DISTILLATE CAPITAL

Year-End Letter to Investors: Value Mattered in 2022

Letter Summary

Amid rising interest rates, elevated inflation, and moderating economic activity, equity market sentiment remains poor. In contrast to the views often offered from pundits in the media, we believe the opportunity to invest in high quality companies at attractive valuations remains very appealing for long-term investors. Higher interest rates are not abnormal, but more the old normal, and the economy and corporations have weathered much more difficult circumstances in the recent past. Low rates have, however, fueled debt binges and stretched valuations that persist in pockets of the market and so capturing the attractive longer-term opportunities available in equities amid current pessimism requires navigation around these risks.

Performance Summary

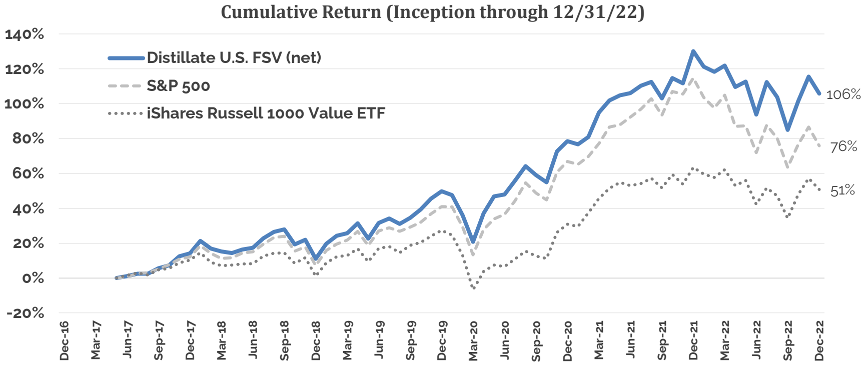
U.S. Fundamental Stability & Value (U.S. FSV): In an adverse market environment in 2022, Distillate's U.S. FSV strategy held up much better than the overall market with a drop of 10.58% net of fees vs. an 18.11% decline for the S&P 500 Index. (See **Figure 2** on the following page). This follows better-than-benchmark performance in each year since inception in 2017, with the result being annualized net of fee returns since inception of 13.80% compared to 10.64% for the S&P 500 of over the same period. While still well short of the multi-decade time horizon most investors should employ, initial results for the strategy as seen in the cumulative return in **Figure 1** are encouraging with better performance in both up and down markets and a strong argument that value investing as a style, when rationally implemented, is still highly efficacious despite decrees to the contrary.

U.S. Small/Mid Cap Quality & Value (SMID QV): Our SMID QV's 2022 return of -8.64% net of fees was substantially better than that of the iShares Russell 2000 ETF at -20.49%, and the -14.67% return for the iShares Russell 2000 Value ETF. Following previous relative gains, the strategy is significantly ahead of the Russell 2000 and Russell 2000 Value ETFs by 8.92% and 7.80% on an annualized net-of-fee basis since inception (See **Figure 3** on the following page).

U.S. Large Cap Value Long 130%/Short 30% (U.S. Value 130/30): A strategy that Distillate operates and which we have not previously discussed is a portfolio that operates with leverage, known as a 130/30 strategy. The mechanics involve being long 130% of the starting value of the portfolio in the cheapest 100 names in the Large-Cap U.S. universe, funding the extra 30% exposure by being short the 100 most expensive stocks in that same starting universe. Unlike our FSV strategies, a quality filter is not applied as a first step, and the strategy is significantly more volatile than its U.S. FSV peer. Driven purely by valuation, the strategy provides an opportunity for significantly more differentiated performance, as occurred in 2022 with the strategy gaining 18.59% while the S&P 500 declined 18.11%. Annualized outperformance net of fees for this strategy over the three years since inception is 12.09% above the S&P 500 and 13.96% ahead of the Russell 1000 Value ETF. (See **Figure 4** on the following page and pages 7 & 10 for additional information on this strategy).

International Fundamental Stability & Value (Intl. FSV): Hampered by its underweight in financial stocks, Distillate's Intl. FSV lagged the iShares MSCI ACWI ex-US ETF in 2022 with a total return of -18.68% net of fees vs. -16.01% for the benchmark (See **Figure 5** on the following page). Annualized returns net of fees since inception are roughly flat vs. the benchmark.

Figure 1: Cumulative Return of Distillate's U.S. FSV Strategy vs. Benchmarks



Source: U.S. Bank, Morningstar Data; Inception 5/31/2017; See performance disclosures.

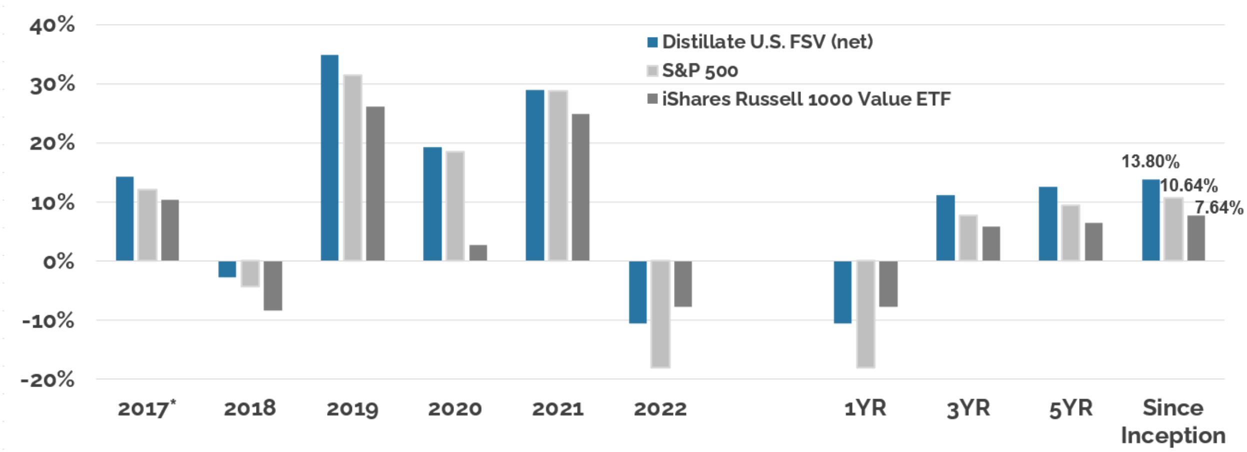
Past performance does not guarantee future results. Please see the full disclosures at the end of this letter.

Performance Charts: **Figures 2 through 5** depict net returns for Distillate's U.S. FSV, SMID QV, U.S. Value 130/30 and Int'l FSV composite strategies versus their respective benchmarks since inception.

Figure 2: Distillate U.S. Fundamental Stability & Value Composite Performance

As of December 31, 2022

	2017*	2018	2019	2020	2021	2022	1YR	3YR	5YR	Since Inception
Distillate U.S. FSV (net)	14.18%	-2.79%	34.91%	19.22%	28.91%	-10.58%	-10.58%	11.18%	12.50%	13.80%
S&P 500	12.11%	-4.39%	31.49%	18.40%	28.71%	-18.11%	-18.11%	7.66%	9.42%	10.64%
iShares Russell 1000 Value ETF	10.27%	-8.41%	26.13%	2.73%	24.91%	-7.72%	-7.72%	5.79%	6.47%	7.64%

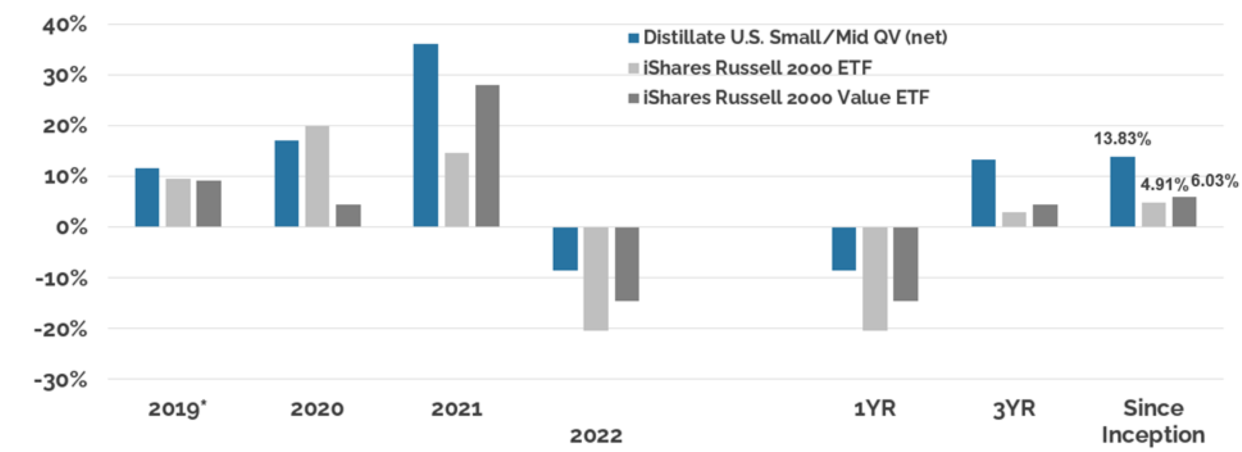


Source: U.S. Bank, Morningstar Data; Inception 5/31/2017; the period "2017*" reflects returns from inception through 12/31/2017; See performance disclosures.

Figure 3: Distillate U.S. Small/Mid Quality & Value Composite Performance

As of December 31, 2022

	2019*	2020	2021	2022	1YR	3YR	5YR	Since Inception
Distillate U.S. Small/Mid QV (net)	11.65%	17.15%	36.03%	-8.64%	-8.64%	13.34%		13.83%
iShares Russell 2000 ETF	9.49%	19.91%	14.64%	-20.49%	-20.49%	3.01%		4.91%
iShares Russell 2000 Value ETF	9.18%	4.50%	27.96%	-14.67%	-14.67%	4.49%		6.03%



Source: U.S. Bank, Morningstar Data; Inception 3/31/2019; the period "2019*" reflects returns from inception through 12/31/2019; see performance disclosures.

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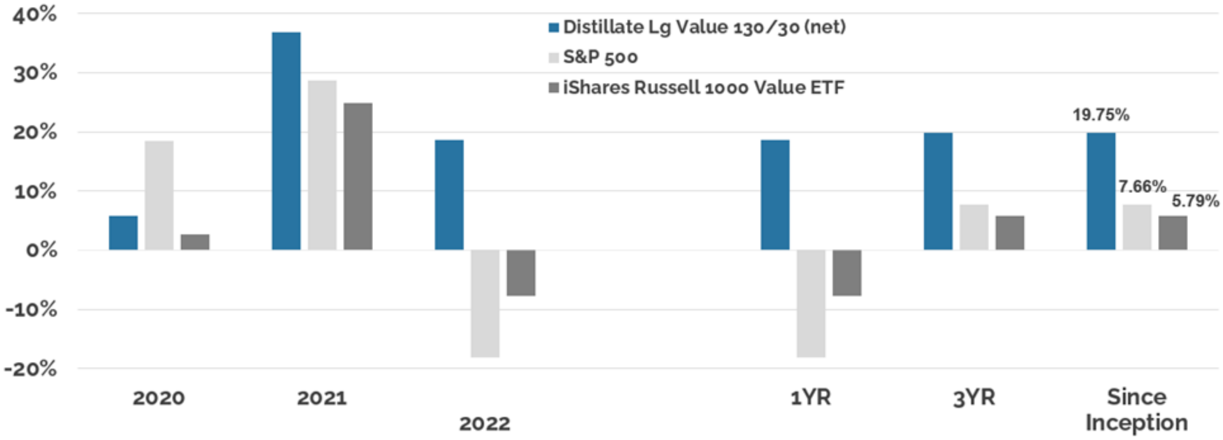
Figure 4: Distillate U.S. Large Cap Value 130/30 Composite Performance

As of December 31, 2022

	2020	2021	2022	1YR	3YR	5YR	Since Inception
Distillate Lg Value 130/30 (net)	5.81%	36.86%	18.59%	18.59%	19.75%		19.75%
S&P 500	18.40%	28.71%	-18.11%	-18.11%	7.66%		7.66%
iShares Russell 1000 Value ETF	2.73%	24.91%	-7.72%	-7.72%	5.79%		5.79%

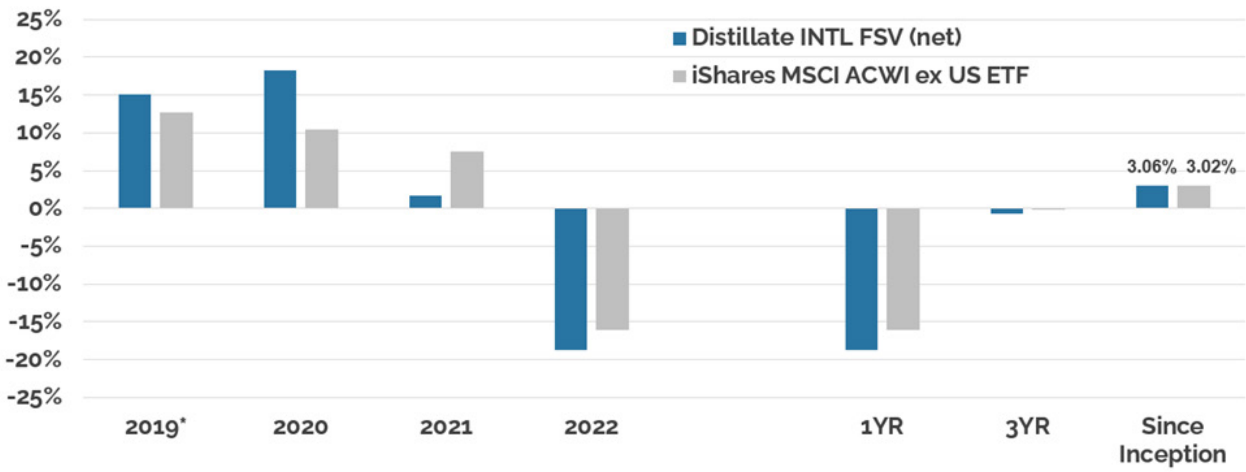


Source: U.S. Bank, Morningstar Data; Inception 12/31/2019; see performance disclosures.

Figure 5: Distillate INTL Fundamental Stability & Value Composite Performance

As of December 31, 2022

	2019*	2020	2021	2022	1YR	3YR	5YR	Since Inception
Distillate INTL FSV (net)	15.08%	18.26%	1.67%	-18.68%	-18.68%	-0.75%		3.06%
iShares MSCI ACWI ex US ETF	12.67%	10.48%	7.48%	-16.01%	-16.01%	-0.09%		3.02%



Source: U.S. Bank, Morningstar Data; Inception 1/31/2019; the period "2019*" reflects returns from inception through 12/31/2019; See performance disclosures.

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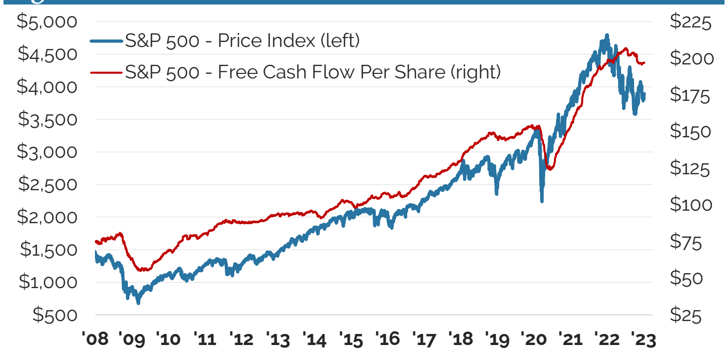
Market Commentary:

Equity markets declined sharply in 2022, though consensus estimates for next-twelve-month free cash flows (NTM FCF) have held up much better (See **Figure 6**). While estimates may fall further, the combination of more modest erosion in estimates and sharply lower prices has led to a substantial increase in the equity free cash flow yield to 5.1% from just over 4% in the recent past.

Free cash flow estimates have held up better than prices.

Figure 6: Estimated S&P 500 Free Cash Flows vs. Price



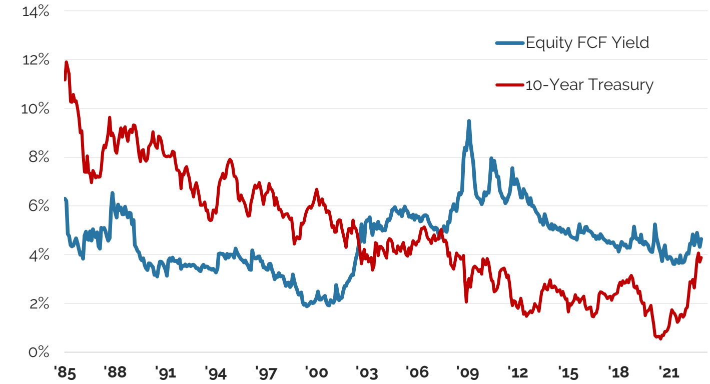
Source: FactSet, data as of 1/9/2023

Even though equities have gotten cheaper on a free cash flow basis, their valuation relative to bonds has become somewhat less appealing as the 10-year treasury yield has risen much more than the equity free cash flow yield (see **Figure 7**, which uses last twelve month, LTM, data going back to 1985). The potential for even higher bond yields has thus caused some analysts to fret that equity valuations may fall much further. Historically, however, this relationship is more complicated and the equity free cash flow yield has not always traded at a premium to the 10-year yield as it does now. There is some logic to this since the equity free cash yield is computed after growth-related investments in research and development and capital expenditures have been made. Consequently, the free cash flows underpinning the equity yield grow solidly over time while the bond coupons do not. As well, companies often have the ability to pass through inflation, which bonds do not. While it is certainly possible that equities could get cheaper in the near-term, we do not find current valuations to be unreasonable in a historic context as many are claiming. Moreover, there is a fair amount of valuation dispersion in the market at present so there remains a significant opportunity to achieve a much better than market valuation through selectivity.

The other important element to note from **Figure 7** is that the current bond yield is still well below where it has traded in the past when economic activity was very healthy. Potential growth is slower now given more subdued demographic gains and so a lower level or rates is more restrictive, but still, we do not see the current level of bond yields as being as unusual or punitive in a longer-term context as some commentary we have seen may suggest.

The equity FCF yield did not always match the BAA bond yield and used to trade at a discount to it.

Figure 7: Long-Term Equity FCF Yield (LTM) vs. 10-Year Treasury Yield



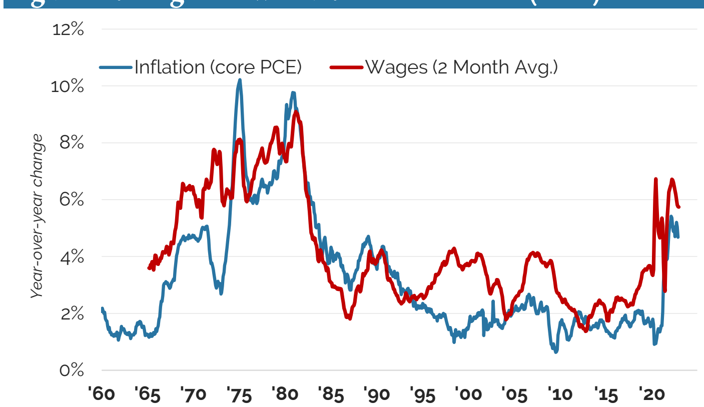
Source: FactSet, Standard & Poor's (data through 12/31/2022)

As it pertains to inflation, wage growth is the key driver. This is evident in **Figure 8**, which compares wage growth to the Fed's preferred inflation metric, core personal consumption expenditures. It is logical that the two would closely follow one another with wage gains often being somewhat higher due to the potential for productivity to offset some of the wage increases. The chart shows that both figures have recently begun to moderate, which again makes logical sense given softening economic activity and employment gains. As this continues, inflation and wage growth are likely to continue easing back to more normal levels.

While it is possible that the Fed may raise interest rates to a level or keep them at a higher level for a period of time such that a sharper than desired slowdown or even economic contraction results, this seems like a much more addressable challenge than the extraordinary circumstances of the pandemic or financial crisis, which required unprecedented fiscal and monetary reactions and were periods of immense uncertainty. For long-term investors, the current situation therefore seems much less severe.

Core inflation closely follows wage growth, both of which have recently begun to moderate alongside economic softening.

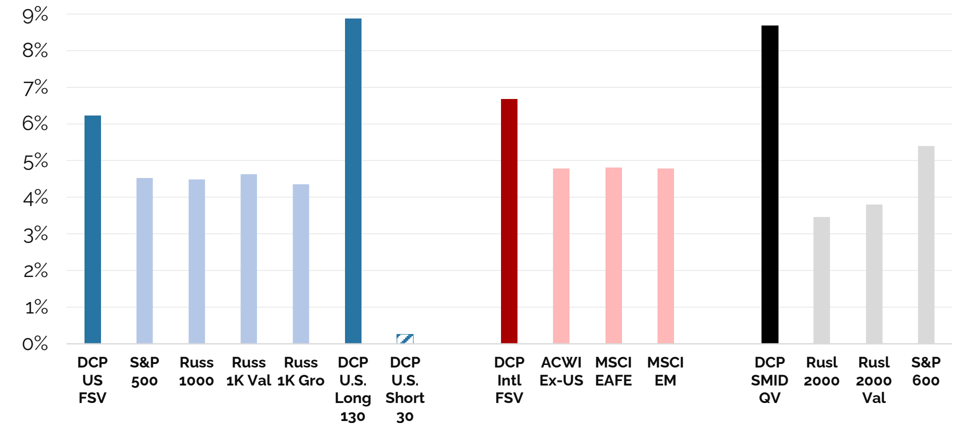
Figure 8: Wage Growth vs. Core Inflation (PCE)



Source: FactSet, data as of 12/31/2022

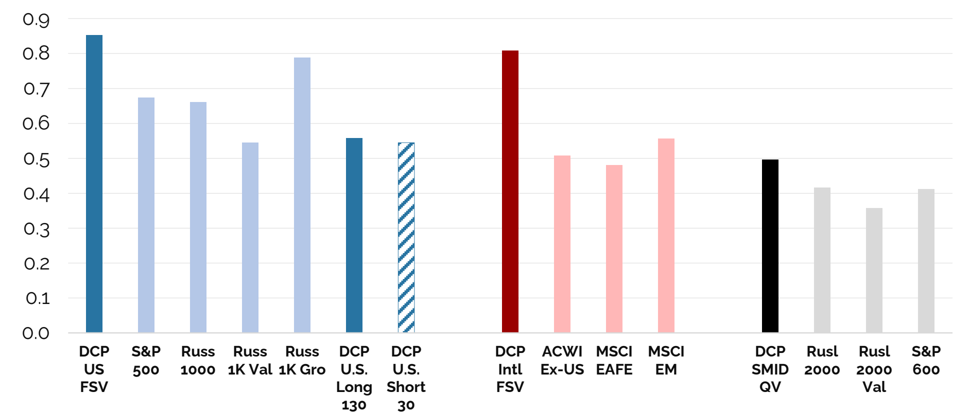
Valuation & Quality Statistics: **Figure 9** shows the current valuations for Distillate's U.S. and International Fundamental Stability & Value (FSV), its U.S. Small/Mid Cap Quality & Value strategy versus various benchmarks, as well as the long and short components of our U.S. Large Cap Value 130/30 strategy. **Figure 10** compares the same Distillate strategies and corresponding benchmarks on our cash flow stability scores, and **Figure 11** examines the degree of financial leverage across the same strategies and benchmarks.

Figure 9: Next 12-Month Free Cash Flow to Enterprise Value



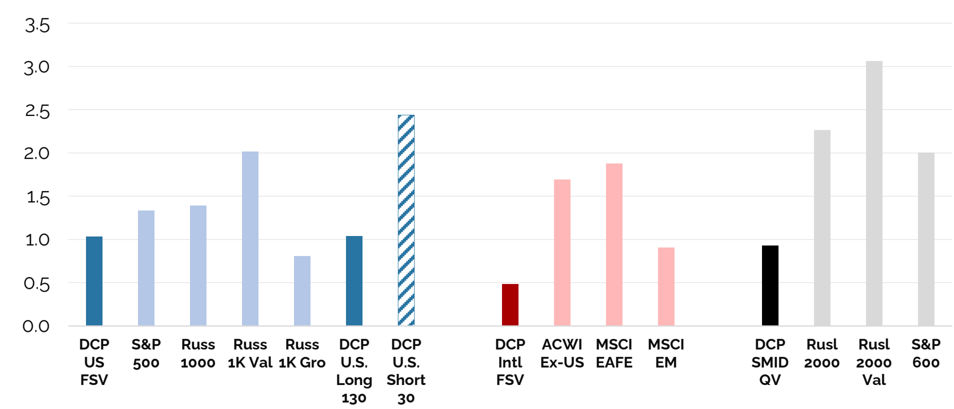
Source: FactSet, See end-notes for methodology. As 1/9/2023

Figure 10 (Quality): Distillate's Cash Flow Stability Score



Source: FactSet, See end-notes for methodology. As of 1/9/2023

Figure 11 (Quality): Net Debt to Adjusted EBITDA



Source: FactSet, See end-notes for methodology. As of 1/9/2023

Valuation & Quality vs. Indexes:

Key quality and value differences between our strategies and their benchmarks are highlighted in the charts on the previous page.

Starting with valuation, **Figure 9** compares next-twelve-month estimated free cash flow to enterprise value, and highlights substantial valuation advantages for each of Distillate's strategies versus their relevant benchmarks. The yield differential of the U.S. FSV strategy over the S&P 500 Index remains very elevated despite significant recent outperformance, and the international and small/mid cap strategies also enjoy significantly more attractive valuations than their benchmarks. Likewise, the nearly 9 percentage point spread between the long and short components of the U.S. large cap value 130/30 strategy speaks to the valuation dispersion in the market and opportunity available from being selective.

Figure 10 looks at fundamental stability by assessing the through-cycle variability of cash flows, with a higher score equating to greater stability. We believe the greater stability available through our strategies is particularly important to our goal of preserving capital in adverse scenarios, including recessions. The small/mid cap strategy does not employ a stability overlay in the stock selection process since we have found this metric to be less useful in the smaller cap space where companies tend to have shorter histories and much less stability in general. Nonetheless, the figure is calculated and the portfolio does show modestly better stability than the comparable benchmarks.

Figure 11 measures leverage in the form of total debt relative to normalized lease-adjusted consensus estimates for earnings before interest, taxation, depreciation, and amortization (EBITDA). Amid rising interest rates and bond yields, we believe this is a critical risk to avoid and a key differentiator for our strategies.

In the small cap space, leverage is an even bigger issue as it is high among smaller cap companies generally despite the fact that the fundamentals for these companies are more volatile and they are thus on average less able to support higher debt burdens. Potentially compounding the issue is the weight in companies that are expected to generate negative free cash flow in the next twelve months. For our Small/Mid Quality & Value strategy, that figure is zero. For the Russell 2000 ETF and Russell 2000 Value ETF, the weight is 19% and 18% (and around 3% for the S&P 500 as a point of reference).

In the long/short components of the Large-Cap U.S. Value 130/30 strategy, this is also a metric that speaks to the wide array of risk in the market with 35% of the short portfolio in names not expected to earn positive free cash flows in the next twelve months, compared to expected positive free cash flow generation in all of the names held in the long side of the strategy.

Performance:

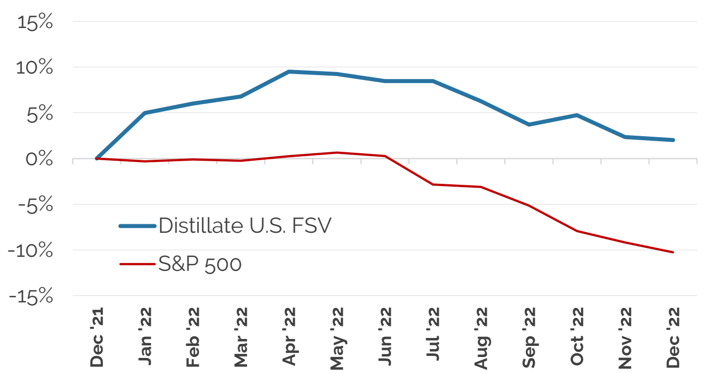
U.S. Fundamental Stability & Value (U.S. FSV)

Distillate's U.S. FSV strategy declined 10.58% in 2022 on a total return basis net of fees compared to a decline of 18.11% for the S&P 500 benchmark. This relative outperformance occurred despite a nearly 2.5% headwind from being underweight the energy and utilities sectors where cash flow instability and leverage tend to limit our holdings domestically. By individual stock, the largest contributors to relative outperformance were unowned positions in Amazon and Tesla which declined around 50% and 65% during the year, respectively. Conversely, the lack of ownership in Exxon and Chevron detracted from performance by 1.1% combined. Among owned stocks, AbbVie, Cigna, and McKesson were the largest contributors to relative performance, with each generating 60, 60, and 50 basis points of excess return. Generac, FedEx, and TopBuild were the biggest detractors among owned names at -40, -20, and -20 basis points of drag to relative performance. Among all owned positions, 59% outperformed the market while 41% lagged the market. Among the 59% that did better, the average relative contribution was 17 basis points, while the average detractor cost around 10 basis points. This favorable spread is similar with past performance and is consistent with the goal of mitigating downside.

Another way to deconstruct performance at the portfolio level is to compare changes in estimated average free cash flows with the same measure for the overall market, using FactSet data. Given the emphasis on fundamental stability, in an adverse economic environment, the goal for the strategy is to see less erosion in projected free cash flows than the market. As **Figure 12** highlights, this is exactly what happened as the portfolio weighted average free cash flow estimate for our U.S. FSV strategy for 2023 was up 2% from the start of the year, while the same metric for the S&P 500 declined by 10%.

Estimated portfolio weighted average 2023 free cash flows for Distillate's U.S. FSV strategy held up much better than those of the S&P 500 in 2022.

Figure 12: Portfolio Weighted Average Estimated 2023 Free Cash Flows, Distillate US FSV vs. S&P 500

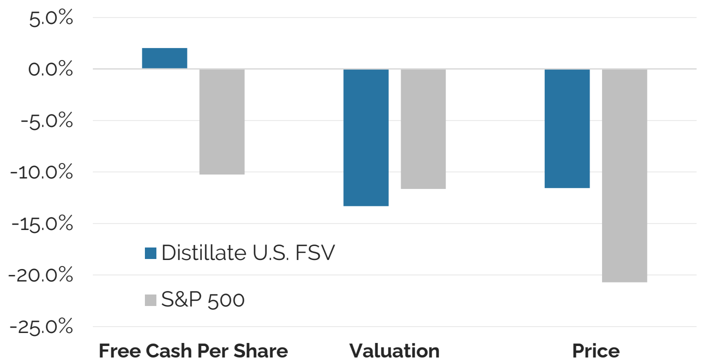


Source: FactSet, data as of 12/31/2022

We can use the same data set to examine valuation changes. For our U.S. FSV strategy, the multiple on 2023 estimated free cash flows fell from 15x at the start of the year to 13.5x at year's end. In percentage terms, this 13.3% drop was larger than the comparable 11.6% drop (from 21.7x to 19.1x) for the S&P 500. In combination, the change in free cash flows and valuation translate into the price change (not total return) shown in **Figure 13**. The figure highlights that the relative price outperformance was a function of free cash flow estimates holding up better even though the price paid for those estimated cash flows declined by more than the market. It also explains how the relative valuation of our U.S. FSV strategy has widened relative to the market even as the strategy protected capital during 2022.

Distillate's U.S. FSV strategy declined less than the S&P 500 though it became relatively cheaper, because free cash flow estimates held up better than the market's free cash flow estimates.

Figure 13: 2022 Price Returns split by Free Cash Flow (FCF) Change and FCF Valuation, Distillate's US FSV vs. S&P 500 Index



Source: FactSet, data as of 12/31/2022, returns do not include dividend income.

U.S. Small/Mid Quality & Value (SMID QV)

Better relative performance for Distillate's SMID QV strategy continued into 2022 with the decline of 8.64% on a total return net-of-fee basis, significantly ahead of comparable decline of 20.49% for the Russell 2000 ETF and -14.67% for the Russell 2000 Value ETF. After strong relative performance in prior years, the strategy's annualized performance is now 8.92% and 7.80% ahead of the same benchmarks since inception in 2019. Top contributors in 2022 include Helmerich & Payne, Warrior Met Coal, and Helix Energy Solutions, contributing around 80, 60, and 60 basis points of relative performance against the Russell 2000 ETF benchmark, respectively. The largest detractors from relative performance were Rent-A-Center, Kohl's, and GrafTech International, which subtracted 30, 25, and 25 basis points of relative performance. Similar to the analysis of the U.S. FSV strategy, 63% of owned names in SMID QV outperformed the benchmark while 37% lagged, and the average relative performance for those that did better was 14 basis points versus a relative loss of 9 in the group of underperformers.

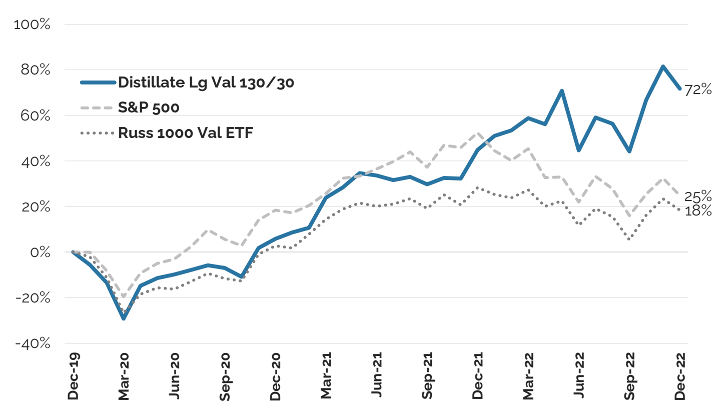
U.S. Large Cap Value 130/30 Composite Performance

The U.S. 130/30 is our fourth and last strategy in operation. Its performance track record dates to the end of 2019, and while we will discuss the portfolio in greater detail in the Portfolio Changes and Valuation section, it supplements the U.S. FSV strategy as more of a pure value strategy that is designed to benefit not only from buying the 100 cheapest names among the largest 500 U.S. stocks, but also from being able to short the most expensive 100 in that group. The long and short portfolios are combined with an exposure of 130% of the starting value of the portfolio in long positions, funded by 100 stocks that are shorted that represent 30% of the starting portfolio value. The net position remains 100% of the starting value. Unlike with the U.S. FSV, there is no emphasis on our stability scores or balance sheet quality. While the U.S. FSV is very much a slow and steady product designed to protect capital in a down market and capture some gains in a rising one, the U.S. 130/30 is likewise designed to do well over the longer-term, but we would expect much greater variability around the underlying benchmark.

Figure 14 shows the cumulative performance of the strategy since inception. Both its long and short components lagged the S&P 500 during the pandemic such that the overall strategy significantly underperformed in 2020 while our U.S. FSV strategy outperformed. Beginning around the end of 2020, however, the 130/30 strategy began to outperform and bested the S&P 500 by about 8 percentage points in 2021. Solid relative performance on the long side and underperformance of the short side again both contributed in 2022, with the result being that the overall portfolio was up 18.59% net of fees while the S&P 500 was down 18.11%. In terms of attribution, around a third of the roughly 25 percentage points of outperformance on the long component in 2022 came from the energy sector with Occidental, Continental, and Marathon being the largest contributors to relative gains at around 70 basis points each. On the short side of the strategy, Carvana, Twilio, Unity Software, Snap, Lucid Group, and Rivian Automotive, combined to account for around 5 of the roughly 18 percentage points of underperformance that benefited the combined strategy's relative gains.

After lagging in 2020, Distillate's 130/30 strategy outperformed in 2021 and significantly so in 2022 as both the shorts and longs performed well.

Figure 14: Cumulative Return of Distillate's 130/30 Relative to its Benchmarks



Source: U.S. Bank, Morningstar Data; Inception 12/31/2019; See performance disclosures.

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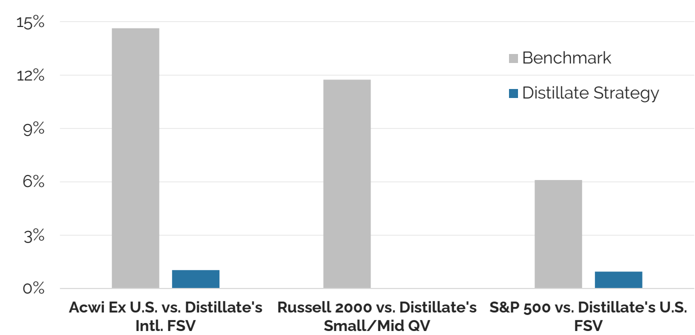
International Fundamental Stability & Value (Intl. FSV)

After underperforming in 2021, Distillate's Intl. FSV strategy again lagged its MSCI ACWI Ex-US benchmark in 2022. As was the case in 2021, strong performance in financial stocks, and bank stocks in particular, remained a headwind and detracted over 2% in relative performance. High leverage, low stability, and lacking free cash flows limit our ownership in financials, thus causing greater swings in relative performance in the international strategy given the group's large index weight (this is evident in **Figure 15**). Despite potentially more volatile relative short-term performance, we believe our avoidance of the group helps reduce risk and will likely strengthen long-term compounded returns given the legacy of many financials and the many competing constituents those companies serve that are often not shareholder friendly or oriented.

Outside of the drag from financials, sector and region weights did not have meaningful impacts on relative performance, consistent with our goal of letting individual stock selection determine weights and drive performance. The failure to own several European pharma stocks like Novo Nordisk and AstraZeneca, which looked expensive, subtracted another roughly half percentage point. But unlike in the U.S., this was not offset by either sharp underperformance of large unowned names or strong performance among owned names. Among stocks that were owned, PT Adaro Energy Indonesia, Tourmaline Oil, and China Tower were the strongest contributors to relative performance at 80, 70, and 50 basis points each while Alibaba and Samsung Electronics and were the largest detractors at 60 and 50 basis points, respectively.

The bank weight in the MSCI ACWI Ex-U.S. benchmark is much higher than for the S&P 500. Given the aversion to owning heavily indebted stocks, this creates a large relative underweight in the international strategy that can be a headwind if bank stocks are performing well as they have been.

Figure 15: Bank Weight by Benchmark & Strategy FSV vs. S&P 500 Index.



Source: FactSet, data as of 12/31/2022. Banks includes FactSet sectors: regional banks, investment banks/brokers, financial conglomerates, major banks, and savings banks. The bank holding in Distillate's Intl FSV is the London Stock Exchange which is included in the investment bank/broker sector as is Intercontinental Exchanges which is the holding in the U.S. FSV strategy.

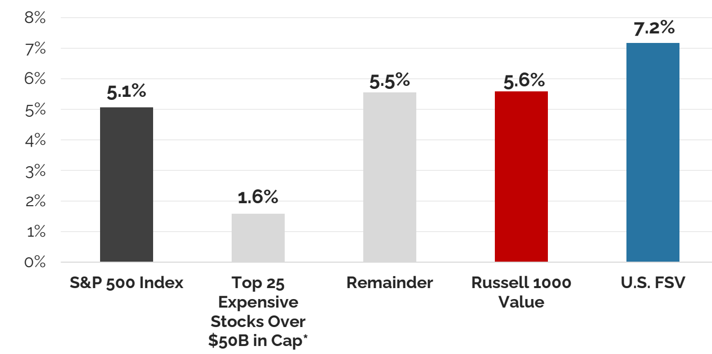
Changes & Valuation

U.S. Fundamental Stability & Value (U.S. FSV)

After rebalancing, Distillate's U.S. FSV strategy's free cash flow to market cap yield valuation of 7.2% compares very favorably to 5.1% for the same measure for the S&P 500 (see end notes for methodology). While slightly less impactful than in recent periods, there are still pockets of extremely high valuations that are pulling the average free cash flow of the market meaningfully lower (as seen in **Figure 16**). There remains a wide dispersion in valuations in the market even after the sell-off and a significant opportunity is available by being selective.

Distillate's U.S. FSV strategy is avoiding several large richly valued stocks that are driving the overall S&P 500 free cash flow yield lower.

Figure 16: Free Cash to Mkt Cap Yield for the S&P 500, 25 Large Expensive Stocks, & U.S. FSV



Source: FactSet, 1/9/2023
Stocks without estimates are excluded and the index re-weighted

In addition to the valuation advantage, Distillate's U.S. FSV strategy also enjoys significantly more stable long-term fundamentals, as evidenced by the higher fundamental stability score, and less leverage, (see **Table 1**.)

Distillate Capital's U.S. FSV Strategy is less expensive, more fundamentally stable, and less levered to the S&P 500.

Table 1: U.S. FSV Portfolio Characteristics*

	U.S. FSV	S&P 500
Free Cash Yield to Mkt Cap[1]	7.2%	5.1%
Free Cash Yield to EV[1]	6.2%	4.5%
P/E[2]	16.1	21.0
Leverage[3]	1.03	1.33
Fundamental Stability[4]	0.85	0.67

*as of 1/9/2023, see methodology endnotes.

Sector Changes: The largest sector change in the rebalance was a six-percentage point increase in technology. The biggest component of this increase was the introduction of a 4% weight in Apple, which is discussed further below. Offsetting this increased tech weight was a 3-percentage point decrease in industrials and a two-percentage point decline in health care. These sector shifts broadly mirror the performance of the S&P 500 sectors where technology lagged considerably during 2022, with a total return of -28.2% and industrials and health care outperformed considerably with total returns in 2022 of -5.5% and -2.0%, respectively. It makes intuitive sense that our process that employs bottom-up stock selection based on the combination of valuation and quality would reduce the weight in places that outperformed and add to areas that were weaker. Current sector weights relative to the S&P 500 are shown in **Table 2** which also breaks out the distortive impact of several mega-cap stocks in certain sectors for better comparison.

Sector weights are driven by bottom-up stock selection.

Table 2: U.S. FSV Sector Exposure*

	U.S. FSV	S&P 500
Communication Services	7.9%	7.5%
Consumer Discretionary	11.3%	9.9%
Ex AMZN & TSLA	11.3%	6.6%
Consumer Staples	1.6%	7.2%
Energy	1.7%	5.1%
Financials	5.3%	11.8%
Health Care	17.7%	15.3%
Industrials	16.4%	8.7%
Information Technology	33.1%	25.8%
Ex AAPL & MSFT	29.2%	14.6%
Materials	4.0%	2.8%
Real Estate	0.8%	2.7%
Utilities	0.0%	3.2%

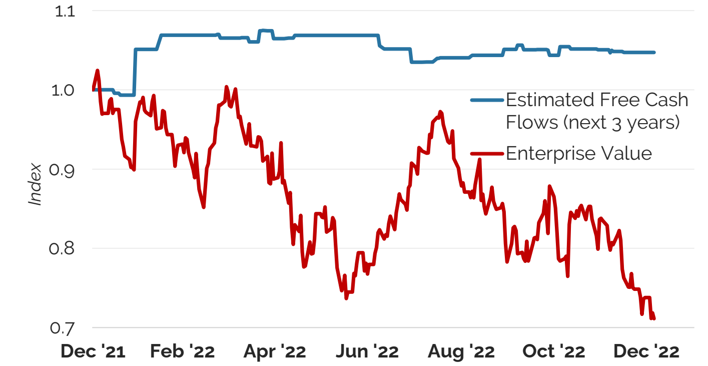
*as of 1/9/2023

Sells: The largest exited positions in the quarter were Philip Morris International, which saw its stability score fall slightly below the threshold for inclusion, Horizon Therapeutics, which was acquired, and Becton, Dickinson & Co, which outperformed and no longer met the valuation criteria.

Buys: The largest new purchase was Apple, which after underperforming saw its valuation improve significantly. Over the course of the last year, Apple's consensus estimated forward free cash flows rose modestly, while its enterprise value fell by around 30% (See **Figure 17**.) Apple ranks below the 25th most attractive name in the portfolio and so its weight is capped at 4% vs. 6% for names in the top quartile. The other two largest purchases were Visa and Abbott Labs which likewise saw their valuations improve as their estimated free cash flows held up or improved while their enterprise values declined.

Apple entered the portfolio after its valuation improved due to rising free cash estimates combined with a significant drop in its enterprise value.

Figure 17: Apple Indexed 3 Year Forward Free Cash Flows vs. Enterprise Value



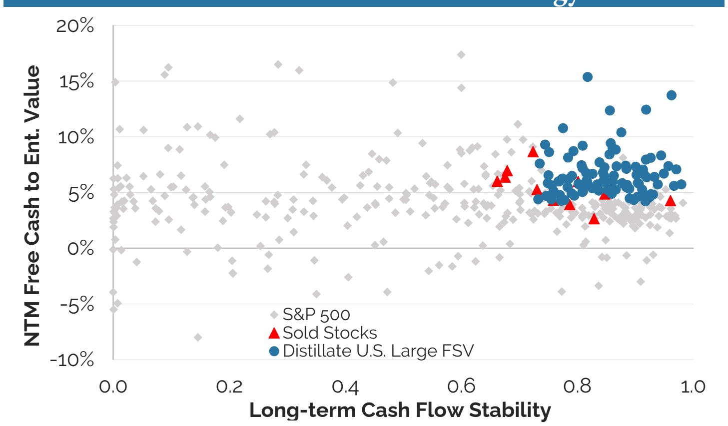
Source: FactSet, data as of 1/5/2022

Adds/Trims: The largest adds were Alphabet, the parent of Google, and Generac, which both underperformed considerably last quarter. The biggest reductions in weight were UnitedHealth Group, which is capped at a 2% weight as it ranks in the bottom quartile of the fund by valuation, and Comcast, which outperformed and saw its valuation become less attractive.

Summary of Holdings vs. the Benchmark: Similar to our prior presentations, one way to visualize the current portfolio and note recent changes versus the benchmark is to look at scatter plot of all of Distillate's U.S. FSV holdings versus those in the benchmark with valuation on the vertical axis and free cash flow stability on the horizontal axis (See **Figure 18**). The index stocks in grey are scattered across both axes, while FSV's stocks (blue circles) are clustered to the upper right where attractive valuations and high levels of fundamental stability converge. Positions that were sold (red triangles) generally shifted to the left or fell below this cluster having become less attractively valued, but could also have been exited if debt levels changed and now exceeded the threshold for inclusion. New purchases are included among the owned stocks.

Distillate's holdings are clustered where attractive valuations and high levels of stability converge while benchmark stocks are more scattered.

Figure 18: Valuation vs. Stability for all Stocks in the S&P 500 vs. Distillate's U.S. FSV Strategy



Source: FactSet, data post Q1 2023 rebalancing

U.S. Small/Mid Cap Quality & Value (SMID QV)

Small cap stocks overall (as proxied by the Russell 2000 ETF) offer a free cash flow to enterprise valuation yield well below that of their larger counterparts (as proxied by the S&P 500 Index), despite generally being of lower quality with less stable fundamentals and significantly more debt. Fortunately, there is enormous dispersion under the surface of this headline valuation figure, and a significant number of very attractive valuation opportunities. Consequently, Distillate's small/mid cap strategy of 150 stocks is able to achieve a very attractive 8.7% free cash flow to enterprise value yield that is substantially higher than that of either the Russell 2000 ETF or Russell 2000 Value ETF benchmarks (See **Table 3**).

Beyond the valuation differential, Distillate's U.S. Small/Mid Cap Quality & Value Strategy is also highly distinct from the Russell 2000 and 2000 Value ETF benchmarks in terms of indebtedness. Leverage is very elevated among small cap stocks broadly and could prove to be a significant risk with rising interest rates (and thus borrowing costs. Distillate's small/mid cap strategy looks to avoid the risks inherent in highly levered situations by controlling for indebtedness, and after rebalancing, the portfolio has a leverage ratio of 0.9x which is significantly lower than the 2.3x and 3.1x figures of the Russell 2000 and Russell 2000 Value benchmarks (See **Table 3**).

Lastly and also related to quality, Distillate's SMID QV has no position in stocks that have negative next-twelve-month free cash flow estimates. For the Russell 2000 and Russell 2000 Value benchmarks, after reweighting for stocks without estimates, nearly a fifth of each benchmark consists of equities that are not expected to earn positive free cash flow in the next twelve months. For the S&P 500, by way of comparison, this figure is around 3%. Along with leverage, this looks to be another critical risk in the small cap segment that we believe is important to avoid.

The largest new purchases, Albertson's and Masco, are consistent with the criteria outlined above. The biggest sale, InterPublic Group, appreciated considerably in value and no longer fits the market cap criteria for the strategy. Macy's was the second largest sale and also outperformed but was exited for exceeding the debt threshold for inclusion.

Distillate's U.S. Small/Mid Cap Quality & Value strategy is more attractively valued and less indebted than its benchmarks

Table 3: U.S. Small/Mid Cap QV Characteristics*

	SMID QV	Russell 2000 ETF	Russell 2000 Value ETF
Free Cash Yield to Mkt Cap[1]	11.1%	5.3%	6.6%
Free Cash Yield to EV[1]	8.7%	3.5%	3.8%
P/E[2]	11.1	21.5	17.3
Leverage[3]	0.93	2.26	3.06
Fundamental Stability[4]	0.50	0.42	0.36
Negative FCF Weight[5]	0%	19.3%	18.1%

*as of 1/9/2023, see methodology endnotes.

U.S. Large Cap Long 130/Short 30 (U.S. 130/30)

The overall goals of the 130/30 strategy were outlined in the performance section, but are also evident in the portfolio characteristics which show a wide divergence between the valuation of the long and short portfolios (See **Table 4**). The same table also shows a wide gap in leverage, which is not directly screened for, but picked up somewhat indirectly in the FCF/EV filter. Stability, which is similar between the portfolios, is not utilized in stock selection as the goal of the strategy is less around stability and more about capturing upside from valuation divergences in the marketplace.

Distillate's 130/30 strategy seeks to capitalize on valuation divergences in the market which remain wide as evidenced by the large gap between the valuations available on the long and short portfolios.

Table 4: U.S. Large Cap Value 130/30 Characteristics*

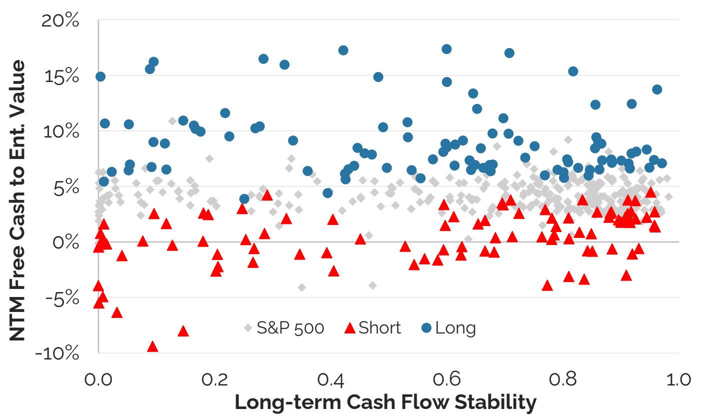
	Long	Short	S&P 500
Free Cash Yield to Mkt Cap[1]	10.9%	-0.5%	5.1%
Free Cash Yield to EV[1]	8.9%	0.3%	4.5%
P/E[2]	11.7	37.3	21.0
Leverage[3]	1.04	2.44	1.33
Fundamental Stability[4]	0.56	0.54	0.67
Negative FCF Weight*	0%	35.1%	3.4%

*as of 1/9/2023, see methodology endnotes.

In addition to the differing performance between the U.S. FSV and 130/30 strategies, a replication of the scatter plot of valuation and stability for the long and short portfolios in **Figure 19** is instructive. While the U.S. FSV names are clustered in the top right where stability and value intersect, the 130/30 long names are scattered throughout in the upper part of the chart and the short names fill out the bottom. The resulting overlap in holdings between U. S. FSV and U.S. 130/30 is only around 30% and again highlights how the two strategies are intended to complement one another.

Unlike Distillate's FSV strategies, the 130/30 strategy invests in (and sells short) companies across the stability spectrum.

Figure 19: Valuation vs. Stability for all Stocks in the S&P 500 vs. Distillate's 130/30 Strategy



Source: FactSet, data post Q1 2023 rebalancing

International Fundamental Stability & Value (Intl. FSV)

After rebalancing, Distillate's International FSV strategy offers a higher free cash flow yield both to market cap and enterprise value, and has substantially more stable fundamentals and less leverage than the index (See **Table 5**). The international FSV strategy is thus significantly differentiated from its benchmark not just on valuation, but critically on quality as well.

Distillate Capital's International FSV Strategy is less expensive, more fundamentally stable, and less levered than its benchmark.

Table 5: International FSV Portfolio Characteristics*

	Intl. FSV	ACWI Ex-US
Free Cash Yield to Mkt Cap[1]	6.7%	4.8%
Free Cash Yield to EV[1]	7.3%	6.0%
P/E[2]	15.5	17.6
Leverage[3]	0.49	1.69
Fundamental Stability[4]	0.81	0.51

*as of 1/9/2023, see methodology endnotes.

Changes & Regional Weights: The largest sale in the quarter was SK Hynix which was sold as its cash flow stability deteriorated below the threshold for inclusion. The largest new positions are Japan Tobacco, which has negligible debt and a nearly 9% next twelve month estimated free cash flow to EV yield and Volvo, which offers a roughly 8.5% free cash flow to market cap yield on NTM FCF. The biggest increased existing position was Roche, which lagged last quarter and now offers an over 7% free cash flow to market cap yield on next twelve-month consensus estimates. The biggest trim was Safran, which outperformed by around 20%.

Regional weights after the quarterly rebalance remain fairly well matched with the ACWI Ex-U.S. benchmark. Japan is the largest overweight at 19% vs. 13% for the benchmark. Europe is modestly overweight at 45% vs. 42%, with somewhat larger relative weights in France, Sweden, and Norway offsetting relative underweights in Germany and the Netherlands where banks constitute large portions of the benchmark along with Dutch semiconductor company ASML. (See **Table 6**). As a reminder, region and country weights are determined by bottom-up stock selection, but region weights are limited to 150% of the benchmark to avoid any outsized influence from region-specific or currency risk.

Distillate Capital's International FSV Strategy is less expensive, more fundamentally stable, and less levered than its benchmark.

Table 6: International FSV Portfolio Characteristics*

	Intl. FSV	ACWI Ex-US
Europe	44.9%	42.5%
Japan	19.1%	13.3%
Asia Ex China & Japan	14.7%	18.9%
China & Hong Kong	12.1%	11.3%
Americas	9.1%	10.1%
Middle East & Africa	0.0%	3.7%

*as of 1/9/2023 based on FactSet headquarters definition.

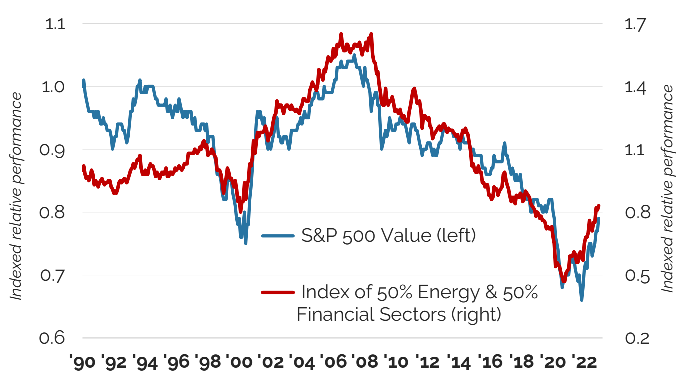
Final Word

The return to value happened in 2022. Or did it? In some respects, the answer is an unequivocal "yes." Valuation, broadly defined, mattered a lot last year. Avoiding the implosions of many of the most dearly valued stocks was vital to protecting capital during the period and this could have been reasonably achieved with most any valuation approach, including those curated around low Price-to-Book (P/B) or Price-to-Earnings (P/E) ratios. We would, however, be skeptical of calls for a sustained return of such traditionally defined value styles, as these strategies and benchmarks tend to favor industries with significant balance sheet assets and thus their performance has tended to mirror the performance of those sectors (see **Figure 20**). Many of you have read previously our view that the Price-to-Book metric, so associated with value investing, has lost its meaning. For those wanting more, our paper titled [Value Investing in a Capital Light World] explores the change in our economy over the last decades, related issues of accounting, and the resulting ineffectiveness of definitions of value like P/B and P/E ratios.

Our own view is that value as a style has really never stopped working – that those most-critical elements discussed by Benjamin Graham so many decades ago are as valuable now as they were then. The issue is measuring valuation correctly in an economy that has been transformed over the last several decades. The strong performance of our domestic strategies not just in 2022, but also in the years prior when value benchmarks struggled, suggests this may be the case. So, while paying attention to valuation of any kind was key to relative success in 2022, we remain convinced that definitions of value that accurately tie company fundamentals to market prices are as important as ever and likely to remain so as the economy transitions to a "new old normal" in which positive real interest rates and short-term economic weakness matter tremendously for leverage, fundamental resilience, and valuation.

The relative performance of certain traditionally measured value styles has continued to closely track the relative performance of the asset-heavy energy & financials sectors.

Figure 20: Relative Performance of S&P 500 Value vs.



Source: FactSet, data as of 12/31/2022

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The U.S. Dollar is the currency used to express performance. Returns are presented net of management fees and include the reinvestment of all income. For non-fee-paying accounts, net of fee performance was calculated using a modeled management fee equal to the highest investment management fee that may be charged for the applicable composite (see fee schedule below). For accounts calculated with a per share, net-of fee NAV, gross performance was calculated by adding back the unitary fee associated with that fund. Policies for valuing investments, calculating performance, and preparing GIPS Reports are available upon request.

The investment management fee schedule for the strategies discussed are as follows: 0.39% for U.S. Fundamental Stability & Value; 0.55% for U.S. Small/Mid Quality & Value; 0.79% for U.S. Large Cap Value 130/30; and 0.55% for International Fundamental Stability & Value. Management fees may vary and are negotiable.

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The ***U.S. Fundamental Stability & Value*** *composite seeks to distill a starting universe of large cap U.S. equities into only the stocks where quality and value overlap using Distillate's proprietary definitions. Its goal is to achieve superior compounded long-term returns by limiting downside in periods of market stress, while still providing strong performance in up markets. This composite was created in May 2017.*

The ***U.S. Small/Mid Cap Quality & Value*** *composite seeks to distill a starting universe of small- and mid-cap U.S. equities into only the stocks where quality and value overlap using Distillate's proprietary definitions. Its goal is to achieve superior compounded long-term returns by limiting downside in periods of market stress, while still providing strong performance in up markets. This composite was created in March 2019.*

The ***International Fundamental Stability & Value*** *composite seeks to distill a starting universe of large- and mid-cap non-U.S. equities into only the stocks where quality and value overlap using Distillate's proprietary definitions. Its goal is to achieve superior compounded long-term returns by limiting downside in periods of market stress, while still providing strong performance in up markets. This composite was created in January 2019.*

The ***U.S. Large Cap Value 130/30*** *composite seeks long-term capital appreciation by holding approximately 130% of an account's value in the most attractively valued large cap U.S. stocks measured using Distillate's proprietary free cash flow valuation method. The market exposure in this composite is brought back to approximately 100% by selling short 30% of an account's value of the least attractively valued stocks among the same starting set. This composite was created in December 2019.*

Free Cash Flow *refers to a company's operating cash flow, less its capital expenditures.* ***Enterprise Value*** *refers to a company's market capitalization plus its net debt balance.* ***Free Cash Flow to Enterprise Value Yield*** *refers to a company's or group of companies' free cash flow divided by the company's (or companies') Enterprise Value, with a higher resulting ratio indicating a more attractive valuation. This metric is a valuation measure and not a form of investor yield.* ***Normalized Free Cash Yield (or Distilled Cash Yield)*** *refers to the firm's proprietary valuation measure that looks at estimated, adjusted free cash flow relative to a company's adjusted enterprise value. References to historical stocks that ranked well using this methodology refer only to these stocks' historical valuation and not their inclusion in any actual or hypothetical strategies/accounts managed by Distillate Capital Partners LLC. This metric is a valuation measure and not a form of investor yield.* ***Long-term Fundamental Stability*** *is Distillate Capital's proprietary measure of through-cycle cash flow stability with a higher value indicating greater stability.*

Methodology note for ***Figure 9****: free cash flow (FCF) figures reflect consensus estimates of next-twelve-months (NTM) FCF in comparison to enterprise value (EV) for the relevant portfolio/strategy or benchmark. Stocks without data are excluded and portfolios are reweighted accordingly. Stocks with FCF/EV* *values of greater than 50% or less than -20% have been eliminated to avoid distorting overall averages. For **Figure 7**: trailing twelve month free cash flows are used and stocks with free cash yields over 50% or below -50% are eliminated and stocks without data are excluded and the index is reweighted accordingly. **Figures 12 & 13** are calculated based on ETF equivalents of the indexes or strategies listed using FactSet's method of aggregating portfolio level cash flows.*

*Methodology Notes for **Portfolio Characteristics Tables**: [1]**Free Cash Yield to Market Cap and Enterprise Value (EV)** are based on the next-twelve-month free cash flow estimates relative to market capitalization and EV, which adds Distillate's proprietary measure of indebtedness. Stocks without estimates in the are excluded and the remaining names are reweighted based on those exclusions. [2]**P/E** is based on consensus estimates for next-twelve-months and excludes P/Es over 250 and under 0 to avoid the distortion from outliers. [3]**Leverage** is based on Distillate Capital's proprietary measure of indebtedness which looks at the ratio of adjusted net debt to an adjusted measure of forecast Earnings Before Interest, Taxation, Depreciation, and Amortization (EBITDA.) [4]**Fundamental stability** is Distillate Capital's proprietary measure of through-cycle cash flow stability with a higher value indicating greater stability. [5]**Negative FCF weight** is measured as the weight of stocks with negative free cash estimate as a share of those with any estimate.*

*The **S&P 500 Index** is an index of roughly the largest 500 U.S. listed stocks maintained by Standard & Poor's. The **iShares Russell 1000 Value ETF** is an investable benchmark used as a proxy for its underlying index, the **Russell 1000 Value Index**, an index of U.S. listed stocks that possess attractive valuation as measured by FTSE Russell. The **iShares MSCI ACWI Ex-US ETF** is an investable benchmark used as a proxy for its underlying index, the **MSCI ACWI ex USA Index**, an index managed by MSCI representing large and mid cap stocks outside of the U.S. The **iShares Russell 2000 ETF** and **iShares Russell 2000 Value ETF** are investable benchmarks used as a proxies for the underlying indexes of the **Russell 2000 Index** (an index of U.S. listed small cap stocks) and the **Russell 2000 Value Index** (an index of U.S. listed small cap stocks that possess attractive valuation as measured FTSE Russell).*

Indices are not available for direct investment. Investment in a security or strategy designed to replicate the performance of an index will incur expenses, such as management fees and transaction costs, which would reduce returns.