Cardinal Capital Management, L.L.C.

SMID Cap Value

First Quarter 2023

FIRM OVERVIEW

- Focus on Small & SMID Cap Value
- Experienced, Stable Team
- 30-Year Track Record
- FCF-Based Valuations
- 100% Independent, Partner Owned
- $3.4 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, SMID, and large cap indices, as represented by the Russell 2000, 2500, and 1000, rose 2.7%, 3.4%, and 7.5% in the first quarter. Within the Russell 2500, the Value Index rose 1.4%, while the Growth Index rose 6.5%. The Value Index rose less than its growth counterpart due primarily to its higher weighting in poorly performing financials stocks and its lower weighting in better-performing technology stocks. Financials fell significantly due to weakness in bank stocks, particularly regional banks, which declined 18.7% within the Value Index in the quarter following the runs on and closures of Silicon Valley Bank and Signature Bank in mid-March. With no decisive regulatory actions to deal with the collateral damage from these high-profile bank failures, the equity market assumed that there would be broad negative impacts on the U.S. economy. As a result, in March, small cap stocks experienced their worst monthly relative performance since the pandemic, going from four hundred basis points ahead of large cap stocks on February 28th to five hundred basis points behind by quarter end. Consistent with what often occurs when the odds of a recession increase, stocks of companies with the highest return-on-investment, price-to-earnings ratios, and absolute price levels outperformed the broader indices. However, sector returns were less economically bearish as the more cyclical information technology and materials sectors provided well above average returns while the more defensive health care and utilities sectors were laggards.

With inflation still elevated, markets continued to focus on the negative impact on corporate profits from the Federal Reserve's efforts to use short-term interest rates and a restrictive money supply to slow the economy. The impact of almost five hundred basis points of short-term rate hikes in the last year, along with tighter lending conditions and shrinking liquidity, is expected to turn economic growth negative for the last nine months of 2023. However, employment and consumer spending have yet to turn negative as consumer savings built during the pandemic and wage gains have broadly offset higher prices and borrowing costs. The most recent addition to economic concerns is the impact of accelerated deposit flows out of non-money center banks due to the lack of an explicit FDIC guarantee on all deposits and as consumers seek higher yields elsewhere. Higher interest rates had started to put pressure on bank capital as their securities portfolios were marked-to-market, but a more volatile deposit base will clearly reduce banks' appetite to make new loans and increase the cost of those loans. Economic damage from further Federal Reserve rate hikes could be significant until the banking system stabilizes. As a result, the fixed income market is currently pricing in interest rates cuts later this year.

First Quarter Performance Commentary

The preliminary first quarter return of Cardinal's SMID Cap Value Composite, at -1.4% net of fees, trailed the Russell 2500 Value Index return of 1.4%. The primary detractors from relative performance were stock selection and a lower weighting in the better-performing consumer discretionary sector and stock selection in the real estate, information technology, and communication services sectors. In consumer discretionary, the share price of Leslie's declined despite the pool supplier reporting solid results due to concerns about weak demand, lower chlorine prices, and higher inventories. It is too early in the pool season to assess the first two issues, but the company tried to guide conservatively. The increased inventories result from management's actions to proactively manage the company's supply chain logistics and decrease its reliance on just-in-time inventory well before the upcoming pool season. In real estate, the share price of Medical Properties Trust fell despite progress on two sizeable divestitures after the real estate investment trust provided disappointing funds from operations guidance as one of its hospital operators works to restructure and divest unprofitable operations. Medical Properties expects to be made whole for any 2023 rent shortfall through the sale of this customer's noncore assets. In information technology, the stock price of Consensus Cloud Solutions fell after the digital eFax provider reported weaker-than-expected fourth-quarter results and 2023 financial guidance. In communication services, the share price of Nexstar Media Group fell slightly after the nation's largest local television broadcaster tempered its retransmission guidance to reflect more protracted renewal negotiations. Cardinal's investments in the financials sector were not a significant detractor, however, the stock price of PacWest Bancorp did fall significantly in sympathy with Silicon Valley Bank, as a third of its deposits were venture-based. While PacWest did see significant deposit outflows immediately following the closure, the bank was able to build its liquidity to one hundred and twenty percent of all uninsured deposits and reduce its uninsured venture deposits to four percent of all deposits, which Cardinal expects will last until the current banking crisis of confidence subsides.

The main contributors to relative performance were stock selection in the industrials and consumer staples sectors. In industrials, the share price of welding equipment supplier ESAB rose after Enovis sold its remaining shares, lifting the overhang, and the company reported quarterly results and 2023 guidance that beat analysts' expectations. In consumer staples, the stock price of Spectrum Brands rose after investors responded well to pretrial hearings in which the Judge was critical of key Department of Justice positions seeking to prevent the pending sale of Spectrum's Hardware and Home Improvement business.

Highlighted Investments

QuidelOrtho is a diagnostic healthcare testing business that services the full spectrum of end users, including hospitals, clinical laboratories, and consumers. The company was created by the merger of Quidel and OrthoClinical in 2022. Soon after the onset of the pandemic, Quidel developed two COVID tests, a rapid antigen one for at-home use and an immunoassay test for its point-of-care-based Sofia platform. The latter enabled Quidel to take meaningful market share in the flu test market by entering bundled multi-year contracts with its customers who wanted access to the COVID tests. The cash flow produced by these successful new products helped fund the Ortho merger. While the combination of Ortho and Quidel has typical merger integration risk, it does diversify Quidel away from the volatile flu diagnostics business and should promote best practices across the company. The merger also helps to de-risk the company's U.S. launch of its Savannah molecular diagnostic testing platform. Savannah is ramping up in Europe and should benefit from integrating Ortho's sophisticated salesforce. At a high level, Quidel operates in an attractive industry characterized by high recurring revenues with a razor/razorblade business model, long-term contracts, barriers to entry, and strong intellectual property. Cardinal is optimistic about QuidelOrtho's growth prospects because of its sizable backlog, continued industry shift to integrated offerings like the company's Sofia and Vitros platforms, and optionality in their Savannah launch. Given its free cash flow and balance sheet, the company has ample room to continue buybacks should its share price remain depressed. Despite the business's strong market position and growth opportunities, Quidel trades at an undemanding valuation versus its peers. As a result, Quidel's shares should re-rate higher as the company executes on its growth initiatives.

Ritchie Brothers is a global leader in asset management as well as the disposition of durable assets and used equipment. Through unreserved auctions, online marketplaces, and private brokerage services, the company auctions off a broad range of primarily used commercial and industrial assets and government surplus. Construction and commercial transportation assets comprise most of the gross transaction value that the company handles. Customers include end users such as construction companies, equipment dealers, OEMs, and rental companies. Richie Brothers also provides other value-added services such as financing, appraisals and inspections, online listings, logistical services, and equipment refurbishment. Cardinal received shares of Ritchie Brothers through its recent acquisition of Insurance Auto Auctions. The combined entity should benefit from increased cash flow after realizing more than $100 million in targeted cost synergies. Additionally, management believes there is potential for revenue synergies driven mostly by differentiated offerings, incremental yard capacity, and international expansion that, over time, could add between $350 million and $900 million in pretax operating cash flow. Given its strong free cash flow profile, Richie Brothers will be able to retire its floating rate debt and subsequently shift a portion of free cash flow deployment to higher return projects. Cardinal believes the combination of these factors should cause the stock to undergo multiple expansion.

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Cardinal's Outlook

Cardinal's near-term outlook for equities remains cautious. In 2023, the U.S. economy is expected to show little growth as the impact of continued monetary tightening becomes more evident. Federal Reserve policy is likely to remain restrictive until there is conclusive evidence that inflation is retreating toward its two percent target. However, the Federal Reserve may, in fact, be forced to reverse course if economic disruption associated with a worsening of the banking crisis or a failure to raise the debt ceiling becomes significant. Nonetheless, healthy consumer and business balance sheets should keep any economic downturn modest. The equity market seems to be discounting a mild recession later 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 SMID Cap Value Composite	Gross %	Net %	Russell 2500 Value %
Inception-to-Date (April 1, 2010)	9.2	8.8	8.8
10-Years	7.2	6.8	7.7
5-Years	3.4	2.9	5.6
3-Years	17.6	17.1	21.8
1-Year	-18.3	-18.7	-10.5
1st Quarter	-1.3	-1.4	1.4

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 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. 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.

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TELEPHONE:
203-863-8990

FOUR GREENWICH OFFICE PARK
GREENWICH, CT 06831

WEBSITE:
www.cardcap.com

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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 SMID Cap Value Equity Composite has had a performance examination for the periods January 1, 2002, through December 31, 2021. The verification and performance examination report is available online at the following link: Cardinal GIPS Report 12/31/2021