Cardinal Capital Management, L.L.C.

Small 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

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Market Commentary

Small and large cap indices, as represented by the Russell 2000 and 1000, rose 2.7% and 7.5% in the first quarter. Within the Russell 2000, the Value Index fell 0.7%, while the Growth Index rose 6.1%. 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 17.3% 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, there may be a pause in rate hikes even if inflation stays elevated and 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 Small Cap Value Composite, at -1.5% net of fees, trailed the Russell 2000 Value Index return of -0.7%. The primary detractors from relative performance were stock selection in the real estate and energy sectors, a lower weighting and stock selection in the better-performing consumer discretionary sector, and stock selection in the financials sector. 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 energy, the stock price of DT Midstream lagged after the owner of natural gas pipelines forecast higher than expected capital expenditures which the company did not properly frame for investors as a timing rather than a cost issue. 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 financials, the stock price of PacWest Bancorp sank 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 120% of all uninsured deposits and reduce its uninsured venture deposits to 4% 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 and a higher weighting in the better-performing industrials sector and a lower weighting and stock selection in the poorly performing health care sector. In industrials, the share price of tolling and traffic control services provider Verra Mobility rose on better-than-expected guidance, which included a well-structured floating to fixed interest rate swap which capped the cost of its debt for the next two years but is cancellable at any time should the rate environment improve. In health care, the stock price of Ligand Pharmaceuticals rose on better-than-expected guidance, which included royalties and milestone payments from Travere Therapeutics' recently approved Filspari drug used to treat the kidney disorder, IgA Nephropathy. Ligand also owns ten percent of Viking Therapeutics, which had positive clinical developments that caused its stock to rise meaningfully.

Highlighted Investments

Ligand®

Ligand Pharmaceuticals focuses on funding late-stage clinical development for pharmaceutical companies in return for the right to receive royalties and milestone payments. The objective is to create a diversified and growing portfolio of high-margin product revenues that are supported by an efficient and low-cost corporate structure. A major benefit of this approach is that it offers investors the opportunity to participate in the rapid growth of the biotech industry in a profitable and diversified manner while mitigating the binary risk associated with single-compound clinical development. Cardinal has made successful investments in Ligand three times over the past ten years but sold the stock last year after the company announced the spin-off of its antibody discovery business into a SPAC and indicated that it intended to accelerate spending which would result in negative cash flow for several years. Although Ligand has had little success in generating meaningful new royalties since Cardinal became involved, the portfolio managers are encouraged by the approval of Filspari for kidney disorders. Filspari extends life expectancy significantly for what is an otherwise terminal diagnosis and carries a high royalty rate with a large addressable market. As important, Cardinal was pleased to see the recent appointment of Board Member Todd Davis as CEO of the company. Mr. Davis has a strong history in pharmaceutical operations and co-founded two successful royalty finance firms. He plans to focus on traditional royalty financing activities rather than platform assets, which have produced less than stellar results in recent years. With low financial and high operating leverage, Ligand expects to produce strong earnings growth both organically and on incremental investments, which should provide attractive financial returns to investors.

interdigital.

InterDigital develops mobile and video technologies that are at the core of devices, networks, and services. The company solves many of the industry's most critical and complex technical challenges, inventing solutions for more efficient broadband networks, better video delivery, and richer multimedia experiences years ahead of market deployment. Founded in the 1960s, InterDigital has over 28,000 patents that are essential to virtually all wireless and video devices worldwide, with licenses and strategic relationships covering many of the leading suppliers. Although the smartphone market is forecast to grow modestly going forward, the company has license agreements covering 50% of current volumes and expects to increase that to 75% through negotiated licenses or litigation with Lenovo, Oppo, and Vivo over the next few years and should result in over $500 million in annual revenue. In addition, the company has signed patent licenses with many major consumer electronics and other non-smartphone customers which it expects to grow to over $150 million in annual revenue. Having successfully renewed their license with Apple last September and gotten Samsung to agree to binding arbitration this January, management is confident they can reach $400 million in recurring operating cash flow in the next few years. Given the significant visibility due to the long-term fixed fee contract structures and considerable excess cash and free cash flow generation, InterDigital has begun to aggressively repurchase their shares again. Although the company's share price has risen nicely this year, its solid prospects and clean balance sheet should be attractive to investors in the current uncertain environment.

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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 Small Cap Value Composite	Gross %	Net %	Russell 2000 Value %
Inception-to-Date (July 1, 1992)	11.7	10.8	9.9
10-Years	7.2	6.5	7.2
5-Years	2.2	1.5	4.5
3-Years	19.1	18.2	21.0
1-Year	-15.4	-16.0	-13.0
1st Quarter	-1.3	-1.5	-0.7

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.

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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