

# Midcap QUALITY VALUE STRATEGY



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

4Q: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.

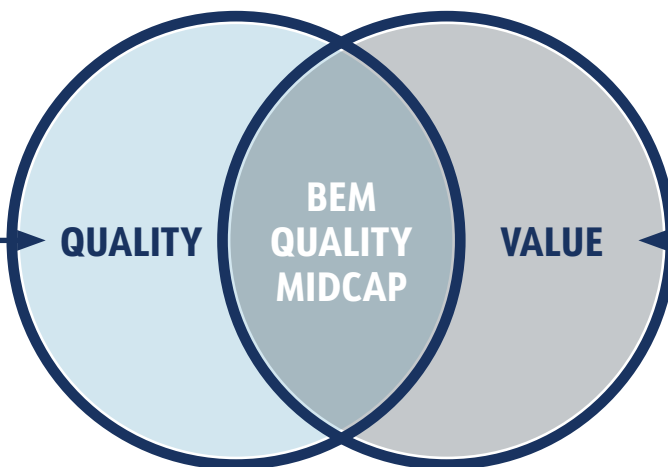


## INVESTMENT TEAM

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.

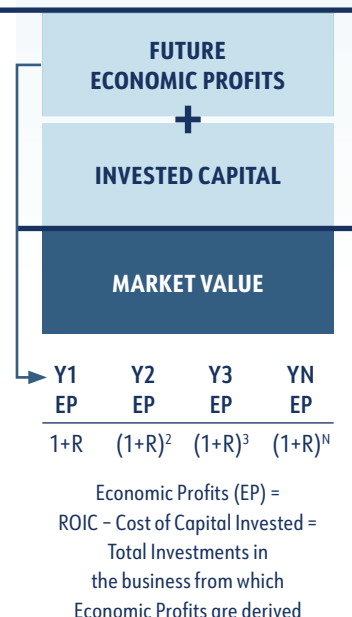
Ballast believes that buying wealth-creating businesses at discounts to intrinsic value will offer our clients stability, with less volatility and lower drawdowns, pursuing our goal to create long-term wealth.

# STRATEGY

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

**OVERVIEW** BEM Quality Value Midcap 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 Midcap Strategy when its stock can be purchased at a reasonable valuation.

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



## 4Q:22 COMMENTARY

Q4 2022 began with a bear market rally that continued into November but waned in December. Rate hikes by the Federal Reserve and Chairman Powell's comments that it was too soon to consider a pause tested investors' resolve. November's mid-term election delivered the ingredients for gridlock in Washington, and we ended 2022 with investors feeling the sting of a difficult year that offered few places to hide from sharply negative results.

The exceptional place to hide for equity investors in 2022 was the energy sector. Ballast has generally found few businesses in this sector that we believe make prudent capital allocation decisions and our underweight to these companies was a meaningful drag on our annual performance.

The **Ballast Quality Value Midcap Strategy** lagged both the Russell Mid Cap Value and the Russell Mid Cap Indexes during the quarter. Security selection added value in the Energy and Consumer Staples sectors, while security selection in Financial names detracted.

### QUALITY VALUE MIDCAP TOP CONTRIBUTORS

**ROSS STORES INC. (ROST)** rose by 38% during the quarter driven by strong Q3 results and optimism for the coming quarter and 2023. Lower income consumers that drive sales for ROST have been challenged in 2022 by higher energy, housing, and food costs, but employment and wage growth appear as positives. ROST is expected to continue to benefit from competitive advantages that include significant vendor relationships and strong inventory management. Returns on invested capital stand at 30% on average.

Shares of management consulting firm **BOOZ ALLEN HAMILTON (BAH)** rose during the quarter as the company both beat quarterly expectations and raised guidance for revenue and earnings for the full year. BAH is a leading provider of management and technology consulting. Its "best of breed" status stands as a competitive advantage as it captures contracts from the U.S. government, generating 97% of the company's revenues. BAH generates returns on invested capital of 15% on average.

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

	% Weighting
Booz Allen Hamilton Holding Corporation Class A	3.41%
Arthur J. Gallagher & Co.	2.82%
Laboratory Corporation of America Holdings	2.67%
Motorola Solutions, Inc.	2.66%
Glacier Bancorp, Inc.	2.36%
Etsy, Inc.	2.32%
Copart, Inc.	2.28%
Campbell Soup Company	2.28%
Toro Company	2.19%
Bank OZK	2.12%
<b>TOTAL</b>	<b>25.12%</b>

### PERFORMANCE

	1Q:22	2Q:22	3Q:22	4Q:22	1 Year	3 Year (Ann)	5 Year (Ann)	Annual Total Return (since inception) 6/30/16
BEM - Midcap (Gross) <sup>3</sup>	-7.06%	-12.94%	-3.17%	9.03%	-14.58%	8.97%	9.80%	11.22%
BEM - Midcap (Net) <sup>3</sup>	-7.29%	-13.16%	-3.41%	8.76%	-15.41%	7.92%	8.74%	10.14%
Russell Midcap Value <sup>2</sup>	-1.82%	-14.68%	-4.93%	10.45%	-12.03%	5.82%	5.72%	8.00%
Russell Midcap <sup>2</sup>	-5.68%	-16.85%	-3.44%	9.18%	-17.32%	5.88%	7.10%	9.48%

# 4Q:22 COMMENTARY – CONTINUED

## QUALITY VALUE MIDCAP TOP DETRACTORS

**FIRST FINANCIAL BANKSHARES INC. (FFIN)** shares fell as rising interest rates increased deposit costs and loan demand moderated. FFIN is a highly profitable bank holding company with a footprint in the thriving Texas market. FFIN produces returns on tangible equity of 16% and its shares are priced at a discount to our view of its intrinsic value.

Shares of self-storage owner and operator **EXTRA SPACE STORAGE (EXR)** fell during the quarter as management lowered earnings guidance. Lower share prices also reflected the impact of higher interest rates; 38% of the company’s debt was variable at the end of Q3 2022. We continue to have confidence in the long-term prospects for EXR, supported by its same-store occupancy rate of 96% and its size and scale, giving it a significant cost advantage and marketing presence over smaller peers.

## QUALITY VALUE MIDCAP PORTFOLIO ACTIVITY

With the early quarter rally and subsequent decline, Ballast saw many opportunities to upgrade our portfolio. Ballast exited **CELANESE CORP. (CE)**, **CLOROX (CLX)**, **TAKE TWO INTERACTIVE (TTWO)**, and **HELEN OF TROY (HELE)**.

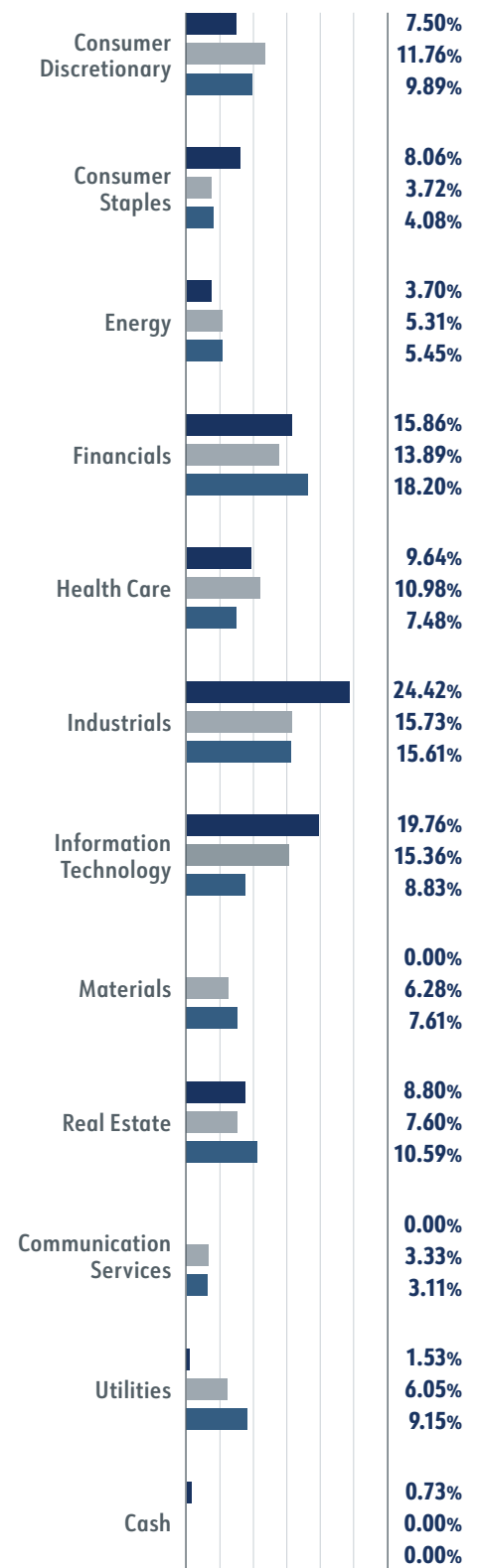
New positions were initiated in exploration and production company **APA CORP. (APA)**, industrial and office **REIT EASTGROUP PROPERTIES (EGP)**, **LENNOX INTERNATIONAL (LII)**, a leader in heating, ventilation and cooling products, **NORTHERN TRUST (NTRS)**, offering leadership in custody and wealth management services, and **ZEBRA TECHNOLOGIES (ZBRA)**, a leader in automatic identification and data capture technology.

## OUR FOCUS ON THE LONG TERM

The folly of predicting macro events was laid bare in 2022 as the Federal Reserve and Wall Street were wildly wrong concerning the persistence of inflation and the direction of equity and bond markets. We suspect that the Federal Reserve has more interest rate hikes in store for 2023, that a recession is possible, that downward earnings revisions are likely, and that consumers face trouble as personal savings rates are down while debt levels are up. To the positive, the employment picture remains strong, although questions remain whether inflation can come down without impacting the labor market.

There is great uncertainty as to the outlook for corporate earnings in 2023. A focus on quality provides some clarity; businesses with low leverage, stable and growing cash flows and returns on invested capital give us a far better starting point for making sound assessments of the future cash flows each business will deliver. The carnage of 2022 has created tremendous opportunities to upgrade to higher quality, small and mid-cap businesses, setting our clients up for success.

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



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

Russell Midcap<sup>2</sup>

Russell Midcap Value<sup>2</sup>

0 5 10 15 20 25 30 %

## PORTFOLIO CHARACTERISTICS

	BEM Quality Value Midcap	Russell Midcap	Russell Midcap Value
Active Share		92.07	93.49
Number of Securities	55	818	699
Weighted Average Market Cap (MM)	15,842.00	21,361.00	19,962.00
Median Market Cap	13,696.00	9,214.00	8,600.00
Dividend Yield	1.32	1.77	2.27
ROIC	15.81	7.80	7.37
Debt/Capitalization	45.44	53.49	52.73
EV/EBITDA	19.17	10.98	10.08

## RISK METRICS

	BEM Quality Value Midcap	Relative to Russell Midcap	Relative to Russell Midcap Value
Annualized Alpha		0.23	0.34
Beta		0.86	0.83
Up Capture		91.27	94.65
Down Capture		92.06	89.98
Standard Deviation*	16.39	18.51	18.96
Information Ratio		0.39	0.55
Sharpe Ratio	0.62	—	—

\*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 Midcap Strategy are taken from the model portfolio.

<sup>2</sup> The BEM Quality Value Midcap Strategy is compared to the Russell Midcap Indices as they are widely used benchmarks for mid 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 Midcap returns are for the BQV Midcap 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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