Cardinal Capital Management, L.L.C.

SMID Cap Value

First Quarter 2018

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FIRM OVERVIEW

- Experienced, Stable Team
- 25-Year+ Track Record
- Repeatable Research-Driven Process
- FCF-Based Valuations
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- Aligned Interests with Clients
- $3.3 Billion AUM

OBJECTIVES

- High-Quality Investment Results
- Preservation of Capital

Market Commentary

Small, SMID and large cap indices, as represented by the Russell 2000, 2500 and 1000, fell 0.1%, 0.2% and 0.7%, respectively, in the first quarter. Within the Russell 2500, the growth index rose 2.4% while the value index declined 2.7% due to the latter's smaller weighting in better performing information technology and healthcare stocks and higher weighting in underperforming real estate stocks. From an economic perspective, the performance of SMID cap stocks was inconsistent as defensive utility and real estate shares were poor performers, but healthcare was the second best performing sector. Cyclical stocks also exhibited contradictory behavior as the share prices of economically sensitive materials, industrials and energy equities were broadly weak while information technology stocks were the best performers. SMID cap stocks with higher long term earnings growth and higher valuations were the best performers.

Fourth quarter GDP rose at a 2.5% annual rate, following two consecutive quarters of growth above 3%. During the first quarter, consumer sentiment hit its highest level since 2004, as the unemployment rate remained near fifty-year lows. The first quarter CPI was unchanged at 2.2%, but inflation concerns picked up as the impact of fiscal stimulus on an economy near full employment has yet to be felt. As a result, the ten year government bond yield rose moderately during the quarter to 2.74%. The Federal Reserve increased short-term interest rates at their March meeting and confirmed their plan to raise them two more times in 2018. Despite higher short and long-term interest rates, the US dollar weakened as prospects for economic growth in Europe and other large international economies improved. Major equity indices ended the quarter modestly lower as the announcement of tariffs increased the potential for a trade war that would slow the economy and the Facebook data breach raised the likelihood of government regulation. The heightened uncertainty weighed on investor sentiment and increased equity market volatility from subdued levels.

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HOW CARDINAL SEEKS TO ADD VALUE

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

INVESTMENT TEAM

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Performance Commentary

The preliminary first quarter performance of Cardinal's SMID Cap Value Composite, at –0.2% net of fees, outpaced the 2.7% decline of the Russell 2500 Value Index. The main contributors to our relative performance were stock selection in the technology, energy, industrials and health care sectors and a lower weighting and stock selection in the real estate sector. In technology, the share prices of IAC/Interactive and its publicly-traded subsidiary Match Group rose sharply due to better than expected results at Match and the strong price appreciation of IAC's other publicly-traded subsidiary, ANGI Homeservices. In energy, the share price of RSP Permian rose after the announcement that it was being acquired at a substantial premium by Concho Resources in the largest deal ever done in the Permian Basin. In industrials, the stock price of KAR Auction Services increased on solid results and its plan to spin-off its salvage business which should unlock substantial value based upon the valuation of its competitor, Copart. In healthcare, the share price of Ligand Pharmaceuticals rose after the company reported solid financial results and raised guidance on additional milestone payments associated with new license agreements. In real estate, the stock price of owner and developer Howard Hughes, rose after repurchasing its shares for the first time. In contrast, the main detractors were stock selection in the consumer discretionary, materials and financials sectors. In consumer discretionary, the share price of Nexstar Media Group declined despite posting solid results and outlook as industry leader Sinclair forecast a weak first quarter for TV advertising. In materials, the share price of FMC Corp declined despite positively preannouncing a strong first quarter and raising guidance for the year on concern that new capacity will negatively impact lithium pricing. In financials, shares of MB Financial, a Chicago-based bank, fell when its earnings and guidance were lower than expected on both the timing of asset growth and a weaker outlook for its mortgage banking segment.

The annualized net return of Cardinal's SMID Cap Value Composite since inception (April 30, 2010) is 12.6% versus 10.8% for the Russell 2500 Value Index and 12.2% for the Russell 2000 Index. Cardinal managed $3.3 billion in small and SMID cap value assets as of March 31, 2018.

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Highlighted Investments

At Cardinal, we focus on finding companies with solid fundamentals at opportunistic valuations. Valvoline Inc. is global producer, marketer and supplier of engine and automotive maintenance products and services, including premium automotive, commercial and small engine lubricants. Its products are marketed through retailers, repair shops and 1,100 owned and franchised Valvoline branded quick lube service stations. Cardinal became interested in Valvoline after its former parent, Ashland Global Holdings, announced its intention to separate the two companies. We were attracted to the business because of its high margins and low capital intensity, consistent with branded consumer product companies. In addition to secular growth from miles driven and expansion of its very profitable quick lube centers, Valvoline's strategy is to increase profits by driving sales of higher margin premium synthetic lubricants which are used in newer vehicles and help manufacturers meet higher fuel efficiency standards. Premium synthetic motor oil is over two times the price of conventional products with comparable costs. As part of Ashland, a diversified chemical company, we believed that Valvoline was misunderstood and undervalued, hence we initiated a position after the spin-off was announced. Despite contracts and market forces which have allowed the company to pass through feedstock costs with a few months lag, investors are currently focused on near-term margin pressures arising from higher oil prices. Nonetheless, Valvoline expects to raise prices to offset these cost headwinds. As confidence builds in Valvoline's pricing power, its rising earnings and accretive capital redeployment should result in an upward revaluation of the company's shares to a level more in line with its consumer product peers.

Hostess Brands is a baker and distributor of iconic sweet baked goods such as Twinkies, Ding Dongs and Ho Hos. Prior to its most recent incarnation, Hostess experienced years of poor financial performance and in 2012 ceased operations. Private equity firm Apollo and food industry executive Dean Metropoulos acquired the assets and intellectual property of Hostess out of bankruptcy in 2013. The new management team who specialize in turnarounds, reformulated the company's products to extend shelf life and improve quality, consolidated operations, automated production, and shifted distribution to the warehouse model. After regaining most of their market share and achieving industry leading profitability, the equity owners chose to take the company public in 2016, although Metropoulos sold none of his stock. While the $15 billion decadent foods category has experienced low single digit growth, Hostess has grown 8% organically over the last four years. This growth was the result of regained market share as well as successful new product innovation. After restructuring operations, management has focused on expanding its product offerings by reintroducing its own iconic brands as well as by acquiring assets and brands to add products in the breakfast pastry space. We believe investors are skeptical about the firm's ability to sustain attractive revenue growth due to the nutritional realities of the category, however we disagree. We expect Hostess to continue to take market share by launching new Hostess Branded products in related niches and via acquisitions that will expand its market offerings. Our view is shaped by having successfully invested in International Home Foods run by Dean Metropoulos and sold to ConAgra. We anticipate that the equity market will positively revalue Hostess shares as management proves that it can execute its growth strategy or if the company is acquired by a strategic buyer given the scarcity of growing high margin food businesses.

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Market and Portfolio Outlook

Our near-term outlook for equities remains cautious as equity market valuations are full despite most indicators pointing to steady economic growth. The Federal Reserve still expects to gradually raise interest rates given the belief that inflation will reach its two percent target. Inflation could emerge as an area of concern if global growth boosts commodity prices and tight labor markets accelerate wage growth. Despite economic fundamentals continuing to improve across much of the developed world, the US dollar could gain support from improving US growth. However, the proposed imposition of tariffs have hurt the dollar and increased uncertainty. The M&A market should continue to be active as long as inexpensive capital is available and shareholder activism continues at high levels. 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 2500™ Index measures the performance of the small to mid-cap segment of the U.S. equity universe, commonly referred to as "SMID" cap. The Russell 2500 Index is a subset of the Russell 3000® Index. It includes approximately 2500 of the smallest securities based on a combination of their market cap and current index membership. The Russell 2500 Value Index measures the performance of small to mid-cap value segment of the U.S. equity universe and includes those Russell 2500 Index companies with lower price-to-book ratios and lower forecasted growth values. 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. 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.

The discussion of specific discrete investments in this newsletter (i) is included merely to illustrate certain investment processes and strategies utilized by Cardinal, (ii) is not intended to indicate overall performance that may be expected to be achieved by the Strategy, and (iii) should not be considered a recommendation to purchase or sell any particular security. The investments discussed herein are not a comprehensive list of securities or positions held by the Strategy. There is no assurance that any securities discussed herein will be or remain in the portfolio or, if sold, have not been or will not be repurchased.

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