Skyline Asset Management, L.P.

Executive Summary

Skyline Small Cap Value Composite

December 31, 2016

Overview

The composite generated a 15.2% return for the fourth quarter, compared to an 8.8% return for the Russell 2000 Index and a 14.1% return for the Russell 2000 Value Index. For all of 2016, the composite generated a 22.9% return, compared to a 21.3% return for the Russell 2000 Index and a 31.7% return for the Russell 2000 Value Index. Small cap stock prices posted strong gains for both the fourth quarter and full year. For most of the year, stocks responded positively to a modestly expanding U.S. economy and a low interest rate environment. Late in the year, stocks took a sharp leg upward in response to the results of the U.S. election that portended a more business-friendly environment over the next several years.

The composite outperformed its benchmarks during the fourth quarter due primarily to advantageous stock selection. For all of 2016, the composite outperformed the Russell 2000 Index due primarily to favorable sector allocation. The composite underperformed the Russell 2000 Value Index during 2016 due mainly to unfavorable stock selection. Despite the adverse stock selection relative to the value benchmark during 2016, we believe the long term earnings prospects of the companies currently in our clients' portfolios remain quite strong.

Surveys taken late in the year showed a high level of business and consumer confidence. If that confidence translates into increased economic activity, corporate earnings should respond accordingly, which would benefit stock prices. In addition, if corporate tax reform is enacted as expected, many companies would benefit from lower rates, another positive for equity valuations. The powerful move in equity prices following the election indicates high expectations for an improving economy and lower corporate tax rates, and the opportunity for further stock price gains depends upon the degree to which those expectations are met.

Market Review

Stocks rose in the fourth quarter, as indicated by the Russell 2000 Index's 8.8% increase, the 14.1% return generated by the Russell 2000 Value Index, and the S&P 500 Index's 3.8% increase. For all of 2016, the Russell 2000 Index rose 21.3%, the Russell 2000 Value Index increased 31.7%, and the S&P 500 Index rose 12.0%.

Stocks rallied strongly following the election in early November of a President and Congressional majorities considered likely to foster an improved environment for businesses. The prospects for a stronger economy, helped by less regulation and corporate tax reform, encouraged equity investors. The strong fourth quarter gains added to increases generated earlier in the year when stocks responded positively to an improved earnings outlook, leading to solid returns for all of 2016.

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Financial stocks were the best performers during the fourth quarter, benefiting from rising interest rates in addition to the expectations for regulatory and corporate tax relief. Economically sensitive sectors, including energy, materials, and industrials, also performed well during the quarter. The only sector to post a decline during the quarter was healthcare. The Affordable Care Act, which increased demand for healthcare services, saw its future thrown into question by the election.

Sector performance for all of 2106 was similar to the fourth quarter. Economically sensitive sectors, particularly materials, performed relatively well, as did financials, while healthcare stocks were again the laggards.

Small cap stocks significantly outperformed large cap stocks in both the fourth quarter and full year. Small cap companies tend to generate a higher percentage of their revenues domestically than large cap companies and several trends are in place that are expected to benefit domestically focused companies. First, the U.S economy is among the strongest globally. In addition, domestically focused companies tend to have higher corporate tax rates so they would be greater beneficiaries of a reduction in those rates. Furthermore, there are fears that the new administration's tougher stance on free trade could negatively impact U.S. firms (typically larger ones) that generate significant overseas revenues.

Small cap value stocks significantly outperformed small cap growth stocks during the fourth quarter and all of 2016. The primary reasons value outperformed growth were the value index's higher weighting in strong performing financial stocks and lower weighting in poor performing healthcare stocks. Technology stocks in the value benchmark also significantly outperformed technology stocks in the growth benchmark.

Portfolio Review

The composite generated a 15.2% return for the fourth quarter, compared to an 8.8% return for the Russell 2000 Index and a 14.1% return for the Russell 2000 Value Index. For all of 2016, the composite generated a 22.9% return, compared to a 21.3% return for the Russell 2000 Index and a 31.7% return for the Russell 2000 Value Index.

The financials sector contributed most to the composite's absolute return during the fourth quarter and full year 2016 due to its high absolute weighting and strong price performance. First Busey Corporation, a Champaign, IL based commercial bank, was among the largest contributors for both the fourth quarter and full year. In addition to benefiting from higher interest rates like most banks, First Busey is expected to generate above average earnings growth as it integrates and improves the operations of a recent sizable acquisition. The industrials sector was also a significant contributor to the composite's absolute return over both time frames due to its large weighting and strong price performance. In addition, within the materials sector, Headwaters Incorporated, a producer of construction products, benefited from a buyout offer that was 21% above the price it sold at prior to the announcement.

Starting with performance relative to the core benchmark, sector allocation was a positive for the composite for the fourth quarter and full year relative to the Russell 2000 Index due primarily to a low weighting in the poor performing healthcare sector. Stock selection was positive during the quarter for most sectors when compared to the Russell 2000 Index, while strong selection in the healthcare sector offset adverse selection in the energy, industrials, and financials sectors for all of 2016.

The healthcare sector contributed most to the composite relative to the Russell 2000 Index for both periods due to its low weighting in the poor performing healthcare sector as well as strong stock selection. Cross Country Healthcare, Inc., a nurse staffing company, was a significant contributor to the composite's fourth quarter performance. Cross Country reported strong earnings during the quarter, allaying fears that waning benefits from the Affordable Care Act would negatively impact its results.

The energy sector detracted most from the composite's performance relative to the Russell 2000 Index during both periods. Bristow Group Inc., whose primary business is providing helicopter services to the offshore energy industry, declined due to disappointing earnings results. The company was not as insulated from lower oil prices as we expected and was sold when we lost confidence in our investment case. The stock was sold prior to the post-election rebound in energy-related stocks and our lack of exposure to the sector negatively impacted relative performance during the fourth quarter.

Moving to performance relative to the value benchmark, sector allocation was slightly negative for both the fourth quarter and full year relative to the Russell 2000 Value Index. Underweights in the relatively poor performing real estate and utilities sectors were mostly offset by an underweight in the strong performing financials sector. Stock selection relative to the value benchmark was broadly but mildly positive during the fourth quarter but significantly negative for all of 2016.

The reasons for adverse stock selection for the composite during the year were varied. Some, like the previously mentioned Bristow Group, were sold because their weakening business trends led us to the conclusion that our original investment thesis was no longer valid. However, several stocks that performed poorest overreacted to temporary factors and not a significant deterioration in fundamentals. In addition, the factors that contributed to price declines for many of our clients' portfolios' holdings were varied and, in our opinion, unrelated.

For example, in the third quarter letter, we mentioned that the hospital staffing company Cross Country Healthcare, Inc. declined sharply due to fears that the beneficial impact of the Affordable Care Act on hospital admissions was waning and would slow demand for hospital staffing services. As mentioned earlier in this letter, those fears proved unfounded and Cross Country rebounded sharply after posting solid earnings results.

Outlook

Equity markets in the last several years were influenced by low economic growth and low interest rates. During this period, investors rewarded stability and dividend yield. In the three years ending October 31, 2016, the utilities, consumer staples, healthcare, and real estate sectors of the Russell 2000 Value Index generated returns between 29.0% and 42.8%. These stable and/or higher yielding sectors significantly outperformed the economically sensitive materials, industrials, and consumer discretionary sectors, which generated returns between -2.9% and 6.6% over the same time frame.

The environment for equities changed dramatically with the 2016 U.S. presidential election. Investors anticipate that Republican control of the White House and both houses of Congress will lead to relaxed regulations, lower taxes, and a stronger economy. In the sharp run-up in stock prices from the election to year end, economically sensitive sectors significantly outperformed stable and yield-oriented sectors.

Post-election stock price gains have pushed small cap valuations towards the high end of their historical range. We believe it is critical for companies to deliver earnings growth because we are skeptical that P/E multiples can expand much further. Fortunately, we expect the companies in our clients' portfolios to generate strong, company-specific earnings gains.

In addition, the economy appeared to be accelerating even before the new government was in place. U.S. manufacturers surveyed by the Institute for Supply Management reported strong new orders, production, and employment in both November and December. Also in December, consumer confidence reached its highest level since January 2004.

Corporate earnings also began rebounding prior to the election. The companies in the S&P 500 Index reported EPS growth in the third quarter of 2016, the first year-over-year gain since the first quarter of 2015, ending the longest earnings slump since the financial crisis.

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At Skyline, our focus is on finding those companies with the best combination of earnings growth prospects and attractive valuations. We do not pay up for earnings stability or yield and for that reason, our clients' portfolios tend to be more heavily weighted towards economically sensitive sectors. If improving business and consumer confidence translates into sustained economic growth, we believe the environment for our clients' portfolios going forward will be better than it has been for the last several years.

William F. Fiedler Partner, Portfolio Manager	Michael Maloney Partner, Portfolio Manager	Mark N. Odegard Partner, Portfolio Manager

Note: Portfolio holdings are subject to change and are not a recommendation to buy individual securities. The views expressed are those of Skyline Asset Management, L.P. and are subject to change. The composite's performance is gross of fees. Gross returns do not reflect the deduction of investment advisory fees or expenses and therefore the client's return will be reduced by the advisory fees and any other expenses it may incur. For example, a separately managed client portfolio, which earned 15% per annum for ten years, would result in a cumulative return of 304.6% before the investment advisory fee of 1% and expenses and 270.7% net of such fees and expenses. The investment advisory fees are described in Part 2 of Skyline's Form ADV.

Sources: C.L. King & Associates; CNBC LLC; Lake Street Capital Markets; MarketWatch, Inc.; Stephens Inc.; The Wall Street Journal; William Blair & Company, L.L.C.; S&P Capital IQ; Morningstar, Inc.; and Skyline Asset Management, L.P.