



For the second quarter of 2025, BAM's strategy returned 3.7% gross and 3.4% net of fees versus 5.0% for the Russell 2000 Value. Given the portfolio's quality bias and relatively low tariff risk, we expected better. However, it is neither surprising nor concerning that strong, improving fundamentals were insufficient to offset market turmoil in such a short measurement period. For the prior 12 months, BAM returned 12.2% gross and 11.1% net versus 5.5% for the Russell 2000 Value.

Performance		Yearly Returns								Annualized Returns*		
		2018	2019	2020	2021	2022	2023	2024	LTM**	3 Yrs	5 Yrs	Inception
Ballast Portfolio ¹	Gross	-2.2%	16.1%	12.5%	41.8%	-13.3%	18.6%	14.7%	12.2%	11.4%	16.3%	11.5%
	Net	-3.2%	15.0%	11.4%	40.4%	-14.2%	17.4%	13.5%	11.1%	10.3%	15.2%	10.4%
Russell 2000 Value ²		-12.8%	22.4%	4.6%	28.2%	-14.5%	14.6%	8.1%	5.5%	7.5%	12.5%	8.1%
Alpha (net of fees)		9.6%	-7.4%	6.8%	12.2%	0.3%	2.8%	5.4%	5.5%	2.8%	2.7%	2.3%

*Annualized 3-Year, 5-Year and (since Inception performance start date 10/01/15) returns reported through 6/30/25

**LTM Performance from 6/30/24 through 6/30/25

We waited a little longer to get our quarterly update out this quarter because, frankly, we did not feel we had a lot to add to the topics de jour. We have written extensively about tariffs and our positioning and do not have a unique perspective on when/if the Fed will cut rates. We thought it was more important this quarter to provide current fundamental data from our owned companies, along with their outlooks coming out of earnings reports. Also of note, we were particularly active in the quarter buying new businesses as the tariff tantrum in April allowed us to pull companies from our Wish List (companies that we have previously underwritten and have "buy at" price targets) at attractive valuations.

Now that earnings season is about over for us, we can share that our companies outperformed expectations quite handily – 82% beat consensus earnings estimates this quarter, compared to 68% for the Russell 2000 (according to Furey Research's report on August 7). While we cannot control performance of the stocks we own, especially in the short term, our research efforts should be able to evaluate whether our companies are executing relative to expectations at a higher percentage than a broad, passive index. We believe this is a better measuring stick to access how well we are doing our jobs as fundamental analysts rather than stock price movements – particularly in the short to medium term.

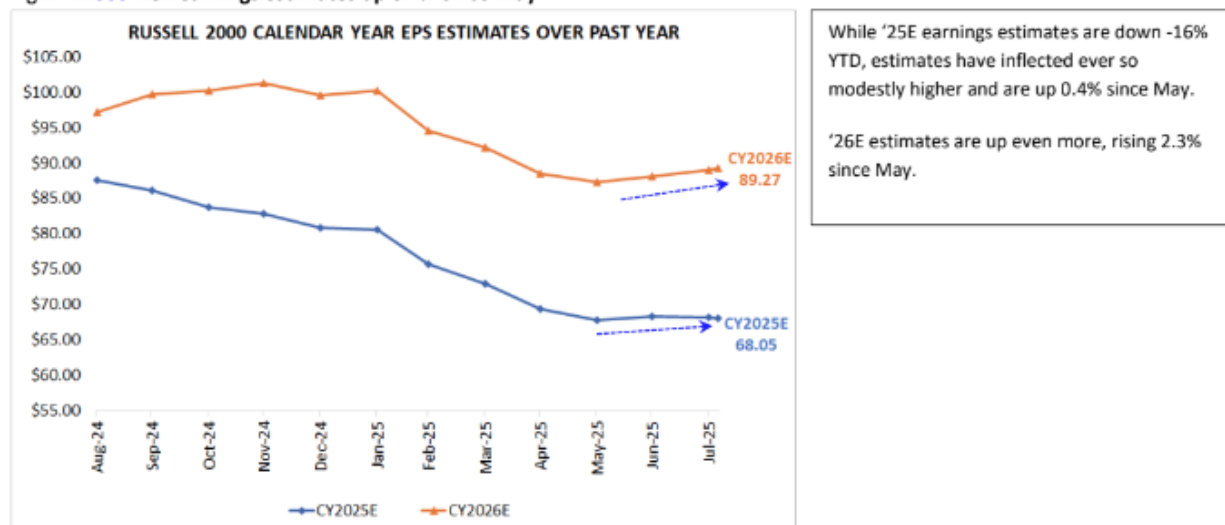
Is Small Cap Value *finally* ready to outperform?

We get asked that question a lot. We have written several pieces on the historic nature of the disconnect between LCG and SCV, most of which you probably know at this point – historic valuation differential, etc. One new consideration that we got from a research report from Furey Research shows the expected growth in earnings and sales for small caps versus large caps. We had two important takeaways from the data.

- 1) EPS estimates for the Russell 2000 have inflected higher after a prolonged period of downward revisions and
- 2) Earnings growth expectations for small caps are much higher than large caps for 2025 and into 2026 than large caps.

The chart below (again from Furey Research) shows the trend in earnings estimates over the last year. While the upward revisions over the last couple of months are a modest 0.4%, it is a notable change in the trend since last fall. Moreover, we believe it is much more likely that we will get multiples to revert to historical means in an environment when earnings revisions are positive than negative.

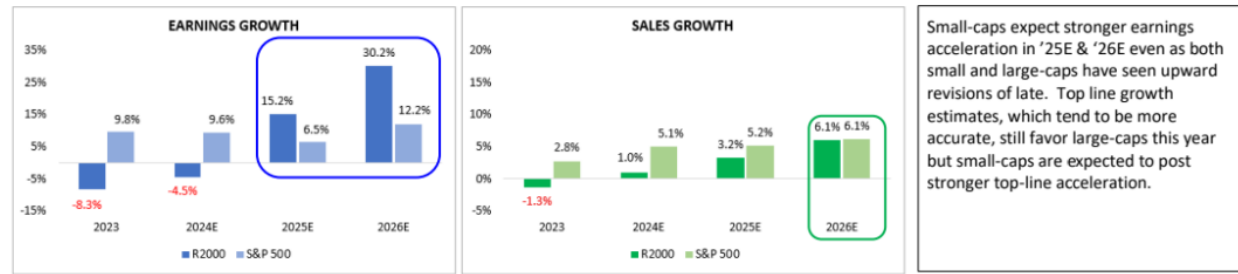
Fig 2. **R2000 '25E earnings estimates up 0.4% since May**



Source: Furey Research Partners and FactSet. Based upon current constituents using our capitalized loss earnings model. Data as of 8/5/25.

In the following chart, one can see the dramatic difference in expected earnings growth both this year and next. We believe this growth differential should lead to a collapse in the valuation differential between the two. While Furey correctly points out that sales estimates tend to be more accurate than earnings, and that sales growth estimates for both are similar, the **rate of change** for small caps is significantly higher. If you are looking for a catalyst for small caps to begin outperforming, these are important metrics to watch.

Fig 4. R2000 '25E & '26E earnings growth expected to outpace large-caps



Source: Furey Research Partners and FactSet. Based upon our capitalized loss earnings model. '25E and '26E based upon current constituents. Data as of 7/29/25.

Index Fundamentals Continue to Deteriorate

We have written extensively with the Zombie problem of the Russell 2000 Value – companies that do not make money and whose operating income does not cover their interest expense – along with the debt levels overall ([Fear the Zombies](#)). A more recent observation is that the Returns (Return on Assets, Return on Equity, etc.) of the index are both poor and getting worse. Based on our calculations, the ROA of the Russell 2000 Value index is 0%. If you have followed us for a while, you no doubt have heard/read our argument about why traditional “Value” as defined by the typical Fama French doctrine (cheap Price/Book) is outdated due to the increasing importance of intangible assets. We are increasingly convicted about the importance of evaluating these intangible assets when determining the quality of business and its ability to sustain and grow earnings and cash flow ([Intangibles](#)).

Portfolio Additions

Bank of Ozark (OZK) – Bank of Ozark is community bank that has carved out a national specialty niche in commercial real estate development loans, where they originate and hold loans and punch way above their weight. This focus and the market’s concern about the health of the commercial real estate market has weighed significantly on the company’s stock price, given their large exposure to CRE. The founder-led CEO’s capital allocation mentality is pervasive through the bank. While much of Wall Street is worried about some of the concentrated commercial real estate exposure, the CEO would tell you that within our development niche that is where excess returns exist. We are obviously very concerned about commercial real estate loan exposure, but not all commercial real estate is the same. OZK focuses on development of real estate with top developers and strong financial backers. They implement strict compliance guidelines that require capital contributions from the sponsors when they are out of compliance. Loan to Value ratios tend to be much lower in development. OZK entered into the construction lending business in 2003 and its track record has been stellar. After the GFC, because they were relatively unscathed, they developed deeper and new relationships with many of the larger financial sponsors within real estate development. Notably, with real estate development the underwriting tests loans to a substantial increase in interest rates (500bps) on the front end. While transactional Commercial Real Estate loans are already operating, loans are based upon the prevailing appraisals with much less scrutiny over a change in environment. Additionally, since development lending supports new real estate, these projects are likely more desirable than older commercial real estate in more traditional commercial real estate transactions. OZK provides more detail down to the individual loan than we have seen from any public bank, which in part they have

to because their business model is concentrated in much fewer loans than most banks. The bank has consistently had the lowest charge-offs while having among the best efficiency ratios within the industry (benefits of concentration). Given what we believe are overblown concerns, we were able to purchase the bank at near tangible book value (with reserves that are conservative), for a bank that should be able to consistently post low teens ROE.

Bruker Corporation (BRKR) – Bruker is a leader in high-end scientific instruments and holds the #1 or #2 position in 70% of its portfolio. The Founder's son is the current CEO and owns 27% of the company. The CEO is very forward-thinking and thinks in years and decades not quarters, which does not always line up with Wall Street. The CEO is looking at positioning the company in the Post-Genomic Era – multiomics and spatial biology. Bruker has been plagued by two main issues: (1) A 1.8 BLN string of acquisitions in 2023 and 2024 that are diluting returns in margins in the near term and (2) Uncertainty as to the impact from their exposure to academic funding (although most of it outside the U.S.). While Bruker's returns and margins have deteriorated, we believe the primary issue is related to cyclical (increasing rates weighed on commercial investment in biotech as well as the government funding concerns) and internal investments in acquired companies that are currently subscale, while the market has taken the view that the returns and margins are structurally impaired. Bruker historically indicated a 20% ROIC threshold on acquisitions, which is much higher than peers and speaks to their focus on margins and returns. From 2015 to 2022, BRKR was able to increase their operating margins from 13.3% to 20% as organic growth and product mix drove most of the improvement over the time period. This backdrop has provided a very favorable reward/risk setup and an opportunity to participate in an industry vertical that rarely meets our valuation criteria.

Cabot Corporation (CBT) – Cabot produces Carbon Black, which is used in a variety of products but predominately in tires. This is an industry that has gone through significant consolidation/rationalization as the costs of dealing with the environmental impacts have escalated. This rationalization of capacity along with demand growth has led to better pricing over the years. During that time, Cabot has been at the forefront of ESG by using co-generation to dramatically reduce their carbon footprint, which puts them on stronger footing both in the U.S. and Europe. Notably, they export 200% of the energy they import as a result of these co-gen efforts. Also of note, management compensation lines up very well with what we want – a combination of EPS, Return on Net Assets and Free Cash Flow, which shows in the results since the CEO took over in 2016. As a result, ROIC has increased significantly, largely led by a 20%-40% increase in their Asset turns. The cost of building a new Carbon Black facility has increased dramatically and the ability to get permitted for that facility is even more prohibitive. Also of note, Electric Vehicle tires wear out faster than those on Internal Combustion Engine (ICE) vehicles due to their weight, which should lead to sustainable higher growth in demand. Finally, most of Cabot's sales go into replacement tires rather than tires for new vehicles, offering a buffer to the cyclical aspects of the business.

Collegium Pharmaceutical (COLL) – is a special pharma company with a legacy in pain management drugs. They are particularly known for their Extended-Release technology that helps prevent abuse of pain medication. We have owned the stock before but sold it after becoming disenchanted with the former leadership of the firm. The reasons we repurchased the company include: 1) a new CEO that we believe has more experience in commercializing drugs, 2) better capital allocation framework and discipline, and 3) a new drug that utilizes extended-release technology for ADHD medications. The specific value proposition of this new drug (called Jornay PM) is taken at night. Other ADHD medications are taken in the morning, and many folks (particularly parents) complain about the period of time between waking up and when the drug takes effect. With Jornay PM, the individual wakes up already experiencing the drug's benefits, which has led to smoother mornings for all parties involved. We purchased the stock with a free cash flow yield of >20%.

Donaldson (DCI) – a global leader in filtration solutions that offers cyclical upside with much less downside risk than a typical cyclical. There are three reasons we think it is a bargain. (1) Revenue chugs along at about GDP+, but the market wants tech-sized growth rates. (2) Softness in industrial and automotive end markets are a headwind. To us, this is a positive feature in the sense that it is already priced in and we can be patient for the eventual upturn. (3) Analysts have concerns about its investments in life sciences and bioprocessing. It is too soon to judge the outcome and, given the company's track record and that ROIC is an important component of management compensation, we are confident it was a good bet up front. Downside is protected by Donaldson's strong competitive position, 65% of revenue from more stable aftermarket sales, solid balance sheet with significant liquidity, and consistently high returns, for instance, during COVID-19 and the industrial slowdowns of the 2010s, it still earned ROEs in the 20%-30% range.

Merchants Bancorp (MBIN) – is a bank out of Indiana that is unique in several ways. Merchants has a large mortgage warehouse financing business with short duration, low-risk loans (~90 days) that depend more on transaction volume than pure interest rate spreads (Net Interest Margin). They operate primarily in multifamily housing space, including within the affordable multifamily housing space. These types of loans have unique complexities that allow the company to differentiate itself, which it has used to grow to the third-largest multifamily affordable lending company in the U.S. While higher interest rates have had a dampening effect on growth, the housing shortage in the U.S. serves as a tailwind for this business. Furthermore, any action by the Fed to reduce interest rates should lead to higher transaction/origination volume in a boost to their growth. Finally, management are significant owners of the business, with insiders holding 38% of the outstanding stock (and they continue to buy). We purchased the stock trading at 85% of its book value, which we find particularly compelling given its history of generating Return on Equity in the 20%-25% range (most banks operating in the low teens).

Performance Attribution

In the second quarter, the portfolio underperformed the Russell 2000 Value, returning 3.7% gross (about 130bps behind the index). Sector allocation was about 330bps tailwind, more than completely offset by security selection.

Second quarter's top and bottom contributors are as follows:

Company	Ticker	Avg Weight	Total Return	CTR (bps)
Solaris Energy Infra.	SEI	3.7%	30.6%	108
Turning Point Brands	TPB	3.6%	27.6%	91
Bel Fuse	BELFB	2.8%	30.6%	86
Ecovyst	ECVT	2.1%	32.7%	62
RCM Technologies	RCMT	1.5%	51.1%	59

Company	Ticker	Avg Weight	Total Return	CTR (bps)
Cavco Industries	CVCO	3.4%	-16.4%	(61)
Geo Group	GEO	2.6%	-18.0%	(51)
Nat. Resource Part.	NRP	5.5%	-7.3%	(43)
Hillman Solutions	HLMN	1.6%	-18.8%	(36)
Kosmos Energy	KOS	1.1%	-24.6%	(35)

We allocate to sectors based on our bottom-up security selection. Financials, REITs and Utilities are relatively undifferentiated businesses with limited prospects for above-market ROIC and as a result our 18.5% allocation was 60% lower than the Russell 2000 Value's 47.6% weight, which was a 100bps tailwind this quarter.

Technology is one of the portfolio's largest overweights (15.3% weight versus R2KV's 6.4%), which was also the largest contributor from an allocation perspective (+187bps) and largest drag on selection on performance (-206bps). The technology sector was the best performing sector of the R2V by far returning 26%:1, while the portfolio's tech exposure gained 11.8%.

Industrials was the next largest detractor to performance with security selection (-170bps) where both Hillman and Geo Group were down roughly 18%. Hillman was down on tariff fears, which we believe was misplaced and subsequent to quarter end our belief was confirmed. Geo Group provides government services, particularly as it relates to Immigration Enforcement. While there have been additional contracts awarded, it appears that the market was positioning expecting a shorter timeline. In addition to slower than expected awards of new contracts, the negative media given the immigration has become a very divisive issue and likely weighed on the stock as well. Subsequent to quarter end, GEO was able to sell an underperforming asset tied to Oklahoma Bureau Prisons at a price that highlighted the significant discount to replacement cost GEO trades.

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.

¹Account 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.

²The 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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