Cardinal Capital Management, L.L.C.

Small Cap Value

Fourth Quarter 2021

FIRM OVERVIEW

- Focus on Small & SMID Cap Value
- Experienced, Stable Team
- 25-Year+ Track Record
- FCF-Based Valuations
- 100% Independent, Partner Owned
- $5.2 Billion AUM

INVESTMENT TEAM

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Market Commentary

Small and large cap stock indices, as represented by the Russell 2000 and 1000, rose 2.1% and 9.8%, respectively, in the fourth quarter and rose 14.8% and 26.5%, respectively, for the year. Within the Russell 2000, the Value Index rose 4.4%, while the Growth Index was flat for the quarter. The Value Index rose more than its growth counterpart primarily due to a lower weighting in poorly performing health care stocks and a higher weighting in better performing financials and real estate stocks. For the year, the Value Index rose 28.3% while the Growth Index rose 2.8%, the largest outperformance by the Value Index since 2000, the result of investors positioning for an economic recovery. The better annual performance of the Value Index was broad-based, however, the health care, financials, consumer discretionary, energy, and real estate sectors were the largest contributors. Higher quality and lower valuation stocks produced much better than index returns for the fourth quarter. However, for the year, high-quality stocks struggled to offset the leadership of low-quality stocks in the first half. The better relative performance of large cap stocks was a shift from earlier in the year as market anticipation of a strong post-pandemic cyclical rebound faded. Uncertainty surrounding the effects of the Omicron variant, supply chain issues, higher inflation, and less accommodative monetary policy caused investors to take a more cautious stance in the fourth quarter, favoring larger and more defensive stocks. Nonetheless, heavily shorted stocks, including meme stocks, continued to produce outsized returns in the fourth quarter, although the impact was less following the index rebalance.

The U.S. economy continued to recover during the quarter, but the pace slowed as more contagious COVID variants disrupted businesses, intensified supply chain disruptions, and boosted inflationary pressures. While the reported unemployment rate is approaching pre-pandemic levels, millions of jobs have still not returned, businesses are unable to fill openings, and employees are quitting jobs at record rates as families struggle with childcare and healthcare issues. After several quarters of referring to inflation as “transitory”, the Federal Reserve decided to taper monetary stimulus and increase interest rates at a faster rate than expected in order to keep inflation under control until the supply shortages and other cost pressures wane. Despite this change, short-term interest rates remain low and fiscal deficits high, which may make it difficult to keep inflation in check. Supply bottlenecks could last well into 2022, and companies have raised prices to pass on higher input costs due to strong demand for many products and services. Although portions of the President’s Build Back Better bill are targeted to relieve childcare and other labor and supply chain issues that would dampen inflation, it appears unlikely to pass in its current form.

Fourth Quarter Performance Commentary

The preliminary fourth-quarter return of Cardinal’s Small Cap Value Composite, at 5.8% net of fees, exceeded the 4.4% return of the Russell 2000 Value Index. The primary contributors to the better relative performance were a higher weighting and stock selection in the information technology sector, a lower weighting in the poorly performing health care sector, and stock selection in the materials and real estate sectors. In the information technology sector, the stock price of Silicon Motion rose sharply after the leading supplier of NAND controllers announced a $200 million share repurchase program. In the materials sector, the stock price of H.B. Fuller rose as the adhesives provider continued to execute well and gain market share despite a shortage of raw materials and raising prices to counter cost inflation. In the real estate sector, the share price of Newmark Group increased on new long-term financial guidance which exceeded expectations as the commercial real estate services company continues to gain market share. The main detractors from Cardinal’s relative performance were stock selection in the financials sector and not owning better-performing utilities. In the financials sector, the stock price of Columbia Banking System fell sharply after it announced an all-stock deal to merge with Umpqua, whose shareholders received a premium to market. Also, shares of inter-dealer broker BGC Partners fell after the company reported results within its prior guidance range but slightly below sell-side estimates.

2021 Performance Commentary

The preliminary 2021 return of Cardinal's Small Cap Value Composite, at 26.7% net of fees lagged the 28.3% return of the Russell 2000 Value Index. The main detractors from relative performance were stock selection in the industrials and consumer discretionary sectors, a lower weighting in the better performing energy sector, and holding residual cash in a rising market. Not owning retail-driven "meme stocks," particularly GameStop, Avis, Macy's, and AMC Entertainment, detracted over two percentage points from relative performance. In the industrials sector, the share price of CIRCOR International declined due to a slower than expected recovery versus its early cycle peers and reduced guidance as a result of supply chain logistics and labor constraints. In addition, shares of BWX Technologies lagged as investors preferred more cyclical industrial investments and then fell after the supplier of nuclear components provided disappointing 2022 and 2023 guidance due to an unexpected pension change and amortization related to its new nuclear isotope product launch. In the consumer discretionary sector, the share price of Lithia Motors lagged on concerns about peak earnings for traditional automobile dealers despite Lithia's faster acquisition pace than anticipated in its five-year plan. The main contributors to the relative performance were stock selection in the health care sector, a higher weighting and stock selection in the communication services sector, not owning poorly performing utilities, and stock selection in the financials sector. In the health care sector, the share price of Ligand Pharmaceuticals rose sharply on short-covering, and Cardinal sold the position. Cardinal later repurchased the stock at a much lower price despite positive developments in the interim. In the communication services sector, the stock price of Nexstar Media Group outperformed on increased free cash flow guidance and better-than-expected trends in cable cord-cutting and net retransmission fees. In the financials sector, shares of commercial bank PacWest Bancorp rose as credit concerns eased, loan growth resumed, and capital was deployed into two acquisitions that provided loan growth opportunities and increased long-term, low-cost deposits.

The annualized net return of Cardinal's Small Cap Value Composite since inception (July 1, 1992) is 12.1% versus 11.0% for the Russell 2000 Value Index and 10.2% for the Russell 2000 Index. Cardinal managed $5.2 billion in small and SMID cap value assets as of December 31, 2021.

Highlighted Investments

MAGNOLIA OIL & GAS CORPORATION

Magnolia Oil & Gas Corporation engages in the acquisition, development, exploration, and production of oil and natural gas properties in South Texas, where the company targets the Eagle Ford Shale and the Austin Chalk formations. Magnolia's assets consist of a total leasehold position of 500,000 net acres. The company has about 1,200 net wells with an average production of 67 million barrels of oil equivalent per day. About 50% of the production from Magnolia's wells is attributable to oil, with the rest from natural gas and natural gas liquids. The company has an exceptionally long reserve backlog. The CEO of Magnolia is Stephen Chazen, a well-respected industry veteran who served in senior management at Occidental Petroleum for over 20 years. Magnolia has a reasonable and straightforward business model which seeks to generate mid-single-digit production growth while spending well within its cash flow. Currently, the company targets 60% of cash flow for ongoing investments in drilling and development and allocates the remainder to dividends and stock buybacks. The company has full exposure to export gas and oil pricing due to its proximity to Gulf Coast ports as well as the fact that it chooses not to hedge its production. This strategy is only possible because management has a very low-cost operating structure and a balance sheet with extremely low leverage. Magnolia represents a unique opportunity to enjoy the upside from higher oil and gas prices while taking materially less risk than many of its E&P peers.

WOW!

WideOpenWest, Inc. is a leading broadband services provider that offers high-speed data, cable television, and digital telephony services to residential & commercial customers in 14 markets across the United States. The company's network passes 1.9 million homes and businesses and serves over 500,000 customers. Its markets are primarily in economically stable suburbs adjacent to large metropolitan areas and in other markets that have favorable competitive and demographic characteristics. In 2020, the company shifted its focus to higher-margin IP-driven services provided over its high-speed data network. While the reduced focus on video and telephony subscribers will mean that revenue is unlikely to grow meaningfully, it also means that with the positive mix shift, the company's profit margins will benefit materially. Until recently, WideOpenWest was highly financially levered and thus could not afford to build out new markets. In 2021, the company sold its operations in five markets for $1.8 billion, which brought balance sheet leverage below management's targeted level and provided it with the financial flexibility to pursue greenfield buildouts in new service areas. As a result, management recently outlined its plans to invest $160 million in new markets through 2025 with the goal of passing 200,000 incremental homes. The company believes it can reach penetration rates of 30% in these new markets, resulting in 60,000 new subscribers. Also, management began to implement a plan to reduce its operating expenses by $35 million over three years. The combination of accelerating high margin product growth and cost savings should provide strong and growing free cash flow despite the significant growth investments outlined above. These characteristics, paired with an under-levered balance sheet and a valuation below recent private market transactions, offer a strong risk-reward trade-off for investors.

Market & Portfolio Outlook

Cardinal's near-term outlook for equities remains cautiously optimistic. In 2022, the U.S. economy should grow nicely though slower than the 5% plus rate experienced in 2021 as fiscal and monetary stimulus decline and labor and other supply constraints dampen growth. Inflation is likely to remain well above the Federal Reserve's 2% target for most of the year but should begin to ease as supply constraints lessen and demand pressures ebb. The Federal Reserve has signaled that it will use its policy tools to keep inflation in check while trying to keep the economic recovery on track. The real unknown is the fallout from the COVID pandemic and its future economic impact. In summary, the U.S. economy is strong, and liquidity and corporate profits are at record levels as businesses have adapted well to the pandemic. However, stock valuations are no longer depressed, interest rates are rising, and earnings comparisons are set to become more difficult. While there is always uncertainty in forecasting business results, 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.

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Disclosures

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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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