



1st Quarter 2018

This was one quarter where I wish I could have channeled the management “genius” of Jack Welch. The legendary former CEO of General Electric always managed to maintain a cookie jar of earnings so that he could keep beating Wall St. expectations by one penny each quarter. After four exceptional quarters in 2017, our portfolio returned to earth in the first quarter of 2018.

We would point to two stocks as major culprits. The first was a late 2017 spin-off of a domestic coal producer, which did a partial round trip in five months. It went from \$22 to near \$40 at year-end, and then reversed to \$29 at the end of March, reflecting some volatility in energy prices. Actually, I would have felt really good about a \$22 to \$29 move in under 6 months if it had been smoother. Of course, I would have felt even better if we had been smart enough to sell this stock near its year-end price. However, as long term fundamental investors, we tend not to react to short-term price gains unless we get contradictory signals from management. The future still looks positive here with \$3.50+ in earnings expected in 2019.

The second troublemaker was also a spin-off, this time a chemical producer. It was our largest position by virtue of having appreciated from near \$15 to \$42 in a little more than a year. Fundamentals remained extremely strong, as we were looking forward to an earnings progression to near \$4 in 2019 (from \$1.12 in 2016). However, one day in March, FBI agents with search warrants conducted a raid on the company’s major production facility, apparently focused on compliance records. We still do not know why the raid took place, but made the assumption that the FBI needed probable cause to get the search warrant, and immediately started selling our stock. Our net realization wound up being just somewhat better than the approximate \$35 price at the end of the first quarter (the stock reacted quickly to the news), with the selling complete at the time of this writing. Again, an extremely successful investment, but with a less than stellar finish.

I do not wish to imply things were all doom and gloom in the quarter. To provide some symmetry with the previous commentary, our best performer was one of the worst performers in the previous quarter. Quick handling of problem loans by this financial services company turned things around quickly. Unfortunately, since the market capitalization of this company was relatively tiny compared to the previously mentioned equities, it did not have a comparable portfolio impact.

Our strategy is not one that produces consistent alpha over every time period. However, over the long-term, it has produced a solid excess return with a beta of ~.85 relative to the Russell 2000 Value Index[®]. Perhaps if Jack Welch were managing the portfolio, he would have figured out a way to smooth the returns sufficiently to give the appearance of consistent results. Jack Welch retired with his reputation intact; his successor had to deal with the problems of maintaining the streak when fundamentals deteriorated – not surprisingly, he ran into difficulties. We do not have Jack Welch’s flexibility with our portfolio. Our investments are marked to market every day, and our decisions, both good and bad, are transparent to our clients. We would not have it any other way.

Abbott J. Keller, CFA
Chief Investment Officer

KESTREL SMALL-CAP VALUE COMPOSITE¹

	Gross Return (%)	Net Return (%)	Russell 2000 [®] Value Index (%)	Composite 3-Yr Annualized Std Dev (%)	Russell 2000 [®] Value 3-Yr Annualized Std Dev (%)	Number of Accounts in Composite ²	Internal Dispersion (%)	Composite Assets ² (\$ millions)	Composite Firm Assets ² (%)	Total Firm Assets ² (\$ millions)
2018 (1st Quarter)	-3.8	-4.0	-2.6	13.2	14.1	18	N/A	273.7	100.0	273.7
2017	24.6	23.5	7.8	13.0	14.2	18	0.2	295.2	100.0	295.2
2016	36.7	35.4	31.7	14.0	15.7	18	0.2	273.4	100.0	273.4
2015	-13.3	-14.1	-7.5	12.2	13.7	31	0.6	289.5	100.0	289.5
2014	0.6	-0.4	4.2	11.5	13.0	41	0.6	461.1	59.5	774.4
2013	28.7	27.5	34.5	12.9	16.0	46	0.9	528.8	63.2	836.1
2012	13.5	12.4	18.1	15.3	20.2	48	0.4	420.4	52.8	796.6
2011	3.3	2.3	-5.5	23.2	26.4	48	0.4	398.2	54.4	732.3
2010	20.4	19.3	24.5	27.3	28.8	49	0.5	402.3	54.4	740.2
2009	35.2	33.9	20.6	26.3	26.0	52	0.8	337.5	54.2	622.6
2008	-33.0	-33.7	-28.9	19.5	19.4	53	1.0	263.1	53.8	488.7
2007	0.2	-0.8	-9.8	11.9	12.8	57	0.5	471.7	57.8	816.5
2006	24.9	23.8	23.5	11.2	12.5	58	0.6	480.5	50.4	952.8
2005	4.6	3.6	4.7	12.8	14.3	56	0.6	420.9	50.9	826.3
2004	28.3	26.8	22.3	15.7	17.8	62	0.9	944.2	100.0	944.2
2003	36.9	35.7	46.0	17.4	18.7	60	1.1	784.2	100.0	784.2
2002	-6.6	-7.7	-11.4	15.7	17.6	64	0.9	627.9	100.0	627.9
2001	19.6	18.3	14.0	14.3	14.9	61	1.7	719.3	100.0	719.3
2000	16.1	14.8	22.8	15.0	16.8	71	2.2	609.9	100.0	609.9
1999	7.7	6.7	-1.5	15.8	16.6	100	1.9	522.2	100.0	522.2
1998	2.0	1.0	-6.5	14.5	15.3	114	1.2	478.6	100.0	478.6
1997	31.8	30.7	31.8	10.3	9.5	55	1.1	228.1	100.0	228.1
1996	37.4	36.3	21.4	10.5	9.5	10	0.8	83.7	100.0	83.7
1995	31.3	30.2	25.8	N/A	N/A	6	0.4	41.6	100.0	41.6
1994	9.9	9.0	-1.5	N/A	N/A	4	0.4	28.8	100.0	28.8
1993 (8/17/93)	9.6	9.3	7.7	N/A	N/A	1	N/A	18.0	98.9	18.2
Since Inception (8/17/93)										
Cumulative	2105.4	1643.7	984.7							
Annualized	13.4	12.3	10.2							

¹ The returns and assets figures presented for the current year are preliminary. Final figures will be available upon request and, if different from the preliminary figures, will be included in the next Fact Sheet. Final figures for 4th quarter 2017 did not differ from reported preliminary numbers. This information is incomplete without the performance disclosure statement on page 2.

² Effective January 2005, an existing large account was shifted from Kestrel’s Small-Cap Value Composite to a new Small/Mid-Cap Value Composite leading to a change in the Composite Assets.

² During the second quarter of 2015, Kestrel’s single Small/Mid-Cap Value account was closed, leading to a reduction in Total Firm Assets.

INVESTMENT STYLE

Kestrel is an equity manager with a unique, value-oriented approach. We select stocks primarily from the universe of companies undergoing voluntary restructurings. In addition, we may devote a portion of the portfolio to other groups of companies sharing a common characteristic which investors fail to price properly.

CURRENT INVESTMENT THEME

Restructuring

Voluntary proactive move by management indicating stock undervaluation

Incorporates share repurchases, spin-offs, and asset sales

UNIQUE, VALUE ORIENTED DOMESTIC EQUITY SPECIALISTS

- Independent investment manager founded in 1993
- Principals have worked together since 1978
- Open to new accounts (minimum \$1 million)
- Experts in voluntary restructurings
- Stay fully invested

REPRESENTATIVE PORTFOLIO HOLDINGS* (As of March 31, 2018)**

Restructuring (96.9%)

Advanced Emissions Solutions	Michaels Companies Inc
AMN Healthcare Services Inc	Mitel Networks Corp
Avis Budget Group Inc	NetScout Systems Inc
Big Lots Inc	PCM Inc
Bloomin Brands Inc	PDL BioPharma Inc
BWX Technologies Inc	PICO Holdings Inc
CalAmp Corp	Pinnacle Entertainment Inc
Citi Trends Inc	Sally Beauty Holdings Inc
CNX Resources Corp	Spirit Realty Capital Inc
CONSOL Energy Inc	SPX Corp
CRA International Inc	Tanger Factory Outlet Centers
Donnelley Financial Solutions	TEGNA Inc
Federated National Hldg Co	The Ensign Group
GAIN Capital Holdings Inc	TreeHouse Foods Inc
Generac Holdings Inc	TriState Capital Holdings
Gulfport Energy Corp	Verint Systems Inc
iStar Inc	Wabash National Corp
Kforce Inc	Walker & Dunlop Inc
Kimball Electronics Inc	World Fuel Services Corp
Linn Energy Inc	Zix Corp
Marlin Business Services	

Cash (3.1%)

INVESTMENT PROFESSIONAL TEAM

Abbott J. Keller, CFA

Chief Investment Officer

44 years of investment experience

David J. Steirman

President

42 years of investment experience

Lee Kaplan, CFA, CPA/ABV

Vice President

Equity Research

19 years of investment experience

Gregg S. Uyekubo, CFA

Vice President

Trading Manager

23 years of investment experience

Thomas E. Stickley

Chief Compliance Officer

Client Services Analyst

18 years of investment experience

CONTACT: Thomas E. Stickley

Direct Line: (650) 572-9469

Fax: (650) 572-8689

E-mail: tstickley@kestrelinvestment.com

Website: <http://www.kestrelinvestment.com>

* Kestrel Small Cap Value Composite. A complete disclosure is available below.

** The specific securities identified and described do not represent all of the securities Kestrel has purchased or sold for clients and the reader should not assume that investments in the securities identified and discussed were or will be profitable.

Past performance does not guarantee future results. It should not be assumed that recommendations made in the future will be profitable or will equal the performance of the securities included in this report. Kestrel Investment Management claims compliance with the Global Investment Performance Standards (GIPS®) and has prepared and presented this report in compliance with the GIPS® standards. Kestrel has been independently verified for the periods 01/01/2001 – 12/31/2017. Verification assesses whether (1) the firm has complied with all the composite construction requirements of the 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 Value Composite has been examined for the periods 01/01/2001 – 12/31/2017. The verification and performance examination reports are available upon request. Kestrel is a value manager that invests primarily in small- and mid-cap U.S. securities and is registered with the SEC as an investment adviser. Kestrel is not affiliated with any parent organization. The Small-Cap Value Composite, created in August 1993, includes all discretionary accounts managed across the small capitalization segment of the U.S. equity market including accounts no longer with the firm. Kestrel invests primarily in the securities of companies undergoing voluntary restructuring activities such as share repurchases and spin-offs. Internal dispersion is calculated using the asset-weighted standard deviation of all accounts included in the composite for the entire year; it is not presented for periods less than one year or when there are five or fewer portfolios in the composite for the entire year. The three-year annualized standard deviation measures the variability of the composite and the benchmark returns over the preceding 36-month period. All returns are expressed in U.S. Dollars. The Russell 2000® Value Index is an unmanaged market-capitalization weighted index and includes Russell 2000® companies with lower price-to-book ratios and lower forecasted growth values. It is diversified across companies, industries and sectors and is constructed to provide a comprehensive and unbiased barometer for the small-cap value segment of the U.S. equity market. The Index's performance is calculated on a total return basis with dividends reinvested, but does not reflect the deduction of any transaction or management fees. The volatility of the Russell 2000® Value Index may be materially different from that of the strategy depicted, and the holdings in the strategy may differ significantly from the securities that comprise the Index. Index performance information is included solely to show market performance generally during the periods for which composite returns are presented, and does not reflect a belief by Kestrel that investing in an index is a viable investment alternative or is in any way comparable to Kestrel's performance. The Russell 2000® Value Index is a trademark /service mark of the London Stock Exchange Group companies. Kestrel may concentrate its investments in relatively few stocks, industries or sectors; may invest in stocks with smaller or larger market capitalizations than the stocks in the index; may trade actively; and may be more or less volatile than the index. Gross returns are net of actual transaction costs; net returns are net of actual transaction costs and actual investment management fees. During the period from 1999 through 2004, the Composite included two accounts subject to performance-based fees and a lower flat fee. For separate accounts, Kestrel's standard non-institutional fee schedule is 1.25% for the first \$3 million and 1.0% thereafter, and its standard institutional fee schedule is 1.0% for all assets. Actual investment advisory fees incurred by clients may vary. Fees are payable quarterly. Performance results include the reinvestment of all income. Account returns are calculated monthly, using a time weighted total return which includes realized and unrealized gains and losses and accrued interest and dividends. Quarterly and annual returns are calculated by geometrically linking monthly returns. For the period from 1994 through 1997, the Composite included one non-fee-paying account representing less than 1.0% of total assets at all times; net returns have been calculated as if that account paid fees at standard rates. A complete list and description of Kestrel's composites and policies for valuing portfolios, calculating performance and preparing compliant presentations is available upon request.