Cove Street Capital Small Cap Value Fund Letter to Shareholders

DEAR FELLOW SHAREHOLDER — As the year toils forward to the halfway mark, we reflect.

Returns in the world of small cap have predictably ground to a halt after a torrid 2016. Strategies that include larger cap companies—particularly those that have benefited from the scorching performance of the favored few tech stocks— have shown excellent returns, both absolutely and relative to common indices, prevailing rates of inflation, fixed income competition, and common sense. "Growth," commonly abused as a categorization, continues to mulch "value." While reasonably outperforming a flat index is better than a sharp stick in the eye, it's no great shakes. Additionally, we are sick of talking about either Washington policies or Amazon. And mathematically speaking, this quarter represents the "dumb point" of our short-term performance comparison.

Total Return (CSCAX) — % as of June 30, 2017

	3 MONTH	1 YEAR	3 YEAR	5 YEAR	10 YEAR	INCEPTION (09/30/98)
Cove Street Capital Small Cap Value Fund	1.90	12.95	4.22	11.49	5.73	10.78
Russell 2000® Index	2.46	24.60	7.36	13.70	6.92	8.96
Russell 2000® Value Index	0.67	24.86	7.02	13.39	5.92	9.70

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 1.40%. Net expense ratio, as of the most recent prospectus, is 1.24% and was applicable to investors. Cove Street Capital, LLC (the "Adviser" or "Cove Street") has contractually agreed through at least January 28, 2018 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.

While we are also somewhat tired of the next topic, important things are worth repeating and it is relevant to our efforts to produce value for clients: the cascading rush of capital toward passive investing. Several things are crystal clear to us...and shall be repeated. With an acute understanding of the long history of financial markets and burdened by thirty-plus years of experience, I believe a massive move toward indexing from "faux" active management is an entirely rational idea that should be widely embraced. I don't see it "going back" and recent graduates should consider that statement carefully. So, if this is to be the state of the world, what does it mean for Cove Street and our clients—current and prospective?

We sometimes frame the spectrum of investing to include U.S. Treasury bonds on one end and Botswanan private equity on the other. These are two asset classes that arguably represent distinctly different opportunities for an active investor to theoretically add value, the latter being a much higher probability bet if you can stand the heat and are a seswaa aficionado. While we frankly know little about either pole, we would argue that value and smaller cap represent something closer to the latter than the former. Cove Street was designed from the ground up to be able to invest in what others "fear" by limiting asset growth, limiting the number of positions, and focusing on old school things such as company fundamentals. The last category inexorably includes an analysis of whether management and the board are stealing for us or from us, and what a security is roughly worth under a variety of scenarios. In other words, while we strive to be a superb fisherman, we are at least fishing in the right pool.

And that is a crucial issue. There are a LOT fewer public companies versus twenty years ago—as in, nearly half. The two obvious reasons are the massive explosion in money to invest in private deals that both fund private companies and take public companies private, and the ever increasing regulatory and legal burden associated with being public. As a quick aside, what value is being derived for private equity investors who pay 2x to 10x the fees that most public managers charge in order to invest in companies that legitimately could be public? And "private equity" adds what management value if you are REALLY paying attention? And asset allocators are saving how much in fees by moving from active to passive in public markets while still paying exorbitant rates for the privilege of investing in private companies?

But we digress. For the record, we calculate 2,284 stocks (at current count) with market caps between $100mm and $3.5 billion that are U.S.-based and trade on major U.S. exchanges; 262 more if you add non-U.S. domiciled firms to the same screen; and 4,397 if you include the farther reaches of Over-the-Counter. That is still plenty to choose from IF you limit your asset size and concentrate your positions. We have 33 in small cap. You should have fewer the larger your target market cap universe. The other point that is somewhat neglected is that while there are fewer stocks, there are arguably also fewer people paying attention.

One of the core functions of "markets" is to provide investors with a sense of the pricing of asset values so that they can make allocation decisions regarding their capital. For the moment let's ignore giant existential questions surrounding Adam Smith and the future of democracy and capitalism. Currently, investors are trying to answer simple questions such as: how on the margin are rational people pricing assets and estimating cost of capital and return on capital when ETFs are collecting x dollars per day and simply buying what is in a stated asset class, regardless of value? How can I evaluate what the market is telling me about credit conditions if I cannot price credit within a barely functioning corporate bond market, especially when trading is down some 70% in the last few years due to the giant sucking sound of central banks and ETFs? How does a CFO price an acquisition opportunity? These are weird questions and the answers probably contain unpleasant implications.

What pricing we do see and try to make sense of tends to be…expensive. We are as driven as is the next person to look for the next great investment, but trying not to do something stupid is a full time job in financial markets that have had a mighty impressive run since 2009. We have adopted something of what will attribute to infectious disease specialist Justin Graham: "Don't just do something. Sit there."

What Happened (CSCAX) — % for the Quarter Ending June 30, 2017

TOP 5 CONTRIBUTORS	AVERAGE WEIGHT	RETURN	CONTRIBUTION
Select Comfort Corp	2.7	41.2	1.0
Novanta Inc	2.2	34.3	0.7
Heritage-Crystal Clean Inc	4.3	16.1	0.6
Avid Technology Inc	3.5	12.5	0.4
Forestar Group Inc	1.6	16.2	0.4

The 5 Contributors measure the top five contributors to the portfolio's total 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.

TOP 5 DETRACTORS	AVERAGE WEIGHT	RETURN	CONTRIBUTION
E.W. Scripps Co	2.8	-22.8	-0.6
Cherokee Inc	2.7	-19.3	-0.5
WPX Energy Inc	1.4	-27.9	-0.4
Liberty Global Plc LiLac A	3.5	-9.4	-0.4
Carrols Restaurant Group Inc	2.6	-13.4	-0.4

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.

And with that, we start our detractors. E.W. Scripps Company (Ticker: SSP) is an owner of TV broadcast and digital assets during a time when the whole U.S. media industry is in flux. There are legitimate questions regarding what the cable bundle will look like in the future, as well as about how much advertising spending will shift from TV to digital. By investing heavily in digital businesses, SSP is positioning itself to succeed regardless of where ad dollars end up being spent. In addition, as it relates to the TV business, our extensive research led us to conclude that the broadcast stations are the least likely to be impacted when people cut the cord or reduce the number of stations in their cable bundle. The reason being that local news, live sports, and highly-rated shows continue to attract large, consistent audiences that advertisers are desperate to reach given the uncertain returns associated with digital ad spending. As such, while there may be short-term concerns that periodically impact the stock, as was the case this quarter, SSP should continue to generate cash and to have the opportunity to make value-enhancing deals. At the current valuation, expectations appear to be very low and we are happy backing the SSP management team. We recently bought more.

Moving on to another top detractor—Cherokee (Ticker: CHKE) has unfortunately been caught up in the market's concerns about all things retail (or at least those not named Amazon). However, many domestic investors are not familiar with the fact that the retail dynamics outside of the U.S. do not exactly mirror what we are witnessing here. As a result of the recent acquisition of Hi-Tec (headquartered in the Netherlands), Cherokee has become a much more international company. In reality, that is where most of the growth has come over the last few years and we expect that trend to continue. Also, the company is in the middle of replacing its formerly largest U.S. customer—Target—with a slew of other wholesalers and retailers. The ramp up has been slow and the market has clearly become concerned about Cherokee's ability to regain its domestic position. However, our research suggests that Cherokee has built a global platform into which it can drop new and existing brands, and thus has built a growth engine for the future. The valuation remains undemanding, and if Cherokee's initiatives are successful over the next 12 months, it is possible that the current stock price will have represented a very attractive entry point.

Finally, WPX Energy (Ticker: WPX)—an independent oil exploration and production company—was a detractor for the quarter thanks to a sharp drop in the price of crude oil, which represents over half of current daily production and a vast majority of the company's upside potential. The company is well capitalized and has an immense runway in terms of the potential drilling locations in its inventory. While we cannot predict the short-term price of oil, we like the value embedded in WPX's top tier acreage in the Permian Delaware Basin and see significant long-term upside.

Moving to the positive side, our largest contributor in the quarter was Select Comfort (Ticker: SCSS). After experiencing a number of fits and starts over the last few years, Select Comfort appears to be hitting its stride. The company is in the middle of rolling out its innovative 360 Bed, a product that is designed to distance Select Comfort's offerings from those of the rest of the mattress world. The stock has had a very nice run since the company reported very solid Q1 2017 same-store-sales and margin numbers. However, our research suggests that the move into the low $30s has only corrected an excessive undervaluation. While the stock is not as glaringly cheap as it was when we first invested, the company has put itself in a position to continue to grow the top line and improve margins, all the while generating very attractive returns on capital.

Another contributor for the quarter was Novanta (Ticker: NOVT), which supplies laser, optical, and motion control technologies to medical and industrial original equipment suppliers. The company has evolved over time through a series of acquisitions and divestitures that resulted in a more medical-focused, higher margin, and better return business. Novanta's COO recently became the company's CEO and articulated an ambitious plan to further enhance revenue growth, both organically and through acquisitions. Since his appointment, Novanta has undertaken several acquisitions—the most notable of which is a medical equipment component supplier. In addition, the CEO implemented a series of cost cutting measures to enhance margins.

And then there is the improbable phoenix of Forestar Group (Ticker: FOR), a company that led us into our foray of legitimate activism (i.e. active defense in the face of an original mistake). We bungled the initial value due to badly misunderstanding energy exposure. However, our subsequent actions led to the ousting of management and certain members of the Board, and those who left were replaced with excellent shareholder representatives. Early in the quarter the company signed an agreement to sell itself to Starwood Capital for $14.25 per share, but in June, public homebuilder D.R. Horton (Ticker: DHI) offered to acquire 75% of the company for $16.25. After Starwood countered, DHI upped its bid to $17.75. And voila—we sold our shares during a bidding war between two real bidders, and thus we can finally claim that every client actually made money in the stock from our highest cost basis. Let's just say accuracy on this task was not associated with the amount of professional experience of the judges, a great line which we hope not to use more frequently.

We sold a handful of stocks for no reason other than massively positive deals that have vaulted them way over any reasonable definition of "small cap." Goodbye Formula One Group (Ticker: FWONA). Companies graduating, by the way, is the only intrinsic flaw in small cap investing for institutions. On the margin we sometimes end up selling our "best" ideas for uneconomic reasons. For anyone who has lost track of the various machinations of John Malone, FWONA was formerly Liberty Media Group. In closing the deal to purchase international racing league Formula One in early 2017, what was once a small cap stock with an unclear future is now a branded sports franchise with a lot more shares outstanding.

Although we have not exited the position fully, FMC (Ticker: FMC) is in that same category. As you might recall, FMC announced that it had signed a deal to acquire certain assets that were to be divested by DuPont as a condition of the company's merger with Dow. In exchange for $1.2 billion in cash and its Health and Nutrition business and upon regulatory approval, FMC will receive a portfolio of herbicides and insecticides that is currently housed within DuPont's Crop Protection segment. After closely reviewing the deal terms, it became clear that FMC is paying a very low effective multiple for these assets. In addition, this acquisition also positions FMC to vastly expand its research and development and product development capabilities. Not surprisingly, the stock has continued to appreciate, and due to its current market capitalization, the position will not be in the portfolio much longer.

One of our biggest position changes in the quarter was Wesco Aircraft Holdings (Ticker: WAIR), which is now our largest position in the portfolio. Regular readers might remember Wesco as a position exited with a small loss several years ago. The long version of the story begins with a guy sweeping up a factory floor for an aerospace company (actually not far from our offices), picking up any variety of bolts and widgets that were deemed to be trash, and reselling them to neighboring companies. This is now known as "supply chain management for the aerospace industry," which is the Wesco of today—one of the largest in the industry.

The company was bought by the private equity firm Carlyle from the son of the founder, and let's just say, one did little and the other almost nothing of consequence for the benefit of shareholders from then on. They went public in 2013 at $16, hit a high of $24, sold shares along the way…and then the wheels began to come off. The veneer suggested a sophisticated distributor tied into its big clients through deep system integration, which would produce high margins, returns, and free cashflow. An acquisition was made with debt.

The reality was that the company had antiquated systems, an antiquated warehouse with scattered B-52 parts, little in the way of financial systems appropriate for a public company, and "light" management. Thanks again, Carlyle—the alleged Dean of the Private Equity business. Roll forward and they missed every forecast made; took inventory write-offs; replaced the CEO, the CFO, and a variety of others; and generally wasted what most would consider to be the biggest commercial aerospace build since WWII.

Our in-depth research several years ago picked up much of this, and we sold stock in the mid-teens with minor damage. After what appeared to be the right management changes and a walk that looked like it was following the right talk, we began repurchasing shares just under $11 several years later. The core business properly managed IS a good business with solid returns and high free cashflow. That worked to a point. The flaw in the ointment turned out to be that the new CEO Dave Castagnola was a "manufacturing guy," and distribution even on the highest scale still required a softer touch. While there was a tremendous amount of improvement in many financial areas, Wesco still was not "in the zone" and did not create what we would consider to be acceptable cashflow given the level of new business they were signing.

We greatly increased our position this quarter after Dave got the boot, and took his overly optimistic projections with him. The company is being led by Todd Renehan, who we think is the right match of skills to pair new business with free cashflow. We would also note that Carlyle still owns 23% of the stock in a fund that is long closed and they received a two year extension to keep the investment that ends this December. The Snyder family still owns 10%. Good value, large, unhappy shareholders with a quiet clock ticking in a consolidating industry. We see either outcome—fundamental improvement from a cheap stock or a takeover—as satisfactory for us.

We also are investing in 3 new stocks which we had barely touched before they took off and we would be forced to silence the reader permanently if we revealed them here. (That also accounts for our cash position looking "high.") This recent experience highlights a mistake we have often made and we are trying to fix. Doing a lot of work and finding a great idea but only ending up with 15% of the stock you wanted at a low cost basis is not as good as owning 100% of what you wanted at a price 15% higher—especially if the investment is going to appreciate 80% over 5 years. This is an innate behavioral finance problem for us and it is another factor that is currently impacting our perception of the proper size of our small cap strategy.

Finally, Cove Street Capital, as a firm, just celebrated its sixth year anniversary. We have an enviable group of client-partners; a young, smart, and growing group of teammates who are increasing their equity ownership in our efforts; and as Warren Buffett would say, we continue to tap-dance our way to work. "Delight Clients, Have Fun, Make Money" has been our mantra since day one and we thank you for our continued partnership!

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.

Top 10 Holdings (CSCAX) — % for the Period Ending June 30, 2017		
Wesco Aircraft Holdings Inc	6.0	%
ViaSat Inc	5.3	%
Heritage-Crystal Clean Inc	4.5	%
Avid Technology Inc	4.2	%
GP Strategies Corp	3.9	%
FMC Corp	3.8	%
E.W. Scripps Co	3.5	%
TEGNA Inc	3.4	%
Millicom International Cellular S.A.	3.3	%
Compass Minerals International Inc	3.3	%

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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. Cashflow measures the cash generating capability of a company by adding non-cash charges (e.g. depreciation) and interest expense to pretax income. Free cashflow is a measure of financial performance calculated as operating cashflow minus capital expenditures.

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