



**BALLAST EQUITY  
MANAGEMENT, LLC**

STABILITY. QUALITY. VALUE.

## Ballast Equity Management, LLC Q4 2020 Commentary

More information including since-inception performance for each of the strategies may be found at [www.ballastequity.com](http://www.ballastequity.com).

### 2020: A Long Strange Trip

Investors who decided to ignore the news, leave their brokerage statements unopened and simply view the results of the full twelve months of 2020 would be both pleased at the outcome and shocked to learn about all of the events and volatility that was packed into one short year. Those of us who watch such events daily and (often to our detriment) pay attention to the news, would argue that 2020 was hardly a “short” year and was unprecedented, to use an overworked word, in countless ways. A global pandemic, economic recession and job loss, political turmoil and social unrest topped the list of issues that disrupted our lives in ways we did not anticipate on New Year’s Day 2020.

One year ago, Ballast began its commentary stating that “2019 began with U.S. equities at reasonable valuations and, as a result of tepid earnings growth during the year, ended at more fully valued levels. Accordingly, the team at Ballast Equity Management feels that selectivity and an emphasis on stable, quality companies purchased at reasonable valuations will be increasingly important in the year ahead.” That selectivity served our investors well when markets fell sharply in March of this year and each Ballast strategy outperformed its respective indexes during the drawdown.

Our focus on quality detracted from performance as markets roared back from the short, steep bear market, favoring lower quality stocks with limited or no earnings and lacking economic moats. Ballast uses a proprietary ranking system for its universe of prospective holdings, with companies ranked in the top two (A and B) quintiles recognized as high quality and those in the bottom two (D and E) quintiles considered low quality. From the bottom of the bear market drop in March through December 31, 2020, the stocks of high quality companies in this universe lagged those of low quality businesses by 33.08%. Looking at small cap (below \$3 billion market cap) businesses in this universe, high quality was outpaced by low quality by 36.62%.

### Ballast Strategy Quarterly Performance

While not as pronounced as the returns of the Q3 2020, the fourth quarter saw strong returns in U.S. equity markets with bullish investors propelling the stocks of lower quality businesses ahead of those of high quality companies.

The [Ballast Quality Value Midcap Strategy](#) returned 17.91% and 17.62%, gross and net of fees, for the quarter, lagging both Russell Mid Cap Value Index return of 20.43% and the Russell Mid Cap Index return

of 19.91%. Security selection helped performance in the Energy and Financials sectors and detracted from performance in the Technology and Industrials sectors.

### Quality Value Midcap Top Contributors

**TCF Financial (TCF)** was the leading contributor to performance during the quarter as news of a proposed acquisition of the bank by rival Huntington Bancshares (HBAN) lifted its shares. Ballast believes the fit between the two banks to be good and expects the all-stock transaction to close in Q2 2021 at a share price of \$39. Ballast continues to hold its shares with an eye toward capturing the remaining acquisition premium.

**Synovus Financial (SNV)** shares rose during the quarter buoyed by strong financial results and optimism over a reopening economy. Synovus is a significant banking force in higher growth markets in the Southeastern U.S. Positive results have included improving fee income growth in its mortgage banking and capital markets businesses. Management is keenly focused on managing expenses and the bank has Returns on Tangible Equity of 13% and its stock currently yields 4.2%.

### Quality Value Midcap Top Detractors

Despite solid earnings that were ahead of expectations, **Waste Connections, Inc. (WCN)** detracted from performance as its share price was flat during the quarter. Ballast believes WCN will emerge as a winner in the fragmented waste collection business due to its competitive advantages that include scale, hard to obtain regulatory permits and route density. Solid waste collection is an essential, recession-proof business and WCN continues to grow through acquisitions.

After trading up in Q3, shares of **McCormick & Company (MKC)** dipped slightly during Q4 2020, detracting from performance. The company added to its flavor portfolio during the quarter with its acquisition of hot sauce maker Cholula. Strong free cash flows have supported the company's acquisition of smaller U.S. and international companies, as well as enabling share buybacks and dividend payments. McCormick's leading brands, cost advantages and shareholder base stand as competitive advantages and the company has U.S. market share of more than 50%.

The **Ballast Quality Value Smallcap Strategy** returned 23.06% and 22.76%, gross and net of fees, lagging both the Russell 2000 Value and Russell 2000 Indexes returns of 33.36% and 31.37%, respectively. Security selection detracted most notably from performance in the Healthcare sector, where Ballast was overweighted to under performing stocks. An underweighting to Real Estate stocks aided performance.

### Quality Value Smallcap Top Contributors

**Advanced Energy Industries (AEIS)** is a leading provider of advanced power supplies with strong business performance evidenced by operating margins of 13% and Returns on Invested Capital of 9%. 43% of its revenue is presently generated from the semiconductor equipment industry, but AEIS has been diversifying into less cyclical applications, including medical, industrial and telecommunications. Share performance was strong during the quarter as AEIS' results in its core semiconductor power segment were strong and sales rebounded along with improving economic prospects.

**Badger Meter, Inc. (BMI)** shares rose more than 44% during the quarter. BMI is one of the largest water meter companies in the U.S. and competes effectively against larger companies in the international arena. BMI is well situated to capitalize on the move to connected technologies with smart meters and data analytics technologies. Management intends to further these capabilities through acquisitions, such as its Q4 2020 purchase of Austria-based private company [s::can GmbH](#). We expect that BMI's market will continue to grow as countries replace old meters and install meters for the first time. Business performance has been strong, and the company produces operating margins of 15% and Returns on Invested Capital of 14%.

### Quality Value Smallcap Top Detractors

Shares of leading biodefense contractor **Emergent BioSolutions (EBS)** fell during the quarter as sentiment shifted regarding the winners and losers involved in solving the COVID crisis. EBS shares rose approximately 80% for the year but sold off from highs as Pfizer and Moderna got to the finish line before EBS and its partners, Johnson & Johnson and AstraZeneca. Ballast originally purchased EBS due to its exclusive government contracts to manufacture BioTrax for the prevention of anthrax and other vaccines, therapeutics, and anti-infectives and still has high levels of conviction in the company.

**PaySign (PAYS)** detracted from performance as a revenue recognition issue in its pharma business and impacts of the COVID pandemic on the company's plasma businesses led to disappointing Q3 2020 financial results. The change in revenue recognition for the Pharma segment, recommended by PAYS' auditors, resulted in a one-time \$6.3 million reversal of past revenues. Shuttered plasma centers and a reluctance of donors to visit those remaining open lowered revenues and the near-term outlook for that segment. Ballast believes PAYS will remain strong in this segment supported by its 41% market share. Four large companies operating plasma collection centers control over 70% of the centers in the U.S. and generate nearly 80% of total collections. We believe PaySign currently only works with two of the four operators and growth opportunities exist by developing business with the other two.

The **Ballast Select Value Strategy** returned 18.58% and 18.34%, gross and net of fees, lagging the returns of 28.51% and 27.41% for the Russell 2500 Value and Russell 2500 Indexes, respectively. Stock selection in the Financials and Real Estate sectors aided returns, while selection in the Technology and Consumer Defensives sectors detracted.

### Select Value Top Contributors and Detractors

Select Value is a high conviction strategy that takes Ballast's "best ideas" from its Quality Value Smallcap and Quality Value Midcap strategies. **Badger Meter, Inc. (BMI)** and **Synovus Financial (SVN)** were the leading contributors to performance of the Select Value Strategy during the quarter and our comments on each company are found above. **Emergent BioSolutions (EBS)** and **PaySign (PAYS)** were the leading detractors to performance of the Select Value strategy and commentary on each is also provided above.

### Our Focus on the Long Term

The issues of 2020 are a reminder that forecasts are often worthless and that known facts can turn on a dime, leading to unexpected outcomes. We began last year commenting on fully valued markets and, again, find ourselves concerned with valuations and what the New Year may bring. In addition to valuations, risks to the market include growing corporate and federal debt levels, potential challenges to

the rollout and acceptance of the COVID-19 vaccine, and a stage that seems set for higher taxes and interest rates.

We do see opportunities for the market to continue its upward trajectory in 2021. The rapid pace with which vaccines were developed underscores the ingenuity of researchers and the conviction of the businesses and governments supporting the development efforts. Rollout of the vaccine sets the stage for an improving economy supported by consumer and business confidence. This improvement may continue the swing of the stock market pendulum and may continue the bubbly nature of performance of lower quality stocks. Rather than chasing these “stocks of the moment,” Ballast will continue to focus on quality businesses purchased at reasonable valuations. We know that these businesses, supported by their durable competitive advantages, will stand up to the risks that eventually come and will generate strong, risk-adjusted returns for our clients over full market cycles.

#### Disclaimer:

Returns are for the respective composites of Ballast Equity Management (BEM). Gross returns are calculated net of trading fees. Net returns are calculated net of trading fees and net of the firm’s management fee. All dividends are assumed to be reinvested. The returns of the BQV Midcap Strategy are compared to the historical performance of the Russell Midcap Indices as they are a widely used benchmarks for mid capitalization securities. The returns of the BQV Smallcap Strategy are compared to the historical performance of the Russell 2000 Indices as they are a widely used benchmarks for small capitalization securities. The returns of the Ballast Select Value Strategy are compared to the historical performance of the Russell 2500 Indices as they are a widely used benchmarks for SMID capitalization securities. An investment with Ballast Equity Management should not be construed as an investment in a program that seeks to replicate, or correlate with, these indices. Market conditions vary between the BEM products and these indices. Furthermore, these indices do not include any transaction costs, management fees and other expenses, as do the BEM Products. Lastly, BEM may invest in securities and positions that are not included in these indices.

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