# Cove Street Capital Small Cap Value Fund
# Letter to Shareholders

**DEAR FELLOW SHAREHOLDER** — We outperformed in the quarter relative to our benchmarks in a market that recovered with verve from a challenging second half of 2018. One of the benefits of running concentrated portfolios is that you don't need a lot of things to go right in a quarter or a year to move the needle. This quarter, although the portfolio recovered broadly, the key was that some of our largest positions moved higher, driven at least partially by demonstrable fundamental improvement. Although a single quarter is a very short measurement period, any time we can keep pace—or even outperform—in a rapidly rising market is a minor victory in our eyes.

**TOTAL RETURN** (CSCAX) **—** % as of March 31, 2019

| | 3 MONTH | 1 YEAR | 3 YEAR | 5 YEAR | 10 YEAR | (09/30/98) INCEPTION |
|---|---|---|---|---|---|---|
| Cove Street Capital Small Cap Value Fund | 15.58 | 5.64 | 5.20 | 4.30 | 16.06 | 10.05 |
| Russell 2000® Index | 14.58 | 2.05 | 12.92 | 7.05 | 15.36 | 8.73 |
| Russell 2000® Value Index | 11.93 | 0.17 | 10.86 | 5.59 | 14.12 | 9.08 |

*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 1.17%. 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.*

As is our tradition, we lead with our detractors:

**WHAT HAPPENED —** % for the Quarter Ending March 31, 2019

| TOP 5 DETRACTORS | AVERAGE WEIGHT | RETURN | CONTRIBUTION |
|---|---|---|---|
| Capital Senior Living Corp | 2.8 | -41.3 | -1.3 |
| Millicom International Cellular S.A. | 5.6 | -4.4 | -0.3 |
| Tupperware Brands Corp | 1.0 | -18.2 | -0.2 |
| GP Strategies Corp | 4.9 | -3.7 | -0.2 |
| Hallmark Financial Services | 2.9 | -2.7 | -0.1 |

*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. Excludes cash and accrued income.*

Capital Senior Living (Ticker: CSU) operates and owns senior living facilities primarily in Texas and the Midwest. The company recently completed a multiyear process of converting some of its acquired properties to more expensive assisted living facilities. As a result, despite the low occupancy levels, our research suggests that Capital Senior Living is currently at a cash generation inflection point. Furthermore, the ageing of the American population provide the senior housing industry with a growing pool of customers. The company's real estate is substantially undervalued when compared to prevailing capitalization rates and income multiples. Recent management turnover, concerns over excessive supply growth, rising interest rates, and deteriorating occupancy resulted in a fall in CSU's stock price, presenting an opportunity to increase our position.

Millicom International Cellular (Ticker: TIGO) 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 under the direction of a CEO who hails from Liberty Global (Ticker: LBTYA). This past quarter's results were in line with expectations. Millicom' s stock rose during the quarter due to rumors that Liberty Latin America was looking to buy the company. However, when Millicom emphatically stated its desire for independence, the stock came back down to earth. Looking past short-term noise, we still see a company that is continuing to develop into a premier Latin American cable/telecom player, which now includes a cable/mobile bundled offering in each of their markets, and a stock that trades at a valuation reserved for declining telephone focused entities, not growing cable-centric organizations with excellent returns.

Tupperware (Ticker: TUP) is a global direct seller of household goods that has hit a very rough patch. We have followed (and owned) this stock for years and believe we understand the key variables and the short points quite well. However, the degree of the recent decline in Tupperware's stated financials has been somewhat surprising. This was a business that had generated consistent growth, cash flows and high returns for years—until the company started to see a slowdown in mid-2017. In hindsight, the leading indicator of the trouble brewing was a decline in the active salesforce, a deterioration that has continued unabated since the summer of 2017. The strong dollar has certainly not helped the company's cause, but the decline in reps and rep productivity has put pressure on both sales and profitability. In response, Tupperware is in the middle of a complete restructuring of its EU business, and during the quarter, it cut its dividend in order to fund a brand re-invigoration project. While painful in the short run, reallocating capital to invest in the business—one that despite its issues still generates a 20%-plus Return on Invested Capital (ROIC)—is the right thing to do. To say the least we are frustrated. However, Tupperware continues to generate cash, the balance sheet is in fine shape, and management is acutely aware of the issues. It will just take some time to move this ship. We do not think Tupperware is Avon (Ticker: AVP), which has been in restructuring mode for the last 7 years. In the meantime, this is the cheapest stock we own, and there is significant upside if the company can even get back to growing revenue by 1% per year.

**WHAT HAPPENED —** % for the Quarter Ending March 31, 2019

| **TOP 5 CONTRIBUTORS** | AVERAGE WEIGHT | RETURN | CONTRIBUTION |
|---|---|---|---|
| Avid Technology | 4.5 | 57.0 | 2.5 |
| Compass Minerals International | 6.3 | 32.2 | 1.8 |
| ViaSat | 6.1 | 31.5 | 1.8 |
| Colfax Corp | 4.1 | 42.0 | 1.5 |
| E.W. Scripps Company | 3.5 | 33.2 | 1.3 |

*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. Excludes cash and accrued income.*

Our largest contributors included Avid Technologies (Ticker: AVID), which is the leading provider of professional software for video and audio production through its Media Composer and Pro Tools product lines. The company has struggled in recent years to show any pickup in demand for its core products, and the stock has suffered accordingly. However, a new management

team, as well as new bookings, have created a turning point in the company's fundamentals. This quarter the company achieved its highest level of cash flow generation in seven years and produced organic growth for the first time in recent memory. Our research points to improved cash flows in 2019, respectable revenue growth and increased profitability—with significant upside in stock value from these levels.

Compass Minerals International (Ticker: CMP) produces and sells de-icing and industrial salts, specialty plant nutrition, and chemical products. The stock rebounded in the first quarter thanks to a very strong winter in the Midwest and South, an outcome that bodes well for the upcoming bid season for de-icing salts. We view the company as grossly mispriced due to the market's misunderstanding of the micronutrient and specialty fertilizer businesses that Compass has built and due to an overemphasis on short-term issues, such as the strike-induced production miss last year and the general variability of weather.

ViaSat (Ticker: VSAT) performed well for the quarter as the market has begun to appreciate the success of the company's new second-generation satellite (ViaSat-2) in capturing revenue across terrestrial broadband, commercial airlines, and defense services. Continued penetration by the company into airborne services for the military and government is providing excellent high margin growth to the government segment and is generating additional proposal wins for future deployments. We continue to see this as a long-term compounder driven by technological moats that its competitors cannot surmount in the short or medium-term, as well as the company's continued buildout of a global $K_a$-band satellite constellation.

In the aftermath of the 2016 presidential election, the US broadcast TV stocks became some of the most hated of all companies in the market. This was due to a number of bear cases that seemed to be playing out. However, as with most things, the situation was nowhere near as bad as people had feared. Specifically, after very weak ad spending in 2016, 2018 was a huge political year and 2020 promises to be even more prolific. Also, traditional cable subscriber losses have been offset by gains in streaming/over-the-top subs. Finally, the much needed industry consolidation that had been talked about for years has started to play out. E.W. Scripps (Ticker: SSP) is in the process of finalizing three deals that will catapult the company to being the 4th largest broadcast company in the US. TEGNA (Ticker TGNA) just signed a deal that will cement the company as the 3rd largest participant. The result of all of this is that the stocks have rallied from their 2018 lows, with Scripps outperforming TEGNA significantly over that period—mostly because of SSP's growth opportunities outside of broadcast TV. Even with the rebound in the stocks, we see them both as undervalued and continue to expect material cash flow growth. As such, while we have been trimming our positions, they remain core holdings.

We trimmed our position in GTT Communications (Ticker: GTT), which is a provider of cloud networking services and broadband connectivity to multinational enterprises and government customers. We added to the position during the second half of 2018 during a period of weakness. GTT appreciated this quarter, driven primarily by a rebound in sentiment towards leveraged operations. With their maturities not occurring for five years, we see no impending liquidity issues and thus remain holders of GTT. Our research indicates that post their deal integration activities, both EBITDA and cash flow should increase, thus helping to deleverage the company and increase equity value over the long-run.

All of this brings us back to patience. It is true that we abhor frenetic activity and unnecessary turnover and therefore we are uniquely unsuited to jump in headfirst just because stocks are temporarily in a "bear market." But, how do you know when to act? Perhaps the best way to gauge how active you should be—within the context of being a fiduciary of other people's money—is to use valuation as your North Star. If you put the recent little stock hiccup into historical context, even with the drop, the Shiller PE Ratio[1] never fell below 28x—a number that is 10-plus turns above the long-term average and median. What we still see is an expensive market and generally rosy extrapolations that assume revenue growth and margin expansion will continue unabated. Down does not necessarily mean cheap. Similarly, a 20% drop in altitude when you are flying 30,000 feet above sea level doesn't even get you to a place where humans can breathe normally (about 8,000 feet if memory serves). Our saving grace—or oxygen mask—is that we run concentrated portfolios and therefore we only need a few of stocks to fall out of the sky per year.

So, we continue to fish in attractive ponds and to focus on simple ideas. There are plenty of ostensibly cheap stocks that will be multi-baggers if a sequence of unrelated but highly impactful events plays out exactly as management hopes. Of course, if the outside world doesn't cooperate exactly the way the company's PowerPoint presentation posits, you had better be prepared for turbulence. Those stocks are easy for us to throw in the "too hard bin." On the contrary, we are looking for companies that have a clear line of sight to success and do not have to jump through lots of hoops. Additionally, we have a list of companies for which there may be a way to exploit a potential time arbitrage. We believe that these are businesses that are unequivocally getting more valuable every day, have the ability to re-invest internally at high rates of return and are likely to be much larger

[1] http://www.econ.yale.edu/~shiller/data.htm

in seven years. Companies with these characteristics often trade at nosebleed multiples but, at times, short-term noise that comes in the form of cyclical pressures and analyst downgrades provides us opportunities to pay a more reasonable price. The arbitrage opportunity arises when the market becomes maniacally obsessed with what the company will earn over the next twelve months and ignores the long-term opportunities that exist when great management is combined with secular tailwinds.

Although the drawdown in the fourth quarter was painful in the short-term, we hoped for another two weeks of December. Several companies that we have followed closely approached our "hitting zone" but didn't quite get there. We think we can all agree the world is odd enough that opportunities will present themselves and we will not hesitate to jump...because, in our opinion, that is how you make money over long run.

Best Regards,

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

**TOP 10 HOLDINGS —** % as of March 31, 2019

| | | |
|---|---|---|
| ViaSat | 6.5 | % |
| Compass Minerals International | 6.4 | % |
| Heritage-Crystal Clean | 6.0 | % |
| Avid Technology | 5.3 | % |
| Millicom International Cellular S.A. | 5.1 | % |
| UFP Technologies | 4.7 | % |
| Colfax Corp | 4.5 | % |
| Spectrum Brands Holdings | 4.2 | % |
| GP Strategies Corp | 3.9 | % |
| TEGNA | 3.8 | % |

Fund holdings 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.**

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.

Cash flow measures the cash generating capability of a company by adding non-cash charges (e.g. depreciation) and interest expense to pretax income. The Shiller P/E Ratio is a valuation measure that uses real earnings per share over a 10-year period to smooth out fluctuations in corporate profits that occur over different periods of a business cycle, and is also known as the CAPE (cyclically adjusted price-to-earnings) ratio.

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 Cove Street Small Cap Value Fund is distributed by Quasar Distributors, LLC. Quasar Distributors, LLC is affiliated with U.S. Bancorp Fund Services LLC.