Punch

Small Cap Commentary
First Quarter, 2017

Overview

The first quarter of 2017 was a relatively quiet one for small-cap stocks, with the Russell 2000 rising 2.5% and the Russell Microcap Index up only 0.4%. After an unusually strong fourth quarter that saw the small-cap index rise nearly 14% after the November 8 presidential election, it perhaps isn't surprising to see the market take a "breather" and digest recent gains.

From a sector perspective, the first quarter was the mirror opposite of the fourth quarter: generally speaking, the best-performing areas in the fourth quarter were the worst-performing ones in the first, and vice versa. Post-election, financials and energy sectors did substantially better than the rest of the market; both, however, declined in the first quarter. Healthcare, which was the lone declining sector in the fourth quarter, was far and away the best-performing one in the first (+12.5%). [See chart below].

Our continued underweight to healthcare stocks impacted performance of the Punch Small Cap Strategy in the first quarter of 2017, and our strategy lagged the benchmark, gaining 0.3% while the Russell 2000 rose 2.5%. From both an investor behavior and a valuation perspective, we continue to find it difficult to stomach the heady prices and capital inflows into this area of the market and are having difficulty finding investment ideas with a sufficient margin of safety.

We are, however, finding interesting opportunities in the financial and industrial areas, and we detail several recent additions to the portfolio in the paragraphs that follow.

Russell 2000 Sector	Q4 2016 Return	Russell 2000 Sector	Q1 2017 Return
Financials	23.5%	Health Care	12.5%
Energy	18.0%	Technology	5.8%
Industrials	12.5%	Materials	5.8%
Materials	11.5%	Utilities	4.7%
Telecom	9.1%	Industrials	1.2%
Consumer Disc.	7.9%	Consumer Disc.	1.1%
Consumer Stpls.	6.4%	Real Estate	0.3%
Utilities	5.3%	Consumer Stpls.	-1.4%
Technology	5.1%	Financials	-1.6%
Real Estate	4.0%	Telecom	-5.4%
Health Care	-6.0%	Energy	-10.7%

Annualized Performance Net of Fees as of 3-31-2017

	Q1 2017	1 Year	3 Years	5 Years	10 Years	Since Inception*
Punch Small Cap	0.3%	21.3%	6.3%	12.9%	7.5%	10.5%
Russell 2000 Index	2.5%	26.2%	7.2%	12.4%	7.1%	8.4%

**Inception date is 3-31-2002*

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Positive Contributors in the First Quarter

Our top contributor to performance in the first quarter of 2017 was EW Scripps Company (SSP, $1.9 billion market cap), the sixth-largest television broadcaster in the country by number of stations owned.

Following a year (2016) when many broadcasters underperformed (SSP was up only 1.7% compared to a 21.3% return for the Russell 2000 Index), this group has started 2017 with a bang (SSP +21.3% vs RTY +2.5%). In 2016, concerns over shifting television viewership, as well as disappointing election spending on television advertising, contributed to underwhelming performance by both broadcast companies as a whole and their stocks. Following the election, however, there has been renewed excitement over the possible positive effects of relaxed regulations on television station ownership—which we believe could make broadcasters significantly more profitable—as well as a return to industry consolidation that took a hiatus last year. Already in 2017 we have seen news surface of a potential mega-deal in the purchase of Tribune company (NYSE: TRCO) by Sinclair Broadcasting (NDQ: SBGI).

We continue to like the broadcasting business in general for its cashflow characteristics and for the value that we think television still has for many viewers. We like Scripps in particular for their long track record of creating value in media, for their conservative capital management, and for their progress in shifting the business model to digital.

Our second-best contributor to performance in the year was a relatively new holding, Par Pacific Holdings (PARR, $750mn market cap), an oil refinery concern whose investment case we detailed last quarter. In February, we sat down with company management at their Houston headquarters and came away excited about the opportunities that the company has to deploy capital by buying small refinery operations around the country and utilizing their over $1 billion in corporate net operating losses (NOLs).

Top Contributors

Holding	Average Weight	Total Return	CTR** (bps)
EW Scripps	3.4%	21.3%	66
Par Pacific Holdings	1.6%	13.4%	38
Capital Southwest	4.0%	7.7%	36
Novanta	1.8%	26.4%	35
SP Plus	1.9%	19.9%	35

Bottom Contributors

Holding	Average Weight	Total Return	CTR** (bps)
DIGI International	3.5%	-13.5%	-72
CECO Environmental	1.7%	-24.1%	-48
Destination XL	1.1%	-32.9%	-47
ARC Document	1.0%	-32.1%	-39
Lithia Motors	2.9%	-11.3%	-33

Perhaps the biggest takeaway from our meeting was management's opinion that the "story" of Par Pacific remains relatively complicated and underappreciated by many investors, resulting in an attractive valuation, because the company never had a formal IPO and has only raised outside equity once. We think that, in time, as the company executes its strategy and gains more of a following, the investment case should become easier to understand.

The third-largest contributor to performance in the year was one of our largest holdings, Capital Southwest Corp. (CSWC, $270mn market cap), a Dallas-based business development company (BDC) that makes debt investments to private middle market companies.

Capital Southwest is distinct from most other public BDCs (of which there are approximately 40 in the U.S.) for three reasons: one, the company is internally managed whereas most BDC's are externally managed; two, a majority of the company's assets were in cash until very recently; three, the shares continue to trade at a 10% discount to net asset value (NAV) while most of the peers trade at premiums. Capital Southwest has no analyst coverage, and we think this lack of surveillance has contributed to undervalued shares. We last sat down with management in November in Dallas and came away feeling good about their ability to underwrite sensible debt deals despite a somewhat frothy credit environment.

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Negative Contributors in the First Quarter

Our largest detractor from performance in the quarter was communications equipment maker Digi International (DGII, $320 million market cap), a company that makes embedded components and networking equipment to wirelessly connect a wide variety of things to the internet, including NASA satellites, Doppler radars, and the international space station.

In November, Digi received an unsolicited offer from Belden Corp (NYSE: BDC) to acquire the company at $13.82 per share, a 33% premium at the time. Digi management quickly rejected the offer, and since then Belden has been oddly quiet about their further intentions. Shares of Digi have slowly drifted down from the offer price during this period of silence. We don't know what the odds are that a deal eventually gets done, but we are happy owning Digi shares on their own merits as 40% of the market cap is in cash (with no debt) and the new management team has done an impressive job reinvigorating the once-sleepy company.

Our second largest detractor from performance was CECO Environmental Corp (CECE, $360mn market cap), a manufacturer of air pollution control equipment and specialty pumps.

In mid-January, the company abruptly announced the resignation of its longtime CEO, Jeff Lang, the architect of the company who had successfully acquired and integrated several large acquisitions since joining in early 2010. We believe that many investors had a favorable impression of Mr. Lang and his track record—ourselves included—and his abrupt departure took many by surprise.

Unsurprisingly, though, when the company reported its fourth quarter results in March, the numbers were disappointing and included a significant write-down of goodwill related to a prior acquisition. Write-downs and disappointing earnings seem to indicat that all was not well at the company and while the previous CEO was an excellent acquirer of businesses, he was perhaps not stellar at driving growth in a larger combined entity.

We met with the interim CEO of CECO at an industry conference in March following the fourth quarter earnings release and came away feeling hopeful that a refreshed management team and strategy can drive organic growth at the company (a missing piece of the puzzle under previous management). The company's core end markets of power plants, industrial manufacturers, refineries, and energy pipelines are healthy and, importantly, CECO has a large installed base of equipment and a long history and reputation for reliability and quality that drives recurring aftermarket sales and new equipment installations. The company could generate 10% of its market cap in free cash flow this year, which we think makes the shares more than reasonably priced.

A significant detractor from performance, for the second quarter in a row, was Destination XL Group (DXLG, $140mn market cap), a retailer of men's big-and-tall clothing. We extensively detailed our rationale for continuing to hold the shares last quarter, and since then the retail environment has only worsened. There were more retail bankruptcies in the first quarter of 2017 than there were in all of 2016 combined. Clearly, the "Amazon effect" is having a profound impact on the way Americans shop, especially for everyday items like clothing and accessories. We think there are reasons to believe that the niche of men's big-and-tall has some immunity to the onslaught of online shopping, but at this point we are in "wait and see" mode, unwilling to commit further capital until we see convincing evidence that the business model is indeed intact. DXL management has communicated to investors that they believe 2017 will be the "inflection point" in their business when capital investments in new stores should slow and free cash flow should grow significantly. We are inclined to believe them but are taking a "trust but verify" approach as the sands of the retail landscape are shifting quickly.

Initiations and Exits in the First Quarter

We initiated two new positions and exited one in the first quarter, ending with 48 total positions.

The first new position was LSC Communications (LKSD, $830mn market cap), one of the largest providers of print services in the country, with over $3 billion in annual sales. The company was the book, catalog, and magazine division of printing conglomerate RR Donnelly (RRD) until it was spun out in September of 2016, concurrent with the formal split of

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the parent company into three separate, independent companies.

It should come as no surprise that print services, in general, is a slow-decline industry that is being disrupted by the secular shift toward digital media. However, LSC has several attractive characteristics. First, the company is in several of the more stable categories of the print industry, and we estimate that nearly half of LSC's revenues are growing organically today. Second, LSC operates in a duopoly with Quad Graphics Corp (NYSE: QUAD), a similarly-sized peer that is stable and rational, which is positive for industry pricing and profitability despite its secular growth headwinds. Finally, the company generates significant free cash flow and is appropriately leveraged, with only 2x debt-to-EBITDA. We estimate that the company could fully pay off its debt within five years if it devoted free cash flow solely to debt reduction.

We believe, spin-offs can create interesting investment opportunities as there is often a lack of information and analysis around these newly-public companies, as well as forced selling pressure that can depress shares. LSC shares these characteristics as well as a couple others that piqued our interest. Book and magazine printing is an unsexy business that is widely known to be in decline; we believe there is a stigma associated with a business like this that contributes to a compelling stock valuation: LSC sports a 20% free cash flow yield and a 4% dividend yield (that can easily grow over time). Also, when the company was spun out of RR Donnelly, the parent company retained an approximately 20% equity stake that needed to be divested in relatively short order. This overhang and imminent equity offering translated into a nearly 40% decline in shares from the day of the spin-off up to the day of the stock offering. It was at this depressed level that we initiated our position.

We have met and talked with LSC management several times since their separation from RR Donnelly and have been impressed by their track record and strategy. We think it is relevant that the CEO of RR Donnelly, when given the choice, chose to move to smaller LSC to become its CEO, and we certainly like the provision in his employment contract that requires him to own stock in the company worth five times his annual salary.

The second new position we added to the portfolio in the first quarter is Bar Harbor Bankshares (BHB, $500mn market cap), a community bank based in Bar Harbor, Maine, with $1.8 billion in total assets. Bar Harbor Bank is a conservative, well-managed community bank that mainly focuses on commercial and retail customers in northern Maine—a region with lower banking competition than many parts of the country whose primary industries are tourism, fishing (lobster), and agriculture (blueberries). The bank has excess capital, managed through the credit crisis virtually unscathed, and pays a consistent and rising dividend.

In 2015, the company announced its intention to deploy some of its excess capital by purchasing a similarly-sized New Hampshire community bank by the name of Lake Sunapee Bank. We think there are meaningful cost synergies for Bar Harbor management taking over the show at Lake Sunapee, and are excited to see what they can do instilling the operating and underwriting discipline of their own bank to a larger organization. In addition, both banks have wealth management divisions that, we believe, are underappreciated.

Our lone exit in the quarter was CorEnergy Infrastructure Trust (CORR, $420mn market cap), an energy-focused real estate investment trust (REIT) that underwrites triple-net-leases on oil and gas infrastructure assets, including pipelines and storage facilities.

Our initial investment in CorEnergy dates back to early 2015, a time when energy markets were in flux as commodity prices around the globe were falling. With a dividend yield over 8% and a stock price under stated book value, we thought the shares were being unfairly punished.

While the subsequent two years were anything but placid for the company and its stock price (shares fell 57% from peak-to-trough but fully recovered within a year), the fundamentals of the business withstood a terrible energy market quite well. Despite its two largest tenants going through bankruptcy proceedings, CorEnergy actually raised, not cut its dividend. During the first quarter, we decided that there were better opportunities elsewhere and exited the position.

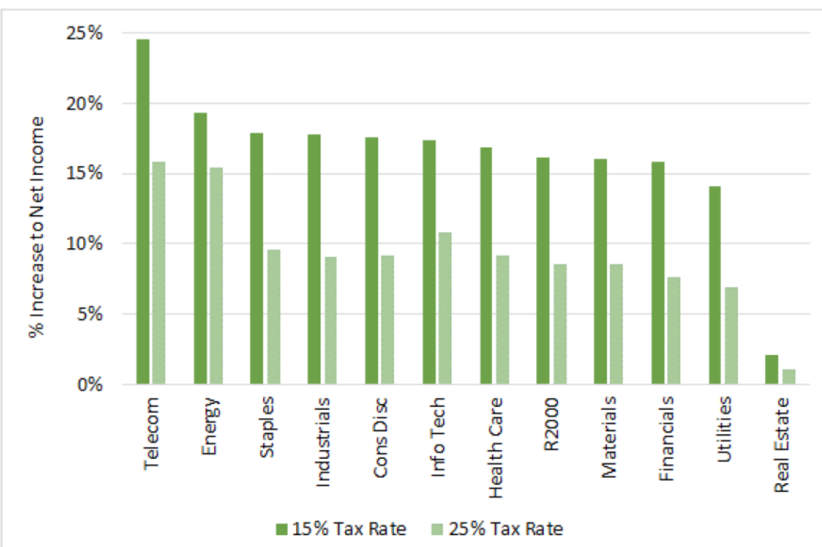
Outlook and Conclusion

Despite recent gains in the small-cap market post-election, we believe that there remain interesting opportunities for finding undervalued, underappreciated companies. Spin-offs, forced liquidations, companies with no analyst coverage, and the like are all parts of the small-cap landscape that are regular areas of interest to us. The additions to the portfolio this past quarter largely fall into those categories.

Regarding the market at large, we have two observations. The first is the potential effect of tax cuts on the valuation of small-cap companies. As the chart below shows ("The Potential Effect of Lower Corporate Tax Rates", courtesy of Furey Research Partners), the boost to net income of hypothetical decreases in corporate tax rates could be meaningful—especially to more profitable industries and businesses. Although the ultimate outcome is anyone's guess, tax reform appears to us to be one of the more concrete, and likely, proposed reforms to come out of the current administration.

The second observation is that, for small-caps as a whole, growth stocks have outperformed value in seven of the last ten years (the exceptions being 2008, 2012, and 2016, see table "Small Cap Performance: Growth vs. Value" below). Buoyed by falling interest rates and an improving economy, many lower-quality, unprofitable, and growth-oriented stocks have done well. In 2016, that trend dramatically reversed itself, and value stocks outperformed growth stocks by a wide margin (+32% vs +11%). While that trend has not continued so far in 2017 (the Russell 2000 Growth Index rose 4.6% while the Value Index fell 1.3% in the first quarter), we believe that at some point in the not-too-distant future, this cycle may turn again.

The Potential Effect of Lower Corporate Tax Rates



Source: Furey Research Partners and StockCharts.com. Data as of Dec. 2nd, 2016

Small Cap Performance: Growth vs. Value

Year	Russell 2000 Growth Index	Russell 2000 Value Index	Best Performer
2007	7.0%	-9.8%	Growth
2008	-38.6%	-29.0%	Value
2009	34.3%	20.4%	Growth
2010	29.0%	24.5%	Growth
2011	-2.9%	-5.5%	Growth
2012	14.6%	18.0%	Value
2013	43.3%	34.5%	Growth
2014	5.6%	4.2%	Growth
2015	-1.4%	-7.5%	Growth
2016	11.3%	31.6%	Value

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Composite performance is shown net-of-fees and brokerage commissions paid by the underlying client accounts. Certain client accounts have directed us to reinvest income and dividends, while others have directed us to not reinvest such earnings. As such, performance data shown includes or excludes the reinvestment of income and dividends as appropriate, depending on whether the account has directed us to reinvest income and dividends. Past performance is no guarantee of future results, and investing in securities may result in a loss of principal.

Punch & Associates claims compliance with the Global Investment Performance Standards (GIPS®) and has prepared and presented this report in compliance with the GIPS® standards. Please refer to the attached Composite Profile and Schedule of Performance for information regarding Punch & Associates' compliance with GIPS® standards.

The reference to the top five and bottom five performers within the Punch Small Cap Equity Strategy portfolio is shown to demonstrate the effect of these securities on the strategy's return during the period identified. The holdings identified do not represent all of the securities purchased, sold or recommended for advisory clients during the period of time shown. Past performance does not guarantee future results; therefore, it should not be assumed that recommendations made in the future will be profitable or will equal the performance of the securities in this list. Please contact Punch & Associates at andy@punchinvest.com or (952)224-4350 to obtain details regarding the calculation's methodology or to obtain a list showing every holding's contribution to the overall strategy's performance during the period of time shown.

Any benchmark indices shown are for illustrative and/or comparative purposes and have only been included to show the general trend in the markets in the periods indicated. Such indices have limitations when used for comparison or other purposes because they may have volatility, credit, or other material characteristics (such as number and types of securities or instruments represented) that are different from those of the Composite and/or any client account, and they do not reflect the Composite investment strategy or any other investment strategies generally employed by Punch & Associates. For example, the Composite for a particular client investment portfolio will generally hold substantially fewer securities than are contained in a particular index.

**Inception of the Punch Small Cap Equity Strategy was March 31, 2002. **CTR represents the contribution to total attribution.*

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Punch & Associates Investment Management, Inc.
Small Cap Composite

Notes to Composite Profile and Schedule of Performance

Punch & Associates Investment Management, Inc.
Small Cap Composite
Composite Profile and Schedule of Performance
As of June 30, 2016

Year	Annual Performance History Small Cap Gross of Fee	Small Cap Net of Fee	Benchmark [1]	Composite 3-Year Std Deviation (%) [2]	Benchmark 3-Year Std Deviation (%) [2]	Number of Portfolios	Year-End Composite Assets ($mil)	Year-End Firm Assets ($mil)	Percent of Total Firm Assets	Dispersion [2]
2002 (since 3/31)	-15.21%	-15.85	-23.53 %	N/A	N/A	12	$ 5.1	$ 103.9	4.9 %	N/A
2003	55.64	54.21	47.25	N/A	N/A	29	12.9	167.3	7.7	6.8%
2004	21.93	20.68	18.32	N/A	N/A	52	21.0	206.2	10.2	4.8%
2005	13.02	11.80	4.55	N/A	N/A	67	23.8	258.7	9.2	3.3%
2006	22.83	21.75	18.37	N/A	N/A	98	38.8	335.0	11.6	3.3%
2007	3.65	2.65	-1.57	N/A	N/A	272	103.9	397.0	26.2	3.7%
2008	-33.54	-34.18	-33.80	N/A	N/A	243	65.5	261.5	25.0	2.1%
2009	32.65	31.41	27.20	N/A	N/A	257	85.2	340.4	25.0	3.3%
2010	18.87	17.77	26.85	N/A	N/A	283	108.4	395.6	27.4	1.0%
2011	0.81	-0.14	-4.18	20.7	25.3	284	113.6	475.6	23.9	0.7%
2012	20.07	19.04	16.34	17.4	20.5	292	152.4	613.6	24.8	0.8%
2013	42.63	41.52	38.82	13.6	16.7	320	266.1	832.7	32.0	0.9%
2014	-0.21	-0.91	4.89	12.8	13.3	328	265.0	905.7	29.3	0.7%
2015	0.51	-0.26	-5.11	15.7	14.2	330	254.7	938.1	27.2	0.8%
2016 (6/30)	0.31	-0.13	1.41	N/A	N/A	337	251.2	957.4	26.2	N/A
Cumulative	321.44	270.07	170.77							

Period	Annualized Performance History Small Cap Gross of Fee	Small Cap Net of Fee	Benchmark [1]
1 Year	-8.15%	-8.96 %	-8.14%
3 Year	7.73	6.90	6.54
5 Year	10.65	9.77	8.02
Since Inception	10.62	9.61	7.24

Punch & Associates Investment Management, Inc. (Punch) claims compliance with the Global Investment Performance Standards (GIPS®) and has prepared and presented this report in compliance with the GIPS standards. Punch has been independently verified for the periods from April 1, 2002 through June 30, 2016. Verification assesses whether (1) the Firm has complied with all the composite construction requirements GIPS standards on a firm-wide basis and (2) the Firm's policies and procedures are designed to calculate and present performance in compliance with the GIPS standards. The Small Cap Composite has been exam for the periods from April 1, 2002 through June 30, 2016. The verification and performance examination reports are available upon request.

The Composite creation date is December 31, 2005. The creation date is the date in which Punch started reporting returns at the strategy level while they had previously been reported at the account level.

[1] The Russell 2000 Index is the Composite's benchmark.
[2] See Note 5 for discussion of the composite dispersion and 3-year standard deviation calculation. N/A indicates statistics are not required to be presented for the time period pursuant to GIPS.

Note 1. Organization and Nature of Business
Punch & Associates Investment Management, Inc. (Punch) is an investment adviser registered with the Securities and Exchange Commission under the Investment Advisers Act of 1940. The term "Firm," as defined by Global Investment Performance Standards (GIPS), represents Punch & Associates Investment Management, Inc.
The Punch Small Cap Strategy (Small Cap Composite) invests in U.S. listed public companies with market capitalizations between $250 million and $2 billion. Companies from the small cap universe are selected on the basis of economically attractive business models, accelerating fundamentals, cash flow characteristics, valuation relative to cash flow, and general investor recognition.
This description of products and services of the Small Cap Composite (the Composite) is not an offering. Past performance is not an indication or a guarantee of future results. Investments are subject to risk and may lose value. A list of our composite descriptions and our policies for valuing portfolios, calculating performance, and preparing compliant presentations are available upon request.

Note 2. Performance Presentation Standards
This report includes all of GIPS' mandatory disclosures as well as additional disclosures deemed prudent by Punch's management. Investment philosophies did not change materially during the reporting periods or from period-to-period.

Note 3. Calculation of Rates of Return
The portfolio returns for the period are based in U.S. dollars and have been calculated using a time-weighted, monthly, geometrically linked rate of return formula to compute quarterly percentage returns. Each portfolio's monthly rate of return is the monthly percentage change in the market value, including earned interest and dividends, after allowing for the effects of cash flows.
The monthly composite rate of return calculation is weighted by beginning values. This results in an asset's size-weighted rate of return. Security transactions and any related gains or losses are recorded on a trade-date basis.

Note 4. The Composites
Punch has established composites for all fee-generating portfolios for which it has full discretionary investment decision-making authority. Punch's client base within the composites was comprised of institutional and individual investors with a minimum asset balance of $100,000. No alterations have been made to the composites as a result of changes in investment professionals. In addition, Punch is the investment adviser to transitory portfolios that were not eligible for inclusion in any composite because the portfolios are either new for the month first funded, or the portfolios had restructuring which took place during the month.
The Small Cap Composite is one of several composites managed by Punch. Punch's list is available upon request.
Performance is based on total assets in the portfolio, including cash and substitute securities. Generally, a portfolio will enter a composite on the first day of the first full month following its inception. A portfolio is removed from a composite as of the last day of its last full month. Historical performance results include the results of clients who are no longer clients of Punch. Each composite is comprised of separately managed portfolios.
The Composite is subject to Punch's large cash flow policy which defines a cash withdrawal of more than 10 percent of the portfolio's market value as a large cash flow which requires the Composite to be valued at the date of the withdrawal. This policy has been in effect for the periods from April 1, 2002 through June 30, 2016.

Note 5. Composite Dispersion
Composite dispersion measures represent the consistency of a firm's composite performance results with respect to an individual account's portfolio returns within a composite. Account dispersion is measured by the standard deviation from the central tendency (mean return).
The dispersion of the annual returns of the Composite is measured by the asset-weighted standard deviation method. Standard deviation attempts to measure how much exposure to volatility was taken historically by the implementation of an investment strategy. Only portfolios that have been managed for the full year have been included in the annual dispersion calculation of the Composite. Effective for the year ended December 31, 2011, GIPS requires the presentation of the three-year annualized standard deviation. This statistic measures the volatility of returns for the Composite and benchmark over the preceding 36-month period.

Note 6. Investment Management Fees
The net performance results set forth in the Schedule of Performance reflect the deduction of actual investment management fees. The standard fee structure is based on 1 percent of assets per annum on all discretionary assets unless otherwise specified. Prior to December 31, 2005, the fee structure was variable based on strategy and account size, not to exceed 1.5 percent per annum.
Account minimums and fees are negotiable on a case-by-case basis due to potential growth, size and services rendered.

Note 7. Comparison with Market Index
Punch compares its Small Cap Composite returns to a certain market index management believes has similar investment characteristics. The returns of this index do not include any transaction costs, management fees or other fees. This index is the Russell 2000 Index.