CARDINAL CONNECTION

Client Letter – First Quarter 2011

Mid Cap Value Equity Strategy

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Recent Investment Environment

Small, mid and large cap equity indices rose 7.9%, 7.6% and 6.2%, respectively, during the first quarter. The market continued to rise as a result of modest improvement in the economy and a pickup in mergers and acquisitions activity. Money flows into equities from fixed income continued as U.S. equities remain attractively valued on a relative basis while long-term government bonds posted losses during the quarter. Within the Russell Midcap Index, the value component posted a total return of 7.4% during the first quarter, trailing its growth counterpart which increased 7.9%. The value index trailed as a result of its higher weighting in financial services stocks which lagged the overall index (banks in particular), and growth's better performing consumer staples stocks. Higher quality stocks, in addition to those with larger market capitalization and higher beta, were the best performers which one would expect as the economy begins to normalize.

The U.S. economy showed further signs of improvement during the first quarter as employment growth picked up but remained modest and consumer expectations ticked up. Even so, the Federal Reserve's quantitative easing program is likely to continue through June as policymakers consider the economic recovery fragile and not yet self-sustaining. In February, the stock market corrected briefly in reaction to the political turmoil in the Middle East, which caused oil prices to spike, and the potential economic disruption associated with the earthquake and tsunami in Japan. Investors quickly concluded that these events were unlikely to derail the global recovery; however, if oil prices remain well over $100/barrel, economic growth should moderate. High food and gas prices have already raised inflation concerns and will likely hurt discretionary consumer spending. These headwinds, along with weakness in the housing market and recent political actions to cut federal, state and local government spending to address deficit issues, are impediments to economic growth. Despite these challenges, global growth prospects remain attractive, business confidence continues to rise, and credit is readily available at attractive rates for most corporations, providing companies several options to enhance their revenue and earnings growth rates.

Performance Commentary

The first quarter performance of Cardinal's Mid Cap Value composite, at 9.2% net of fees, was solid in absolute and relative terms versus the Russell Midcap Value Index return of 7.4%. Stock selection in the industrials, consumer discretionary and financials sectors and also a lower weighting in the poorly performing financials sector were the key contributors. Our investments in the industrials sector (one of the largest weightings in Cardinal's portfolio) produced double-digit returns. Standout performers included Atlas Air Worldwide and Teledyne Technologies. Atlas Air Worldwide is the leader in international airfreight services. The business has seen robust volumes and firm pricing due to strong secular trends and supply constraints. Teledyne, an electronic and communication systems provider for space, defense and industrial applications, announced the sale of its legacy piston airplane engine business for a healthy price and the acquisition of a higher margin and growing niche electronics business. The two deals are accretive to earnings and facilitate the company's shift toward higher margin commercial businesses. Our consumer discretionary investments, led by

Six Flags and Stanley Black and Decker, also posted strong returns. Six Flags, which emerged from bankruptcy last summer, announced better than expected results and reacted positively to insider buying and its first investor day following the reorganization. Stanley Black and Decker, an industrial tool and security manufacturer, announced better than expected earnings and increased its guidance for 2011. In the financial services sector, our lower weighting in banks and insurance companies, which posted only nominal returns, added to our relative performance. Stock selection in health care and an underweight to energy modestly detracted from relative performance in addition to the headwind from holding residual cash in a strong equity market.

The annualized net return of Cardinal's Mid Cap Value composite since inception (December 31, 2005) is 5.7% versus 5.3% for the Russell Midcap Value Index and 5.7% for the Russell Midcap Index. Cardinal managed $1.3 billion in small, small-to-mid and mid cap value assets as of March 31, 2011.

Highlighted Investments

At Cardinal, we focus on finding companies with solid fundamentals at opportunistic valuations. For example, IAC/InterActive Corp. operates more than 35 online brands in a well-positioned portfolio following Barry Diller's 2008 spin-off of Ticketmaster, Home Shopping Network, LendingTree and Interval. The company's largest business segments are search (Ask.com, toolbars and applications) and personals (Match.com). Last year, Ask.com was restructured to improve profitability and reinvigorate growth while the toolbars and applications business already has above-average growth and profitability. Match.com is the dominant player in a fragmented industry with many opportunities for growth. Management feels that they can more than double the subscription-based revenues in the personals business without saturating the market. IAC/Interactive has $1.2 billion of net cash on its balance sheet, which is almost half of the current market value despite buying back about a third of the market cap over the last three years. The company generates significant free cash flow and with no major acquisitions planned and a very attractive valuation, we think management will continue to aggressively repurchase its shares. The stock's valuation suffers from both its conglomerate history and the nominal earnings on its cash hoard, so as IAC/InterActive's management continues to narrow its business focus and reduce its cash balance, the discount should dissipate and in turn, the valuation rise.

KAR Auction Services is a leader in the vehicle redistribution business in the US and Canada. Company operations include whole car auctions, salvage auto auctions and a used car dealer floor-plan finance operation. The auctions are internet-based and physical with locations across North America. Whole car auction buyers include franchised and independent used car dealers while interest in salvage auctions comes from dismantlers, rebuilders and scrap dealers. Although the new car and truck business is quite volatile from year to year, used vehicle and salvage volumes have been much more stable which has

provided good visibility for the businesses. KAR does not take title to the vehicles, but acts as agent, earning a fee collected from both buyer and seller. The company also provides value added services that add to profits. As the businesses are oligopolies with pricing power, KAR generates substantial free cash flow. In 2007, the company went private in a leveraged buyout which permitted it to make needed management, operational and structural changes. A poorly handled IPO, in late 2009, provided Cardinal with a second opportunity to invest in the business as we owned it prior to the buyout. Management's current focus on reducing debt should benefit shareholders in next few years as they are able to focus on growth opportunities and whole car industry volumes turn up.

Strategy and Outlook

Our investment outlook for 2011 remains constructive as fiscal and monetary policy are accommodative and economic and credit conditions continue to improve. Equity valuations remain attractive and mergers and acquisition activity is increasing. The cyclical rotation of fund flows from fixed income into equities is only likely to gain momentum if the positive relative return trend for equities persists. Cardinal's lower weighting in bank stocks, which has been a major contributor to our strong relative performance remains in place. With recent adverse regulatory changes like the Dodd-Frank bill, we believe that the banking business is not as attractive as it once was, and as a result, historical valuation metrics are not relevant. Assuming a normal economic recovery, we find very few banks which offer us the high rates of return or visibility that we seek in our investments.

Cardinal's approach of opportunistically buying sound free cash flow producing businesses at inexpensive valuations has generated attractive long-term returns and we are confident that it will continue do so. Our portfolio company managements have become much more active in redeploying their cash flow in accretive ways, including acquisitions and share repurchases. These actions will benefit 2011 results but also bodes well for the future. Please call us if you have any questions.

Best Regards,

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