For the full year 2024, BAM returned 13.5% net of fees and 14.7% gross compared to an 8.1% return for the Russell 2000 Value. In the fourth quarter, BAM's strategy returned 8.5% gross and 8.3% net of fees versus -1.1% for the Russell 2000 Value.

Performance		Yearly Returns								Annualized Returns*		
		2017	2018	2019	2020	2021	2022	2023	2024	3 Yrs	5 Yrs	Inception
Ballast Portfolio[1]	Gross	13.5%	-2.2%	16.1%	12.5%	41.8%	-13.3%	18.6%	14.7%	5.6%	13.5%	12.7%
	Net	12.4%	-3.2%	15.0%	11.4%	40.4%	-14.2%	17.4%	13.5%	4.6%	12.3%	11.6%
Russell 2000 Value[2]		7.8%	-12.8%	22.4%	4.6%	28.2%	-14.5%	14.6%	8.1%	1.9%	7.2%	8.9%
Alpha (net of fees)		4.6%	9.6%	-7.4%	6.8%	12.2%	0.3%	2.8%	5.4%	2.7%	5.1%	2.7%

*Anualized 3-Year, 5-Year and from Inception returns reported through 12/31/24

As the son of a farmer of a farmer, I witnessed firsthand the number of things that can go wrong in a given year. Some of those things are in your control, and many are out of your control. Whether it was too wet during the winter to get the field properly prepared for planting season, drought, blight, noxious weed development, insect infestation, equipment failure, and on and on. Often a crop would look terrible early on and through good decision making and a lot of hard work, it turned out to be great. Other times everything went right, until a hurricane hit right before harvest with devastating results.

The onset of these exogenous events, and one's ability to properly react, ultimately leads to how fruitful the crop is that year. Regardless of how great the yield is in any given year, that result does not necessarily make one a good farmer. An excellent farmer is someone who uses their knowledge, work ethic, skill and process to grow productive crops over a long period of time. As asset managers, that truth is not lost upon us. While we celebrate last year's crop, we remain laser-focused on being exceptional farmers.

Performance Year in Review

For much of the year, we felt an onslaught of exogenous events. The ability to understand and react is a key attribute of our process – determining when something is a temporary setback requiring only patience and when there is a permanent impairment to our investment thesis. We experienced some of both. For instance, the bridge collapse in Baltimore was a significant but short-term issue for Consol Energy, because they ship the bulk of their product out of a marine terminal there. We determined that was a temporary setback and an operationally proficient management team, so we held it. Or a contract dispute with a local government coupled with a discovery of unknown corrosive issues with a flame-retardant product that permanently impaired an asset (Compass Minerals). We decided these two events permanently impaired our intrinsic value calculation and thus sold it.

From a macro perspective, we experienced a stiff headwind from lower-quality, high-beta stocks leading up to the Fed announcing the start of interest rate cuts, which we believe was driven by folks that were short those stocks covering their positions. That was a storm we simply chose to wait out.

Over the last third of the year, the tides began to turn in part due to some of our decision making (although most of our adjustments were pretty minor), the operating prowess of the management teams we align ourselves with, and perhaps a little bit of luck. As an example of management prowess, our best-performing stock was Solaris Energy Infrastructure and was a result of management being opportunistic in acquiring a business that supplies large but portable power units. Their current units and those on order are scheduled to power new data centers being built for AI (we elaborate on that more below). We go into more detail in the contributor/detractor section below, but one last notable point on attribution – over 100% of our outperformance for the year was driven by stock selection, with our overweight to Energy leading to an overall 25 basis point drag from allocation.

Regardless of what this or future years throw at us, we feel pretty good about two things. First, we will continuously analyze new information and make decisions based on that new information, without emotional regard to past decisions (e.g., avoidance of anchor bias). Second, our performance over time is extraordinarily unlikely to be linear – we are farmers.

Stock Prices Disconnecting from Fundamental Business Performance

Something we have witnessed a great deal more often today than 25 years ago is the increasing disconnect between fundamental company performance and stock performance in small cap companies. Stated plainly, the smaller businesses that continue to operate at rates equal to or better than similar large cap companies, but whose stock prices tend to languish for extended periods of time, and then suddenly show massive outperformance over a short period of time. Certainly, the increase percentage of assets held in passive index funds is a culprit, but like most things in life no one thing explains it all. In fact, several of the companies we own are not included in any index. Our thesis to explain this was simply increased market inefficiency resulting from a 20-year trend of reduced research coverage in small cap (many of our holdings have no sell-side research coverage).

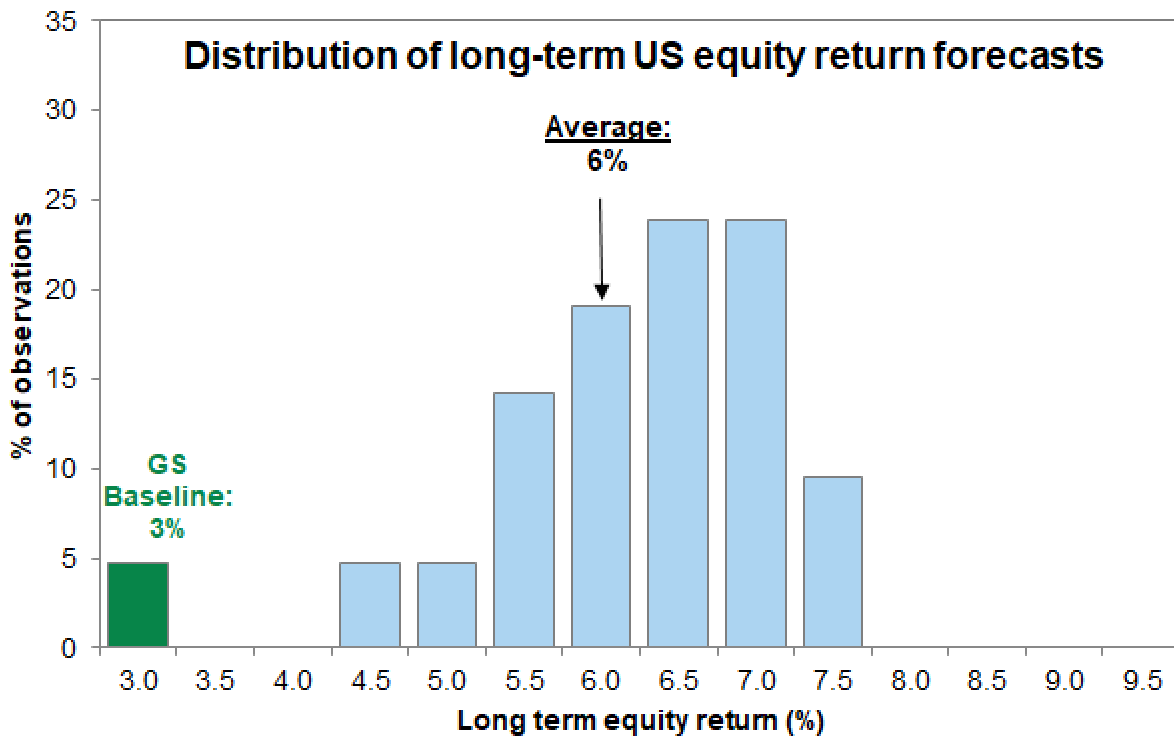
Recently we came across a Bloomberg article (by Sujata Rao, Denitsa Tsekova and Isolde MacDonogh) that explored this phenomenon. The article suggested that post-financial crisis, the biggest banks have cut their analyst pools by 30%. What the article does not mention, but we have witnessed, is that the remaining analysts tend to spend their time covering larger companies because those stocks trade more (e.g., more profitable to cover). There are several reasons for this trend we are happy to go into in more detail offline (Spitzer effect, decimalization, etc.), but the reality is information/research on small companies is less available today than 20 years ago. They cite several studies that point to the long-term underperformance of stocks with no/less research coverage to those with more coverage. In fact, a study by Steven DeSanctis at Jefferies showed that since 2001, companies covered by fewer than 10 analysts underperformed by 300bps/year.

So why not just own the stocks with more research coverage, right? Great question. What these studies do not show, but we have empirically witnessed, is that owning stocks with no to little coverage that ultimately gain coverage is where the real opportunity for outperformance resides. The inefficiency typically leads to a valuation discount, often significant, that ultimately gets unlocked. This typically occurs as a result of a business compounding its underlying fundamentals (revenue, cash flow) such that they ultimately get big enough that they need investment banks. They sell bonds, converts, acquire smaller companies, etc. That tends to be the catalyst for the banks to begin covering them, which often leads to sudden and dramatic outperformance. While stagnant returns of these stocks for periods of time can be frustrating and performance thus nonlinear, the ultimate total return upon experiencing the hockey stick

can be well worth it from our perspective and experience.

Asset Allocation to Small Cap Value

We have written extensively in the past about how we view the opportunity set for Small Cap Value relative to Large Cap Growth, so we will spare the audience the rehash, except to say that we believe there is enormous asymmetry in the risk. Candidly, most folks agree with us that there is likely to be a reversal at some point based on the performance and valuation dispersion. In fact, consensus appears to agree. Goldman forecasts the expected returns on the S&P over the next 10 years to be ~3%. In that same report, they surveyed 21 fund managers and got an average of 6%. Both are below the long-term average of ~10%. Morgan Stanley points to “roughly flattish” returns of 2%-3%. By the way, the “risk-free” 10-year sits at 4.8% as of this writing. Think about that for a second.



Source: Goldman Sachs Global Investment Research

The question we get most often focuses on the “when,” not “if.” While we can point to several potential catalysts we see on the horizon (likelihood of reduced regulation under a Trump administration, tariffs should benefit small caps versus large caps, and less restrictive M&A environment), we do not actually know this answer better than anyone else. That said, here is the framework for how we think about it.

Returns are born of basically two fundamental characteristics – how much a company earns and how much you are willing to pay for those earnings (e.g., the multiple applied). That is admittedly overly simplified, given one or both of those will likely be influenced by the rate of growth, the capital efficiency (e.g., RoIC), stability of earnings, dividends, etc. However, for the sake of this exercise, let us set that aside for just a moment. If you can accurately predict the level of the earnings on the S&P 500 10 years from now, and the multiple to apply to that, you are probably 90%-95% of the way there.

The long-term average on the S&P 500 is ~16, +/- 1-point either way depending on the timeframe and if you do cyclical smoothing like Case-Shiller. Notably, the S&P 500 currently trades at 25x earnings. While the Russell 2000 Value skyrocketed over the last year or so from ~10x to 32x, largely due to falling earnings from cyclicals, the Ballast strategy is at ~15x. If you believe multiples, in the short term, are driven by sentiment rather than pure fundamentals, as we do, then it is likely that multiples we eventually revert to the long-term mean. Said plainly, we believe the S&P 500 will face a 36% headwind at some point, something we believe our small cap companies should avoid, with the potential for a modest tailwind to the multiple.

But the earnings growth of the S&P 500 is likely to be higher due to more exposure to AI, right? Our answer – IT BETTER! Furthermore, we would argue that the earnings growth of 7 stocks – the companies in the S&P 500 directly benefiting from AI, is likely not going to be enough to support that multiple. From a risk perspective, consider this – one of those 7 stocks (Nvidia) is supplying the necessary products (e.g., chips) to facilitate AI, and the other 6 companies are its biggest customers. What could possibly go wrong? Furthermore, even if something does not "go wrong," we think to support that multiple you need something else to *go right*. What is going to drive that next thing?

Last point, the Return on Equity of a company is theoretically the cap on its earnings growth potential. The ROE of the Ballast portfolio is similar to the S&P 500. So even if we are no better at predicting the earnings of our businesses 10 years out, that consensus is in predicting earnings for the companies in the S&P 500. Not only is the risk heavily weighted in our favor, but the expected returns are also heavily weighted to our strategy.

Performance Attribution

The portfolio outperformed the R2V by 956bps in the 4th quarter, returning 8.50%. About three-quarters of the outperformance was selection while the balance was allocation. Stock selection contribution was broad-based across industries with only Materials and Real Estate underperforming. The biggest contributor to both stock selection and absolute performance was Energy, driven primarily by Solaris, but even without Solaris, our energy stocks would have outperformed both the index and the sector. In total, Energy contributed 341bps of absolute return and 363bps of relative return.

Fourth Quarter 2024 Contributors and Detractors

Top 5 Contributors	Ticker	Avg Weight	Total Return	Tot Return Contrib.
Solaris Energy	SEI	3.6%	126.6%	3.1%
Geo Group	GEO	2.5%	117.7%	2.3%
Climb Global	CLMB	5.7%	27.5%	1.5%
Turning Point	TPB	2.6%	39.4%	0.9%
Natural Resources	NRP	5.3%	14.3%	0.8%

Bottom 5 Detractors	Ticker	Avg Weight	Total Return	Tot Return Contrib.
Eagle Materials	EXP	2.9%	-14.1%	-0.4%
Brinks	BCO	1.7%	-19.6%	-0.4%
Green Plains	GPRE	1.0%	-30.0%	-0.4%
Bioceres Crop	BIOX	1.2%	-22.7%	-0.3%
Patrick Industries	PATK	2.1%	-12.1%	-0.3%

Solaris' entrepreneurial CEO/Founder acquired an adjacent business providing mobile electric power to oil infrastructure and data centers. Solaris transformed perception of it from an E&P services company to a data center play, which is hot with investors at the moment, to say the least.

GEO Group was another notable fourth-quarter contributor. The election played a large role in its outperformance because funding for ICE is likely to increase substantially, which was not part of our base case. This development unlocks several "free" options that, depending on the specific policy implementation details, could be substantial. In contrast to GEO, the election was a negative development for Green Plains because the new administration views the cost/benefit of renewable energy subsidies skeptically.

Excluding GEO and Solaris, the portfolio gained 3.2%, outperforming the index by over 400bps in the fourth quarter.

For the full year 2024, the portfolio returned 14.6%, outperforming the Russell 2000 Value by 663bps. Stock selection contributed more than 100% of the return, offsetting slightly negative sector allocation. Similar to the fourth quarter, contribution from stock selection was broad-based with only 2 sectors underperforming.

Full Year 2024 Contributors and Detractors

Top 5 Contributors	Ticker	Avg Weight	Total Return	Tot Return Contrib.
Solaris Energy	SEI	2.8%	277.4%	4.6%
Climb Global	CLMB	4.2%	133.3%	4.3%
GEO Group	GEO	2.0%	137.9%	2.6%
Intl. General Ins.	IGIC	2.5%	92.2%	1.8%
Phinia	PHIN	3.1%	62.6%	1.5%

Bottom 5 Detractors	Ticker	Avg Weight	Total Return	Tot Return Contrib.
Green Plains	GPRE	1.6%	-62.4%	-1.7%
Bioceres Crop	BIOX	1.8%	-55.7%	-1.4%
Compass Minerals	CMP	0.7%	-67.3%	-1.2%
Teradata	TDC	2.6%	-28.4%	-1.0%
Kosmos Energy	KOS	1.5%	-49.0%	-1.0%

Materials were the biggest detractor on a relative and absolution basis, largely due to Bioceres facing temporary weather issues and more permanent problems at Compass Minerals. We exited Compass because approval for its flame-retardant business was revoked and new government regulations that stop it from leveraging its existing infrastructure to extract lithium.

Energy was the largest relative and absolute contributor, adding 338bps on an absolute basis and 376bps on a relative basis. Solaris was by far the biggest driver, posting a total return of 277%, which more than offset underperformance by Green Plains and Kosmos.

Portfolio Additions

Hillman (HLMN) is a building products supply company primarily centered on stocking fasteners at home improvement retailers. Hillman's competitive advantages of scale, infrastructure and reliable service sustain strong margins and returns. Its customers value Hillman because it keeps fasteners in stock and organized, which is critical to pulling through larger, higher-value retail transactions. Additionally, fasteners are cheap in the context of total project costs, making it easier to pass cost inflation on to final consumers. Furthermore, management is laser-focused on returns and return on invested capital is being added to its executive incentive compensation plan, which will further align executives and shareholders.

Existing home sales are a major demand driver, and despite falling to multi-decade lows, Hillman has consistently grown its earnings. In our base case, which does not assume a significant recovery in existing home sales, we estimate the stock can more than double over the next 3 years. We think the market does not fully appreciate Hillman's unique position and competitive advantages because it was owned by Private Equity and came public overleveraged via SPAC. Since then, execution has been strong and leverage improved to 2.8x at 3Q24 from 4.7x in June 2022. As the balance sheet strengthens, it is likely to pursue acquisitions, which historically have been highly accretive.

Metallus (MTUS) is a Steel producer that spun off from Timken in 2014. Metallus utilizes EAF (Electric Arc Furnace) technology, which melts scrap steel and then reprocesses it to be used in new products. The company has gone through significant restructuring and focused on ROCE targeting 15% to 17% through the cycle. The company's balance sheet is pristine ($300MM in net cash). Metallus should benefit from infrastructure spend (more macro) but also have a significant ramp in their defense business (highest margins) that will provide some non-cyclical tailwinds to their business over the coming years. Additionally, the company continues to try to improve their product mix into higher value channels and was part of their significant restructuring and strategy shift after the spin-off from Timken. The stock is trading at what we believe is a mid-cycle multiple on trough earnings with significant operating leverage to the cycle. We expect that the company will generate over 50% of their Market Cap in cash with a significant portion of this cash earmarked for shareholder returns through the next cycle. Additionally, the company is trading at a significant discount to replacement cost (> $2 BLN versus current EV of $410MM).

Ingles Markets (IMKTA) operates 198 grocery stores within a 280-mile radius of its distribution center near Ashville, NC. It has a dominant market position (average 33% market share) and in most markets it has three or fewer competitors. Store density, solid execution and buying up much of the suitable real estate in its territory make it hard for others to compete. For instance, Piggly-Wiggly mostly exited the region. Despite reinvestment in the large, lazy real estate portfolio, ROIC has run well over 15%.

It is very cheap, trading at less than 80% of book value. In economic terms, it is even cheaper because its real estate is carried at historical cost, about $500 million. Lease earnings from third parties exceed $25 million, which at prevailing cap rates values the leased land alone at more than $300 million. We estimate its total real estate is worth roughly the current market cap.

It is so cheap for two temporary reasons. First, revenue and margins have been declining for 2 years as the 2020-2022 boost from C19 normalizes. Second, hurricane Helene hit it hard. Operations (including card payment processing) were disrupted for several weeks, it wrote off approximately $40 million of inventory and property damage (non-cash and more than half of which is likely covered by insurance), and three stores are closed pending repairs of uncertain duration. We estimate C19 normalization is mostly complete, and that earnings power will return to a normal run rate over the next 12-18 months.

Although the current quarter is likely to be terrible, our downside is protected by a pristine balance sheet, the massive discount to asset value, and our 5x EV/EBITDA and roughly 10% FCF/EV estimates for 2026. Furthermore, controlling shareholder Robert Ingles' economic interests are well aligned with outside owners.

Terex (TEX) is a leading global manufacturer of material processing and waste handling equipment, and aerial work platforms, with top one or two market positions in most of its segments. ROIC is a significant component of management compensation, which is reflected in cost control, portfolio reshaping and shareholder aligned capital allocation. The stock's 14% earnings yield reflects cyclical fears and a very stale consensus. Neither 4Q24 estimates nor subsequent years have been updated for the acquisition of Environmental Service Group (ESG), a manufacturer of garbage trucks, waste and recycling equipment, which closed in October 2024. We think part of the undervaluation relates to bad data in quant models and inattention from fundamental investors anchored on the old TEX. There are three other reasons we think it is undervalued:

First, the market appears to completely ignore the impact of divesting the most cyclical parts of the portfolio over the last decade. Prior to C19, the worst y/y sales decline for businesses it still owns was 8%, in 2016 during the mid-decade industrial slowdown. That is less than half the 17% revenue hit for the divested segments. EBIT margin was 9% on the retained businesses versus -27% for the divested businesses. In 2020, sales fell 29% y/y to the LTM trough in 3Q20, however EBIT margin held at 5% and FCF/Sales was over 3%. The ESG deal further reduces cyclicality – adding 18%-20% more revenue that only declined 8% in 2020.

Second, the ESG acquisition increased leverage to nearly 4x Net Debt to EBITDA from about 0.5x. Although that is more than our normal 3x limit, it does not include 10 months of EBITDA from ESG, and it ignores reduced cyclicality and likely rapid deleveraging. Even in a recessionary scenario, we estimate it would remain under 4.6x ND/EBITDA, stay comfortably in compliance with covenants, and maintain EBIT interest coverage of nearly 3x. Base case, we expect debt paydown and EBITDA growth to bring leverage down to about 2.5x in 2025.

Third, the ESG deal looks expensive on the surface at 11x EBITDA. However, we estimate it will earn at least mid-teens ROIC once integrated and potentially more. The synergy targets look very conservative relative to typical industrial deals. With a new CEO, we suspect it is, more likely than not, an underpromise-overdeliver situation.

Consensus Cloud Solutions (CCSI) is a fairly straightforward story. The company generates most of its revenue from selling electronic fax capabilities. They have two revenue models – monthly subscription (most used in the Small and Medium-Sized Business space – or SoHo) and a transaction model used by their large Corporate customers. While fax has largely been thought of as a melting ice cube, there are several use cases where the security protocols inherent in sending a document via fax is still critical. This is particularly true in the Financial Services, Legal and Healthcare industries.

The company was originally spun out of Ziff Davis (formerly J2 Global) where it started as an electronic fax roll-up of an extremely fragmented industry. Under the leadership of Scott Turicchi (current CEO of CCSI), J2 was able to become the market leader in electric fax (primary brand is eFax) and leveraged an efficient asset base to expand EBITDA margins to >50% with exceptional returns. Ziff Davis used most of the cash flows from the fax business to build out a digital media business. Now that the two are separate entities, CCSI is focused on adding ancillary services to its fax business and shifting its focus from B2C to B2B, primarily targeting the Healthcare industry.

During the spin-off, CCSI was saddled with a hefty amount of debt, $800 million. Since the spin-off in 2021, market value dropped about 60% and EV was cut almost in half. Revenue stalled and churn increased as it shifted to B2B from B2C. Notably, the sales cycle in B2B is 6-18 months versus less than a month in B2C. However, B2B ASP is about 20x B2C and B2B is now about 70% of total revenue. As a result, we estimate revenue will start growing again in the next few quarters, at which point we expect the stock to re-rate reflecting its fantastic ROIC and reduced leverage. The company is paying down ~$100mm/year, which should reduce leverage to less than 3x in 2025. With just the slightest top-line growth, we estimate the stability and visibility of revenue and cash flow justify a mid-single digit FCF yield. Given that it trades at about a 20% FCF Yield, the stock could more than double on valuation alone.

Regards,

Ballast Asset Management

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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]Account returns are presented both gross and net of management fees. All account returns are net of transaction costs and gross of non-reclaimable withholdings taxes, if any, and reflect the reinvestment of dividends and other earnings. Monthly composite returns are calculated by weighting each account's monthly return by its relative market value. All returns are expressed in US dollars. **Past performance does not guarantee future results.**

The gross performance results presented do not reflect the deduction of investment advisory fees. Actual returns will be reduced by such advisory fees and other expenses as described in the individual contract and, where applicable, Form ADV Part 2A.

Net performance results do not reflect the deduction of investment advisory fees actually charged to the accounts in the composite but do reflect the deduction of a model investment advisory fee of 1.00%, which is the maximum advisory fee rate in effect for the respective time period. Actual advisory fees may vary among clients invested in the strategy. Returns for each client will be reduced by such fees and expenses as described in the individual contract and, where applicable, in Form ADV Part 2A.

[2] The Russell 2000 Value Index measures the performance of the smallcap value segment of the US equity universe includes those Russell 2000 companies with relatively lower price-to-book ratios, lower I/B/E/S forecast medium term (2 years) growth and lower sales per share historical growth (5 years).

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