Cardinal Capital Management, L.L.C.

SMID Cap Value

Third Quarter 2023

FIRM OVERVIEW

- Focus on Small & SMID Cap Value
- Experienced, Stable Team
- 30-Year Track Record
- FCF-Based Valuations
- 100% Independent, Partner Owned
- $2.7 Billion AUM

INVESTMENT TEAM

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Market Commentary

Small, SMID, and large cap indices, as represented by the Russell® 2000, Russell® 2500, and Russell® 1000, fell 5.1%, 4.8% and 3.2%, respectively, in the third quarter. Within the Russell® 2500, the Value Index fell 3.7%, while the Growth Index fell 6.8%. The Value Index fell less than its growth counterpart due primarily to its lower weighting in poorly performing healthcare stocks, a higher weighting in better performing financial stocks, and better performing materials and industrial stocks. Energy was the best performing sector as oil prices rose dramatically during the quarter on a combination of supply cuts from OPEC+, China's continued recovery from pandemic lockdowns last year, and a solid U.S. economy. Financial stocks benefited from the stabilization of regional bank stocks following substantial declines in the first half of the year in the aftermath of the Silicon Valley Bank collapse. Deposit flows and costs began to moderate as it became apparent that there would not be widespread bank failures. While small capitalization stocks outperformed large ones early in the quarter on expectations for a soft economic landing, small cap returns lagged in September as interest rates climbed sharply and recession fears intensified. With the yield on ten-year U.S. Treasury Bonds climbing from 3.85% to 4.57% over the quarter, the Federal Reserve seems to have finally convinced the bond market that monetary policy will remain tight and interest rates are likely to stay higher for longer. As a result, long duration stocks and low-quality businesses lagged. From an economic growth perspective, sector returns were broadly more procyclical as financials and energy outperformed while defensive consumer staples and utilities lagged.

While inflation has fallen to less than half of last year's peak of 9.1%, it is still above the Federal Reserve's two percent target and the monetary authority continues to fight this stubborn problem. Not only has the Federal Reserve executed one of the most aggressive tightening campaigns in history, but it has also continued to signal that more hikes may be ahead even as the financial markets remain concerned about the impact that monetary tightening and fading fiscal tailwinds will have on the economy. The labor market has already started to cool, and the housing market has slowed. In addition, the problems that have plagued U.S. banks have not gone away. High money market rates pose a risk to bank deposits, while loan collateral values are under pressure due to rising bond yields. Commercial real estate values, particularly office, are falling on higher interest rates and as businesses provide for more people to work from home. Although a full-blown banking crisis was averted, tighter credit conditions will weigh on the economy as lending standards and borrowing rates rise. These factors, along with the resumption of student loan repayments and the UAW strike at the three major automakers, have increased the chances of an economic slowdown although it may take time before weaker U.S. growth becomes evident. Until then, the Federal Reserve will likely remain hawkish and thus forestall any meaningful decline in bond yields.

Third Quarter Performance Commentary

The preliminary third quarter return of Cardinal's Smid Cap Value Composite, at -6.0% net of fees, trailed the Russell 2500® Value Index return of -3.7%. The main detractors from relative performance were stock selection in the materials and information technology sectors, a lower weighting and stock selection in the better performing financials sector, stock selection in the real estate sector, and a higher weighting in the poorly performing communication services sector. In the materials sector, the share price of FMC Corporation fell after the agricultural chemicals provider reduced financial guidance despite relatively stable end market demand as the market experienced significant inventory destocking in light of rapidly rising financing costs and a more reliable supply chain. In the information technology sector, the stock price of Verint Systems fell after the customer engagement software provider missed quarterly estimates and forecast lower annual revenue on weaker bookings citing lower pipeline conversion due to increased budget scrutiny. In financials, the share price of Euronet Worldwide fell when the electronic financial transaction provider lowered guidance despite improving European travel trends as consumers are spending less due to the weaker macroeconomic environment. In the real estate sector, the stock price of Medical Properties Trust fell as some of its key tenants remain fiscally challenged and the hospital real estate owner company needs to sell assets to reduce leverage which will also lower cash flow. In communication services, the share price of television broadcaster Nexstar Media Group lagged as contentious distribution negotiations within the television broadcast industry put pressure on the stock.

The main contributors to performance were stock selection in industrials, a higher weighting in better performing energy and lower weightings in poorly performing healthcare and utilities. In industrials, the share price of ESAB rose after the provider of welding equipment and supplies raised guidance on stronger pricing and volumes as customers embraced their new products and underlying demand remained solid.

Highlighted Investments

XPO operates the third largest less than truckload ("LTL") network in North America and is essentially a pure play after having successfully spun off and sold other transportation assets over the last two years. Following management's decision to delay the sale of its European business and a couple of lackluster quarters, the position was sold due to the absence of a near-term catalyst to unlock the full potential of the business. After the sale, Cardinal communicated to XPO management what they needed to see to become a shareholder again. Cardinal was pleasantly surprised to see these concerns addressed in short order. The company improved disclosure by providing historical proforma results on a consistent basis, added a well-respected industry executive to the board of directors, and named David Bates as COO. Bates was the driving force in building and optimizing Old Dominion Freight Line's LTL network which has industry leading margins. These actions gave the team conviction to repurchase XPO shares because of the belief that XPO's 2027 financial targets were not only achievable but could be hit even earlier. Furthermore, Cardinal built the position as they observed management executing its growth plan by expanding network capabilities through adding drivers, trucks, trailers, distribution hubs, and local sales representatives as well as enhancing cost containment efforts by promptly taking actions to lower damage claims and improve net promoter scores. These initiatives are being accomplished by properly incentivizing front-line workers and centralizing decision making under the new COO, who has used this approach successfully in the past. With the best technology and network in the industry, Cardinal sees no reason XPO cannot achieve best in class performance under Bates' leadership and do not believe this is currently reflected in the company's stock price despite its recent strong performance.

Teradata Corporation is a leading connected multi-cloud data platform for enterprise analytics which helps companies integrate and simplify their data and analytics ecosystem as well as streamline access and management of data. With more companies moving to the cloud, it is essential for them to integrate ecosystems across cloud based and on-premise environments to operate effectively. Teradata has the unique ability to address the full spectrum of analytics needs, from cloud-only to multi-cloud to hybrid and on-premise. Historically, Teradata's products were oriented to on-premise data warehouse offerings and the company was slow to build solutions for cloud-based environments. A new CEO hired in mid-2020 crafted a plan to adapt its legacy offerings and move to a cloud-based growth strategy. Today, Teradata's annual recurring revenue is nearly one third cloud-based and those revenues are growing at a high double-digit rate. Its rapid growth in cloud revenue has been masked by the transition from one time on-premise license fees to annual revenues associated with the company's SAAS offerings. However, now that cloud revenue is a material portion of overall sales, the company is expected to report accelerating total revenue growth and increased profit margins in the future. These results should improve Teradata's valuation as the company shows that it is clearly a beneficiary of the long-term growth in information technology spending. In addition, most of the company's current free cash flow is being used to buy back stock, which will increase the benefit from an upward revaluation of the business. The misperception that Teradata solutions are not as good as newer competitors has provided Cardinal with an opportunity to invest in an attractive secular growth business whose products have built credibility as a leading vendor in the cloud.

Cardinal's Outlook

Cardinal's near-term outlook for equities is once again cautious. The Federal Reserve's determination to thwart inflation through higher interest rates should ultimately slow the US economy, despite what has been resilient consumer spending since the pandemic induced stimulus actions. Not only have interest rates moved much higher over the last eighteen months, the impact of higher credit costs and tighter lending standards from the regional bank failures earlier this year are only now beginning to become more pervasive across the economy. A mild recession is still the most likely scenario, but the slowdown could be greater if interest rates continue to rise. Nonetheless, once interest rates stabilize and financing conditions improve, merger and acquisition activity should increase as substantial liquidity is poised to be put to work. Regardless, Cardinal continues to prefer investments whose success is dependent on company-specific drivers with as many as possible under management control rather than relying solely on near-term economic growth to produce sustainable growth in free cash flow.

Performance Track Record (as of 9/30/2023)

Cardinal SMID Cap Value Composite	Gross %	Net %	Russell 2500 Value %
Inception-to-Date (April 1, 2010)	8.4	8.0	8.5
10-Years	5.8	5.4	6.9
5-Years	0.7	0.3	4.0
3-Years	7.0	6.6	13.3
1-Year	3.1	2.7	11.3
3rd Quarter	-6.0	-6.1	-3.7

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 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.

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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