

Cardinal Capital Management, L.L.C.

SMID Cap Value

Fourth Quarter 2018

FIRM OVERVIEW

- Focus on Small & SMID Cap Value
- Experienced, Stable Team
- 25-Year+ Track Record
- FCF-Based Valuations
- 100% Independent, Partner Owned
- \$3.2 Billion AUM

INVESTMENT TEAM

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Market Commentary

Small, SMID, and large cap indices, as represented by the Russell 2000, 2500, and 1000, fell 20.2%, 18.5% and 13.8%, respectively, in the fourth quarter. Within the Russell 2500, the value index fell 17.1% while the growth index fell 20.1%. The value index fell less than its growth counterpart due to its higher weighting in the better performing real estate sector, a higher weighting in the better performing utilities sector, and a higher weighting in the better performing financials sector. Despite a healthy domestic economy, an escalation of the trade war with China, concerns about global growth and the direction of monetary policy led investors to reduce risk broadly. As a result of this flight to safety, utilities were the best performing sector despite just a 2.5% average dividend yield. Health care stocks, although normally defensive, fell sharply because of their high valuations and significant year-to-date appreciation. Energy was the worst performing sector due to the significant decline in oil prices as the market became oversupplied along with the expectation of weakening demand. Smaller cap stocks lagged their larger cap peers as the growing fear of a U.S. recession outweighed the potential benefits of their greater domestic focus.

The double-digit decline in equity prices during the fourth quarter of 2018 was the most significant since the financial crisis. Growing concerns about the impact and duration of the U.S. trade war with China, continued tight monetary policy by the Federal Reserve and economic weakness in Europe and China were the primary factors. These issues reduced expectations for economic and corporate profit growth in 2019 and stoked fears of recession as confidence in the ability of the current administration to avoid fallout from its trade initiatives deteriorated. The last broad-based tariffs imposed by the U.S. were in 1930. These tariffs led to the loss of millions of domestic jobs. Nonetheless, seeing a healthy U.S. economy with low unemployment and inflation approaching its target, the Federal Reserve again increased short-term interest rates in December and reiterated its plan to raise them again in 2019. Nervous investors saw any further tightening of monetary policy as ill-advised considering the uncertain economic outlook and, as a result, sold equities aggressively. Despite moderate U.S. economic growth and generally favorable credit conditions, concerns grew of lower than expected corporate profits as a result of weaker international sales. Other factors which contributed to the severity of the market correction were a highly valued equity market, the extended length of the U.S. economic expansion and general political dysfunction in Washington which has undermined business and consumer confidence.

Fourth Quarter Performance Commentary

The preliminary fourth quarter performance of Cardinal's SMID Cap Value Composite, at -18.3%, net of fees, lagged the Russell 2500 Value index return of -17.1%. The primary detractors to Cardinal's relative performance were stock selection within the financials, health care, and consumer staples sectors and the absence of investments in the better performing utilities sector. In financials, the stock price of PacWest Bancorp declined after reporting a lower than expected net interest margin, due in part to increasing competition for deposits. Nonetheless, the bank still has top tier profitability, excellent credit metrics and a current dividend yield of almost 7%. In health care, the share price of Ligand Pharmaceuticals declined significantly after doubling earlier in the year despite no material adverse change to the company's positive prospects. Management did issue better than expected financial guidance for 2019 and repurchased a meaningful amount of stock. In consumer staples, the stock price of Spectrum Brands declined after management released disappointing financial results and announced that they were selling their auto care business rather than the less attractive personal care and appliances business.

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The main contributors to Cardinal's relative performance were holding residual cash in a sharply declining market, stock selection in the materials, consumer discretionary, and information technology sectors and a lower weighting in the poorly performing energy sector. In materials, the share price of Valvoline held up relatively well as the supplier and marketer of premium motor oils should benefit from lower base oil prices despite earlier reducing 2019 guidance after competitors attempted to take market share in a rising input cost environment. In consumer discretionary, the stock price of auto dealer Lithia Motors rose after reporting much better than forecast earnings despite a challenging operating environment. In information technology, the share price of electronic payment software provider ACI Worldwide rose as management raised guidance for the current year and reiterated attractive cash flow growth for the next few years as it leverages earlier infrastructure investments.

As previously seen at perceived economic inflection points, investors focus on the short-term and rotate into utilities, more defensive REIT's, and low beta financial stocks in order to preserve capital. Since these investments generally offer modest single digit returns, they do not meet our return objectives and thus make it difficult for long-term absolute return-oriented investors such as Cardinal to add value. Since the fear of recession increased meaningfully during the fourth quarter, Cardinal's relative performance was not entirely unexpected. The administration's aggressive use of tariffs made this quarter particularly challenging because the strategy is unusual and thus hard for investors to assess at an individual company level. As a result, investors avoided businesses that could be impacted by tariffs, concentrating in an even narrower universe of defensive stocks. Tariffs also impacted corporate behavior as many managements were reticent to deploy capital aggressively until pending trade issues are resolved. An additional obstacle was selling pressure from fundamentally-oriented hedge funds which had big withdrawals following subpar returns. As a result, prices of many of our stocks became disconnected from fundamentals and are currently depressed relative to the value of their long-term future free cash flows.

2018 Performance Commentary

The preliminary full-year 2018 performance of Cardinal's SMID Cap Value composite at -12.3%, net of fees, outpaced the Russell 2500 Value index return of -12.4%. The main contributors to Cardinal's relative performance for 2018 were stock selection in the communication services, industrials, information technology, health care, and real estate sectors along with holding residual cash in a sharply declining equity market. In communication services, the stock price of internet services provider IAC/InterActiveCorp rose sharply as its publicly traded subsidiaries, Match Group and ANGI Homeservices, delivered strong business results and stock price appreciation. IAC management also reported strong consolidated results and raised annual EBITDA guidance throughout the year. In industrials, the share price of Teledyne Technologies increased after the electronics provider beat and raised guidance throughout the year. In information technology, the stock price of ACI Worldwide rose as the provider of electronic payment software raised guidance for the current year and reiterated its forecast of attractive cash flow growth for the next few years as it leverages earlier infrastructure investments. In health care, the share price of Ligand Pharmaceuticals rose significantly early in the year on new partnerships, strong results and raised guidance. In real estate, the stock price of Medical Properties Trust, a hospital-focused real estate investment trust, rose after management sold assets at attractive prices to optimize its financial leverage and provide the company significant capacity for accretive acquisitions without the need to raise expensive equity capital.

The primary detractors from Cardinal's relative performance were stock selection in the financials sector, stock selection and a higher weighting in poorly performing consumer staples sector, and not owning better performing utilities. In financials, the stock price of California-based Pacific Premier Bancorp lagged on moderating loan growth and increased non-cash expenses from its acquisition of Grandpoint Capital which took the bank over the \$10 billion in assets regulatory threshold. The share price of Affiliated Managers Group also declined sharply as the asset manager experienced modest outflows, market depreciation and was related along with other traditional asset managers due to ongoing concerns about flows and fee pressure. The stock price of BGC Partners declined due to weakness in the share price of its publicly-traded subsidiary Newmark Group, whose spin-off was delayed. Although the spin was completed in December, BGC's stock price did not recover despite management's affirmation of guidance and maintenance of the quarterly dividend. In consumer staples, the stock price of Spectrum Brands fell after it reported weak results due to short-term manufacturing and distribution issues at two facilities. While these issues continued for longer than anticipated, the sale of Spectrum's battery and auto care businesses will permit the company to substantially reduce leverage and repurchase a material amount of stock.

The annualized net return of Cardinal's SMID Cap Value Composite since inception (May 1, 2010) is 9.8% versus 8.5% for the Russell 2500 Value Index and 9.7% for the Russell 2500 Index. Cardinal managed \$3.2 billion in small and SMID cap value assets as of December 31, 2018.

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Market & Portfolio Outlook

Cardinal's near-term outlook for equities remains cautious despite the recent sharp price drop as corporate earnings guidance for 2019 is apt to be conservative, domestic monetary policy remains in a tightening mode, and tariffs will continue to depress economic growth until the trade dispute with China is resolved. We do not expect a recession in 2019 and, barring a major policy mistake, the U.S. economy should grow. Corporate profits are likely to grow only modestly due to international economic headwinds and the impact of tariffs. Nonetheless, equity valuations are attractive as they are below historical averages and long-term interest rates remain low. Although the Federal Reserve still expects to raise interest rates in 2019, its decisions appear to be data dependent. The prospects for small cap stocks relative to large caps appear mixed with lower valuations and less exposure to tariffs seen as positives while the weaker dollar and greater economic sensitivity as headwinds. The M&A market remains very active and share repurchase activity strong. 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 Cardinal portfolio. We remain optimistic that portfolio companies will continue to deploy their free cash flow through share repurchases, dividends, and opportunistic acquisitions which should bode well for future value creation. For investors with a long-term time horizon, equities are likely to produce solid returns from today's depressed levels as stock prices ultimately reflect fundamental values based upon cash flow, not emotion.

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. 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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