BALLAST
ASSET MANAGEMENT

FOURTH QUARTER 2019 LETTER

For the fourth quarter of 2019, the Ballast Portfolio returned 6.3% before fees and 6.1% net of fees, compared to 7.1% for the Russell 2500 Value and 8.5% for the Russell 2500. For calendar year 2019, the Ballast Portfolio returned 16.1% before fees and 15.0% net of fees, compared to 23.5% for the Russell 2500 Value and 27.7% for the Russell 2500.

		Periodic Returns					Annualized Returns	
		2015*	2016	2017	2018	2019	1 Year	3 Years
Ballast Portfolio[1]	Gross	-7.6%	23.8%	13.5%	-2.2%	16.1%	16.1%	8.8%
	Net	-8.0%	22.6%	12.4%	-3.2%	15.0%	15.0%	7.7%
Russell 2500 Value[2]		-5.8%	25.2%	10.3%	-12.4%	23.5%	23.5%	6.1%
Russell 2500		-6.9%	17.6%	16.8%	-10.0%	27.7%	27.7%	10.3%

Performance (as of 12.31.2019) *2015 performance from 8.11.2015 through 12.31.2015

Sometimes in life, we get caught up in the moment and do not take the time to think things through. Which reminds me of a crisp fall morning, more recent than I care to admit, when we went out to round up our herd of cattle for their semiannual vaccinations and to separate the heifers and steers from the cows. I put my old saddle (that had not been properly oiled or cared for in decades) on a young quarter-horse (affectionately named Rowdy) that I had not ridden in years, cinched it down and trotted off to where the herd was grazing. Seeing the horse, after a brief deliberation, most of the herd began moving toward the pens. Inevitably, a few young heifers or steers at just the right age to become rebellious, not unlike my children, wandered off, leaving me and Rowdy to chase them down.

As the herd approached the gate, one particular heifer turned and began running the other way. So Rowdy and I began loping across the pasture to collect the straggler. The heifer ran faster, and so too did we. We overtook our maverick heifer and quickly reined (turned) the horse to the left to get in front, to stop and turn her around. Now, on a horse, there is no safety equipment to keep you onboard. There are no handles to hold and they are not OSHA approved. A rider must use the relative force of their feet in the stirrups to stay on. Simple physics – apply force in an equal but opposite direction upon making a turn. So, I applied appropriate force to my right foot. Well, my mass times our velocity created force greater than the dry-rotted leather that held the stirrup to my saddle could handle, and with no downside protection, I went on a brief flight ending with a rough landing.

When I gathered myself and looked up, off in the distance our Polaris Ranger UTV was coming my way. My father (the driver) pulled up and looked at the horse and me. Seeing that we were both fine, he took out a bag of cattle feed we call "cake." He shook the bag, at which point the heifer turned and looked. He shook it again and dropped three pieces to the ground. The heifer came over to eat those pieces. He shook the bag once more as he put it in the back of the Ranger, and then drove off slowly toward the gate. The heifer followed. I eventually showed up, bruised and humbled, but in time to close the gate behind them.

At the moment, it feels like the market is running around chasing things just because they have a significant dividend in a low yield environment, or because they are rapidly growing revenue in a low growth environment. Having been in this business and picking stocks in the late 1990s/early 2000s, I already know what it feels like to get thrown off that horse. Instead of doing that again, we will patiently watch as our companies compound book value through their ability to generate cash and self-fund their own growth. Eventually, we believe the market will pick up its head, look over, and come our way.

Performance

On an absolute basis, we were pleased with our 2019 return. The portfolio, as it stands today, has the highest Reward-to-Risk ratio in its history and we believe we are well-positioned going into 2020. We are not surprised that our relative returns lagged the benchmarks given the narrow leadership we observed in the market and the key drivers; namely a quest for yield leading investors to predominantly Utilities and REITS, and growth at any price, with the most extreme examples in Technology stocks. The market felt very similar to 2000, when tech stocks were melting up despite very high multiples while many excellent businesses traded at extremely favorable valuations. Understand that we do not own the indexes, nor do we manage to them. This is evident in the portfolio's characteristics when compared to the benchmarks; the portfolio's average Return on Assets (ROA) is 10% versus 1%-1.2% for our benchmarks. The portfolio's 22% Return on Equity (ROE) compares to 4.8%-5.2%, and yet our companies have dramatically less leverage (debt) at only 1.2x Net-Debt to EBITDA versus 4.7-5.0x, and 77% Debt/Equity versus 124%-132%. Stated more plainly, not only do we own higher return businesses with safer balance sheets, we pay a lot less for them than the market (our Free Cash Flow Yield is 6% versus 1.8-2% for the indices). The differences are the result of putting our valuation framework around downside risk first for each investment we own while also owning good businesses that are trading at good valuations and with attractive upside potential. We believe our strategy will be of even greater importance given the increased uncertainty we are experiencing on a global basis and where investors are likely to demand greater certainty from their investments which traditionally can be found in well-run companies with strong fundamental underpinnings and in particular free cash flow generation.

Our strategy's long-term Sharpe Ratio is about 0.60 on net returns, which compares very favorably with both the Russell 2500's 0.50 and HFRI's Hedged Equity index's 0.50 (and we don't charge 2/20 for the privilege). Our strategy's superior Sharpe is partly a function of outperforming in bear markets, our downside capture is about 65%. Whether 2020 repeats 2019 or brings a deep correction, a bear market, pandemic or financial dislocation, we expect our strategy will continue to provide excellent absolute returns for investors who believe equities are important to own for long-term capital appreciation but seek even greater downside protection to withstand changing investment environments.

4Q 2019 Top and Bottom Performance Contributors

Top Performing Positions			Bottom Performing Positions		
	Name	Total Return		Name	Total Return
XPO	XPO Logistics	68%	**TDC**	Teradata Corp	-30%
COHR	Coherent Inc	57%	**CRTO**	Criteo	-24%
OSK	Oshkosh Corp	57%	**DBI**	Designer Brands	-33%
CRMT	America's Car-Mart	52%	**GDP**	Goodrich Petroleum	-26%
WTS	Watts Water	56%	**ALOT**	Astronova	-26%

Additional details related to the drivers of the top and bottom performers are included within the Portfolio Holdings Section

What is Free Cash Flow and why do we focus on it?

Simply put, as a business owner, free cash flow (FCF) is what you actually put in your pocket at the end of the day, quarter or year. A business's FCF generation is a simple, transparent and reliable place to start one's analysis of the health of a company. In contrast to Net Income, which makes assumptions in order to match the timing of revenue and expenses with accounting periods, FCF is cash coming in minus cash going out. It is what you get to keep after you pay all your employees, suppliers, banks, Uncle Sam, and any new equipment or facilities needed to keep the business running. As most often defined (and our definition), FCF is operating cash flow minus capital expenditures. The FCF a business earns is what is available to invest for growth, pay down debt, buy back stock, pay a dividend or make an acquisition.

Things like liquidity flowing into the economy from the Fed, interest rates, the yield curve and the attractiveness of growth from a new technology push stock prices around and distract from the underlying value of the cash profits a company earns. All these things are important for sure, but ultimately a company and the underlying worth of its stock is determined from the cash it throws off.

The income statement measures of a company's operations, like margins or earnings per share (EPS), and can help determine the normalized economic health of the business and give valuable insight into where it is going or what it could do, but FCF is what the business is doing right now – today. Unfortunately, nearly every line on an income statement can be distorted by anything from simple accrual accounting rules that do not quite fit or are pushed too aggressively to outright fraud (see Enron). At the top, revenue can be over- or understated due to "revenue recognition" rules and may bear little relationship to when the related cash was received. On the bottom line, net income can be over- or understated due to things like amortization and depreciation schedules, excessive or insufficient accruals that pull ahead future net income or recognize past losses that were buried under accounting rules, and again fraud (see also Worldcom).

Accounting can also distort the balance sheet (see Enron and Worldcom again) with things like off-balance sheet transactions and financing, contingent liabilities or the occasional hidden asset (see Alexander and Baldwin). What you cannot do is distort the amount of cash going into and out of a bank account. So that is always where we start.

The next step is to decide how much we are willing to pay for that level of FCF. One simple way to look at it is as a yield. For example, a 20% FCF Yield means that one could theoretically buy the entire business and completely pay for it in 5 years. This is very similar to a dividend yield, except with much greater clarity into the actual health and profitability of a business. It tells us how much cash a business throws off every year relative to how much we are paying for that level of cash.

The next question is if the company will still be in business in 5 years. How long can they sustain existing free cash flow? How much can they grow it? Some of the things we consider:

- how are supply and demand growing?
- how much competition do they face?
- are they at risk of technology or regulatory disruption?
- are rising input costs going to squeeze margins?
- if the industry turns down, is the balance sheet strong enough for the company to survive?
- can we trust management to make good investment decisions with the FCF?

We are more confident in our ability to predict that Hanesbrands, which is self-financing, will still be selling underwear in 5 years than whether Tesla will be selling cars in 50 years (that is assuming its FCF yield does not stay at 0.2%). This has nothing to do with our opinion of Tesla's leadership, brand and products (they are remarkable), but we feel a lot more certain in our calculations of the risk of losing money in Hanesbrands than we do in Tesla, if for no other reason than there are fewer scenarios to consider over 5 years versus 50.

Finally, we want to understand how management is incented and thinks about returns on capital. Many CEOs operate their companies well, but fewer understand how to allocate FCF to maximize growth of return on capital – effectively balancing reinvestment, appropriate leverage and returning surplus capital to owners.

Stealth QE and the Next Recession (not yet)

Good times come and good times go,
I only wish the good times would last a little longer.
I think about the good times we had
And why they had to end.
— *Social Distortion*

The good times have lasted 10 years, a record expansion that looks set to continue in 2020, mid-year yield curve inversion notwithstanding. The economy expands more than 85% of the time, growing more than 20% on average versus the average contraction of 2% in recessions, so that is sort of a base rate for our moderate growth expectation. Economic data and company commentary also support an optimistic economic outlook. However, we also believe systematic risk is elevated and that there is long-term potential for a major discontinuity stemming from unconventional monetary policies used since 2008.

Ballast's absolute-return investment discipline prioritizes avoiding excessive downside risk at the individual stock level, avoiding crippling drawdowns without sacrificing long-term upside.

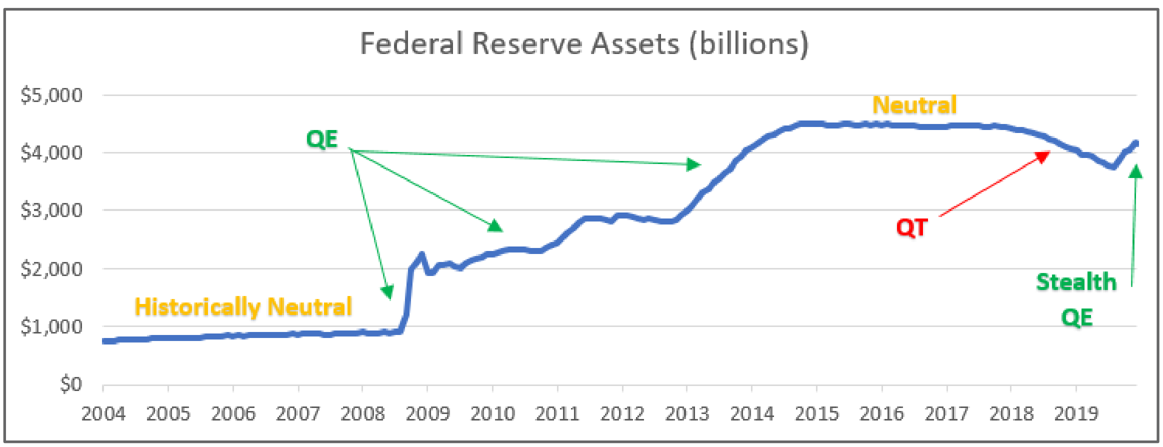
Expansions normally end for one of three reasons: excessive Federal Reserve tightening, credit problems or global impacts (like 1970s oil crisis). As things are today, we think the risk of recession is lower than at the start of 2019, call it a one-in-five chance over the next 12 months compared to the 30% chance we began last year with. It is not just trade war de-escalation. There is broad economic evidence for our outlook: low unemployment, stabilizing industrial production, rising commodity prices, low interest rates, low credit spreads, global economic data generally coming in better than expected and, perhaps the most important (but least understood), Stealth QE.

Although the real economy looks okay, we are less sanguine about financial markets. As we wrote in more detail last year, Quantitative Tightening (QT) was taking cash out of the economy, starting in earnest in mid-2018. QT leaves less liquidity for banks to extend credit, which tends to slow the economy. It also has ramifications for financial markets, which need liquidity to function smoothly, which we will get to below. For now, consider that the market returned less than 4% from the end of January 2018 to the start of Stealth QE in mid-September 2019, roughly 300 basis points (bps) below its historical Compounded Annual Growth Rate (CAGR), while at the same time, the Fed withdrew $660 billion from the economy, roughly 3% of GDP. We suspect that QT was a significant driver of the fourth quarter 2018 stock market melt-down and of negative stock returns in 2018.

Quantitative Easing (QE) is the opposite of QT, putting cash into the economy which promotes credit growth and smooth functioning markets. After the housing bust, the Fed stepped into the vacuum created by opposition to fiscal stimulus, announcing several rounds of QE between 2008 and 2014 cumulating to $3.5 trillion, 15%-20% of those years' GDP. It is impossible to be certain what would have happened without the Fed's monetary help, but we are Keynesian enough to be grateful.

However, the Global Financial Crisis (GFC) rounds of QE were part of a clearly articulated strategy to use the wealth effect to jump-start the economy. We call the latest round of easing Stealth QE because the Fed does not acknowledge it as such. It began in September 2019, injecting $440 billion, roughly 2% of GDP before credit multipliers, as a kludge for the repo market, which nearly seized that month. (Repo markets, which sit at the base of the financial system, provide overnight funds against high-quality collateral, about as risk-free a rate as it comes, yet it spiked intraday to nearly 10% and fixed at 6% on the 17th of September.) We do not think it a coincidence that equity markets ripped higher starting at about the same time.

The amount of QE or QT is captured by the size of the Federal Reserve's assets, shown below. When the line is rising, we have QE, when it is declining, QT.



We were perhaps a little too optimistic about how much the economy could grow in the face of tighter liquidity last year, but the Fed saved us, even if only by accident, with its fix for problems in the repo market. When the yield curve inverted over the summer, it caused much consternation in markets and the media because of its record as an early warning of impending recession. The Fed got the message that short-term rates were too high and responded by cutting. Whether that would have been enough to short-circuit the yield curve prophesy is unanswerable, but the blast of Stealth QE seems to have done the job. As long as the Fed's assets are growing, we think the economy and markets will trend favorably.

Furthermore, easing is a global phenomenon. BOJ and ECB are not reducing their balance sheets and there were over 70 policy rate cuts last year. While off the $17 trillion peak, the world still ended 2019 with more than $11 trillion of negative yielding debt. All this low-cost credit is quite supportive of near-term economic growth. The downside, to the extent there is one, is that low rates are encouraging debt growth. According to Institute for International Finance, global debt ended 2019 at $253 trillion, 322% of global GDP. A proxy data set from the St. Louis Fed reports total global debt is up 60% since 2009 – so much for a beautiful deleveraging!

How long can Stealth QE continue? We do not have an answer other than it must have a limit, and we hope we do not find it by stumbling over it. The repo market problems are an example of the sort of financial system problems we mentioned in a general way last year. Very difficult to identify in advance, but traceable after the fact. The problem is that it is a complex adaptive system operating in a novel environment, no one can know with specificity or certainty what might go wrong. We do not see signs of excessive credit-fueled consumption in the real economy, but fear the financial economy is less resistant to liquidity-driven malinvestment. For instance, Baa/BBB rated debt, two steps above junk bonds, has increased from roughly a third of outstanding investment-grade debt prior to the crisis to nearly 50%. The problem is not just degradation in corporate credit quality so much as the potential impact of a wave of ratings downgrades causing forced selling by institutions with limited ability to own junk bonds.

Since we stay effectively fully invested, invest bottom-up and do not try to time the market, why do we care about the macro environment? Mainly because businesses don't operate in a vacuum, and we need to understand the environment to satisfy reward-to-risk at both the stock and portfolio level. The macro environment, and prevailing risk appetites, inform how we weight positions, and how our aggregate positions balance individual stock upside against risk factors like operating and financial leverage, interest rate and economic sensitivity, commodity exposure, and end market cycles. Our goal is to deliver strong absolute returns over a market cycle, perhaps lagging during strong bull runs but more than offsetting that by drawing down significantly less in bear markets.

Portfolio Updates

New Positions Initiated

Texas Pacific Land Trust (TPL)

In the fourth quarter, we bought Texas Pacific Land Trust (TPL, $5.6b market cap at the time). TPL is essentially a toll collector on Permian basin oil and gas development, principally by earning royalties from production on its roughly 450,000 acres of West Texas land where it owns mineral rights. The beauty of this business is that TPL does not have to risk any capital developing wells, that's done by companies like Chevron and Pioneer. In exchange for the right to drill, TPL collects cash proceeds from the sale of a fraction of the oil and gas produced, not quite recurring revenue given sensitivity to oil selling prices, but the incremental FCF margin is in excess of 90%.

It also owns surface rights on about 900,000 acres (much overlapping), that it leases to producers, pipelines, and others needing access to oil fields. In 2017, it began further leveraging its surface acreage, which includes water rights, with the establishment of a business that provides water to wells for fracking, recycling, and eventual disposal. Water revenue is based on volume and price of water, i.e., independent of oil prices at least into the medium term.

TPL has grown revenue at 3-5x the 10%-20% rate of Permian production in general and earned FCF margins in the range of 40%-70%. While difficult to predict growth precisely, only 7% of its developable acreage has been tapped so far. Moreover, the focus of the O&G industry's activity is shifting from the Midland to the Delaware basin, where TPL has its largest concentration of mineral rights.

In terms of downside, we estimated that the current Enterprise Value (EV) was about equal to the market value of its landholdings, based on a sampling of real estate listings for its surface acreage, and public comps and deal multiples for its mineral rights acreage. That is, the $190 million or so cash flow it generated in 2019 (estimated) is accorded no value. Even if our land estimate is too high by half, based on its historical multiples, the FCF yield trough of 5.3% during the 2014 oil bust equated to only about 30% downside. That would put it at 10 EV/Sales multiple, a level it has not seen since before the Great Financial Crisis (GFC), way before the economic significance of the Permian was known.

The growth opportunity, relatively low operational risk, and high incremental FCF margin made the trailing 3.5% FCF/EV we paid tolerable. That's where it typically trades, yet with no analyst coverage at the time and no quarterly management calls, we may still have gotten a bargain on an off-the-radar business. FCF is currently depressed by upfront investment in the water business that we expect will be lower going forward, helping drive FCF (before land sales), up 2-3x over the next 3 years, producing a recurring ~10% FCF yield on investment. Alternatively, at a 4% FCF/EV, that would be about 150% upside.

While not at all central to our thesis, there is a potential catalyst. The top two executives signed change in control agreements last August, about the same time TPL agreed to work with dissident certificate holders to explore converting from a trust to a C-corp. That could upgrade corporate governance, attract a change-in-control premium, or lead to other value-surfacing actions.

Exited Positions

LogMeIn (LOGM)

LogMeIn markets a portfolio of collaboration, IT administration, and customer support products, including the GoTo family of software acquired from Citrix in 2017. In broad terms, the businesses are a mixture of either high-growth, lower-margin or high-margin, lower-growth software businesses. The assets generate substantial recurring revenue, 85% cash gross margins, 37% EBITDA margins, and high free cash flow conversion due to tax shielding and low capital intensity. We first started a position after the stock fell 25% in 3Q18, losing $1.5 billion in value on an annualized 4.5% one-time hit to revenue and EBITDA, which we saw as an overreaction. We later added to the position at still-attractive prices with confirmation that churn had stabilized in the subsequent quarter's results.

In early 3Q19, the stock started to rally on rumors that private equity buyers were interested in acquiring the company, and in December, we learned management had entered into an agreement to be acquired by Francisco Partners and Evergreen Coast. The acquisition price implied a premium of 25% to the unaffected closing price in September. While acquisitions are generally great for near-term performance, we were disappointed to see this company go private at that price. First, at the time of the announcement, the balance sheet only had $190 million in net debt (about 0.5x EBITDA). The acquiring group indicated plans to issue $3.3 billion in debt. As a public company, management could have utilized the balance sheet for the benefit of shareholders. For example, they could have supported a $1 billion debt issuance to buy back about 30% of the shares at 3Q19 prices. Second, several embedded growth businesses, including LastPass, were not getting full credit in the stock price. It's more appropriate to place an EV/Revenue multiple on the high-growth businesses and an EV/EBITDA multiple on the lower-growth, highly profitable businesses. Those distinctions are lost in aggregate. Had management been fully committed to unlocking the value for shareholders, they could have broken up the company, sold assets, or spun off the high-growth businesses. Unfortunately, the value of this great business will accrue to its future shareholders out of the public eye.

Top 5 Contributors

XPO Logistics (XPO) was the top performer for the year with a total return of 68%. When we initiated the position in 1Q19, the stock had been under pressure by two reductions to EBITDA guidance, a changing investor base, and a misinformed short-selling report. The stock had fallen from $113 in October 2018 to the mid-40s at the time of our purchase in March. Aggressive buybacks (questioned by many investors) and the substantial value of its businesses, including the 3PL business, eventually came into focus and pushed the stock substantially higher throughout the rest of the year. We applaud CEO Brad Jacobs' focus on unlocking value for shareholders.

Coherent (COHR) was a top contributor, returning 57% for the year. The stock rallied more than 40% YTD through April, coming off the lows at the end of 2018, only to give it all back in May. The feared effect of the China-U.S. trade war was fueled by 1Q results which showed headwinds from China weighing on the Materials Processing business. The rest of the year, however, was more favorable and the stock reached a bottom at the end of May. Later in the year, Apple announced an all-OLED iPhone lineup and the Trump administration reached a to-be-announced phase 1 trade deal with China. This improved the chances of Chinese manufacturers adding capacity and purchasing more equipment from Coherent. With dominant share of the LCD display market, Chinese fabricators are yet to move aggressively into OLED technology. When they do, we expect it will be a significant source of demand.

Oshkosh (OSK) was up 56% for the year. Oshkosh was also a top performer for us in 2016 and 2017 and a top detractor in 2018. Even though the stock was down in 2018, Oshkosh beat earnings estimates every quarter for the last 4 years by an average surprise of 46%. Operationally, this company has been outstanding, tracking nicely to our investment thesis since our initial purchase in 2015. Performance on a shorter-term basis, however, is driven by sentiment and multiple, given the cyclical end markets. Starting in October, equipment companies like Oshkosh, Caterpillar, United Rentals, and Terex rallied into the year end on improving economic outlook.

America's Car-Mart (CRMT) gained 51% in 2019 after returning 62% in 2018. America's Car-Mart has emerged stronger than ever from the difficult competitive environment of the last several years. Assuming a stable competitive environment, we believe they are likely to earn a 25% ROE and grow book value per share at 18%-20% over the next 3 years. The company's honest approach in a shady auto-lending industry has earned them loyalty with customers, provided affordable transportation to communities, and offered attractive returns to shareholders.

Watts Water (WTS) generated a total return of 56% for the year. Like Oshkosh, Watts has shown solid execution toward our investment thesis. A multiyear margins-over-growth strategy has resulted in the company meeting or beating earnings expectations for 19 consecutive quarters. Watts enjoys a significant installed base resulting in steady level of replacement demand upon which to build new business by accretion.

Bottom 5 Detractors

Teradata (TDC) faced a difficult year, finishing down 30%, culminating with the unexpected firing of their CEO in November. While the growth in recurring revenue was on track, the perpetual license and consulting revenue fell more quickly than expected. The board said that the new CEO would need to drive execution across the organization. This sudden change surprised us and prompted a review. We concluded that the thesis was intact, and that although the maintenance decline was more rapid than expected, the company is poised to grow its software business in 2020. By simple math, the subscription business is $1.4 billion and growing at 10% (implying $140 million incremental revenue). The perpetual license is $90 million, so even if that business goes to zero in 2020, they should be able to show top-line growth in software by maintaining their momentum in subscription. Further, the stock trades at 2x enterprise value to recurring revenue, which historically is the bottom for software companies. With no debt and stable FCF, TDC is also a prime candidate for M&A.

Criteo (CRTO) was down 24% for the year. We determined the thesis was violated when Google announced its plan to eliminate cookies. Cookies are an important way in which advertisers track users' behaviors and offer them targeted, relevant advertising. Since Google's business model is aligned with advertising partners, we expected the changes to incorporate solutions for these advertisers, including cookies. Instead, Google has moved to eliminate them altogether. We think this decision may eventually evoke antitrust challenges for Google. While Google's new format may keep Criteo and other third parties involved by offering aggregate data, it brings substantial uncertainty regarding the monetization and investment required. We exited the name in 1Q20 on the thesis violation.

Designer Brands (DBI) was down 33% for the year. The pressure on the stock first started when they announced the acquisition of Camuto Group in 4Q18. We've watched transformations in retail closely. In general, we believe stores can be assets to traditional retail brands if the selection is differentiated and stores are both efficient and strategically located. We think the course Designer Brands has embarked upon can double the private label business to 20% of sales, increase private label margins by 700bps, and digitize Camuto's underutilized brands. We expect they can drive 240 basis points of gross margin improvement, low-single-digit same-store-sales (SSS) growth, and $2.70 in 2021 earnings per share (EPS). While short-term variations in retail can be challenging, we think Designer Brands' longer-term execution with Camuto bears more importance.

Goodrich Petroleum (GDP) traded down 26% for the year. Like much of the energy sector, Goodrich felt pressure throughout the year due to lower oil and natural gas prices and generally negative sentiment in the energy space. A warmer than normal winter so far and robust production growth led to natural gas prices hitting a 21-year low in January. While commodity prices are difficult to predict, we have seen a dramatic cut to capital spending plans going into 2020 from most E&Ps. With year 1 decline rates for most natural gas wells running at 40%-50% along with new liquefied natural gas export capacity coming on line this summer, we believe natural gas prices will recover to a more normalized rate going into the winter of 2020. Meanwhile, the company's strong free cash flow generation brought about by a strong book of price hedges and solid balance sheet discipline should position Goodrich to benefit from the eventual recovery in natural gas prices. Notably, in December, management shared plans to cut 2020 cap-ex by one-third, resulting in a forward free cash flow yield of nearly 20%.

Astronova (ALOT) was down 26% during the year. The stock came under pressure when cockpit printer sales and margins missed expectations due to the grounding of the 737 MAX. While first order effect of lower Boeing production was expected, we underestimated 1) what second order effect of higher in-service levels meant for retrofit opportunities and 2) the length of the Boeing 737 MAX being out of service. We've since reviewed the investment thesis, met with management, and visited the company's facilities with their CEO and CFO. We remain confident in the long-term thesis and downside is intact and that the stock will recover substantially once the 737 MAX is cleared.

Thanks again for your interest in Ballast. If you have any questions about our firm, our team, or our strategy, please feel free to reach out.

Regards,

Ragen Stienke

Important Notes and Disclosures

The investment decisions we make for clients' accounts are subject to various market, economic, and other risks, and there is no guarantee that those investment decisions will always be profitable. Clients are reminded that investing in any security entails risk of loss, which they should be willing to bear. The past performance of the firm or its principal is no guarantee of future results.

Some information contained in this communication was obtained from third-party sources. While these sources are believed to be accurate, that information has not been independently verified.

[1] The Ballast Portfolio represents the performance of a composite of accounts invested in the firm's model strategy that was launched on August 11, 2015. Gross Performance represents the returns of the composite after all expenses, but before deduction of management fees. An individual client's account would be subject to the deduction of management fees in accordance with the Ballast fee schedule. Net Performance represents returns net of all expenses and the highest management fee rate (1%) in the firm's fee schedule. The returns achieved by an individual client's account may vary from those reported for various reasons, including management fee rate, timing of cash flows, frequency of rebalancing of individual accounts, and an individual client's restrictions. In April 2019, Ballast transitioned from calculating performance based on a proprietary account to composite. The composite performance should be the sole source of information used when evaluating past performance. Past performance does not guarantee future results.

[2]The Russell 2500 Value Index measures the performance of those Russell 2500 companies with lower price-to-book ratios and lower forecasted growth values. Returns shown include the reinvestment of dividends and are based on data obtained from FTSE Russell.

[3]The Russell 2500 Index is a market capitalization weighted index of the 2,500 smallest companies in the Russell 3000 universe of United States equities. Returns shown include the reinvestment of dividends and are based on data obtained from FTSE Russell.