Cardinal Capital Management, L.L.C.

Small Cap Value

Fourth Quarter 2022

FIRM OVERVIEW

- Focus on Small & SMID Cap Value
- Experienced, Stable Team
- 30-Year Track Record
- FCF-Based Valuations
- 100% Independent, Partner Owned
- $3.8 Billion AUM

INVESTMENT TEAM

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Market Commentary

Small and large cap indices, as represented by the Russell 2000 and 1000, rose 6.2% and 7.2%, respectively, in the fourth quarter and fell 20.4% and 19.1%, respectively, for the year. Within the Russell 2000, the Value Index rose 8.4%, while the Growth Index rose 4.1%. The Value Index rose more than its growth counterpart due primarily to its higher weighting in better-performing financials, its lower weighting in the poorly performing health care sector, and better-performing industrials and consumer discretionary stocks. For the year, the Value Index fell 14.5%, while its growth counterpart declined 26.4%. The superior performance of the Value Index was due to better-performing financial, industrial, materials, and energy stocks and a lower weighting in the poorly performing information technology, health care, and consumer discretionary sectors. Besides the utility sector, which showed a nominal rate of return, the energy sector was the only sector that produced positive returns for the year. Despite the fourth-quarter rally, full-year 2022 equity returns were the weakest since 2008. This was the result of an unusual combination of macroeconomic forces arising from pandemic-related fiscal and monetary policy stimulus and the subsequent normalization, which produced some anomalous factor returns. For example, cyclical stocks outperformed the indices for the quarter and year despite a weakening economy and increased risk of recession. Pandemic-driven demand increases and supply chain disruptions caused elevated commodity prices, which boosted the earnings of many cyclical companies. An economic slowdown also normally results in lower interest rates, but the Federal Reserve is instead raising interest rates to cool inflation. Higher interest rates have disproportionately impacted less cyclical but traditionally more highly valued defensive and growth stocks. However, as would be expected in uncertain economic conditions, larger market capitalization, higher quality, and less expensive stocks performed relatively well.

Macroeconomic concerns dominated the stock and bond markets in 2022 and created a particularly challenging investment environment. The key issues were persistent high inflation, significantly more restrictive monetary policy, and the economic fallout from the Russian invasion of Ukraine. While inflation may have peaked, the Federal Reserve's decision to continue aggressively raising short-term interest rates increased the likelihood of a recession in 2023. Although GDP growth in 2022 was tepid, the labor market remains quite healthy even with increasing corporate layoffs. In fact, consumer spending has been resilient because the savings accumulated during the pandemic and strong wage gains have broadly offset higher prices and borrowing costs. However, real estate as well as mergers and acquisitions activity have fallen off significantly as valuations adjust to higher interest rates. A materially higher U.S. Dollar created another headwind for the profitability of many multinational companies. More recently, the Chinese government's abrupt decision to drop its zero covid policy has created more global economic challenges as China deals with the impact of a surge in new COVID-19 cases. Corporate earnings have already begun to reflect weaker economic conditions and higher input and interest costs. Considering these challenges, company guidance has generally been more cautious. However, market prices continue to reflect this impact as the valuation of small capitalizations stocks is low in absolute and relative terms.

Fourth Quarter Performance Commentary

The preliminary fourth-quarter return of Cardinal's Small Cap Value Composite, at 6.7% net of fees, lagged the Russell 2000 Value Index return of 8.4%. The primary detractors from relative performance were stock selection in the consumer discretionary and financials sectors, a higher weighting in the poorly performing information technology sector, and holding residual cash in a rising market. The main contributors were stock selection in the health care, consumer staples, and materials sectors. In the consumer discretionary sector, the share price of pool cleaning and maintenance supplier Leslie's lagged its peers after management provided disappointing guidance based on weaker consumer spending and higher interest expense. In the financials sector, the stock price of Tennessee-based FB Financial fell after the bank reduced its expectations for net interest margins and mortgage profitability late in the quarter. In the information technology sector, the share price of Verra Mobility fell despite beating expectations and increasing guidance as analysts reduced 2023 earnings estimates for the business service provider due to higher interest rates on its floating rate debt.

2022 Performance Commentary

The preliminary full-year return of Cardinal's Small Cap Value Composite, at -17.3% net of fees, lagged the Russell 2000 Value Index return of -14.5%. The primary detractors were stock selection in the financials, energy, consumer staples, and real estate sectors, a higher weighting and stock selection in the poorly performing information technology sector, and not owning utilities. This was partially offset by stock selection in the materials and industrials sectors and holding residual cash in a declining market. In the financials sector, the share price of PacWest Bancorp fell due to pressure on its capital levels, which was the result of unrealized losses on its fixed-income securities portfolio. In the information technology sector, the stock price of Cognyte Software fell, and the portfolio managers sold the position as the provider of cyber security software continued to struggle with converting its pipeline of orders into revenues. In the energy sector, the value of our holdings rose nicely but lagged the increase seen in smaller, more highly levered exploration & production companies. In the consumer staples sector, the share price of conglomerate Spectrum Brands fell after the Department of Justice filed suit to block the sale of its Hardware and Home Improvement segment to Assa Abloy. Subsequently, Assa Abloy agreed to divest its overlapping businesses in the U.S. and Canada to Fortune Brands in an $800 million all-cash deal as the parties seek to overcome U.S. antitrust opposition. In the real estate sector, the stock price of Newmark lagged the prices of other commercial real estate service providers after outperforming last year as its business is more sensitive to a slowdown in transactions.

Highlighted Investments

consensus Cloud Solutions

Consensus Cloud Solutions, Inc. provides secure information delivery services through its eFax technology using its SaaS platform. Most of its revenues are recurring and generated through fixed subscription plans or usage-based contracts. The company recently shifted its attention from small businesses to the corporate cloud fax market with a focus on healthcare. In an increasingly data-driven environment, interoperability is essential to ensuring quality care delivery while safeguarding patient information. This is particularly true in the healthcare industry, where seventy-five percent of all communication is still via fax, while patient data is maintained in digital databases. Fax remains the standard because email does not meet the security levels required to maintain patient privacy. Consensus' Unite platform uses the underpinnings of the firm's legacy fax platform to enable the user to choose between several HIPAA-complaint protocols to send and receive information in a highly secure and certified system that can also be integrated into an existing electronic health record. Following its spin-off from Ziff Davis in late 2021, Consensus focused on executing a product roadmap aimed at securing its position as the interoperability service provider of choice in a healthcare setting. Recently, the company was awarded a multi-year contract to provide fax as a service to the Veterans Administration, which potentially opens other U.S. Government agencies as potential customers. The new roadmap and recent wins are expected to accelerate the organic revenue growth rate to a mid to high single-digit percentage without significantly impacting their industry-leading profit margins and maintaining strong cash flow. Cardinal expects investors who were leery of the secular growth challenges of the legacy fax business will revisit Consensus amid this growth acceleration.

LivaNova

Health innovation that matters

LivaNova is the product of the 2015 merger of two medical technology companies, Cyberonics and Sorin. The transaction combined a cardiovascular business with a neuromodulation franchise. New management subsequently streamlined the strategy while selling non-core assets. The company's most valuable asset is its vagus nerve stimulation business which helps treat people with drug-resistant epilepsy. VNS generates 60% of revenues from consumables, has over 90% market share, and generates cash flow margins of over 40%. With mid-to-high single-digit revenue growth expected over the medium term as well as modest competition and pricing headwinds, the neuromodulation business is extremely attractive. The remainder of LivaNova's cash flow comes primarily from its heart and lung machine business. This segment has a dominant capital equipment market share and should grow modestly over time, with the potential to grow faster if new product launches are successful. The investment team believes this segment is a candidate for divestment after the new products are launched and should be attractive to a financial buyer. In addition, the company is investing in three projects that could produce substantial future revenue, including using its vagus nerve stimulation device to treat depression which could produce favorable data in 2023. Because the FDA has previously approved this device and it comes with many years of safety data, Cardinal believes commercialization hurdles for the treatment of depression are lower than a typical clinical trial. The potential revenue opportunity is roughly two billion dollars based on the addressable patient population. There are several paths to a favorable outcome with this investment. If the depression trial has a positive result, the portfolio managers expect the stock to rise meaningfully. If the trial fails, Cardinal believes that the company would likely become a takeover candidate, as it was broadly reported in the press in 2021 that LivaNova attracted both strategic and private equity interest at much higher prices before the depression trial started. The combination of a solid core business with significant upside options from future approvals presents an attractive risk reward for shareholders.

Cardinal's Outlook

Cardinal's near-term outlook for equities remains cautious. In 2023, the U.S. economy is expected to show slower growth with less fiscal stimulus, continued monetary tightening, and moderating inflation. Federal Reserve policy is likely to remain restrictive until there is conclusive evidence that inflation is retreating toward its two percent target. Nonetheless, healthy consumer and business balance sheets should keep any economic downturn modest. The equity market currently appears to be discounting a mild recession beginning in 2023, but monetary policy acts with a lag, so it is still premature to know the severity of any slowdown. The portfolio managers do not expect to see a material increase in merger and acquisition activity until interest rates and equity prices stabilize. Regardless, 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.

Performance Track Record

Cardinal Small Cap Value	Gross	Net	Russell 2000 Value
Inception-to-Date (July 1, 1992)	11.9	11.0	10.0
10-Years	8.7	7.9	8.5
5-Years	2.6	1.9	4.1
3-Years	2.1	1.4	4.7
1-Year	-16.7	-17.3	-14.5
4th Quarter	6.9	6.7	8.4

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.

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Cardinal has been independently verified for the periods July 1, 1992 through December 31, 2021. A firm that claims compliance with the GIPS standards must establish policies and procedures for complying with all the applicable requirements of the GIPS standards. Verification provides assurance on whether the firm's policies and procedures related to composite and pooled fund maintenance, as well as the calculation, presentation, and distribution of performance, have been designed in compliance with the GIPS standards and have been implemented on a firm-wide basis. The Cardinal Capital Small Cap Value Equity Composite has had a performance examination for the periods July 1, 1992, through December 31, 2021. The verification and performance examination report is available online at the following link: Cardinal GIPS Report 12/31/2021

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