# Letter to Shareholders

March 31, 2021

C S C A X

## GREETINGS FELLOW SHAREHOLDER:

Well, let's just say things are different in 2021. From an investing standpoint—and from our standpoint—it's obviously a lot better. While we invest in securities that represent ownership stakes in real companies run by real people, we are certainly not immune to the whims of 'factor flows' orchestrated by people who have recently deemed 'Small Cap' and 'Value' as factors with some redemption value. In 2020, those factors were deemed 'near worthless.' In 2021, they appear to be the equivalent of a hot fudge sundae with a COVID virus vaccine as the cherry on top.

'Not an obnoxious headwind' is our desired state of an environment in which to work, because our behavioral bias against buying stocks that go up every day—for no reason than technical fund flows—is at the moment being tested. Markets seem to be currently parsed into 3 distinct camps:

1. Ridiculously speculative concepts that are doomed to failure.

2. Real businesses whose stocks are grossly over-inflated and thus there should be high expectations for a divorce between business success and investment success for a decade. And,

3. 'all other.'

We tend to operate more so in the third category, although we don't mind being early in the second.

ViaSat being up 70% from year-end lows means nothing, just as something that is 'worth' $5 but just went from 100 to 60 means nothing. Go nose around some GMO or AQR research on their websites - it is not that 'value' per se is that cheap, it's that Growth and silly are so expensive. And, I can tell you from 'fund flows' is that as is often and usually the case, people are afraid to be early, people usually miss inflection points, people miss the big part of the first move, people are afraid to top-tick a recent move and wait for the pullback that often doesn't happen, and then people pile in and make a top. The world as we see it, is firmly in the 'wait for the pullback' brain set. But we think this train has left the station and continue to see enormous relative opportunity and reasonable absolute opportunity in a focused portfolio of curated companies.

Normally we start with our detractors, but this quarter we do not have any that were meaningful. This will not always be the case, but we will savor this instance. On the plus side we have ViaSat (Ticker: VSAT) which bounced back in expectations for its inflight connectivity business improving with greater travel activity. We have a longer-term view that the company is severely mispriced by the market with its defense business worth as much, if not more, as the entire market cap today and the massively positive, in our view, launch of VSAT 3 in 2022 draws nearer. We continue to hold the company as a top position in our strategy.

GP Strategies Corporation (Ticker: GPX) had a massive rally in the quarter on the back of improving topline results with sustained corporate cost cutting. GPX has also made a series of small asset sales at valuations 4x (multiples higher) the multiple of the whole company, highlighting its 'cheapness', as well as completely de-levering the company. We expect further progress on all fronts, but we have been reducing our position as it approaches a semblance of reasonable value.

After the 2016 election in the U.S., many investors decided that political advertising on broadcast television was dead.

**TOTAL RETURN** **(CSCAX)** — % as of March 31, 2021

| | 3 MONTH | YEAR to DATE | 1 YEAR | 3 YEAR | 5 YEAR | 10 YEAR | INCEPTION (09/30/98) |
|---|---|---|---|---|---|---|---|
| Cove Street Capital Small Cap Value Fund | 20.38 | 20.38 | 82.76 | 7.44 | 6.45 | 9.30 | 9.90 |
| Russell 2000® Index | 12.70 | 12.70 | 94.85 | 14.76 | 16.35 | 11.68 | 9.83 |
| Russell 2000® Value Index | 21.17 | 21.17 | 97.05 | 11.57 | 13.56 | 10.06 | 9.82 |

*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 December 31, 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 1.23%. 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.*

In fact, all ad spending was going to move to digital platforms like Facebook, and therefore the biennial political gravy train for owners of broadcast affiliates was over. Unfortunately for the bears, 2020 turned out to be far and above anything people ever expected in terms of ad dollars flowing to broadcast. Oddly enough, broadcasters were likely the beneficiaries of all of the policing of disinformation that Facebook and YouTube had to perform. Suddenly, digital political advertising was toxic and that benefitted two of our companies, TEGNA (Ticker: TGNA) and E.W. Scripps Company (Ticker: SSP). Specifically, SSP was one of our best performers during the quarter. In addition to having the tailwind from a blowout political year, the company also made a sneaky, good acquisition of a company called ION Media. ION is a fast growing 'Over The Air' (OTA) broadcast network that offers really compelling synergies that no other broadcast company could legitimately realize. SSP's CEO Adam P. Symson has done a really nice job zigging when others are zagging, and we have been pleased with the capital allocation at Scripps, both in terms of acquisitions and divestitures. We trimmed the stock as the position became overweight, but we think there is plenty more upside if the company can continue to grow its non-broadcast TV portfolio. And, given the history of spinning off assets (most notably Scripps Networks (Ticker: SNI)). We will even venture to say that there is a good chance that side gets spun off to be its own company at some point.

We can speak somewhat to two of the contributors in the same breath: 'People are insatiably incented get out of their house and do something. Anything.' We see Six Flags Entertainment (Ticker: SIX) as a longer-term, 'franchise holding' and Liberty TripAdvisor Holdings (Ticker: LTRP.A) as more of a multi-year tactical move, and have weighted them accordingly. We see more upside for both.

Under new ideas, we have KAR Auction Services (Ticker: KAR) is a company we have followed for several decades and have owned in several reincarnations. The U.S. auto auction world is a little funky and our sense is that most people don't quite grasp the nuances. Due to COVID, 2020 was a transformational year for KAR. The company had to shut down its physical auctions for a period of time and was forced to get really good at selling cars online. Now, as opposed to running cars within its physical auctions as the world opens up, KAR has gone all-in on digital, culminating with the purchase of BacklotCars. After stumbling a bit at first, our research suggests that KAR has assembled a portfolio that allows it to be a share taker in the rapidly growing dealer-to-dealer market for used cars. Plus, there is cyclical rebound that we believe will benefit KAR. Specifically, when used car prices are really high, new car dealers that accept trade-ins turn around and sell the older car on their lots as opposed to sending it to an auction. That dynamic should abate as new car sales rebound and people feel more comfortable going to a dealership to trade in their old cars. With the stock in the mid-teens, we think the valuation is discounting a permanent impairment in the hybrid physical/digital auction model that is unlikely to occur. This is a business that used to have a very large moat, so there is a chance that it could maintain some of its Buffett-y characteristics. We will make the Buffett versus Graham call if/when the stock gets in to the low-$20s but we are happy to own the stock at the current valuation.

On a slightly related topic, there are some twists in Small Cap investing that are 'different' than larger company investing, as we are often faced with either accepting a lack of diversification within a product portfolio or a lack of 'institutional infrastructure' versus a larger company. It is what it is – Chevron will have some structural mass that CNX Resources Corporation doesn't. Or in this case, Sandstorm versus industry behemoth Franco Nevada. We started a position in Sandstorm Gold Ltd (Ticker: SAND), which is a 'royalty' company focused mostly in precious metals, but also is involved in industrial metals and energy to a lesser degree. To cut to the chase, a royalty/streaming company is a 12 person company with geologists and lawyers who 'pre-funds' new mining projects with a royalty 'off the top'. There are no shovels or environmental issues. While a reasonable environment for gold is helpful, this research team has watched Franco Nevada become a monster business enterprise, throw a LOT of different commodity environment over 20 years. Look at this as a portfolio of free cashflow that can be reinvested or paid out to shareholders. SAND is a smaller version of Franco that fits our space. We think with a reasonable jockey/founder at the helm, a reasonable commodity environment, and some 'nose' for future investment, we can make a lot of money. If thinks misfire on any of these, we are paying a price that suggests boredom. The asset is also nicely uncorrelated with anything else we own, and…an inflation play, which we lean toward being a tailwind.

During the quarter, we completed our 2.5% position in Viemed Healthcare (Ticker: VMD), which we had initiated in 2020. Viemed provides non-invasive ventilators (NIV) to patients at home through their network of respiratory therapists. Over the past few years, the medical community has seen the benefits of these devices for late stage chronic obstructive pulmonary disease (COPD) patients. These devices allow COPD patients to have a higher quality of life and have been shown to lower emergency room visits for these patients, which ultimately lowers total costs to the healthcare system. Due to the efficacy of the device along with great operational execution, VMD has experienced rapid growth over the past few years. In 2019, NIVs were put into a Medicare bidding process that was expected to lower the pricing and significantly hamper the growth of the business, putting pressure on the company's stock. In 2020 due to COVID 19, NIVs were removed from the bidding process, reopening the runway of growth for VMD. Cove Street had been following the situation very closely and after the NIVs were removed from the bidding process, we began to build our position as the market was underestimating the new growth profile of the business. Additionally, during COVID, VMD's patient growth has been hampered due to the inability of their RTs to enter hospitals and add new patients. Hospitals are one of the largest sources of referrals for VMD. When the economy reopens, VMD's rapid growth trajectory should continue as they have kept most of their RTs on staff even though they have been less productive during COVID.

In other moves of note, we have been long-term shareholders of Avid Technology (Ticker: AVID), and we recently completely exited the position. AVID is the leader in software and services for music and video creation. The company has been in the midst of cost cutting and a change of business model from license software sales to subscription sales. The market has rewarded the company for these improvements with significant appreciation over the last year. At one point, this was our largest position in the Fund, and Cove Street clients owned 15% of the firm. We very publically pounded the company to improve its corporate governance, cost structure and capital allocation, and nominated a Director to the Board. We would prefer NOT to work so hard and so long, but sometimes the upside is worth the dirty elbows.  We sold the balance of our position, as we believe the company has appreciated to above its fair value.

Avanos Medical (Ticker: AVNS) is healthcare company that is focused on non-opioid-based pain management as well some other chronic care products such as enteral feeding tubes. The company was spun out of Kimberly-Clark (Ticker: KMB) a number of years ago and in all honesty has been on a rollercoaster ride since then. Excitement about the company's product set has waxed and waned based on execution and of course short-term issues such as COVID-related impacts on physician visits. We have two recurring themes in healthcare investing: the first is that there will be a 'return to the doctor' increase in a post-COVID world and the second is that smaller healthcare companies either succeed or get taken-over. We bought Avanos on both principles and sold it when it reached a fair value for an acquirer.

Transcat (Ticker: TRNS) is a wonderful business that has been run wonderfully that is simply becoming very expensive. The company calibrates and services 'technical' equipment for a wide customer base, but there is much room for growth and consolidation. We bought the stock in the throes of COVID in 2020 and have more than doubled our money. We retain a sliver of a 1% position after our sell-down on 'getting to be preposterous valuation.'

Going forward, it might be a cliché to say we 'hate the market, but like what we own' but we will say it anyway. We continue to cling to quaint ideas like long-term-oriented investing and reasonable analysis of the probabilities of an uncertain future that looks weirder and more uncertain than ever. Buying fears of uncertainty is at the heart of what a value orientation suggests. We see incredible pricing of certainty in many areas. But there continues to be an exodus of people out of our space (the machines and AI continue to rumble around nearly unmolested) and we see less focus on actual research on actual companies versus analysis of the next 30 days of popularity/momentum. Also, there are fewer people who seem 100% focused on making money rather than saving us from the soulless depravity that seemingly was rampant until about 6 months ago.

We think common sense investing vs the silliness d'jure has a lot of legs to it as much of what passes for Growth investing remains preposterously overvalued.  There remain choice opportunities to buy small pieces of real businesses (legacy code words for a stock) that grow reasonably, generate cash and have a pretty good chance of still being here in 7 years. Protecting capital in the midst of a market that may come to its financial senses at some point might not be as easy as writing about it, but we think our neighborhood is 'fine' and the mission of finding value in smaller public companies remains an enduring source of opportunity.

Best Regards,

Jeff Bronchick

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

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## TOP 10 HOLDINGS — % as of March 31, 2021

| | |
|---|---|
| ViaSat Inc | 7.25 % |
| Compass Minerals International Inc | 6.60 % |
| Colfax Corporation | 5.40 % |
| GP Strategies Corporation | 4.96 % |
| PQ Group Holdings Inc | 4.91 % |
| Millicom International Cellular S.A. | 4.86 % |
| KBR Inc | 3.88 % |
| StoneX Group Inc | 3.72 % |
| White Mountains Insurance Group Ltd | 3.38 % |
| Skechers U.S.A. Inc CL A | 3.36 % |

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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.

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