

Cardinal Capital Management, L.L.C.

Small Cap Value

First Quarter 2021

FIRM OVERVIEW

- Focus on Small & SMID Cap Value
- Experienced, Stable Team
- 25-Year+ Track Record
- FCF-Based Valuations
- 100% Independent, Partner Owned
- \$5.1 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 stock indices, as represented by the Russell 2000 and 1000, rose 12.7% and 5.9%, respectively, in the first quarter. Within the Russell 2000, the Value Index rose 21.2%, while the Growth Index rose 4.9%. In its second-best relative performance ever, the Value Index rose more than its growth counterpart due to its higher weighting in the financials and energy sectors, its lower weighting in the health care sector, and holding better performing consumer discretionary stocks. Quarterly performance was consistent with a more optimistic view of the economy with small cap returns led by the energy, materials, and financials sectors. Health care and information technology stocks, which had produced strong performance last year, lagged as these longer duration assets were more sensitive to the increase in long-term bond yields. Investors reacted to positive vaccine progress and the passage of a third stimulus package by continuing to invest in small cap value products. Profitable small cap companies outperformed significantly in the quarter after underperforming every quarter in 2020.

With an improving economy and unprecedented monetary and fiscal stimulus, the stock market continued to produce strong returns in the quarter. GDP forecasts for 2021 increased to over 5% due to the supplemental COVID relief package passed by Congress last December and an additional \$1.9 trillion spending bill passed this year. Despite the obvious benefits of strong economic growth, concerns about product shortages and inflation arose as it will take time for global supply chains to respond to the sharp rebound in activity. As a result, long-term interest rates rose but remain very low by historical standards. Although the pandemic impacted a major portion of the population, the strong government response and societal choices allowed U.S. households to save over five trillion dollars in 2020, some of which is likely to be spent as people are vaccinated and the economy reopens. Home sales have recovered quickly and exceeded pre-pandemic levels, while pent-up demand for travel, leisure, and recreation activities is expected to fuel a sharp recovery in those businesses once they fully reopen. Nonetheless, it is too early to know the full extent of the structural damage that the pandemic has done to the U.S. economy as there are still over eight million fewer jobs than there were before the outbreak. It is clear that the administration is committed to increases in fiscal spending and higher corporate and personal taxes. The Federal Reserve has also pledged to maintain low short-term interest rates until employment has recovered, even in the face of temporarily higher inflation. The biggest potential threat is a resurgence of COVID-19, which depends upon the ability of current vaccines to protect the population from the new virus variants.

First Quarter Performance Commentary

The preliminary first-quarter return of Cardinal's Small Cap Value Composite, at 18.5%, net of fees, lagged the 21.2% return of the Russell 2000 Value Index. The main detractors from relative performance were industry and stock selection in the industrials sector, a lower weighting in the better performing consumer discretionary and energy sectors, a higher weighting in the poorly performing information technology and consumer staples sectors, and holding residual cash in a sharply rising market. In the industrials sector, Cardinal's ownership of commercial services and aerospace and defense contractors with significant government exposure was not rewarded as the market preferred cyclical businesses more leveraged to an economic rebound. Nonetheless, the share price of KAR Auction Services, which provides auction and other services to the wholesale used car market, declined 20% after announcing disappointing fourth-quarter results and guidance. Sharply elevated used car prices and pandemic-related moratoriums on auto repossessions have reduced auction volumes. Although impactful near-term, Cardinal expects these supply constraints will prove transitory.

Cardinal Capital Management, L.L.C.

Small Cap Value

First Quarter 2021

Also, in the industrials sector, the share price of Circor lagged as the provider of mission-critical flow control products to industrial and aerospace and defense markets provided lower than expected guidance as the recovery in its later cycle products is unlikely until the second half of 2021. In the consumer discretionary sector, portfolio holdings kept pace with the sector; however, the weighting was lower. In addition, not owning GameStop alone contributed two-thirds of the relative underperformance. Of the two current holdings in the sector, the share price of Lithia Motors, one of the largest national auto dealers, continued to perform strongly as management remained ahead of their five-year plan to reach \$50 billion in revenues and \$50/share of earnings via acquisitions and its recently launched online platform. In the information technology sector, portfolio holdings performed in-line with the sector, which lagged the overall index after very strong returns last quarter as investors worried about high valuations with long-term interest rates rising.

The main contributors to performance were stock selection in the health care and financials sectors and not owning poorly performing utilities. In the health care sector, the stock price of Ligand Pharmaceuticals rose as the share prices of heavily shorted stocks benefited when market participants covered positions. Cardinal sold the position on valuation. In the financials sector, the stock price of commercial bank PacWest Bancorp rose significantly after its earnings beat expectations on a lower than expected loan loss provision and announced a niche lending acquisition. As a result, its large valuation discount started to dissipate.

The annualized net return of Cardinal's Small Cap Value Composite since inception (July 1, 1992) is 12.2% versus 11.0% for the Russell 2000 Value Index and 10.4% for the Russell 2000 Index. Cardinal managed \$5.1 billion in small and SMID cap value assets as of March 31, 2021.

Highlighted Investments

WILEY

John Wiley & Sons is a leading publisher of scientific, technical, and medical research. Its online publishing platform offers subscription or pay-as-you-go access to over nine million articles from 1,675 journals, as well as 22,000 online books and hundreds of reference works, lab protocols, and databases. The company also publishes technical textbooks for higher education and provides professional books and training services to corporations. Wiley has recently expanded into the design and delivery of digital textbooks and courseware for the university classroom, as well as the management of online programs. Wiley's strong competitive position is clear from its high cash operating margins, returns on capital, and discretionary free cash flow. This has been critical as Wiley has repositioned its business through investing in digital assets to mitigate the secular decline of print textbooks and the transition of published research from print journals to digital platforms. After years of revenue declines, an inflection point has been reached as the growth in Wiley's digital businesses is now more than offsetting the decline in legacy print. Management now expects modest organic revenue growth and high single-digit EBITDA growth as software and services drive higher margins. In the research publishing business, where Wiley is the smallest of the top three players, it is poised to gain share, especially in the pay-as-you-go market, which is not a focus of its competitors. In digital courseware, the pandemic is likely to make digital courseware a permanent addition to the university educator's toolkit. Finally, strong employment growth should increase the need for skills-based higher-education and professional-education programs underpinning demand for Wiley's online services. Despite these positive trends, Wiley's valuation remains attractive due to limited sell-side coverage, skepticism about the ongoing demand for digital courseware, and the lack of good public comparables for its non-journal businesses. These factors provided Cardinal with the opportunity to initiate a position at an attractive valuation. As Wiley continues to execute its digital transformation and grow revenues and profits, its valuation should rise closer to its journal peers to better reflect the high quality of its business.



Forward Air operates a North American network specializing in the transportation of premium expedited freight via less-than-truckload, truckload, final mile, and intermodal drayage. The business was built as an alternative to airfreight with a more environmentally friendly carbon footprint and similar time-definite delivery. The company's network has over 90 facilities located at or near major U.S. and Canadian airports, 12 regional sort centers and offers services at over 300 secondary airports, making it one of the industry's most comprehensive line haul networks. It is structured to optimize savings and service to its customers through partnerships with owner-operators and other surface transportation providers. The economics of the less-than-truckload business are appealing, but Forward's

Cardinal Capital Management, L.L.C.

Small Cap Value

First Quarter 2021

results have been mediocre from diversification into other businesses. A 13D filing last December by an activist investor caught Cardinal's attention as they planned to replace members of the current board with a slate that included the company's founder and former CFO. In addition, the activist also called for the sale of non-core assets to fund a large stock repurchase, improve operations, and increase margins back to historical levels. Based on Cardinal's analysis, if these changes were successfully made, Forward's stock was materially undervalued. There was a high likelihood that management would have to adopt some of the activist's strategy given the company's lackluster results. Initially, Cardinal built a small position and added to it after a settlement was announced, giving the activist much of what they requested, including board seats. With management under pressure to deliver operational improvements and a favorable economic environment for transportation providers, Forward's valuation should rise closer to peers.

Market & Portfolio Outlook

Cardinal's near-term outlook for equities remains cautiously optimistic. On the positive side, 2021 GDP growth is estimated to be above 5%. With COVID-19 vaccinations proceeding rapidly and certain parts of the economy fully reopening, job growth has begun to accelerate. Fiscal and monetary stimulus should remain significant given Democratic control of Congress and the White House. The Federal Reserve has also committed to keep short-term interest rates low until the economy has recovered despite the risk of higher inflation. Corporate earnings are forecast to recover significantly in 2021, particularly for small companies. The mergers and acquisitions market has also begun to recover despite increased antitrust scrutiny. On the negative side, equity indices are at all-time highs, and valuations are near pre-pandemic levels despite higher long-term interest rates. Corporate and individual tax rates, including those on capital gains, are also more likely to rise as President Biden searches for ways to pay for his infrastructure bill. Such tax increases would not only reduce corporate earnings but also incentivize investors to realize gains ahead of the increase. Finally, inflation is likely to increase with stronger economic growth, which should inevitably result in further increases in long-term interest rates. Higher long-term interest rates are also negative for most companies earnings, and have historically had a depressing effect on valuations.

While there is always uncertainty in forecasting business results, long-term changes in consumer and business behavior associated with the pandemic have made the exercise more challenging. As a result, Cardinal continues to prefer investments whose success is dependent on company specific drivers with as many as possible under management control rather than solely relying on near-term economic growth to produce sustainable growth in free cash flow.

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.

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.

Any projections, market outlooks or estimates in this newsletter are forward looking statements and are based upon certain assumptions. Other events which were not taken into account may occur and may significantly affect the returns or performance of the Strategy. Any projections, outlooks or assumptions should not be construed to be indicative of actual events which will occur.