

# Smallcap QUALITY VALUE STRATEGY



**BALLAST EQUITY  
MANAGEMENT, LLC**  
STABILITY. QUALITY. VALUE.

3Q:21

## MISSION STATEMENT

At Ballast Equity Management we strive to deliver a smoother ride in good markets and bad, seeking to help our clients reach their long-term investment goals by setting clear expectations and through investment in high-quality small- and mid-cap value stocks.

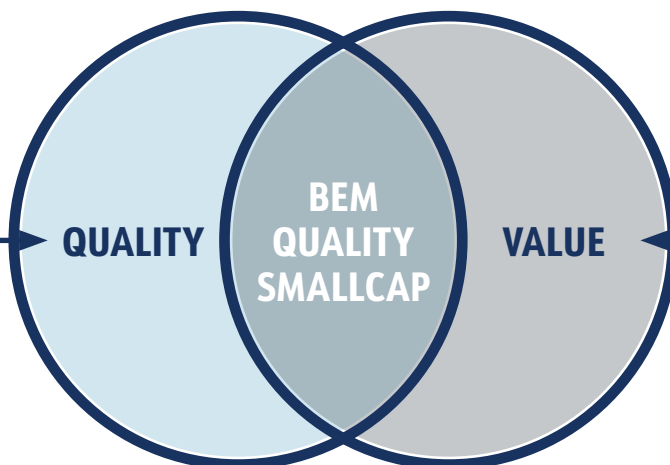


## INVESTMENT TEAM

Ballast's investment team has navigated markets together for more than 20 years. Jeff Kautz and Randy Hughes founded Ballast in 2016 and worked together previously at Perkins Investment Management, a subsidiary of Janus Henderson. While there, Jeff held roles including Portfolio Manager, CEO and Chief Investment Officer and Randy held the roles of Director of Research and Analytics and Equity Analyst. Ballast is 100% employee owned and fosters a culture that marries independent thought with collaboration. Employee-owners invest alongside the clients of the firm in each of its strategies.

**Ballast Quality Bias:** Invest in companies exhibiting strong balance sheets, stable and growing cash flows and returns on invested capital (ROIC) well in excess of their cost of capital (WACC).

Strong financial characteristics are sustained through the presence of a durable competitive advantage allowing the companies to drive economic profits well into the future.



Ballast purposefully acts like business owners, focusing on a company's intrinsic value and blocking out day-to-day price moves.

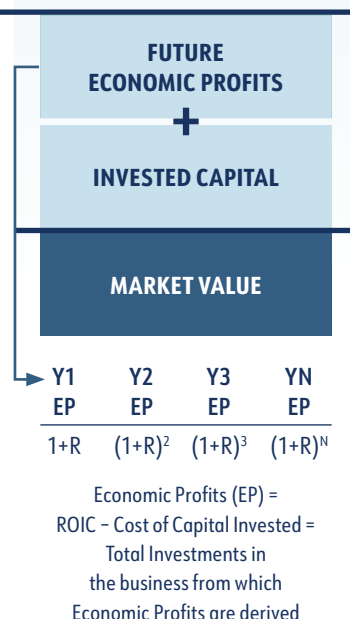
Ballast believes that buying wealth-creating businesses at discounts to intrinsic value will offer our clients stability, with less volatility and lower drawdowns, pursuing our goal to create long-term wealth.

# STRATEGY

**OBJECTIVE** Ballast Equity Management Quality Value Smallcap Strategy strives to deliver a smoother ride in good markets and bad, seeking to outperform the Russell 2000 Value Index and Russell 2000 Index with less risk over a full market cycle.

**OVERVIEW** BEM Quality Value Smallcap Strategy invests with conviction in 50-70 high quality companies which can deliver high returns on invested capital well in excess of their cost of capital sustained through strong, durable competitive advantages. Identification and selection of these companies is supported by proprietary Quality Scores and fundamental research. Ballast is patient and will only add a company to the Quality Value Smallcap Strategy when its stock can be purchased at a reasonable valuation.

**PROCESS** Ballast employs a research and screening process that includes four distinct steps:



## 3Q:21 COMMENTARY

As noted in our outlook last quarter, U.S. equity markets delivered between one and two years of expected returns in just the first six months of 2021. Equity markets pushed higher through August, but fell in September, as uncertainty regarding fiscal and monetary policy, inflation concerns, and slowing growth impacted investor sentiment. Factors driving performance shifted multiple times during the quarter. Using the Russell Stability indexes as proxies for high and low quality, the Russell Defensive indexes containing businesses with higher Returns on Assets, lower leverage, and lower volatility outperformed low quality businesses, as measured by the Russell Dynamic indexes, across the market cap spectrum.

Quality “Ballast-like” businesses, those with less sensitivity to economic and credit cycles and with more sustainable business models, outperformed. Security selection was a strong contributor to performance, adding more than 100% of the strategy’s relative outperformance.

### QUALITY VALUE SMALLCAP TOP CONTRIBUTORS

Shares of **HOLLYSYS AUTOMATION TECHNOLOGIES (HOLI)** rose significantly during the quarter as multiple offers were presented to acquire the business. HOLI is a China-based leader in integrated solutions for industrial automation and rail transportation and has been a long-term Ballast holding. With the tailwinds presented by the buyout offers, Ballast exited its position in HOLI during the quarter for valuation reasons.

Specialty pharmaceutical company **EAGLE PHARMACEUTICALS, INC. (EGRX)** rose over 30% during the quarter, supported by a court ruling that determined the company’s marketing application for Vasopressin did not infringe on patents held by the makers of the generic Vasopressin. We believe the outlook for EGRX is bright, with numerous late-stage pipeline assets, new collaborations with certain biotech companies, and additional indications in development for its existing products.

### TOP 10 HOLDINGS<sup>1</sup>

	% Weighting
Eagle Pharmaceuticals, Inc.	2.53%
Watts Water Technologies, Inc. Class A	2.20%
NAPCO Security Technologies, Inc.	2.19%
EVERTEC, Inc.	2.16%
Bank OZK	2.14%
UniFirst Corporation	1.97%
Premier Financial Corp.	1.97%
UFP Technologies, Inc.	1.95%
Kadant Inc.	1.90%
WD-40 Company	1.90%
<b>TOTAL</b>	<b>20.90%</b>

### PERFORMANCE

	4Q:20	1Q:21	2Q:21	3Q:21	1 Year	3 Year	Annual Total Return (since inception) 6/30/17
BEM – Smallcap (Gross) <sup>3</sup>	23.06%	11.81%	2.98%	-1.68%	39.30%	8.71%	10.92%
BEM – Smallcap (Net) <sup>3</sup>	22.76%	11.53%	2.83%	-1.77%	38.29%	7.74%	9.90%
Russell 2000 Value <sup>2</sup>	33.36%	21.17%	4.56%	-2.98%	63.92%	8.58%	9.51%
Russell 2000 <sup>2</sup>	31.36%	12.69%	4.30%	-4.36%	47.67%	10.54%	12.41%

# 3Q:21 COMMENTARY – CONTINUED

## QUALITY VALUE SMALLCAP TOP DETRACTORS

In spite of a quarterly earnings beat and management raising guidance, **LESLIE'S INC. (LESL)** was the largest detractor to returns during the quarter. LESL is the largest consumer-facing omni-channel brand in the U.S. pool and spa care industry, operating more than 900 locations across 38 states. Quarterly earnings comparisons have gotten more difficult, and "reopening" has likely resulted in some shift in consumer spending from the home and pool to travel, restaurants, and other discretionary spending. That considered, Ballast believes the competitive advantages of LESL remain intact, which includes the company's installed base of customers driving strong recurring maintenance revenues.

**SIMULATIONS PLUS INC. (SLP)** shares were down during the quarter as its revenues disappointed as a result of a drop in its services business. We believe this dip to be temporary. SLP is a software and services provider to the pharmaceutical industry, aiding those businesses with software and services that support their drug discovery, product quality and innovation. The company is approaching a 20% market share of the companies that would be potential users of its software and consulting services. We see the outlook as strong for SLP, both due to organic growth and through acquisitions supported by its strong balance sheet.

## QUALITY VALUE SMALLCAP PORTFOLIO ACTIVITY

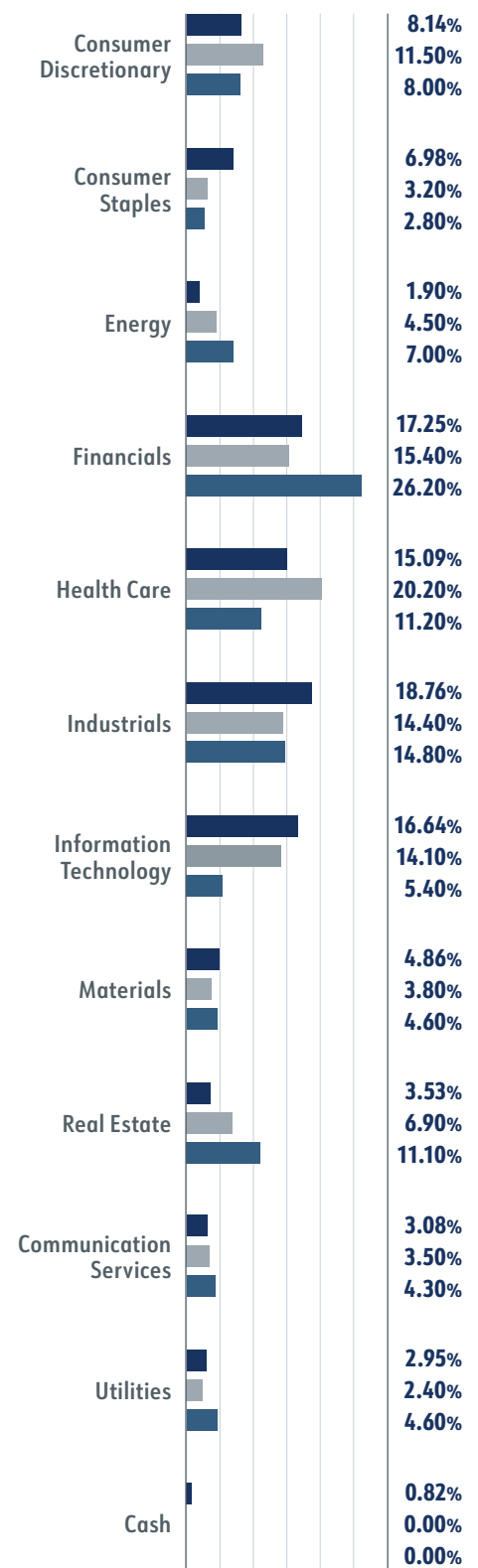
Rising markets and volatility presented abundant opportunities to sell positions for price reasons and to buy where better opportunities arose. Positions added during the quarter were on-line auto marketplace **CAR GURUS (CARG)**, on-line retailer **1-800 FLOWERS (FLWS)**, and **HAWKINS (HWKN)**, a provider of chemicals and ingredients for water treatment and nutrition. Also added were **JOHNSON OUTDOORS (JOUT)**, a manufacturer of outdoor recreation products, insurer **PRIMERICA (PRI)**, and media company **WORLD WRESTLING ENTERTAINMENT (WWE)**. In addition to the previously mentioned sale of HOLI, Ballast exited positions in **US ECOLOGY INC. (ECOL)**, **J&J SNACK FOODS (JJSF)**, **SENSIENT TECHNOLOGIES (SXT)** and airport operator **GRUPO AEROPORTUARIO DEL CENTRO NORTE (OMAB)**.

## BALLAST'S OUTLOOK

There is no shortage of risks in equity markets, including the above-mentioned uncertainty over fiscal and monetary policy, inflation concerns, and slowing economic growth. Tax policy looms as a potential impact to corporate margins and supply chain issues persist. While the potential impact of each of these is important for investors to consider, the macro future isn't knowable. What we do know is the importance of maintaining a focus on fundamentals and quality businesses that have pricing power and persistent performance.

With 42% of the Russell 2000 companies lacking positive earnings in the trailing twelve months, we know that cheap money and government stimulus have propped up the market returns of low-quality companies. Selectivity will be critical in the coming months, and we will serve our clients through careful diligence and a continued attention to the sustainability of business performance and the price paid for each holding in our strategies.

## SECTOR EXPOSURE<sup>^</sup>



BEM Quality Value Smallcap<sup>1</sup>

Russell 2000<sup>2</sup>

Russell 2000 Value<sup>2</sup>

0 5 10 15 20 25 30 %

## PORTFOLIO CHARACTERISTICS

	BEM Quality Value Smallcap	Russell 2000	Russell 2000 Value
Active Share <sup>4</sup>	97.91	0.00	0.00
Number of Securities	60	2,025	1,428
Weighted Average Market Cap (MM)	2,648.63	3,324.32	2,865.82
Median Market Cap	2,007.05	1,187.36	1,059.82
Dividend Yield	1.13	1.31	2.01
ROIC	10.18	3.15	3.61
Debt/Capitalization	34.35	53.37	53.74
EV/EBITDA	19.38	12.50	9.58

## RISK METRICS

	BEM Quality Value Smallcap	Relative to Russell 2000	Relative to Russell 2000 Value
Annualized Alpha		-3.97	-1.89
Beta		0.97	0.92
Up Capture		72.87	71.69
Down Capture		87.72	81.46
Standard Deviation*	19.21	25.33	26.61
Information Ratio		-0.178	0.150
Sharpe Ratio	0.50		

\*Standard Deviation is shown for the BEM Strategy and for each respective Index.



For more information, please call  
**844.322.5527** or visit **ballastequity.com**

WE THANK OUR CLIENTS AND INVITE OTHER LIKE-MINDED INVESTORS TO CONTACT US IF WE MAY BE OF SERVICE.

# DISCLOSURES

---

No client or potential client should assume that any information presented should be construed as personalized investment advice. Personalized investment advice can only be rendered after engagement of the firm for services, execution of the required documentation, and receipt of required disclosures. Investing carries risk of loss. You should consider the strategy's investment objectives, risks, charges and expenses carefully before investing.

<sup>^</sup> Sector classifications are generally determined by referencing the Global Industry Classification Standard (GICS<sup>®</sup>) and exclude cash. GICS was developed by and/or is the exclusive property of MSCI, Inc. and Standard & Poor's Financial Services LLC (S&P). GICS is a service mark of MSCI and S&P.

<sup>1</sup> Top ten holdings, sector weights and portfolio characteristics for the BEM Quality Value Smallcap Strategy are taken from the model portfolio.

<sup>2</sup> The BEM Quality Value Smallcap Strategy is compared to the Russell 2000 Indices as they are widely used benchmarks for small capitalization securities. An investment with Ballast Equity Management (BEM) 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 strategies and positions that are not included in these indices.

<sup>3</sup> BEM Quality Value Smallcap returns are for the BQV Smallcap Composite. Net returns are calculated assuming the maximum advisory fee of 100bps is deducted from the quarterly gross composite return from inception through June 30, 2020. Starting July 1, 2020, actual fees charged are used to calculate net performance. Returns are net of both advisory fees and transaction costs. All dividends are assumed to be reinvested. The reporting currency is USD.

<sup>4</sup> Active Share of the BEM Quality Value Smallcap Strategy is calculated relative to the Russell 2000 Value Index.

Ballast Equity Management, LLC claims compliance with the Global Investment Performance Standards (GIPS<sup>®</sup>). GIPS<sup>®</sup> is a registered trademark of the CFA Institute. CFA Institute does not endorse or promote this organization, nor does it warrant the accuracy or quality of the content contained herein. To receive a GIPS report, please contact Ballast at (844) 3-BALLAST.

This information is presented for informational purposes only and is not intended as an offer or sale of securities. Past performance does not guarantee future results. The performance data quoted represents past performance. The principal value of an investment and investment return will fluctuate so that an investor's portfolio, when redeemed, may be worth more or less than the original cost.

Ballast Equity Management, LLC is a registered investment advisor. For additional information about the firm and its professionals please visit the SEC's website at [adviserinfo.sec.gov](https://adviserinfo.sec.gov).