

# Smallcap QUALITY VALUE STRATEGY



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

1Q:22

## 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.

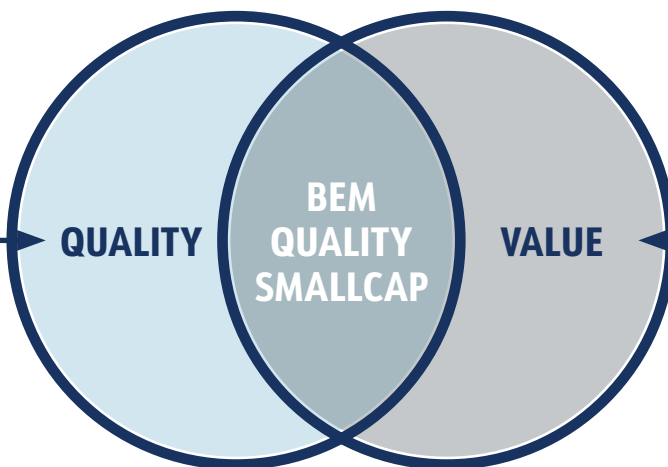


## INVESTMENT TEAM

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.

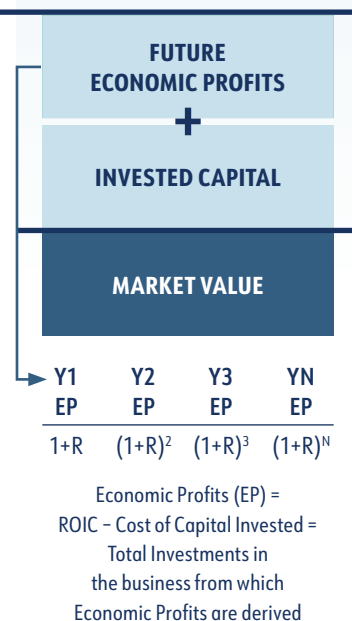
Ballast believes that buying wealth-creating businesses at discounts to intrinsic value will offer our clients stability, with less volatility and lower drawdowns, pursuing our goal to create long-term wealth.

# 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:



## 1Q:22 COMMENTARY

Ballast concluded its commentary last quarter with a list of “known risks” that included a continuation of inflation, the Federal Reserve’s tightening cycle and trajectory, and the fact that attention paid by investors to geopolitical risks stood at a four-year low, while the ambitions of China, Iran and Russia continued to rise. These risks emerged in more profound ways than we expected, with war in Ukraine, a more hawkish Fed, and inflation spiking to 40-year highs. Markets reacted to these risk factors with heightened volatility and negative returns across equity market caps. Performance by energy stocks greatly outstripped all other sectors as worries over global supply – already escalated prior to the war in Ukraine – rose further.

The **Ballast Quality Value Smallcap Strategy** lagged the Russell 2000 Value Index while leading the Russell 2000 Index. Ballast has historically been significantly underweight in Energy holdings, as these businesses generally do not have the high returns on invested capital or consistency of business performance we seek. This created meaningful headwinds to performance, as did robust performance by certain index constituents in the Defense and Shipping industries. Healthcare and Communication Services holdings helped performance, while holdings in the Energy and Industrials sectors detracted.

### QUALITY VALUE SMALLCAP TOP CONTRIBUTORS

Energy services company **CORE LABORATORIES (CLB)** rose over 40% as investor sentiment turned favorable toward the company’s prospects in its reservoir description and production enhancement services divisions. CLB is the singular energy holding in the Ballast strategy and has competitive advantages that include its intangible assets (patents, proprietary technology, and human capital) and network effects (multi-client reservoir studies). Prior to the start of the conflict in Ukraine, CLB announced that it expects double digit gains in 2022 for both its business segments; these gains could improve further as exploration and production increases.

Shares of on-line automotive sales platform **CARGURUS, INC. (CARG)** also rose during the quarter. CARG offers a leading marketplace for both individuals and dealerships to buy, market and sell vehicles in the U.S. as well as Canada and the U.K. CARG has a strong network effect competitive advantage with over thirty-nine million unique visitors each month and over 30,000 paying dealerships globally. Positive stock performance was supported by quarterly revenues that exceeded Street expectations by over 20% and by the company’s investment in dealer-matching service CarOffer.

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

	% Weighting
CSG Systems International, Inc.	2.35%
Simulations Plus Inc.	2.34%
National Storage Affiliates	2.24%
MGP Ingredients Inc.	2.22%
UFP Technologies Inc.	2.11%
Napco Security Technologies, Inc.	2.10%
Insperty, Inc.	2.02%
Evertec Inc.	1.95%
Seacoast Banking Corporation of Florida	1.94%
Addus HomeCare Corporation	1.90%
<b>TOTAL</b>	<b>21.16%</b>

### PERFORMANCE

	2Q:21	3Q:21	4Q:21	1Q:22	1 Year	3 Year	Annual Total Return (since inception) 6/30/17
BEM - Smallcap (Gross) <sup>3</sup>	2.98%	-1.68%	6.67%	-6.50%	0.97%	11.03%	9.66%
BEM - Smallcap (Net) <sup>3</sup>	2.83%	-1.77%	6.57%	-6.58%	0.56%	10.15%	8.72%
Russell 2000 Value <sup>2</sup>	-4.56%	-2.98%	4.36%	-2.40%	3.32%	12.71%	8.88%
Russell 2000 <sup>2</sup>	4.30%	-4.36%	2.14%	-7.53%	-5.79%	11.75%	9.72%

# 1Q:22 COMMENTARY – CONTINUED

## QUALITY VALUE SMALLCAP TOP DETRACTORS

Shares of **1-800 FLOWERS.COM (FLWS)** fell 45% during the quarter. Challenges to the company’s margins included higher freight, shipping, and labor rates all hitting during its important holiday season. FLWS is working to offset these challenges by adding more automation into its manufacturing and distribution facilities, raising prices where possible, and building additional inventories. FLWS continues to have strong and growing free cash flows and delivers average returns on invested capital of 12%. FLWS has a proven record of making accretive acquisitions, something we expect will continue to boost business performance.

**WATTS WATER TECHNOLOGIES, INC. (WTS)** fell during the quarter, along with the other housing related companies, despite strong earnings that exceeded expectations. WTS is a global provider of Smart and Connected water conservation, safety, and flow control products. Share price performance was impacted by conservative guidance for the coming year; WTS has tough comparisons to beat for the first two quarters of 2022 and is making growth investments in its business. The company does have pricing power and we expect price increases and the shift to energy efficient products to aid performance in the second half of 2022.

## QUALITY VALUE SMALLCAP PORTFOLIO ACTIVITY

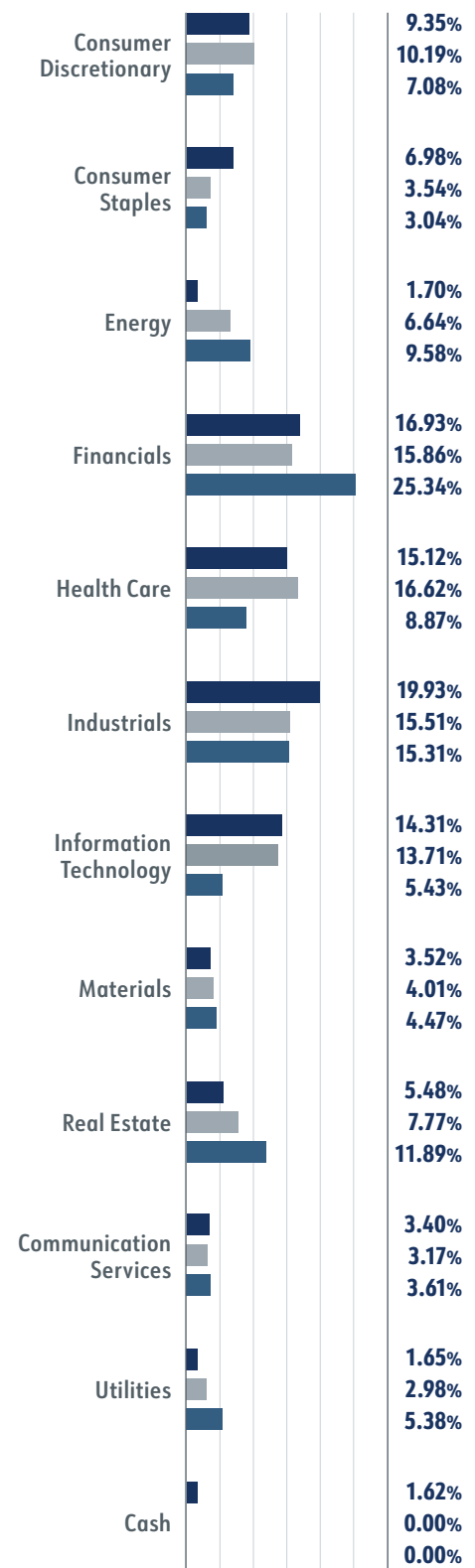
Ballast exited its position in **EAGLE PHARMACEUTICALS (EGRX)**. Prior to the invasion of Ukraine, a new position was initiated in **AEROJET ROCKETDYNE HOLDINGS, INC. (AJRD)**, a manufacturer of aerospace and defense products and systems. Also initiated was a position in **MEDPACE HOLDINGS INC. (MEDP)**, a leading clinical contract research focused primarily on full-service project work for small- and mid-sized biopharmaceutical clients. AJRD and MEDP each produce high returns on invested capital, 18% and 16% respectively, and each sells at a meaningful discount to Ballast estimate of intrinsic value.

## OUR FOCUS ON THE LONG TERM

Inflation, the Fed’s tightening cycle, and geopolitical concerns all weigh on the markets and seem likely to persist during 2022. What seems certain is that economic growth will be slower, leading to slowing corporate earnings growth. The earnings cycle and earnings growth will be in focus, favoring stable and profitable quality businesses such as those emphasized in the Ballast strategies.

Investing in high quality businesses is a winning strategy over time, but we know there will be periods of underperformance. Q1 2022 was painfully such a time, as energy and companies tied to commodity prices drove returns, while stable companies with high returns on invested capital lagged significantly. Investors who can accept these near-term “disconnects” with benchmarks and have the patience to commit to long term ownership are rewarded over time with higher returns and less volatility. We continue to stay disciplined and seek out quality businesses that can be “price makers” in these challenging times.

## 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		96.47	97.76
Number of Securities	58	2,018	1,436
Weighted Average Market Cap (MM)	2,760.73	3,354.54	3,108.97
Median Market Cap	2,184.38	1,026.45	978.79
Dividend Yield	1.21	1.49	2.16
ROIC	7.98	3.87	4.29
Debt/Capitalization	31.68	52.64	53.47
EV/EBITDA	16.91	11.19	9.26

## RISK METRICS

	BEM Quality Value Smallcap	Relative to Russell 2000	Relative to Russell 2000 Value
Annualized Alpha		0.16	0.22
Beta		0.70	0.66
Up Capture		74.53	70.95
Down Capture		87.43	84.19
Standard Deviation*	17.76	23.36	24.59
Information Ratio		-0.01	0.10
Sharpe Ratio	0.51		

\*Standard Deviation is shown for the BEM Strategy and 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

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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.

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