Dear Friends and Clients,

The Covid-19 virus has created an unexpected shock not only to the financial markets, but to all of our lives. We hope that you and your family are safe and healthy.

Although the year started out strong, with the Russell 2500 Value index up 1.19% on January 16th, investor optimism and hopes for continued economic growth for the year were quickly dashed with the social and economic impact of Covid-19 and the equity markets sold off dramatically. The Rewey Asset Management composite returned a -37.45% performance in 1Q20, vs. -34.65% return for the Russell 2500 Value index.[1]

Market Commentary

Reflecting back on the beginning of the year, the markets were poised for continued strong performance. 4Q19 U.S. GDP grew 2.1%, U.S. Unemployment reported in February continued at an extremely low 3.5% rate, U.S. Average Hourly Earnings grew 0.3% in February and New Private Housing Starts grew to a 1.599 million annual rate in February. However, these positive data reports are now essentially meaningless, as the economic landscape changed dramatically with the 'shelter in place' orders. On March 28, reported initial jobless claims rose dramatically to 6.648 million compared to just 281,000 just two weeks earlier.[2] It is likely that jobless claims and other economic statistics will continue to worsen through April, as the nation hunkers down to flatten the curve.

The Policy Response

The U.S. Federal Reserve and the Federal Government have responded to the economic weakness with the approval of substantial stimulus actions. The Federal reserve cut its target Fed funds rate twice in March, for a total of 150 basis points, to a targeted range of 0.0% to 0.25%, removing all of the increases post the financial crisis of 2009. Then on March 23rd, the Fed went further with a massive program of quantitative easing that includes unlimited buying of treasury and mortgage securities, 3 new Term Asset-Backed Lending Facilities, and expanded municipal debt and commercial purchases. Congress also passed the CARES Act on March 27th, a roughly $2 trillion package designed to keep individuals and businesses afloat and ready to resume operations quickly following the economic freeze.

While the hard stop to economic activity will likely yield worsening data, we believe it is more important than ever to keep one's emotions from driving investment decisions and to maintain a disciplined long-term investment plan.

2 Weeks, 2 Months, 2 Years

In our view, this downturn is unlike past recessionary downturns that were a result of cyclical excess, too much leverage and slowing economic activity. This mandated shutdown came at a point of a strengthening economic activity and a banking system that is very well capitalized. Thus, unlike past economic recoveries that needed to work through prior economic excesses, we think there is a strong likelihood that the announced stimulus, and potentially additional actions, can drive a fairly rapid restart to many secotors of the economy, once the shelter in place orders are lifted.

While none of us can predict when and at what pace an economic recovery can happen, we see investment opportunities that exist with companies that offer a strong balance sheet and long-term growth opportunities, and depressed valuations due to the anxious and uncertain times. We discuss this in more detail in our recent Market Musings blog entitled "2 Weeks, 2 Months, 2 Years" (https://www.reweyassetmanagement.com/post/2-weeks-2-months-2-years).

Our investment philosophy has always focused on the long term. Downside protection in the strength of both a company's balance sheet and business model are imperative in our investment process, as the long term always will have short-term periods of volatility. While the economic uncertainty may cause some investors to want to exit the markets and wait for greater clarity and certainty, doing so will likely result in missed opportunities to purchase attractive securities at currently depressed values.

Portfolio Highlights

We believe that our portfolio looks very attractive from a valuation and long-term stability perspective. Fourteen holdings are trading under book value and six additional holdings are trading at less than 1.5x book.[3] It is also worth highlighting that three of our names have no sell-side coverage, one has just one analyst following and four others have five or fewer covering analysts.[4] This anonymity provides us with the opportunity to identify companies that pass under the radar for other investors, and secure positions at attractive valuations.

At quarter-end, our cash position was at approximately 12.8%. Cash levels, as always, are a residual of our investment process, as we continue to invest in new and existing positions, and harvest from positions that are approaching our Assessed Fair Value (AFV) price targets.[5]

Construction Partners Incorporated (ROAD) was our top contributor this quarter. Construction Partners is a $865 million market cap company that that specializes in the construction and maintenance of roadways across Alabama, Florida, Georgia, North Carolina and South Carolina. As most of ROAD's business is geared towards repaving and maintenance, its revenues are highly recurring. ROAD continues to grow both organically and through acquisitions, and would likely be a major beneficiary of any action by congress to pass an infrastructure bill.

Callon Petroleum (CPE) was our worst performing holding in 1Q20. Callon shares sold off in line with the steep sell-off in oil prices, post the failure of Russia and Saudi Arabia/OPEC to reach a deal to renew and expand production curtailments. While we believe the fight between Russia and Saudia Arabia will resolve in a new agreement, the timing of this is unclear. For 2020, Callon is protected by hedges on roughly 70% of its production at approximately $50 per barrel, and has reduced capital expenditures in 2020 to conserve cash. With no debt maturities until 2023, Callon should be able to weather lower oil prices through at least the end of the year and we see Callon's share price recovering with improved oil prices once a renewed Russia/Saudi production agreement is reached. Still, like most U.S. companies, Callon is not currently able to cost effectively produce oil at the quarter-end price of at $20.48 per barrell.[6,7]

Never Waste A Crisis

With economic data weakening, consumers sheltering at home, unemployment rising and sales falling, it would seem that companies have little choice but to protect cash and hope they can outlast this crisis. While protecting their employees and their balance sheets are the appropriate first step, in our opinion management teams should not just hunker down, but instead proactively pull forward longer-term restructuring and resource conversion plans and execute on them in the near-term. Many companies are reluctant to take aggressive actions due to up-front costs that are recovered over longer periods. As most equities are now considerably off their recent highs and anticipate a slew of negative data, companies should not be concerned with implementing major restructuring or resource conversion actions, even if they have a short-term income statement cost versus a compelling longer-term return.

We see several opportunities in our portfolio companies where management teams can implement actions to show the underlying asset strength of their business that are not visibile from a strictly income statement analysis view. We offer a few examples below:

Weyerhauser (WY), in our opinion, should move to monetize a portion or all of its building products subsidiary, which has been strengthed dramatically through restructuring moves over the last few years. We think this unit could be spun out or merged with a peer company, as this manufacturing unit does not fit well with the larger timber REIT unit. Post a spin, WY would be an 11 million acre pure play timber REIT, with a compelling ESG profile of carbon capture and sequestration from the trees they grow. We profiled WY in our 2Q19 client letter.[8]

Webster Financial Corp. (WBS) should move to monetize part or all of its HSA Bank unit. We view the implied valuation of this unit as drastically below its closest pure play peer. The formal separation of HSA bank would free up management to compete more aggressively in this market, and demonstrate what we see as a very depressed valuation for Webster on a sum-of-the-parts analysis.[9]

Monarch Cement (MCEM) should monetize its investment portfolio of publicly traded equities and use the proceeds to repurchase its own shares as they now trade under book value, with over a 4% dividend yield. Monarch's balance sheet holds very little debt and is net cash outside of this investment portfolio, and in our opinion is in a strong position to weather the current crisis. Further, MCEM would likely be a major beneficiary of an infrastructure bill, so we would advise management to act with urgency on this move. We profiled MCEM in our 4Q19 client letter.[10]

ABM Industries

We took advantage of the market sell-off to add a position in ABM industries (ABM), a facility services contractor that provides janitorial servicing, air conditioning, engineering and lighting maintenance and other outsourced facility services to the commercial, industrial, and institutional customers across North America. ABM offers a highly stable and recurring revenue mix, a strong balance sheet and in our opinion a compelling valuation.

ABM has a very strong financial position, driven by its strong recurring revenue profile and its higly variable cost structure. While the shelter at home orders will clearly impact first half 2020 reported revenues and earnings, the lower payroll costs and the payroll tax holiday that are part of the CARES Act will likely provide an offset to lower revenues. In our opinion, ABM has the financial strength to endure this crisis as its trailing 12-month net debt to EBITDA ratio was 2.26x at its January 2020 FY1Q. Further, on March 24th, ABM pulled down its remaining revolving credit capacity, roughly $353 million, to further bolster is existing cash balance of $69.8 million at quarter end. ABM's book value as of Jan. 31, 2020 is $23.20, and as of fiscal year-end 2019 compounded at a strong rate of 9.76% and 8.42% over trailing 5-year and 10-year periods, respectively.

ABM's ability to grow looks compelling post the Covid-19 crisis in the shorter-term and equally compelling from a secular basis for the longer-term. Cleaning and janitorial services comprise over 60% of ABM's revenue mix, and these services should restart in full as soon as buildings and institutions re-open for service, even if they open at reduced occupancy levels. Further, a new normal of cleaning and sanitization could take hold as work resumes, which could lead to more intensive and more frequent cleaning services. ABM has also demonstrated good progress in cost control, with the successful execution of its 2015 "Vision 2020" cost reduction plan, and a follow on cost reduction initiative in 2018. We see continuing, if not more aggressive cost reduction opportunites for ABM stemming from its new human resources computer system implemented in 2019 and its new enterprise resource planning (ERP) system that is being implemented in 2020.

Longer-term, ABM's transition to focus on industry verticals versus services offered should allow more aggressive cross-selling opportunities from its large janitoral business into its smaller scale and new offerings such as parking services, equipment servicing and grounds maintenance. While the short-term visibility of ABM's results is unclear, investors that have the vision to look 12 to 18 months forward can see a healthy resumption of ABM's activites.

We have set our near-term AFV price target at $35, which is roughly 9x its January 31st trailing 12-month EBITDA levels. In our view, since this is the established level of operations ABM recently reported, it is not a major leap to see ABM returning to this cadence shortly post the resumption of economic activity. We see this $35 AFV target as very conservative, as it is 14.1% below ABM's February 6, 2020 level of $40.74, which leaves a margin of safety for a slower recovery in the economy or investor confidence. Our price target impies a 43.7% return opportunity from 1Q20's closing level of $24.36, before adding in the benefit of the quarter-end dividend yield of 3.4%, while book value support of $23.20 is down a modest 5%.[11]

Looking Forward

One phrase we have seen repeatedly come true over our 30-years of investing, is that 'they don't call it the unexpected because you see it coming'. The rapid onset of the Covid-19 virus and the economic damage was not a scenario anyone was likely discounting at year-end 2019. Even though the medical and economic near-term outlook are awash in uncertainty, in our opinion it is more important than ever to stay true to our investment philosophy which is based on financial strength, the ability to grow and discounted valuations.

With the bedrock of a philosophy that is rooted in the ability to survive periods of turmoil, investors can look past the current period of uncertainty and envision a resumed period of normal economic function. If investors purchase well financed companies that have the ability to risk time versus capital, (see our market musing https://www.reweyassetmanagement.com/post/risking-time-instead-of-capital) an exact time frame becomes less important. In fact, in our view, investors should act before full clarity emerges in order to capture deeply discounted opportunities.

Thank you for your continued trust and support. Stay safe and healthy and as always, please do not hesitate to contact us for client service, to discuss our commentary, or to simply opine on the market and stocks.

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1 Russell 2500 Value and 2500 Growth Index performance levels are sourced from Bloomberg.
2 US GDP statistics sourced from Bureau of Economic Analys. U.S. Unemployment data and U.S. Average Hourly Earnings data sourced from Bureau of Labor Statistics. New Private Housing Start data sourced from the U.S. Census Bureau.
3,5 All portfolio discussion is based off our model portfolio. Company financial estimates sourced from Rewey Asset Management proprietary analysis, and Bloomberg BEST company estimates. Historical pricing and company financial data souced from company 10Q and 10K

filings, and Bloomberg. Individual portfolios may hold slight deviations in position sizes and names held due to reasons including tax loss selling and our philosophy of investing newer portfolios over time that could lead to performance variations versus the model portfolio. Performance is unaudited. Past performance is no guarantee of future results.

4 Covering active sell-side analyst data sourced from Bloomberg.

6 Callon Petroleum financial data sourced from company press releases, 10-Q and 10-K filings and corporate presentations.

7 WTI oil price at 3/31/2020 sourced from Bloomberg.

8 Financial statistics for Weyerhauser (WY) drawn from its 2019 10-K, investor presentations and Rewey Asset Management proprietary analysis.

9 Financial statistics for Webster Financial Corp. (WBS) drawn from its 2019 10-K and Rewey Asset Management proprietary analysis.

10 Financial statistics for Monarch Cement (MCEM) drawn from its 2019 Annual Report and Rewey Asset Management proprietary analysis.

11 All financial ratios, statistics, and projections discussed in the ABM Industries Inc. (ABM) commentary are sourced from ABM's 10-K and 10Q filings, company press releases, company public conference calls and webcasts, company slide presentations and Rewey Asset Management proprietary financial analysis. Historical share price information sourced from Bloomberg.

portfolio and in aggregate may represent only a small percentage of the portfolio's holdings. Before investing or using any strategy, individuals should consult with their tax, legal, or financial advisor.

The Russell 2500™ Value Index measures the performance of the small to mid-cap value segment of the US equity universe. It includes those Russell 2500™ companies that are considered more value oriented relative to the overall market as defined by Russell's leading style methodology.