Cove Street Capital Small Cap Value Fund Letter to Shareholders

DEAR FELLOW SHAREHOLDER — As a large shareholder in the fund, as the founder and lead principal of Cove Street Capital, and as a highly competitive and combative investment professional in his 35th year, I am extraordinarily annoyed and disappointed with our performance over the last 18 months. These results are unfortunately doing a lovely job of mathematically crushing our long-term performance record, at least for the time being.

I can talk about "long-term time horizon." I can throw in pithy comments like this one from a Jefferies strategist. I'm paraphrasing here: We also found that valuations in the second quarter and so far in the first half of the year have not mattered. If a manager is focused on valuation factors, that has been the kiss of death.

I can talk about how we are concentrated, we are utterly index agnostic, and thus you are clearly not paying us to dance the tango with an index in the short run. I can clearly state that 2008 was REALLY a lot worse in that losing money is a palpable real worse, versus merely underperforming.

But so what? It doesn't diminish the frustration and lack of wealth creation, nor does it obviate our own errors of omission and commission. It is important to properly understand the environment in which we operate and while outside forces and the trends can clearly create headwinds, or tailwinds, the simple fact is that our top ten positions, which represent 41.0% of the portfolio, have been more boring than watching two teams in the World Cup trying not to win in order to be in a better bracket in the next round. We have often proffered that if we can invest such that our downside is boredom, and we buy 31 stocks with 50% upside in three years, we should do okay. Recently, we have only reconfirmed the former.

That matters more to us than the quarterly yack about the trends du jour. We make carefully researched bets on combinations of Business, Value and People and we wait. It is always wonderful to have an obvious catalyst with an obvious timing, but ANYONE who has spent time investing directly or investing with someone else understands the fickle nature of timing. As suggested by even any cursory read of behavioral finance or psychology, it mentally helps to get off to a good start with either a new position or a money manager.

Total Return (CSCAX) — % as of June 30, 2018

	3 MONTH	1 YEAR	3 YEAR	5 YEAR	10 YEAR	INCEPTION (09/30/98)
Cove Street Capital Small Cap Value Fund	2.66	1.49	3.42	7.17	10.11	10.29
Russell 2000® Index	7.75	17.57	10.96	12.46	10.60	9.38
Russell 2000® Value Index	8.30	13.10	11.22	11.18	9.88	9.87

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 1.22%. 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.

So here are some things that we aren't going to do to "fix" our short performance. We aren't going to wholesale sell half of the of the portfolio and chase what worked the last 6 months. We aren't entirely revamping our investment philosophy and process. We aren't firing people. We are a lean place that is based on a culture that does not mentally crush people for making mistakes that annoyingly form the basis of experience. Our process of recording our decisions, using a devil's advocate as a key part of the process, and creating "constant mortem" versus post-mortem analysis enables a mental environment that pushes investors to make new and interesting mistakes—we do not ground ourselves in a divot of repeating the same mistakes. Investing requires analysis of risk and reward and you cannot be "afraid" to take a thoroughly calculated risk (you don't need help to self-loath—Mr. Market is loud and clear on them)—we aren't mentally sitting on our hands.

So what is interesting about our portfolio is that not only does our research suggest our "spring" has coiled more tightly as most of businesses have gotten more valuable while their stocks have lagged, but we also would suggest we have some highly visible catalysts for near-term improvement which would be…nice. To wit, our largest position is E. W. Scripps (Ticker: SSP), and after the requisite 30 days after our tax sale, we intend to rebuild our TEGNA (Ticker: TGNA) position. With that complete, we will have over 10% of the portfolio in broadcasting companies. One of the critical variables is their ability to deliver on a traditional bastion of political ad spending, a revenue source that was called into question by Trump's campaign tactics. Now, we feel pretty good that there will be an election in November and thus we will find out in 5 months whether or not that supposition is correct. And we would also suggest that if proven correct, the spend—and investor interest—will not wane as eyes cast to the presidential election in 2020. And the stocks are dirt cheap, still generate great cash flow under increasingly contractual arrangements, and have a mostly green light for consolidation. A recent $3 billion deal between Gray Television (Ticker: GTN) and privately-held Raycom Media was priced at roughly 10 times a 2-year average of operating cash flow (you average in the political and non-political years). That's nearly a double if you apply that to the math and current valuation of TEGNA or Scripps. Yes, there are secular questions about broadcasting, and there are plenty of court battles on consolidation as we speak, but it's a big vat of ad dollars and there are historical ways of doing business that are not evaporating overnight.

On another note, one would think that with the mostly successful launch of ViaSat II satellite, investors would begin to discount future cash flow from a $600mm investment. Nope. It's as if we just finished building the most beautiful technologically advanced office building and on the day we finish building—but before the first tenant moved in—we couldn't convince someone to co-invest with us because as of that moment, we cannot prove cash flow. In the meantime, the "no-one talks about defense business" is booming and represents more than two thirds of the current stock price. We think there is an elusively imminent wake-up for one of our largest positions.

And so on. We will now go on and go through the normal winners and losers and some new positions, but I would also anecdotally note more signs of at least a relative bottom for us. As the wife of the portfolio manager (with over 28 years of experience) noted last week, "it's a bottom when you finally start complaining to me how awful you are."

What Happened (CSCAX) — % for the Quarter Ending June 30, 2018

TOP 5 DETRACTORS	AVERAGE WEIGHT	RETURN	CONTRIBUTION
GP Strategies	4.1	-22.3	-1.1
Heritage-Crystal Clean	4.4	-14.7	-0.7
Millicom International Cellular	4.7	-13.3	-0.7
GTT Communications	2.7	-20.6	-0.6
Tupperware Brands	2.9	-11.8	-0.5

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.

TOP 5 CONTRIBUTORS	AVERAGE WEIGHT	RETURN	CONTRIBUTION
Pandora Media	2.2	56.6	1.0
NOW	3.3	30.4	0.8
Carrols Restaurant Group	2.6	32.6	0.8
E.W. Scripps Company	5.9	11.9	0.8
INTL FCStone	3.0	21.2	0.6

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.

GP Strategies (Ticker: GPX) is a global provider of training and e-Learning solutions. They have struggled the last two years with building an appropriate infrastructure for the next phase of long-term growth, which includes management changes, and restructuring charges. GPX continues to have a long runway for growth as it wins an incrementally higher percentage of its customers' training dollars and makes acquisitions in a very fragmented market. 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 added to our position during the recent stock price weakness.

Heritage Crystal Clean (Ticker: HCCI), a provider of environmental services as well as re-refining of used motor oil, declined due to an outage at their re-refinery and a late winter that caused many of their waste collection routes to be out of service during the first weeks of spring. We view these as temporary setbacks and point to the continued production of good free cash flow and increased margins by the Company as indicators for value creation. HCCI's environmental services business has returned to high single-digit growth, helping drive free cash flow higher. We continue to see the normalization of margins within the re-refined oil segment in addition to continued long-term growth of environmental services as the two future drivers for earnings and therefore returns in the stock. This has been an excellent long-term holding for the Fund.

Millicom International Cellular (Ticker: MIICF) is the leading cable and wireless provider in Colombia and Central America. The company is refocusing on its pole position in the quickly growing cable triple play market in Colombia—while shedding valuable but disparate African media assets, as well as other assets such as cell phone towers—under the direction of a CEO who hails from Liberty Global (Ticker: LBTYA). The stock declined due to a sell off by investors of all emerging market related assets. Focusing on the long-term, we still see a severely undervalued stock that is continuing to develop into a premier Latin American cable/telecom player and is approaching a crossover point where its legacy voice revenues will be eclipsed by new cable and 4G customers.

Tupperware Brands (Ticker: TUP) is not your father's Tupperware. This is a global distributor of thousands of innovative personal and houseware products in what still remains—in what seems to be only our opinion —a unique and relevant selling model. Long time CEO Rick Goings recently relinquished his post and the company selected an internal candidate, Patricia Stitzel, to replace him. While these are big shoes to fill, a change is due as the company has had difficulty hitting historic growth targets. The biggest headwind is the strength of the U.S. dollar as TUP generates the majority of its income outside of the US. Tupperware is one of the cheapest stocks in the portfolio, with one of the best return on capital profiles and the stock currently sports a lofty 6.55% dividend yield. We have been adding to our position because we believe that the free cash flow profile of the business more than supports the dividend—and some stock buybacks—and that the Tupperware model can still work in emerging markets.

On the positive front, we will start with Pandora Media (Ticker: P) was the first "online" and ad-supported music provider. After some terrific misadventures by prior "dotcom brain" management, the Liberty Media/Sirius-XM gang bought a material minority position with three board seats. We paid half their price in one of our better timing moves. Simply said, the company has never been allowed to be profitable. We think there is a lot of room for progress between what is now break-even and the EBITDA margins of terrestrial radio at north of 20%. There appears to be a fair amount of low hanging fruit in that just basic blocking and tackling should lead to much better margins and returns. While it will take some time for all of the recent actions to show up in the financial statements, the company generated two consecutive quarters of positive free cash. Our research suggests that there remains significant demand for an ad-supported music streaming service, even in a very competitive world that includes Spotify Technologies (Ticker: SPOT) and Apple Music. In addition, we have yet to see the benefits of any partnerships between Sirius-XM (ticker: SIRI) and Pandora. In fact, our recent meeting with Sirius-XM reinforced our belief that there are tremendous opportunities for the companies to collaborate and obvious synergies if Pandora were to become a part of Sirius-XM. Accordingly, despite the appreciation of the stock, we remain holders.

NOW (Ticker: DNOW) provides logistics and other services to oil field operators, industrial companies, and refiners through their network of 285 service office locations and distributes maintenance, repair, and overhaul (MRO) products to this same customer base. The company spun out from National Oilwell Varco (Ticker: NOV) nearly four years ago, and we have waited patiently for a price that gives us adequate margin of safety. The company has a strong market position, an unlevered balance sheet, and a core management team that focuses on return on capital. The oil rally of the past few months has reinvigorated DNOW's customer base with new rigs coming online and, more importantly, the completion of existing drilled wells has begun. These events have helped DNOW turn profitable, with expectations for further growth increasing thanks to existing backlogs of unfinished wells growing in onshore U.S. oil and gas. Even after the quick rise we've seen, our research indicates plenty of upside from current levels.

Carrols Restaurant Group (Ticker: TAST) is the largest Burger King franchisee in the U.S. The company continues to be a direct beneficiary of Burger King's ongoing efforts to rebuild its brand and differentiate its offerings from those of the rest of the quick service competitors. Specifically, Carrols has seen very solid same-store-sales performance over the last 4 quarters and that has finally started to translate into higher restaurant-level margins. In addition, the company has been building stores that are generating far higher than historical average unit volumes and Carrols maintains an active pipeline of potential restaurant acquisitions. The appreciation of the stock has closed some of the gap between the market price and our estimate of fair value. However, the company has a first class management team and a huge runway to add to the store base that is not properly captured by the current valuation.

A "new" position in the Fund is HRG Group (Ticker: HRG), a public holding company whose main asset is a 62% stake in Spectrum Brands (Ticker: SPB). Spectrum Brands is a company that we have been following for a number of years and we have owned HRG in the past. Spectrum manufacturers a number of well-known consumer brands within categories that vary from batteries to appliances to pet supplies to bug repellant. SPB recently announced that it was selling its battery business (to Energizer, Ticker: ENR) and that it was close to selling its commodity appliance business as well. These transactions will help the company reduce its leverage and limit its exposure to categories that are unlikely to see much growth at retail. In addition, SPB came to an agreement with HRG to merge the two companies, in turn potentiality eliminating the overhang of having a controlling shareholder. In the meantime, the company has been dealing with some operational issues that caused SPB's stock to drop from the mid-$90s to the mid-$70s in a single day. Given our history with the company—a prior holding—we were able to act quickly and buy HRG when its stock fell in sympathy. Our research suggests that the current issues are likely to be transient and that the intrinsic value of the company is significantly higher than the current stock price reflects.

We have discussed Sally Beauty Holdings (Ticker: SBH) a number of times in previous letters so we will be brief in our comments. The company's core Sally Beauty retail business is attempting to make a strategic pivot in the middle of an increasingly competitive environment and without all of the technological capabilities required to be a successful modern retailer. Retail turnarounds are always difficult and this particular one seems like a Herculean task. Further, while we continue to believe that the Beauty Supply Group distribution business is a great asset, there are some shifts in supplier and end customer behavior that our research suggests are eroding the business's moat. There is no doubt that the stock appears to be dirt cheap based on all metrics but the team came to view the stock as a value trap and thus we exited the position to reallocate the capital to better ideas.

During the quarter, USG's (Ticker: USG) second largest shareholder, Knauf, continued its attempts to buy all of USG. After Berkshire Hathaway essentially said it was willing to sell its 28% stake in USG, the writing was on the wall that the company was going to be sold. In fact, a deal was announced during the quarter in which Knauf agreed to buy USG for $44 per share—only a slight premium to the original $42 per share offer. We sold our shares during the quarter due to lack of requisite upside.

Going forward, it is one thing to make a list of all the usual disasters and potential disasters in the world when stocks are cheap, and say, well "stocks are cheap and our risks are discounted in the market." It's more than somewhat difficult to make that case right now.

As an example, we plucked out this pithy quote on the trade nonsense: "How this will play out is idiosyncratic to any given product and unique to each supply chain," said Daniel Rosen, partner at the economic research firm Rhodium Group. "Nobody can honestly claim high confidence that they understand what the overall impact will be. You may as well project the weather on a Tuesday afternoon a year from now."

We think ANY government policy that arbitrarily favors x over y, or deliberately shifts the playing field on poorly understood or absolutely incorrect terms is not helpful to anyone who is investing. And most asset classes are not cheap enough to provide margin of safety to any number similar policy discussions. And if you are asking, what matters is not the actual "tariff" dollars as a percentage of GDP, which seems to have many people pretty blasé about the topic. It's the gazillions of dollars of currency relationships and the fixed income beneath it that is the real risk.

It has also been recently noted that small cap stocks will "do better" because they in theory are less multinational and more domestic focused, and thus aren't tied up in trade wars and have less currency exposure from the strength of the dollar. I think that is somewhat of a canard. Small companies tend to sell to bigger companies and thus when big daddy gets a cold, most of the family suffers as well down the line.

But, as we noted at the beginning, our results, particularly on a relative basis, are much more dependent on what is happening with what we own, given our concentration. And there we feel confident. (Or particularly frustrated which is better than confident.) There is nothing wrong with the theory and practice of careful, focused value investing in small-cap stocks. There appears to be nothing wrong with the health and cognitive abilities of your portfolio manager, and the terrific people who support and surround him on every level, 82% of whom are owners in the firm. We have every financial and competitive incentive to deliver for our fellow shareholders as we have for most of the past.

Our best to you for a wonderful summer.

Best Regards,

Jeff Bronchick

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

Top 10 Holdings (CSCAX) — % for the Period Ending June 30, 2018

E.W. Scripps Company	6.4	%
ViaSat	5.8	%
Millicom International Cellular S.A.	4.3	%
Heritage-Crystal Clean	4.0	%
Avid Technology	3.9	%
UFP Technologies	3.5	%
GP Strategies	3.4	%
Wesco Aircraft Holdings	3.4	%
Capital Senior Living	3.3	%
NOW	3.1	%

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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.

Quotational risk is the potential for gains or losses based upon volatility in the trading price of a security, which in the near-term do not reflect fluctuations in the intrinsic value of the security's interest in the underlying assets but are the manifestation of other dynamics in the market. Any tax or legal information provided is merely a summary of our understanding and interpretation of some of the current income tax regulations and is not exhaustive. Investors must consult their tax advisor or legal counsel for advice and information concerning their particular situation. Neither the Fund nor any of its representatives may give legal or tax advice.

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. Free cashflow is a measure of financial performance calculated as operating cashflow minus capital expenditures. EBITDA stands for earnings before interest, taxes, depreciation and amortization and is one indicator of a company's financial performance and earning potential.

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