Cardinal Capital Management, L.L.C.

SMID Cap Value

Fourth Quarter 2023

FIRM OVERVIEW

- Focus on Small & SMID Cap Value
- Experienced, Stable Team
- 30-Year Track Record
- FCF-Based Valuations
- 100% Independent, Partner Owned
- $2.6 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®, rose 14.0%, 13.4%, and 12.0%, respectively, in the fourth quarter and rose 16.9%, 17.4%, and 26.5%, respectively, for the year. Within the Russell 2500, the Value Index rose 13.8%, while the Growth Index rose 12.6% for the quarter. The Value Index rose more than its growth counterpart primarily due to its much higher weighting in the better-performing financials and real estate sectors as well as its better-performing communication services and consumer discretionary stocks. For the first time, the financials, real estate, consumer discretionary, and health care sectors, all of which are interest rate sensitive, simultaneously outperformed the small cap indices following dovish comments from the Federal Reserve, which triggered a sharp bond market rally. Not surprisingly, the fourth quarter rally in the Russell 2000 was also led by smaller capitalization and lower-quality stocks due to significant ETF inflows as investors added economic risk to their portfolios. For the year, the Value Index rose 16.0%, while the Growth Index rose 18.9%. The Value Index lagged its growth counterpart because of a lower weighting in the better-performing information technology sector and a higher weighting in the poorly-performing financials and utilities sectors. With respect to the broader stock market, performance was driven by a handful of mega-cap technology stocks that are expected to benefit from the adoption of artificial intelligence. The narrowness of the market was clear from the thirty-six-percentage point outperformance of large-cap growth stocks over large-cap value, the second-biggest margin in twenty-five years, with the top seven stocks having constituted about half of the market return.

Macroeconomic concerns again dominated the stock and bond markets in 2023. At the outset of the year, sentiment was cautious as recession fears were top of mind because of higher interest rates, inflation, and increased pressure on consumer spending as pandemic-related stimulus savings were depleted. Although corporate earnings are expected to be down for the year, the economy and employment remained resilient. With results better than feared, the equity indices rose sharply in large part due to the artificial intelligence euphoria but also to the improved prospects for lower inflation and interest rates in 2024. However, double-digit index returns masked very uneven performance across sectors and industries as many companies experienced unprecedented volatility in demand due to the lingering impact of COVID-related company and consumer behavior changes as well as higher interest rates. Investor sentiment improved especially in the last two months of the year as inflation trended lower and job growth moderated while hope for an economic soft landing increased. Following the strong absolute return in the fourth quarter, the valuation of small capitalization stocks is modestly more expensive in absolute terms. However, relative to large capitalization stocks, it is near its lowest level ever. Indeed, the market capitalization of Apple Inc. alone exceeds that of the entire small cap market.

Fourth Quarter Performance Commentary

The preliminary fourth-quarter return of Cardinal's SMID Cap Value Composite, at 10.9% net of fees, lagged the Russell 2500 Value Index® return of 13.8%. The primary detractors from relative performance were stock selection in the communication services, industrials, materials, and health care sectors, and holding cash in a rising market. The main contributor was stock selection in the financials sector. In communication services, the stock price of Ziff Davis lagged peers after the digital media company reported third-quarter results that missed expectations and announced it expected to finish the year at the lower end of its guided range. In industrials, the share price of nuclear components provider BWX Technologies lagged as investors favored more economically sensitive businesses. In materials, shares of Silgan Holdings lagged as unexpected destocking reduced the packaging company's sales due to customers managing their working capital investment. In health care, the stock price of LivaNova lagged despite raising annual guidance after the medical technology company reported some business disruption from a cybersecurity breach late in the quarter, which has subsequently been remedied.

2023 Performance Commentary

The preliminary full-year return for Cardinal's SMID Cap Value Composite, at 3.2% net of fees, lagged the Russell 2500 Value Index return of 16.0%. The primary detractors from relative performance were stock selection in the materials, communication services, information technology, and real estate sectors. Relative contributors included stock selection in the industrials sector and not owning poorly performing utilities. In materials, the share price of FMC fell after the agricultural chemical producer 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. Cardinal continues to hold FMC, but has decreased its estimates of the company's terminal-year results. In the communications services sector, Cardinal continues to own shares of Ziff Davis, highlighted above, as the business has started to show sequential improvement and believes concerns over the company being disintermediated by artificial intelligence are overblown. In information technology, the stock price of Verint Systems fell after the provider of customer engagement software lowered revenue guidance due to macro-driven deal slippage. The portfolio retained this position as the company is maintaining market share and aggressively repurchasing shares in response to the lower valuation. In the real estate sector, the share price of Medical Properties Trust fell significantly after its largest hospital operator tenants developed liquidity issues after having to repay COVID-related government loans before their operations had fully normalized. The position was sold when it became clear that management was not acting decisively enough to address these issues.

Highlighted Investments

kyndryl

Kyndryl is a technology services company that focuses on providing infrastructure solutions. It serves more than 4,000 enterprise customers across more than one hundred countries, with the purposes of designing, building, and managing secure and responsive private, public, and multi-cloud computer environments to foster digital transformation. It has a strong and stable client base following its spin-off from IBM in 2021, which includes 75% of the Fortune 100 companies. Kyndryl is mission-critical to its clients, and many teams work on location with their customers. The company is in the midst of restructuring about 40% of its client contracts which were written with no gross margin before the IBM spin-off, as services were often included as a loss leader by its former parent to facilitate the sale of IBM hardware and software. Since the spin-off two years ago, the company has retained 97% of its clients and successfully negotiated new contracts at market rates. This accounts initiative is one of four parts to Kyndryl's $2 billion profit improvement program that also includes adding new business with hyperscale vendors, implementing advanced delivery through artificial intelligence, and building its consulting practice. All four pieces of the program are ahead of schedule, and as a result, the company is now profitable on a pretax basis and expects to be free cash flow positive for the current fiscal year despite absorbing losses on over twenty-five percent of its revenue. In addition, under IBM's ownership, the company would often own its clients' IT infrastructure, which cost Kyndryl two billion a year in capital expenditures and working capital. As clients now must pay Kyndryl market rates for this capital on new contracts, Cardinal expects the capital intensity of the business to decline. In its valuation, Cardinal penalizes Kyndryl for this capital use, but the stock is compelling at current prices, nonetheless. As Kyndryl's free cash flow grows and revenue bottoms in 2024 with unprofitable contracts running off, Cardinal expects investors to start to rethink its inexpensive valuation.

GLOBUS MEDICAL

Long an innovator in the spine medical device business, Globus Medical has increased its market share for years due to its leading technology and robotics platform. Cardinal successfully invested in the company about a decade ago and is familiar with management and their new product success. Globus' stock price declined in early 2023 after the announcement of its merger with NuVasive, which would make the combined entity the second-largest competitor in the spine business. Investors have traditionally disliked mergers of spine competitors due to the inevitable turnover in the salesforce, which is core to the business. However, Globus management sees minimal overlap between the companies given their regional separation, and has expressed confidence in the company's three-year $170 million cost synergy target, citing shared services, overhead, and other operating efficiencies that will benefit the organization. The company also sees the opportunity to increase utilization at NuVasive's Ohio manufacturing facility, which currently operates at 30% capacity. The territories added by the NuVasive merger double the sales force and potentially double the corresponding pipeline, positioning the company to show a significant ramp in deal flow, robotic, and implant sales pull-through. While Globus' management recognizes the risk of sales force attrition related to the integration, it continues to believe territory overlap of under 10% is reason to expect the attrition to be manageable. Cardinal took advantage of the weakness in the stock to reinvest and believes Globus is undervalued given the company's solid long-term revenue and margin prospects, as well as its strong cash flow that the company will use to repurchase stock should the valuation remain depressed given the company's unleveraged balance sheet.

US. FOODS

US Foods is the second largest domestic foodservice marketer and distributor of fresh, frozen, and dry foods, with approximately 250,000 restaurant and foodservice customers. The company's distribution network includes seventy broad-line locations and over eighty-five cash and carry stores. Over half of the company's sales are to national chains and local restaurants, a quarter are to healthcare and hospitality customers, and the remainder are to a wide range of customers. Of these categories, local restaurants present the largest opportunity for sales growth and increased gross margins. The food distribution industry is a $300 billion addressable market that grows slightly above gross domestic product. The industry is fragmented, as the three largest players represent just one-third of sales. These companies' networks provide economies of scale and density that smaller competitors cannot match. US Foods' 10% market share is growing because it has been winning new business from local and regional providers, who represent 60% of the market. The company expects to continue to grow at 50% more than the market growth rate in the restaurant segment and match the market growth rate in its other end markets. Industry sales also remain over ten percent below pre-pandemic levels, providing further upside as commercial demand normalizes. Cardinal became interested in US Foods after a new activist nominated board removed the previous CEO and hired a well-respected industry veteran, David Flitman. Flitman has significant experience, having successfully run Performance Food Group's Performance Foodservice segment. US Foods' historical lack of focus on supply chain logistics and proprietary product offerings had left the company's operating margins below those of national peers. By increasing private label penetration, executing on better route planning, and automating back-office functions, the company sees the potential for a reduction of administrative costs and an increase in gross margins. The combination of new leadership and a board of directors that has embraced change provides a supportive environment for significant positive change, which Cardinal expects will drive strong returns for shareholders.

Cardinal's Outlook

Cardinal's near-term outlook for equities is cautiously optimistic. The Federal Reserve appears to be finished raising interest rates while the consumer and job market have remained resilient. While a mild recession is still possible in 2024, this could provide a buying opportunity as the market will benefit from inflation and interest rates continuing to fall. Financing conditions have already improved, as has merger and acquisition activity. 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.

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Performance Track Record (as of 12/31/2023)

Cardinal SMID Cap Value Composite	Gross %	Net %	Russell 2500 Value %
Inception-to-Date (May 1, 2010)	9.1	8.6	9.3
10-Years	6.2	5.7	7.4
5-Years	7.0	6.6	10.8
3-Years	2.1	1.7	8.8
1-Year	3.6	3.2	16.0
4th Quarter	11.0	10.9	13.8

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. 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.

Cardinal Capital Management, L.L.C. claims compliance with the Global investment Performance Standards (GIPS®) and has prepared and presented this report in compliance with the GIPS standards. Cardinal has been independently verified for the periods July 1, 1992 through December 31, 2022. 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, 2022. The verification and performance examination report is available online.

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