Cardinal Capital Management, L.L.C.

Small Cap Value

Third Quarter 2018

FIRM OVERVIEW

- Focus on Small & SMID Cap Value
- Experienced, Stable Team
- 25-Year+ Track Record
- FCF-Based Valuations
- 100% Independent, Partner Owned
- $3.9 Billion AUM

INVESTMENT TEAM

Eugene Fox, III
Managing Partner/Portfolio Manager

Robert Kirkpatrick, *CFA*
Managing Partner/Portfolio Manager

Rachel Matthews
Partner/Portfolio Manager

Robert Fields
Partner/Portfolio Manager

Chitra Sundaram
Senior Research Analyst

Christopher Robertson
Senior Research Analyst

Michael Cotogno, CFA
Senior Research Analyst

Market Commentary

Small and large cap indices, as represented by the Russell 2000 and 1000, rose 3.6% and 7.4%, respectively, in the third quarter. Within the Russell 2000, the value index rose 1.6% while the growth index rose 5.5%. The value index lagged due to a higher weighting in poorly performing bank stocks and a lower weighting in better performing software and services within the information technology sector. Despite a strong economy and major stock indices at all-time highs, the Trump administration's aggressive use of tariffs in an attempt to improve U.S. trade deals caused investors to reduce exposure to more economically sensitive stocks. For example, across stocks broadly, materials and energy stocks were relatively unchanged for the quarter while health care, as well as software and services stocks, posted double-digit returns. In addition, bank stocks posted lackluster returns as the potential for weak loan demand and rising deposit costs more than offset continued strong credit metrics. Smaller cap stocks and lower quality businesses lagged their larger cap and higher quality peers. The more cyclical business mix of small cap stocks and a more risk-averse environment in the third quarter seemed to outweigh the greater domestic focus of these companies which benefitted small cap's relative performance in the first half of the year.

Nine years into the current economic expansion, U.S. leading economic indicators still indicate solid growth for the balance of 2018 with few signs of a recession. The Federal Reserve under Jerome Powell has continued to methodically raise short-term interest rates as inflation remains well-behaved despite ongoing stimulus from tax cuts and little slack in the labor force. Nonetheless, even with substantial new debt issuance to fund ongoing deficit spending, the U.S. yield curve remains relatively flat as global growth forecasts have fallen due in part to our more aggressive trade policy. Fulfilling a campaign promise, the President is trying to open markets and eliminate tariffs that have resulted in lost domestic jobs, trade imbalances and an uneven playing field for American companies. The administration did reach new trade deals with Canada and Mexico. However, China has been unwilling to make major concessions and, as a result, more tariffs were put in place by each government, further clouding the global economic outlook and depressing business sentiment.

Performance Commentary

The preliminary third quarter performance of Cardinal's Small Cap Value Composite, at 2.2% net of fees, outpaced the 1.6% return of the Russell 2000 Value Index. The main contributors to Cardinal's relative performance were stock selection in the energy, health care, and technology sectors and our weighting and stock selection in the industrials and real estate sectors. In the energy sector, shares of Magnolia Energy, Callon Petroleum and Viper Energy rose sharply fueled by rising oil prices, lower cost reserves, and positive company-specific events. In the health care sector, the stock price of Ligand Pharmaceuticals moved higher after the company beat analyst estimates and increased their 2018 guidance. Shares rose further after Viking Therapeutics announced positive clinical results for a potential drug where Ligand has nearly $400 million in potential milestones plus an ongoing royalty should the drug be successfully commercialized. In the technology sector, the stock price of software and services provider ACI Worldwide rose after the company affirmed its multi-year outlook for significant profit growth. In the industrials sector, the share price of electronics provider Teledyne Technologies rose after the company reported results that exceeded estimates and raised its annual earnings guidance. In the real estate sector, Cardinal's lower weighting contributed to better performance as interest-sensitive REITs fell as interest rates increased. In addition, the

Performance Commentary

stock price of Medical Properties Trust rose as it monetized assets at attractive prices to optimize its leverage and allow the company to make acquisitions without the need to raise equity. The primary detractors were stock selection in the consumer discretionary and financials sectors and a higher weighting in the poorly performing consumer staples sector. In the consumer discretionary sector, the share price of auto dealer Lithia Motors fell after the company missed analysts' quarterly estimates and lowered annual guidance due primarily to higher overhead expenses and investments to drive future growth. In the financials sector, the largest single detractor was pawn lender EZCORP, which is still feeling the impact of last year's hurricanes on its U.S. business. A few of Cardinal's bank holdings, Columbia Banking and South State, also lagged as they are optimizing recently acquired loan portfolios while Lakeland Bancorp was negatively impacted by changes in the New Jersey tax regulations that will substantially increase their tax rate.

The annualized net return of Cardinal's Small Cap Value Composite since inception (July 1, 1992) is 12.7% versus 11.2% for the Russell 2000 Value Index and 10.2% for the Russell 2000 Index. Cardinal managed $3.9 billion in small and SMID cap value assets as of September 30, 2018.

Market and Portfolio Outlook

Cardinal's near-term outlook for equities remains cautious as valuations are full, the economic cycle is extended, monetary policy is tightening, and the imposition of tariffs will depress economic growth and boost inflation to some extent. Nonetheless, the U.S. economy is currently growing at a solid pace, and the beneficial impact of the U.S. corporate tax cut is only beginning to be felt. The prospects for domestic small cap stocks appear better than for large caps as the stronger U.S. dollar, and the impact of tariffs are less consequential. The Federal Reserve still expects to gradually raise interest rates and is unlikely to deviate from that path unless the trade situation escalates or inflation increases meaningfully. With heightened uncertainty, the portfolio managers continue to prefer stocks where company-specific prospects determine investment success rather than the macroeconomic outlook. Cardinal's high return requirements and long-term focus often make risk-averse environments challenging for relative performance because investors shorten their time horizons.

The strong M&A market, increased share repurchases from repatriated cash, and the lower corporate tax rate are all supporting equity valuations. Private equity and activist funds continue to unlock value by improving operational performance, divesting non-core assets and selling companies. These activities have been, and should remain, a source of alpha in the portfolio. Cardinal is optimistic that portfolio companies will continue to redeploy free cash flow through share repurchases, dividends and opportunistic acquisitions which should bode well for future value creation.

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Highlighted Investments

OXFORD

Cardinal focuses on finding companies with solid fundamentals at opportunistic valuations. Oxford Industries, Inc. designs, markets, and distributes apparel, footwear, accessories, and licensed products under a portfolio of lifestyle brands. The portfolio currently consists of two powerful, full-price, experiential brands, Tommy Bahama and Lilly Pulitzer, which account for the bulk of the company's revenues and the smaller, recently acquired, Southern Tide. Oxford distributes its products through its retail stores and e-commerce websites as well as higher-end department and specialty stores. Management has done an outstanding job of maintaining brand relevance by targeting the appropriate affluent customer bases, promoting lifestyles that match the brands and selectively discounting with promotions at retail. Wholesale distribution, roughly a third of sales, is kept lean and limited to better-performing doors within larger national accounts, thus keeping Oxford's exposure to ongoing retail door closures manageable. Despite the strength of its brands, Tommy, Lilly, and Southern Tide have relatively small store footprints and wholesale distribution. As a result, their digital platforms remain the primary focus and driver of growth. Oxford's biggest concept, Tommy Bahama, has had lumpy performance, creating the opportunity for Cardinal's investment at a reasonable valuation. Oxford has been and remains a growth via acquisition story with strong leadership and execution. The company purchased Tommy Bahama in 2003, Lilly Pulitzer in 2010 and Southern Tide in 2016. It has previously stated that a potential acquisition target would have sales in the $100 to $200 million range, compelling margins, and target high-end customers. The goal is to buy brands that have shown traction in the market that have the potential to scale, similar to its strategy with Southern Tide. With a debt level below most of its peers and consistent free cash flow growth, Oxford has a runway to grow revenues and profits both organically and through future accretive acquisitions.

ColumbiaBank

Columbia Bank is a regional commercial bank in the Pacific Northwest with branches clustered around metropolitan areas in Washington, Oregon, and Idaho. These areas have attractive projected population and economic growth which should lead to above-average loan and deposit growth. Post the financial crisis, Columbia's loan originations have been strong, and the resulting loan book is well-balanced between commercial, industrial and commercial real estate customers. Because of its focus on relationship banking, Columbia's deposit franchise is among the best in the country with 95% core deposits at an annual cost of just ten basis points. This low-cost deposit base has permitted the bank's net interest margin to expand as rates have risen, causing existing loans to reset and adding new loans at higher margins. Management has also been able to control other operating expenses and thus leverage fixed overhead as they have increased scale. Since the financial crisis, the bank has completed eight acquisitions totaling $7 billion in assets making Columbia the third largest bank in the Pacific Northwest. The bank recently surpassed $10 billion in assets, resulting in increased compliance costs and the elimination of a source of fee income. Nonetheless, management should be able to navigate these headwinds with further accretive and opportunistic acquisitions near its geographic footprint. With limited troubled assets and a stellar reputation, the bank is often seen as the acquirer of choice in the region. The bank also retains a strong capital base despite periodically paying out special dividends to supplement a nearly 3% recurring yield. As Columbia continues to execute on its business plan of reasonable organic growth and accretive acquisitions the resulting revenue and profit growth should generate an attractive total return for shareholders.

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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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TELEPHONE:
203-863-8990

FOUR GREENWICH OFFICE PARK
GREENWICH, CT 06831

WEBSITE:
www.cardcap.com