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Market Commentary

Small and large cap indices, as represented by the Russell 2000 and 1000 indices, rose 2.5% and 6.0% respectively in the first quarter. Within the Russell 2000, the value index fell 0.1% while the growth index increased 5.4%. The value index lagged its growth counterpart due to its significantly larger weighting in poorly performing bank stocks, a smaller weighting in the better performing healthcare sector and a higher weighting in the poorly performing energy sector. From an economic perspective, the performance of small cap stocks during the quarter should be viewed as more defensive with strength in health care and information technology shares. In addition, larger market capitalization and higher quality equities provided the best returns. Following the post-election rally in small cap stocks, returns were muted as the market tried to ascertain whether political platform promises would quickly lead to policy changes.

Despite post-election optimism that U.S. economic growth would pick up, GDP rose at a 2.1% annual rate in the fourth quarter, as a larger trade deficit mitigated a rebound in consumer spending. Although jobs data and consumer and business sentiment did improve in the first quarter, the unemployment rate and industrial production were essentially unchanged. Although modest, inflation was solidly above the Federal Reserve's 2% target level. As a result, the Federal Reserve increased short-term interest rates by 25 basis points during the quarter and reiterated their plan to raise rates twice more in 2017. Nonetheless, long-term government bond yields fell as investors became increasingly skeptical that meaningful fiscal stimulus would materialize given that House Republican leaders were forced to pull legislation to repeal the Affordable Care Act. In the fourth quarter, U.S. corporate profits rose 3.7% sequentially as the headwinds from lower commodity prices subsided. Equity valuations, although high on a historical basis, remain attractive relative to bonds.

FIRM OVERVIEW

- Experienced Value Investors
- 23+ Year Track Record
- Research-Driven Process
- FCF-Based Valuations
- Consensus Decisions
- Owned by Current & Former PMs
- \$2.6 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

Cardinal's relative performance improved in the first quarter as higher quality and less cyclical stocks came back into favor and specific events at several portfolio companies resulted in strong stock selection. The first quarter preliminary net of fee performance for Cardinal's Small Cap Value Composite, at 2.3%, outpaced the -0.1% return of the Russell 2000 Value Index. The main contributors to our relative performance were stock selection broadly; a lower weighting and better stock selection in the financial services sector and a higher weighting and better stock selection in the healthcare sector. The primary detractors were stock selection in the consumer discretionary and energy sectors and not owning utilities. In industrials, the share price of defense contractor BWX Technologies rose on better than expected profit growth due to greater submarine-related business and other project wins. In materials, the stock price of Silgan Holdings, which fabricates metal and plastic packaging, increased after the company announced the acquisition of WestRock's closures and dispensing systems business. In real estate, the share price of Colony Starwood Homes climbed following better than expected earnings and the completion of debt and equity offerings which allowed this lessor of single family homes to bring its capital structure in line with its peers and reduced the private equity overhang. In consumer staples, the stock price of industrial and beverage alcohol producer MGP Ingredients jumped on better than expected earnings and guidance as its mix shift towards higher margin premium beverages continues to benefit its bottom-line results. In financials, the share price of financial services and real estate broker BGC Partners rose on the prospect for increased trading volumes should financial deregulation materialize and the company's IPO filing for its real estate business. In Health Care, the stock price of air ambulance services provider Air Methods was up sharply on the news that they were to be acquired by private equity firm, American Securities.

The annualized net return of Cardinal's Small Cap Value Composite since inception (July 1, 1992) is 12.8% versus 11.2% for the Russell 2000 Value Index and 9.9% for the Russell 2000 Index. Cardinal managed \$2.6 billion in micro, small and smid cap value discretionary assets as of March 31, 2017.

PORTFOLIO TEAM

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



GENE FOX
MANAGING PARTNER
At Cardinal Since 1995



ROB KIRKPATRICK
MANAGING PARTNER
At Cardinal Since 2000



RACHEL MATTHEWS
PARTNER
At Cardinal Since 2001



BOB FIELDS
PARTNER
At Cardinal Since 2013

Highlighted Investments

At Cardinal, we focus on finding companies with solid fundamentals at opportunistic valuations. New York REIT is a real estate investment trust which owns a portfolio of institutional quality properties in New York City, including One Worldwide Plaza, their marquee and largest building. The company was formed in 2010 to opportunistically purchase income producing real estate following the Great Recession. New York REIT's properties have high occupancy levels, long-term leases and are located almost entirely in Manhattan. Last year, prior management had agreed to merge with JBG Companies in a transaction that would have been lucrative for them but not for shareholders who voted the deal down. Cardinal became interested when an entity associated with Michael Ashner, an experienced real estate executive with whom we had successfully invested when he liquidated Winthrop Realty Trust, began to publicly lobby shareholders to vote against the deal. These efforts ended in Ashner's company being hired to execute on a shareholder approved plan to sell the company's assets and settle its liabilities. It was at this point that Cardinal began to purchase shares. In addition to the \$10 million dollars of New York REIT stock Ashner owns personally, his firm is entitled to receive 10% of any upside above \$11 per share which aligns his interests with ours. In our experience, Ashner is a tough negotiator who seeks to maximize value for all owners of the company. Given recent institutional-quality commercial real estate transactions in Manhattan, we believe that this investment has limited downside and reasonable upside. Since most of the value lies in four assets, it is possible that much of the value will be realized in the next year.

MGP Ingredients is a leading producer and supplier of distilled alcohol products. Historically, the company was primarily a producer of bulk industrial alcohol with roots selling unaged liquor to the beverage market. Cardinal became interested in MGP after reviewing new management's strategic plan developed by Gus Griffin, a Brown-Forman veteran who ran its flagship Jack Daniels brand. The plan is to refocus on the company's beverage business by renewing customer relationships which had been harmed when former management chased short-term profits in the industrial alcohol business leaving beverage customers without supplies. As relationships are rebuilt, production volumes will be redirected to the more consistent beverage business. Despite its small size, MGP is a low cost producer of private label beverage alcohol servicing the rapidly growing craft distiller market. Given the high cost of building a new distillery, the company is likely to maintain its favorable cost position. Although incremental industry capacity is being added, we feel that investors do not appreciate the size and scope necessary to satisfy the shift towards craft distilled products. In addition, inventory investments in aging whiskey should accelerate earnings growth starting in 2019 once this high margin

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Highlighted Investments Cont'd

product starts to generate meaningful sales. Management also intends to use its aged whisky inventory to induce customers to sign long-term contracts. The final piece of the plan is to build the company's nascent branded liquor business by acquiring regional brands where MGP can expand distribution. These investments should produce a more valuable earnings stream and extend double-digit earnings growth beyond the current whisky supply shortage. Although MGP stock has risen significantly since we first purchased it last June, the company still has little analyst coverage and is not well understood.

Market and Portfolio Outlook

Our near-term outlook for equities remains cautious as valuations are full and the domestic economy is forecast to grow only 2% in 2017. In addition, the odds of meaningful tax reform and infrastructure spending have fallen for both political and financial reasons. With inflation now above the Federal Reserve's target, short-term U.S. interest rates are likely to rise unless the U.S. economy slows. Nevertheless, the major global economies have stabilized and the U.S. dollar has likely peaked near term since Europe has started to improve despite challenges with Greece and Brexit and the risk of a big slowdown in China seems behind us. Given the improving global economic backdrop, the M&A market should remain active so long as capital remains available and inexpensive. Consistent with our investment discipline, our focus remains on the stocks of companies where business performance is generally less dependent on the growth rate of the U.S. economy. By attempting to limit macroeconomic risks and taking them only when we feel that we are being adequately compensated, we believe that we are reducing overall portfolio risk because tools under management's control are generally more dependable. Looking ahead, our portfolio companies continue to redeploy 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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