Cove Street Capital Small Cap Value Fund Letter to Shareholders

DEAR FELLOW SHAREHOLDER — This was a fascinating end to a fascinating year and with the glow of the year-end holidays behind us, we will try to put some thoughts down about what we witnessed.

What is always interesting to professional investors is that there is sometimes confusion over what constitute our common goals. If our goal is to intelligently achieve wealth creation by positioning our clients in small cap stocks that have business models and asset values which appear to us to be unappreciated and thus possess less risk than do alternative propositions, then we had a great year. There is no actuarial hurdle or retirement goal that was not achieved by our performance in 2016. The year also clearly demonstrated a long-held investment tenet at Cove Street Capital: the future remains uncertain and thus one is well served by sticking to the long-term game plan and ignoring the hooting and hollering du jour.

Total Return (CSCAX) — % as of December 31, 2016

	3 MONTH	1 YEAR	3 YEAR	5 YEAR	10 YEAR	INCEPTION (09/30/98)
Cove Street Capital Small Cap Value Fund	4.05	16.24	4.04	14.19	6.13	10.93
Russell 2000® Index	8.83	21.31	6.74	14.46	7.07	8.92
Russell 2000® Value Index	14.07	31.74	8.31	15.07	6.26	9.95

Performance shown for the period through January 20, 2012 reflects performance for CSC Small Cap Value Fund, a series of CNI Charter Funds, the predecessor to Cove Street Capital Small Cap Value Fund "The Fund". The Fund has the same portfolio manager and substantially similar investment strategies to the predecessor fund. The Institutional Class commenced operations on October 3, 2001. The performance results for the Institutional Class reflect the performance of the Investor Class shares from September 30, 1998 through October 2, 2001. The Investor Class subsequently closed, effective November 25, 2015.

The performance data quoted represents past performance. Past performance does not guarantee future results. The investment return and principal value of an investment will fluctuate so that an investor's shares, when redeemed, may be worth more or less than their original cost. Current performance may be lower or higher than the performance quoted. For performance data current to the most recent month end, please call 1-866-497-0097.

The gross expense ratio is 1.42%. Net expense ratio, as of the most recent prospectus, is 1.26% and was applicable to investors. Cove Street Capital, LLC (the "Adviser" or "Cove Street") has contractually agreed through at least January 28, 2017 to reduce its management fees, and may reimburse the Fund for its operating expenses, in order to ensure that Total Annual Fund Operating Expenses (excluding acquired fund fees and expenses, leverage, interest, taxes, brokerage commissions, and extraordinary expenses) do not exceed 1.25% of the Fund's average daily net assets.

The Fund imposes a 2.00% redemption fee on shares sold within 60 days of purchase. Performance data does not reflect the redemption fee. If it had, return would be reduced.

On the other hand and on a relative to the index basis, we were "smoked" in the fourth quarter by a mad rush into the equity markets, particularly as it relates to small cap stocks and financials. As we have often noted, the Russell 2000® Value is heavily weighted with financials (31% as of 12/31/2016) and there are clearly short-term periods where we are either helped or hurt by this percentage. Post-election, with the specter of onerous Dodd-Frank regulations being relaxed and punitively low interest rates likely moving higher, this financial sector's performance was up approximately 26% over the quarter. In our opinion, the other truism about investing in general, and regarding small cap in particular, is that you are either invested before market moving events occur or you aren't likely to participate at all given liquidity issues. We have been leery of bank stocks in general given they represent geographically narrow, highly leveraged bets on commercial real estate, a proposition we have fully considered and passed on given where we think we are in the real estate cycle and with valuations well north of book value. Let's just say valuations are a lot farther north of book value at the end of 2016.

Our recent Strategy Letter, which is always available for your perusal on our website (www.covestreetcapital.com/category/csc-strategy-letter/), covered much of our “election thinking.” So, we will use this letter to focus on specific holdings, which always comprise most of our internal work.

What Happened (CSCAX) — % for the Quarter Ending December 31, 2016

TOP 5 CONTRIBUTORS	AVERAGE WEIGHT	RETURN	CONTRIBUTION
FMC Corp	5.20	17.47	0.94
Heritage-Crystal Clean Inc	4.37	18.22	0.76
GP Strategies Corp	4.24	16.17	0.66
Zebra Technologies Corp CL – A	2.53	23.21	0.54
E.W. Scripps Company	2.42	21.57	0.51

TOP 5 DETRACTORS	AVERAGE WEIGHT	RETURN	CONTRIBUTION
Avid Technology Inc	2.22	-43.61	-1.36
Liberty Global PLC LiLAC – A	4.40	-20.97	-1.14
EVINE Live Inc	1.25	-34.85	-0.55
ViaSat Inc	4.93	-10.95	-0.54
Millicom International Cellular S.A.	2.28	-19.00	-0.50

The 5 Contributors measure the top five contributors to the portfolio’s total return. The 5 Detractors measure the five bottom contributors to the portfolio’s return. Average Weight shown is a calculation of the average percentage held of each included company over the course of the listed period. Return is the total return for each included company over the course of the listed period. Contribution is a ranked measure of how each included company contributed to the Fund over the course of the listed period.

One of our worst performers was Avid Technologies (Ticker: AVID)—the leading provider of professional software for video and audio production—through its Media Composer and Pro Tools product lines. Avid has had a perplexing tendency to be either our best or worst performer on a quarterly basis due to the highly variable nature of Avid’s quarterly results as well as a complex accounting treatment that will mathematically run-off in the second quarter of 2017. Our research continues to suggest a franchise value that is obscured by the current lack of cash flow generation and that 2017 will be the telling year as it relates to the success of management’s current strategy. After selling almost half our position early in the year for a material gain, we have reloaded here at year-end.

The initial returns make it clear that we have been early in our investment in Liberty Global’s Latin American cable businesses, Liberty Global PLC LiLAC (Ticker: LILA). Not long after we purchased the shares, LILA announced the acquisition of Cable & Wireless (Ticker: CWC), a deal which added more scale within the Caribbean and Central America. Unfortunately, the subsequent results suggest that LILA overpaid for CWC and underestimated the impact of competitive pressures in the acquired markets. However, despite the rocky start to this marriage, our analysis indicates that the combination of CWC and LILA has created a platform to continue to consolidate the Latin American and South American cable markets. In addition, even absent further acquisitions, increasing pay TV penetration and high return capital investments should allow LILA to grow its cash flows at a very respectable rate. As a result, we view the stock as materially undervalued in the low $20s.

Lastly, EVINE Live (Ticker: EVLV) which is a home shopping retailer that has recently undergone a management change was also a detractor this quarter. CEO Bob Rosenblatt has the unenviable task of improving profitability by focusing only on products that have high contribution margins while at the same time growing the company's top line. As yet, this transition has been a bit bumpy but very recently the company has made significant progress. Specifically, EVLV secured an investment from a group of fashion and media moguls that included Tommy Hilfiger. Additionally, the company announced a new partnership with actress Eva Longoria in which she will launch a watch collection on the network. While neither of these events is a game changer on its own, our research suggests that they should contribute to the company achieving more respectable margins over time. The company's earnings release during the quarter was not met with enthusiasm but the stock is quite illiquid and can move a lot—up or down—depending on the day. We are carefully monitoring the new management team's progress and believe that our investment case remains intact, despite the volatility in the stock price.

Moving on to our top performers, shares of FMC (Ticker: FMC) were up during the quarter as the company continued to see improved profitability within its Agriculture Solutions and Lithium segments. FMC acquired and began to integrate a Danish pesticide company named Cheminova coincident with the recent downturn in agriculture markets. As a result, FMC has not realized much of the anticipated improved earnings power in its largest segment. However, as acquired inventories have drawn down and FMC exited unprofitable relationships, both cash flows and margins have rebounded. Additionally, existing and expected demand for lithium ion batteries has led to much better pricing for FMC's lithium production, resulting in significantly higher margins and Lithium segment cash flows. Despite the recent run-up in the stock price, the shares remain far below their 2014 highs. Our premise is that agricultural end markets could slowly but surely rebound and with that the stock should go up as investors come to appreciate the true earnings power of FMC.

Shares of Heritage-Crystal Clean (Ticker: HCCI), a collector and recycler of used motor oil and provider of other environmental services, performed well due to a rebound in base oil prices as well as an improved outlook in their core environmental services markets. We continue to see material upside potential given the changing business mix as well as improved return metrics. We would also note the announcement of a new CEO to replace the founder of the firm, which we consider to be a subtle positive. (Please note this remark for review in 2030.)

Lastly, GP Strategies (Ticker: GPX), a provider of training and e-Learning solutions to corporations around the world, was a contributor this quarter. Without a lot of fanfare, the company has been adding new Fortune 500 customers and winning more business with existing partners. GP continues to have a long runway for growth as it opens new offices around the world, wins an incrementally higher percentage of its customers' training dollars, and makes tuck-in acquisitions. Additionally, given the low capital intensity of the business, GPX should continue to generate impressive returns on capital as it grows. We consider GPX a classic "Buffett compounder" and, as such, we are happy to hold the stock even after the recent stock price appreciation.

We initiated a new position in Compass Minerals (Ticker: CMP), which for careful readers was a position in the fund almost ten years ago. Compass is primarily a producer of rock salt used for deicing applications as well as a growing player in agriculture via its micronutrient and sulfate of potash business. The company recently completed an acquisition of a joint venture that produces micronutrients for fertilizers in Brazil. To some degree, this initial investment had flown under the radar of most investors for the three quarters that the JV existed. However, after performing a lot of due diligence and updating our valuation model, we realized that the acquisition was a case of the company being "in the right place at the right time." Additionally, we became more comfortable that a return to a more "normal" level of snowfall in the U.S. (in comparison to that of the last few winters) would return the company to a much higher earnings per share level. We believe this combination of an underappreciated asset and a reversion to the mean created an investment with significant upside potential.

Select Comfort (Ticker: SCSS) is a new position built in the quarter and was also a top contributor. The company produces and then sells its Sleep Number beds within its exclusive store network of about 525 stores. SCSS has had its ups and downs in recent years. The company had difficulty implementing a new ERP system and subsequently saw same-store-sales fall 29% in Q4 2015. However, the large investment in technology and the store base is now mostly complete, and management has suggested that the company is at a cash flow inflection point. Additionally, the new ERP system is allowing SCSS to take costs out of the supply chain and be much more targeted in its advertising. As a result of these and other initiatives, the company has crafted some very ambitious goals for 2019—namely $2.75 in earnings per share. Our research suggests that even if those targets are not reached, basic blocking and tackling can lead to materially better margins and returns on capital. The stock appears to be undervalued based on our modest growth assumptions and with an unlevered balance sheet and the ability to generate a lot of cash, the company should be well positioned to continue to return cash to shareholders.

For the most part we have completely exited our positions in Colfax (Ticker: CFX) and Raven Industries (Ticker: RAVN) due to both companies reaching valuations that could not be justified by the cyclical nature of their underlying businesses. We were especially sensitive to the Colfax valuation as the mix of businesses is geared more to a volatile energy end market and given that the stock price implied a very large snap back in energy demand and infrastructure spending. Raven was much more difficult to part with as we view it as a longer-term cyclical compounder. However, just as with Colfax, we judged the price level to be indicative of too much future growth baked in too quickly.

Going forward, we will reiterate that the future remains uncertain. Our present cognitive dissonance involves the following thoughts: huge moves in equities usually start from low expectations, low valuations, investor apathy and apprehension, and a move from higher to lower interest rates. We think it seems fairly obvious that these preconditions do not exist now. This is compared and contrasted to a long history of markets in which all big moves seem bewildering at the beginning, as prices move well ahead of actual fundamentals, and then earnings and cash flows magically catch up. Waiting for the evidence to be delivered to your inbox before acting is not a recipe for successful investing. “Things will be different” starting January 20th and many of them on a purely economic basis are likely to be highly beneficial to wealth creation and economic activity. How much benefit will be delivered and how much has been “pre-sold” by the markets in the fourth quarter will likely be revealed early in 2017.

Very importantly, we would like to note that Cove Street Capital, LLC remains in excellent shape as an entity. We have $1.1 billion of assets entrusted to us by a diversified group of thoughtful clients who understand and share our common long-term goals. We have a tight-knit group of investment professionals and support staff that constitute a long-term foundation for continuing to put up excellent performance on an absolute and relative basis, and properly servicing client reporting needs. We have roughly $400mm left in capacity to manage in small cap, and we will “hard-close” when we reach that number whether through new client additions or market appreciation.

We close with yet another quote from Ben Graham, one of the founding fathers of value investing:

> The investor who buys securities only when the market price looks cheap on the basis of the company’s statements and sells them when they look high on the same bias, probably will not make spectacular profits. But on the other hand, he will probably avoid equally spectacular and more frequent losses. He should have a better-than-average chance of obtaining satisfactory results. And this is the chief objective of intelligent investing.

Best Regards,

Jeff Bronchick

Jeffrey Bronchick, CFA | Principal, Portfolio Manager
Shareholder, Cove Street Capital Small Cap Value Fund

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The fund’s investment objectives, risks, charges and expenses must be considered carefully before investing. The statutory prospectus and summary prospectus contain this and other important information about the investment company, and they may be obtained by calling 1-866-497-0097 or visiting www.covestreetfunds.com. Read it carefully before investing.

Cash flow measures the cash generating capability of a company by adding non-cash charges (e.g. depreciation) and interest expense to pretax income.

Earnings per share (EPS) is calculated by taking the total earnings divided by the number of shares outstanding.

Top 10 Holdings (CSCAX) — % for the Quarter Ending December 31, 2016

Liberty Global PLC LiLAC – A	4.9	%
FMC Corp	4.8	%
Heritage-Crystal Clean Inc	4.6	%
ViaSat Inc	4.6	%
GP Strategies Corp	4.4	%
TEGNA Inc	3.7	%
Hallmark Financial Services Inc	3.3	%
Carrols Restaurant Group Inc	3.2	%
American Vanguard Corp	2.9	%
Halyard Health Inc	2.9	%

Fund holdings and sector allocations are subject to change and should not be considered a recommendation to buy or sell any security. *Current and future portfolio holdings are subject to risk.*

Mutual fund investing involves risk. Principal loss is possible. There is no assurance that the investment process will consistently lead to successful results. Value investing involves risks and uncertainties and does not guarantee better performance or lower costs than other investment methodologies. Investments in smaller companies involve additional risks such as limited liquidity and greater volatility. Investments in foreign securities involve greater volatility and political, economic and currency risks and differences in accounting methods. Concentration of assets in a single or small number of issuers, may reduce diversification and result in increased volatility.

The Russell 2000® Index measures the performance of the small cap segment of the U.S. equity universe, representing approximately 10% of the total market capitalization of the Russell 3000® Index and the Russell 2000® Value Index includes those Russell 2000® Index companies with lower price to book ratios and lower forecasted growth values. One cannot invest directly in an index. The Standard & Poor's 500® Index (S&P 500) is an index of 500 stocks chosen for market size, liquidity and industry grouping, among other factors.

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