BALLAST
ASSET MANAGEMENT

Real World, Real Businesses, Real Values

The Ballast composite portfolio returned -13.6% net of fees for the second quarter of 2022, which compares to the Russell 2500 Value's -15.6% return and the Russell 2500 at -17.0%.

Performance*		Yearly Returns								Annualized Returns*		
		2015†	2016	2017	2018	2019	2020	2021	2022 YTD	3 Yrs	5 Yrs	Inception
Ballast Portfolio[1]	Gross	-7.6%	23.8%	13.5%	-2.2%	16.1%	12.5%	41.8%	-18.4%	10.4%	10.0%	11.6%
	Net	-8.0%	22.5%	12.4%	-3.2%	15.0%	11.4%	40.4%	-18.8%	9.3%	8.9%	10.5%
Russell 2500 Value[2]		-5.8%	25.2%	10.3%	-12.4%	23.5%	4.9%	27.7%	-16.7%	6.1%	5.5%	8.3%
Russell 2500[3]		-6.9%	17.6%	16.8%	-10.0%	27.7%	20.0%	18.1%	-21.8%	5.9%	7.0%	9.1%

* Annualized 3-Year, 5-Year and from Inception returns reported through 6/30/2022
† 2015 Performance from 8/11/2015 through 12/31/2015

As of the end of the second quarter, the Ballast portfolio trades at 9x earnings. That is historically cheap – very cheap. That translates into an 11% earnings yield for businesses that are, on average, operating with very little debt, are self-funding and with high returns on the capital they invest in their businesses. Simply put, our portfolio is made up of better businesses (as measured by ROA/ROE) that are cheaper and have less leverage than the respective benchmarks. Candidly, we do not believe that situation exists for very long. We have consistently said that timing markets is a fool's game, but we are absolutely convinced that the reward/risk skew and probabilities of success are **extraordinarily** in our favor at this point.

As you know, Ballast invests in companies where we estimate a minimum of a 3:1 upside to downside return potential. We believe this process protects investor capital in down markets while maintaining a long-term positioning for the upside. Currently, the portfolio has reward-to-risk of 6:1, based on the weighted average of our upside and downside estimates for each position. This favorable asymmetry is one of the largest margins we have ever seen and suggests right now is an extremely opportune time to invest in our process.

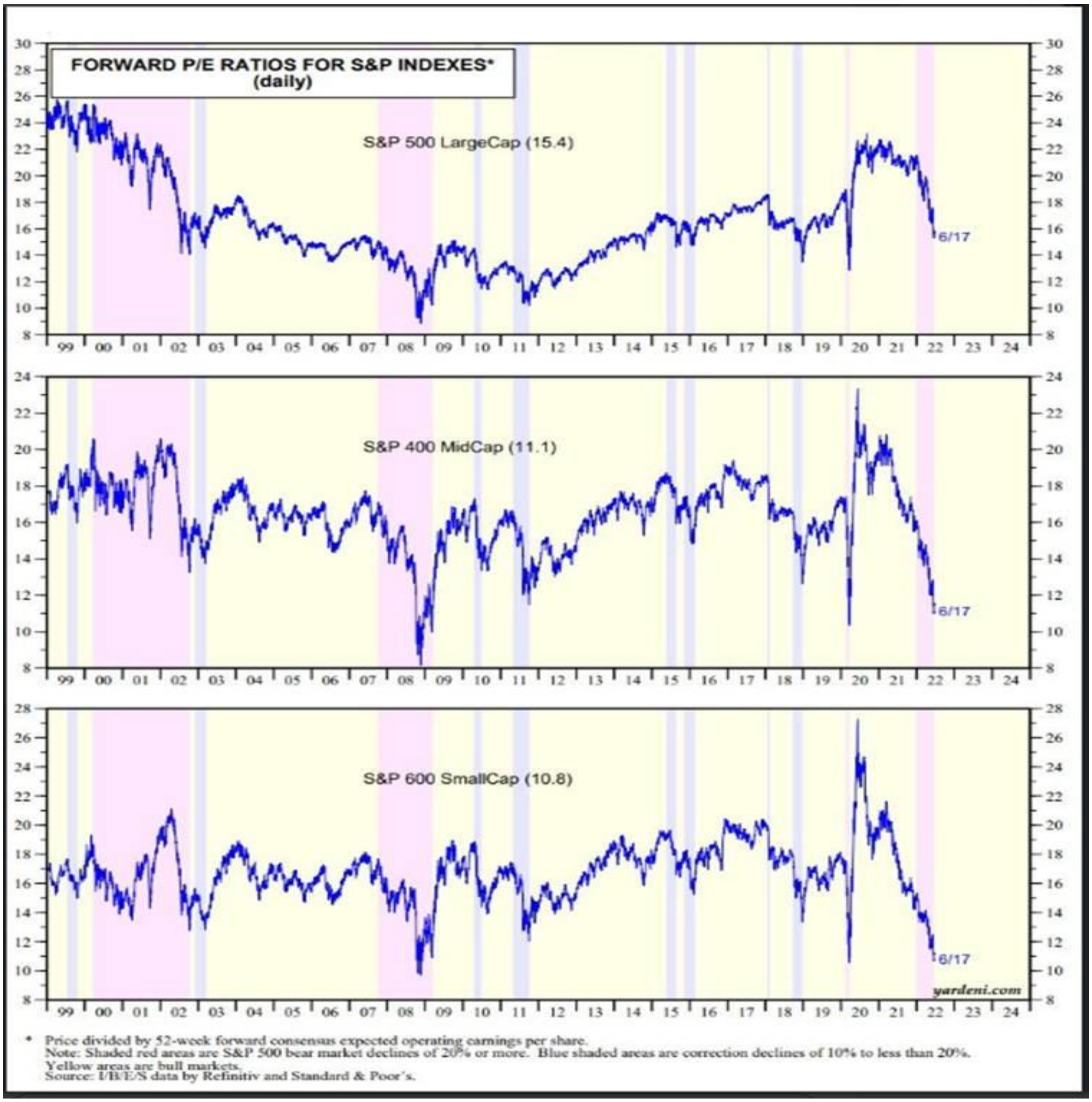
Valuation and Opportunity

Being cheap is not a good reason to own a stock. However, buying a business, or basket of businesses, for less than they are worth is a good reason. So how do we evaluate "value," or worth? Well, we look at the businesses just like an owner of a company might. We ask ourselves a couple of simple questions:

1) How much will it cost us to buy the business?
2) How much money will we need to invest in the business to keep it going?
3) What return do we get on that investment?
4) How much money might we lose if we are wrong?

While answering those questions entails significant analysis, it is really that simple. The hard part is maintaining a discipline of consistently buying the right types of business, at the right price, over and over again. That *Process* is something we have applied for nearly 20 years, and it has worked. We will refer you to previous letters and/or a longer discussion on how we answer questions 2-4. Today, we will focus on the question of cost.

The simplest, and most referred to, valuation metric used in the industry is the Price-to-Earnings Ratio (P/E). On that basis, Small Cap Value stocks in general, and the Ballast Portfolio in particular, is very cheap versus history. Below are some charts we borrowed from long-time Investment Strategist Ed Yardeni that shows the P/E of the S&P Large Cap, Mid Cap and Small Cap Indices.



As Ed noted in his commentary on these charts, "The S&P 500 SMidCaps are priced as though the economy is falling into a recession as bad as the one during the Great Financials Crisis…Perversely, these three freefalls have been exacerbated by V-shaped rebounds in their forward earnings, which are the time-weighted averages of analysts' consensus earnings expectations for the current year and the coming year."

Ballast versus the Indices

That of itself is interesting, but we take it a bit further for our businesses. Three important things that are not included in a P/E ratio are: 1) the amount of debt a company has, 2) the quality of the business, and 3) how much of those earnings are required to reinvest in the business to keep it going/growing. To account for those very important issues, we start by balance sheet adjusting multiples (i.e., including things like Debt, Preferred/Convertible Securities, Warrants, etc.). Next, we calculate the Free Cash Flow – the earnings that end up in the businesses' bank accounts after all the funding costs (inventory, accounts receivable, capital investment). Finally, we evaluate the quality of business based on the returns they generate on the capital invested in the business.

Not all businesses are worth the same, so the final step is to evaluate how much you pay *relative* to the cash you get to keep and the returns on the money invested and the risk you are taking. In the table below, we show the metrics used to assess that.

			Return on			Net Debt	Total Debt
	P/E	FCF/EV	Assets	Equity	Capital	/ EBITDA*	/ Equity*
Ballast	9.0	6.3%	8.1%	16.2%	12.7%	0.8	0.6
Russell 2500 Value	11.3	3.6%	5.1%	14.3%	8.8%	2.1	1.1
Russell 2500	16.0	3.0%	3.6%	11.2%	5.8%	2.0	1.2

*Excluding financials.

As of June 30, 2022

As evidenced by the table above, we are buying businesses with less risk, that are higher quality, and cheaper than the passive indices. It is also worth noting that the portfolio sports a 21% ROE on a forward basis, based on the weighted average of our estimates. All else equal, that means our portfolio ought to be expected to return about 20% a year over the long term.

Putting it all together

But what if we go into a recession? Well, based on the simplest definition of a recession (2 quarters of negative Real GDP growth), we are very likely already in a recession. Recessions are just part of business cycles, and the common characteristic that they all share is that they eventually end. What is important is to own businesses that will at a minimum survive a recession, and then thrive when it is over. Based on all of the above, coupled with the fundamental data we evaluated about our businesses, we believe we are in a good neighborhood, and live in one of the best houses in that neighborhood.

Where we are finding Value

Below are a few businesses we own that we are particularly excited about, and why we are so confident in the portfolio overall.

Bausch and Lomb (BLCO)

Bausch and Lomb is a recent spinout from Bausch Health, which was rebranded after the very public accounting issues that were discovered at Valeant. We believe that association with Valeant has tainted a very high-quality business with compelling absolute value. Bausch and Lomb was one of the many companies acquired by Valeant through the years. Valeant acquired it in 2013 for $8.3 BLN, versus the current enterprise value of $7.5 BLN.

Bausch is one franchise in the somewhat oligopolistic (4 primary players) Eye Care Industry. The stock trades at 11x expected Free Cash Flow (FCF), or an FCF Yield of over 8%. We are using FCF as a proxy for earnings (i.e., 11x P/E), and we calculate an EV/EBITDA multiple of around 9x. Its peers trade at more than 15x EBITDA, so the stock trades at a 40% discount. Leverage is modest at slightly over 2x net debt to EBITDA. Adjusting for the write-up of intangible assets with Valeant's acquisition of Bausch, ROIC is >15%.

The Eye Care industry has and continues to be a consistent LSD to MSD growth market and is expected to continue at similar growth rates over the next decade. The industry is not driven by Medicare, Government pay or Insurance Reimbursement. In fact, less than 20% of Bausch's revenues are reimbursed by governments or insurers, which is compelling from a risk perspective.

We believe that the current valuation of Bausch ignores headway the company has made into becoming a more viable player in the contact lens business with the launch of their newest Silicon Hydrogel products. While Bausch initially lagged in the move to Silicon Hydrogel contact lenses (which resulted market share losses in the past), recent product launches are much more competitive and have driven market share growth within that segment. In the US contact lens market, its share increased to almost 15% in 1Q 2022 from 8% in 2015. Bausch's most competitive Silicon Hydrogel products (Infuse) were not launched until 2020 and there are many markets around the world where Infuse is in the early launch phase. Silicon Hydrogel is growing faster, has higher margins within the larger contact lens market, and should be a mix tailwind for the company. Additionally, Bausch has a number of Eye Care Prescription Pharmaceuticals in the pipeline that could be launched over the next couple of years that could be meaningful drivers to overall revenue and margin expansion. Among them are NOV03, which targets the $3 BLN market for Rx dry eye products in the US and has a novel/differentiated mechanism of action relative to the other products in the market.

Bausch's success or failure will have very little to do with the economy and more to do with their ability to execute on their product development and commercial strategy in the markets they participate in. We believe that Bausch does not have a lot of capital risk and the primary risk is that of opportunity.

Green Plains (GPRE)

Green Plains was historically known as an ethanol/biodiesel producer, an industry that is both cyclical and exhibited modest returns. However, in early 2021, the company acquired technology via the acquisition of Fluid Quip Technologies. That acquisition led to a dramatic transformation of the company. Using the newly acquired technology, Green Plains began augmenting their traditional ethanol plants with a process to take what was effectively waste (what was left over after fermenting the corn kernel to produce ethanol) and turning it into animal feed super high in protein content.

Today, about half of their ethanol facilities have been upgraded with this technology, with the balance to be finished by the end of next year.

The importance of this transformation cannot be overstated. Traditional sources of protein for animal feed (Soybean meal, Cottonseed, etc.) have protein contents ranging from roughly 25%-45%. Green Plains is able to achieve protein levels of >60%. Not only does that give Green Plains a competitive and pricing advantage to other animal protein providers, it opens up enormous market opportunities without the cyclical aspects of the ethanol industry. Initial wins were with traditional pet food manufacturers, but the real upside exists in aquaculture (fish farmers). Notably, the company has already started shipping product to customers in Southeast Asia and South America specifically for that use.

Moreover, the Fluid Quip technology improves corn oil extraction (Biodiesel) and offers other extremely compelling alternatives to ethanol production. Namely, the production of sugar and alcohol. While still too early to hang our hat on this from an investment perspective, long-term Green Plains could be in a position to switch between the production of Ethanol, or Sugar/Alcohol, based on which offered the most attractive pricing/margin profile at the time. That opportunity is simply enormous.

While the stock is not especially cheap on current estimates (~11x EBITDA based on our estimates), we believe that will change materially over the next year or two. Stated plainly, we believe EBITDA will grow from ~$200mm this year to $800mm-$1bn over the next couple years, based purely on the animal feed/corn oil production. Future contributions from options on renewable aviation fuel, carbon sequestration, alcohol and sugar offer true pie-in-the-sky optionality.

Cavco (CVCO)

Cavco has sold off with traditional home builders and trades at 10x earnings with an 8% free cash flow yield to enterprise value. It sells manufactured housing, which is differentiated from site-built home builders by a highly flexible cost structure and, because it does not buy land, stronger free cash flow margins. While we can't predict the path of rates, inflation and employment, we know for certain that the US needs 1-2 million more housing units and that, at 1/2 to 1/4 the cost of a site-built home, manufactured housing has an important role to play. Management has done an excellent job of executing and consolidating. It is the second largest player in an oligopoly dominated by Berkshire Hathaway. Its scale is a competitive advantage that is reflected in its 17% Return on Assets, about 4x the index average. Apart from a $2mm loss in 2009/10, free cash flow has been positive each of the last 20 years. The downside is further protected by a $264mm cash cushion and immaterial debt.

As always, our team is available to discuss performance in greater detail, as well as the changes in the portfolio. We appreciate your continued investment and confidence in our team and strategy.

Regards,

Ballast Asset Management

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.

This presentation contains "forward-looking statements" which can be identified by the use of forward-looking terminology such as "may," "will," "should," "expect," "anticipate," "target," "project," "estimate," "intend," "continue" or "believe" or the negatives thereof or other variations thereon or comparable terminology. Because such forward-looking statements involve risks and uncertainties, actual results of Ballast Asset Management may differ materially from any expectations, projections, market outlooks, estimates or predictions (collectively, "Predictions") made or implicated in such forward-looking statements, and all Predictions contained herein are subject to certain assumptions. Other events which were unforeseen or otherwise not taken into account may occur; these events may significantly affect the returns or performance of any investment strategy. Any Predictions should not be construed to be indicative of the actual events which will occur.