, resulting in more than 70 of our investments being acquired since 1995

Performance Commentary

The preliminary fourth quarter net performance of Cardinal's Small Cap Value Composite, at 8.6%, trailed the 14.1% return of the Russell 2000 Value Index, but was in line with the Russell 2000 Index at 8.8%. Our absolute performance was strong and our portfolio companies' fundamental results were generally in line with our expectations. Nevertheless, there was a rotation into stocks perceived to benefit from the new administration, specifically banks and more economically sensitive and domestic companies, which created a relative performance headwind. This was particularly evident in the industrials sector where our stocks lagged the sector's 14% return. Other detractors from our relative performance were stock selection in the technology, real estate and energy sectors, a lower weighting in the better performing financials sector and the drag from residual cash in a sharply rising market. In technology, the key detractors were Silicon Motion and ACI Worldwide. Silicon Motion saw its share price fall due to worries about a slowing Chinese smartphone market and share loss as its customers transition to new products. Stock of ACI Worldwide lagged the market as management lowered guidance after a few of its clients delayed renewing their licenses until 2017 as they weighed upgrading to ACI's new systems software. In real estate, the key detractors were Medical Properties Trust and Howard Hughes. Medical Properties stock price fell on speculation surrounding the likely repeal of the Affordable Care Act and on financial concerns regarding one of its larger hospital tenants. Howard Hughes, the owner and developer of prime real estate, saw its share price lag despite positive news on several of its major projects. In energy, Callon Petroleum stock gave back its gains after the company raised equity to fund a large acquisition to enter the Delaware Basin in the Permian. Although our bank stocks performed in line with those in the benchmark, our lower weighting hurt our relative performance as they rallied 29% in the quarter on expectations for higher interest rates, less regulation and lower taxes.

The preliminary full year net performance of Cardinal's Small Cap Value Composite at 17.9% trailed the Russell 2000 Value Index return of 31.7% and the Russell 2000 Index return of 21.3%. Similar to the fourth quarter, our absolute return was strong and our portfolio companies' fundamental results were generally in line with our expectations. There were three major performance headwinds. First, beginning in the first quarter, there was a rotation into highly cyclical and commodity-sensitive stocks driven by the markets increasingly optimistic expectations for economic growth. Consistent with our philosophy and process, we did not own these stocks which represented the largest detractor from our relative performance. Second, several of our larger portfolio holdings did not keep pace

PORTFOLIO TEAM

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- Collaborative and dynamic process capitalizes on collective experience
- Consistency in team responsible for 23+ year track record
- Compensation based on portfolio

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with the sharp rise of the small cap value index for reasons unrelated to their business performance. This headwind included investments in Howard Hughes, Ligand Pharmaceuticals, BGC Partners, J2 Global and IAC InterActive. With respect to Ligand and J2 Global, shares paused after very strong performances in 2015 despite positive fundamental news. The other holdings lagged as investors await catalysts, specifically South Street Seaport leasing results at Howard Hughes, a monetization of its real estate business at BGC Partners and a spin-off of Match Group at IAC InterActive. This lumpiness in returns for our large positions is typical as we await the events that unlock value. Although this can be headwind in sharply rising markets, our focus on non-macroeconomic catalysts provides long -term value creation. The third and smallest relative performance detractor was fundamental deterioration at three portfolio companies. Shares of advertising holding company, MDC Partners, one of our larger positions, fell after newly installed management missed expectations and lost investor confidence. The stock of First NBC Bank declined due to accounting issues associated with its tax-related investments and credit issues with two large loans. Shares of engineering and construction firm, Babcock and Wilcox fell after the company's outlook deteriorated. All three stocks were sold. Although there is normally fundamental deterioration at a few of our companies, it typically occurs at our smaller positions, limiting the risk of loss across the portfolio.

The annualized net return of Cardinal's Small Cap Value Composite since inception (July 1, 1992) is 12.8% versus 11.4% for the Russell 2000 Value Index and 9.9% for the Russell 2000 Index. Cardinal managed $2.5 billion in micro, small and smid cap value discretionary assets as of December 31, 2016.

Market and Portfolio Outlook

Early in 2016, the U.S. economy was expected to grow at low rates for the foreseeable future as a result of globalization and an anti-business environment marked by high corporate tax rates and increasing regulation. A cyclical slowdown in Europe and the emerging markets, weak commodity prices and a strong dollar were expected to limit domestic economic activity. The Federal Reserve was actively using monetary policy to stimulate the economy, but fiscal policy was a nonfactor. Wage growth was expected to remain tepid as the quality of most new jobs has been lower reflecting the need of business to maintain profitability by replacing labor with technology and moving operations to countries with lower costs. Although this has kept inflation low, it has also created a growing population which has been unable to find employment at comparable pay. The November election results reflect the frustration of this group with the inability of the U.S. government to address their problems.

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Market and Portfolio Outlook Cont'd

After Trump's election, market views of the U.S. economy, interest rates and the equity market changed significantly. The market's positive reaction appears to assume that his plan to reduce corporate tax rates, create incentives to source goods in the U.S., eliminate excessive government regulation and invest in infrastructure will increase economic growth and bring back higher paying jobs. We are skeptical that these initiatives will be as successful as anticipated because they are likely to be tempered by our national debt burden and delayed due to the need to build political support around complex legislation. Despite our concern that expectations may be too optimistic, Trump's initiatives should eventually stimulate economic growth, subject to the trade initiatives put in place.

In contrast to market consensus, we expect economic growth to remain lackluster in 2017 due to the headwinds created by the strong dollar, higher interest rates and the uncertainty surrounding potential tax changes. Consumer and business confidence have risen since the election, but anecdotal data suggests there has been no broad based acceleration in economic activity. Short-term interest rates are still likely to rise, as inflation has hit the Federal Reserve's 2% target rate and the unemployment rate is well below 5%. The direction of long term interest rates is less clear however, as inflation remains under control and U.S. interest rates are well above those of most major industrialized economies. Based upon valuation and our near-term economic concerns, we are cautious on the stock market. Our expectation is that corporate earnings growth in 2017 is likely to disappoint given the headwinds to economic growth and our belief that the benefits from fiscal policy including any reduction in corporate tax rates will be less than expected. Although we are concerned that near-term corporate earnings expectations are too optimistic, we do believe that, longer term, they will benefit from a pro-business administration.

Consistent with our opportunistic investment approach, our focus remains on the stocks of companies where business performance is less dependent on the growth rate of the U.S. economy. By limiting macroeconomic risks across the portfolio and taking them only when we are being appropriately compensated, the overall risk of the portfolio is reduced because tools under management's control, such as capital allocation, are generally more predictable. As such, Cardinal's short term market views have limited impact on the portfolio. However, we have used post-election market strength to reduce or exit investments where the fundamentals are less certain while adding to stocks of businesses with greater visibility and financial flexibility which have not fully participated in the rally. Our bottom-up investment approach has served us well over time in terms of our absolute performance but

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has produced short periods where our relative performance has lagged the indices around perceived economic inflection points when markets become speculative. Looking ahead, our portfolio company management teams continue to actively deploy their free cash flow through share repurchases, dividends and opportunistic acquisitions which should bode well for future value creation.

Disclosures

Net performance reflects the deduction of advisory fees and expenses which reduce an investor's total return on investment. Returns presume investment for the entire period indicated and reinvestment of all interest income, capital gains, dividends and other distributions. Performance returns are unverified estimates and have been computed by Cardinal. Depending on the timing of an investor's investment in the strategy, net performance for such investor may vary from the net performance stated herein. Past performance is not indicative of future results.

The Russell 2000 Index consists of the 2000 smallest stocks in the Russell 3000 Index that represent approximately 10% of the total market capitalization of that Index. The Russell 1000 Index consists of the 1000 largest stocks in the Russell 3000 Index that represent approximately 90% of the total market capitalization of that Index. The Russell 2000 Value Index measures the performance of the small-cap value segment of the U.S. equity universe and includes those Russell 2000 Index companies with lower price-to-book ratios and lower forecasted growth values. The Russell 2000 Growth Index measures the performance of the small-cap growth segment of the U.S. equity universe. It includes those Russell 2000 companies with higher price-to-book ratios and higher forecasted growth values. These indices are included merely to show the general trend in the small-cap equity markets in the periods indicated and is not intended to imply that Cardinal's investments were comparable to the index either in comparison or element of risk. There is no guarantee that the performance of the strategy will meet or exceed any index. An investor cannot invest directly in an index.

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