Blackwattle Global Quality Fund

Blackwattle Investment Partners

June 2024

About the Fund

The Blackwattle Global Quality Fund is a high conviction long only fund that aims to provide exposure to the highest quality companies in the world, trading at attractive valuations. The fund adopts an 'All-weather Quality' approach for investing.

Our approach recognises a company's persistent competitive edge and the durability of earnings power allowing for the compounding of capital over the business cycle.

Risk is managed through portfolio and stock exposure limits and process discipline.

Blackwattle Investment Partners

Blackwattle is a new generation, highly aligned, Australian investment manager investing in quality businesses and people.

Alignment
Shared staff ownership, zero personal trading, profit and personal salary reinvestment, and most importantly significant personal investment alongside our clients.

Quality
We aim to buy businesses that have a forward advantage, trustworthy aligned management, priced below intrinsic value.

Trust
We believe that honesty and transparency builds trust with our clients, stakeholders, and community.

Key Information

Fund Name	Blackwattle Global Quality Fund
Inception Date	May 2024
Typical number of stocks	20-35
Cash limit	10%
Cash Distributions	Semi Annually
Redemptions	Daily
Constrained Capacity	$10bn
Objective	The Fund aims to outperform the MSCI AC Net World (after fees and before taxes) over the long term. To deliver performance of 8-12% p.a over the long-term.

Investment Team

Sunny Bangia

18+ years' investment experience. Previously Co-Founder and Portfolio Manager of Antipodes Partners, and Co-Portfolio Manager of Antipodes Global funds and lead Portfolio Manager of Antipodes Asia Fund.

Edward Li

8+ years' investment experience. Previously Investment Analyst at Antipodes Partners (Global Strategies). Investment Associate at Colinton Capital Partners and Investment Banking Analyst at Macquarie Capital

Nicholas Tan

13+ years' investment experience. Previously Senior Investment Analyst at Antipodes Partners (Global and Emerging Markets) and at Platinum Asset Management

Fund Performance[1]

Blackwattle Global Quality Fund Performance (net of fees) as at 30 June 2024

	1 month	3 months	6 months	2 Years p.a.	5 Years p.a.	10 Years p.a.	Inception p.a[2]
Fund (Net)	4.89%	-	-	-	-	-	6.02%
Benchmark[3]	1.80%	-	-	-	-	-	3.70%
Active Return	3.09%	-	-	-	-	-	2.32%

[1] Returns are calculated after fees have been deducted and assume distributions have been reinvested. No allowance is made for tax when calculating these figures. Past performance is not a reliable indicator of future performance. Source: Apex.

[2] The inception date for the Fund is 2 May 2024

[3] MSCI AC Net World (AUD)

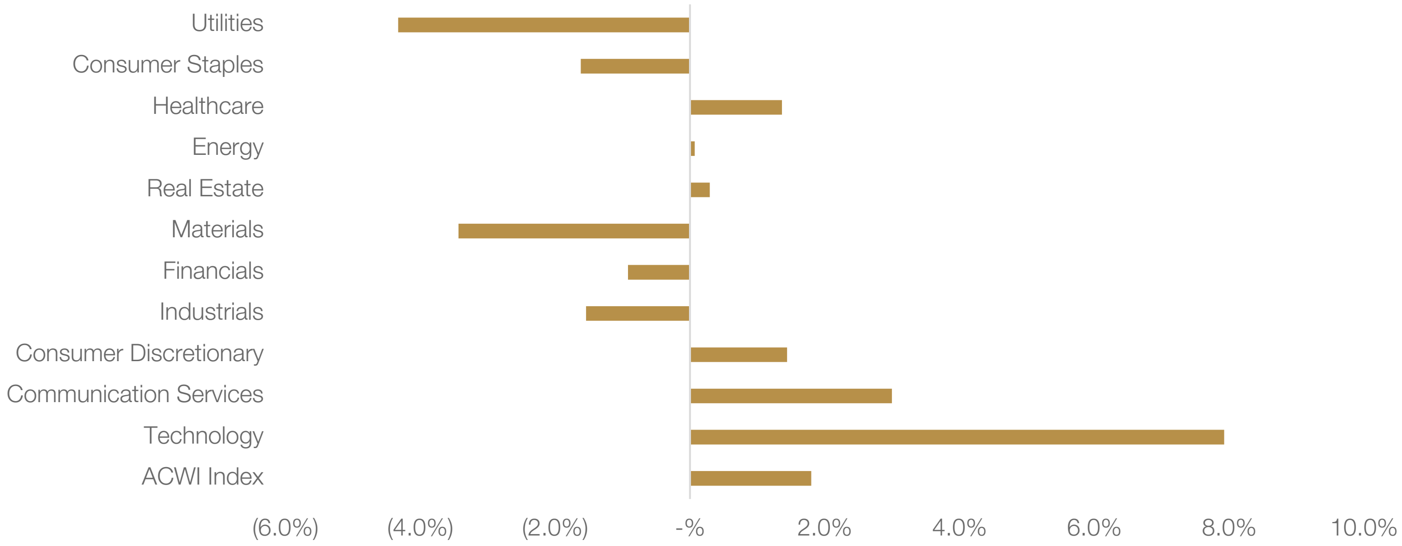
Top 5 Holdings

amazon | Microsoft | ASML | FICO | hemnet

Market Commentary

The MSCI AC World Index (AUD) was up 1.80% in June, primarily led by gains in the Global Technology, Communication Services, Health Care, and Consumer Discretionary sectors. Weakness in global manufacturing and the Chinese property market continued to overhang the Global Materials and Industrials sectors, while utilities notably underperformed due to yield concerns.

MSCI ACWI 1 month returns (AUD) (%)



Portfolio Commentary

The Blackwattle Global Quality portfolio outperformed the MSCI AC World Index (AUD) by 3.09% during the month.

Key Contributor – ASML

ASML manufactures lithography equipment which are the machines that produce computing chips out of silicon. ASML has approximately 90% share in lithography equipment globally.

ASML faced a momentary setback after 1Q24 bookings came in below expectations. This was likely due to TSMC, ASML's largest customer, still finalizing negotiations on orders. However, with TSMC's N2 node ramping up for mass production in 2025-26, the market is expecting for orders to come through 2Q/3Q this year.

Also earlier in June, ASML commented that TSMC will be receiving a high NA extreme ultraviolet (EUV) machine by the end of the year. Only earlier this year, there was belief that TSMC would not be adopting high NA EUV until 2030 or beyond. The recent news helped provide some confidence to ASML's product roadmap from its largest customer.

High NA EUV machines are estimated to cost €350m each, approximately double the cost of ASML's current low NA EUV machines. Adoption of high NA EUV machines would increase ASML's share of total capex spend in the semiconductor industry, which is a positive tailwind for the stock.

Key Detractor – LVMH

LVMH Moët Hennessy Louis Vuitton (LVMH) negatively impacted performance this month. As the world's largest luxury goods conglomerate, LVMH faced challenges due to a slower-than-expected recovery in the Chinese market and ongoing economic uncertainties in Europe. LVMH's diversified portfolio, spanning fashion, jewellery, cosmetics, and wines, helps buffer exposure to regional economic fluctuations. It also has the most profitable brands in the world. For example, Vuitton's 2023 estimated operating profits (€12bn) are more than Chanel (€5.9bn) and Hermès (€5.0bn) combined. The Dior Maison is also one of the fastest growing personal luxury brands over the past decade. Looking ahead, we believe LVMH will benefit from (1) continued market share gains, as the top brands continue to capture increasing share of the profit pool, (2) strategic acquisitions, which fills gaps in the brand portfolio; and (3) better profitability from eventual recovery in luxury spending.

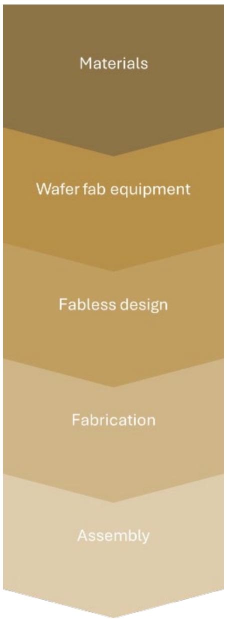
Portfolio Commentary and Outlook

With a lot of attention on Nvidia becoming the world's largest company, what often gets overlooked is that the company's success has been thirty years in the making and the company belongs to an industry that has been in a steady growth phase for decades. The industry we are referring to is semiconductors, and it consists of a diverse group of high-quality companies, but that was not always the case!

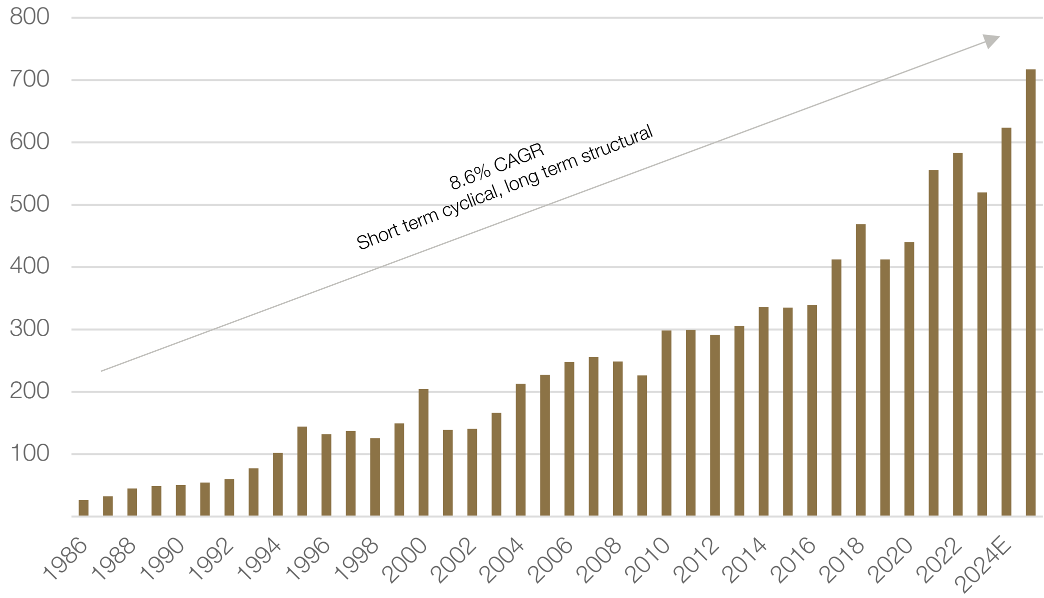
The industry's primary objective is to continue what is referred to as Moore's Law – double computing power every 18 months, this allows our current Apple iPhone to be more powerful than our desktop computers from the 1990s. The improvement in computing power has unleashed the ingenuity of humans to push technology to new frontiers. In the absence of Moore's Law from advancing, we must ask, what would our world look like? Thankfully, the technology advancements have continued, and the semiconductor industry has taken a larger share of the Global GDP and has grown at a steady 8% per annum in revenue since 1986. While the industry has long term structural growth, it is still a cyclical industry, and the industry experienced a downturn in 2023 coming off the COVID boom period. The current upswing is approximately one year into the cycle with total industry sales expected to bounce back to around USD$623 billion in 2024.

The semiconductor value chain consists of five segments with varying capital expenditure requirements and market structure. It is important to understand that these companies are capital intensive to varying extents and through the decades, the industry has consolidated due to rising capital intensity. With reduced to no competition, higher barriers to entry due to capital expenditure requirements, and research and technology advantages, this has led to pricing power with a backdrop of structural growth. As a result, many of the leading semiconductor companies have become significantly advantaged companies.

Semiconductor value chain



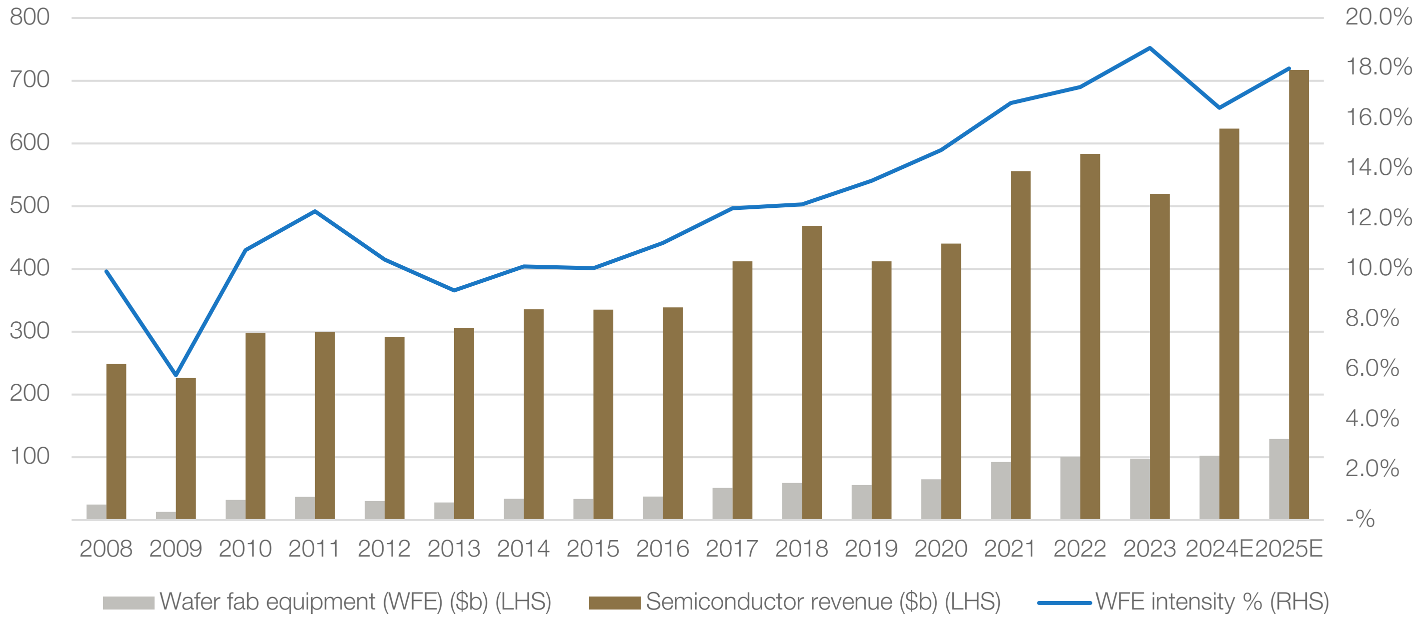
Total semiconductor industry revenue ($b)



Source: WSTS, Internal Estimates

The Blackwattle Global Quality Funds focus inside the semiconductor value chain is within Wafer Fab Equipment (WFE), Fabless Design and Fabrication. The reason for this focus is that this part of the value chain has taken a great share of the overall economics. The Wafer Fabrication Equipment companies provide highly specialized machine tools in the process of manufacturing semiconductors chips. For example, ASML manufactures lithography equipment which are the machines that produce computing chips out of silicon. ASML has approximately 90% share in lithography equipment globally. As we can visualize below, the WFE companies like ASML has seen their percentage revenue of the overall semi-conductor sales rise from 6% to 19%. The reason is that these companies' value-add is significantly higher than the materials or assembly section and these companies are pushing forward with Moore's Law.

Global Semiconductor Sales



Source: WSTS, Internal Estimates

While Nvidia catches much of the fanfare but for good reason, the WFE companies are enabling the technology improvements are some of the highest-quality monopolistic companies in the world, with very high returns on capital, structural growth and earnings that often get mispriced because the industry downturn creates opportunities, or their revenue take-rate have been underestimated for the past decade. The Blackwattle Global fund's exposure: ASML, ASM International, Taiwan Semiconductor Manufacturing and Lam Research.

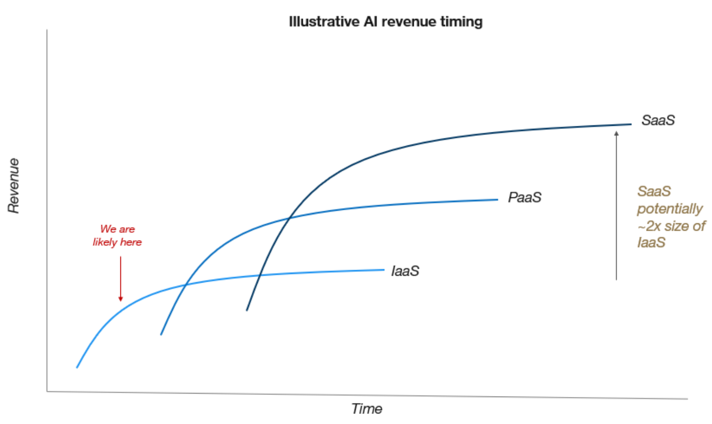
As debates around Artificial Intelligence (AI) have intensified over the past several months, Software as a Service (SaaS) companies, historically durable incumbents, have come under pressure. Market debates often lead to falling share prices or valuation de-rating amid rising uncertainty. In this case, a combination of slowing top-line revenue and the narrative that AI will reduce software development costs has led to a sell-off and de-rating of some dominant incumbents.

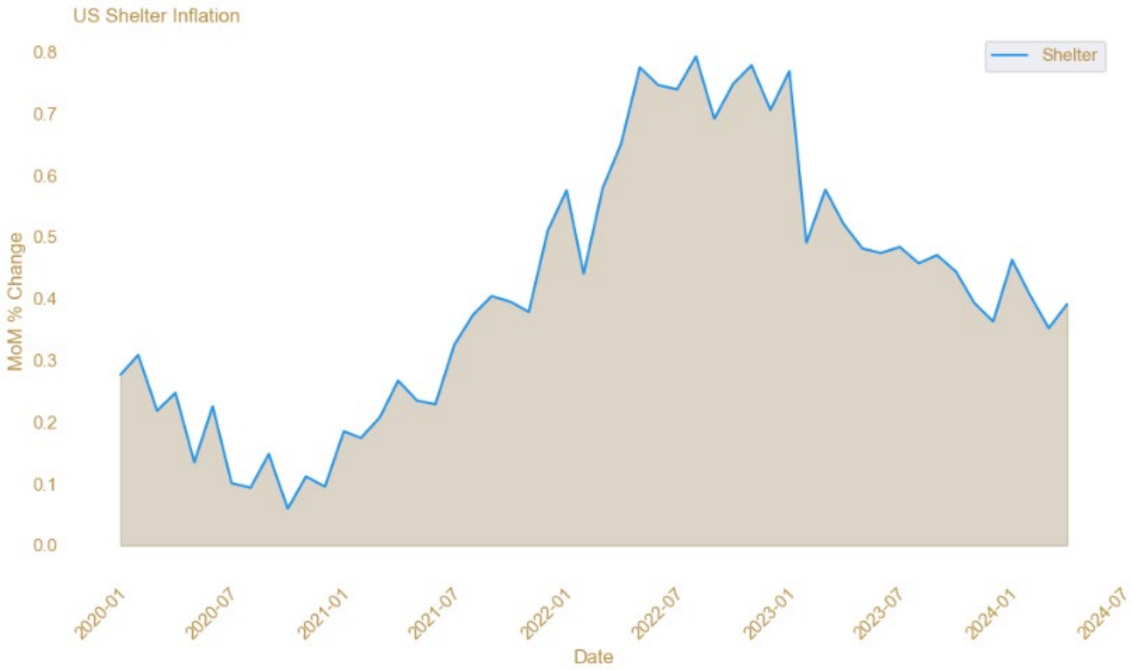
It's important to note that we are still in the early stages of AI revenue realization, with most benefits currently seen in the infrastructure layer. However, as AI features become integrated into existing software applications, we believe significant benefits will accrue to customers, favoring the dominant incumbents. These software companies are not standing still as they have been investing to become more AI enabled. Their incumbency within the enterprise software layer and the concept of data gravity give them an advantage. Customer Relationship Management (CRM) databases, where critical sales, marketing, and service records are maintained and connected to other industry-specific databases, provide enterprises with relevant data to enhance their customer sales/service processes. Many firms will need to consolidate their data silos, presenting opportunities for incumbents due to trust, security, data gravity, and ease. The sell-off in software companies has allowed us to build positions with dominant firms like ServiceNow and Salesforce.

SaaS currently represents the largest revenue category in the traditional (CPU compute workloads) cloud stack…

Cloud stack	2023 revenue ($USb)	% of total revenue
SaaS *(software as a service)*	**~$270b**	**43%**
PaaS *(platform as a service)*	**~$220b**	**34%**
IaaS *(infrastructure as a service)*	**~$150b**	**23%**
Total cloud	**~$640b**	

…which likely also translates to the largest opportunity in the AI (GPU compute workloads) cloud stack





Source: Bureau of Labor Statistics

Finally, inflation remains a focus for global markets, while central banks decipher each data point. The Federal Reserve is welcoming a reduction in the overall inflation rate. However, core services have been sticky, particularly in shelter. This paired with the uncertainty of health in the labor market has kept the Federal Reserve on a more hawkish stance. The conundrum leaves the Federal Reserve in a wait and see mode with the interest rate cycle. Notably, this has placed pressure on the US housing market where mortgage rates have moved to 15-year highs.

Despite the headwinds, Fair Isaac (FICO) has navigated the environment due to its unique business model characteristics. FICO assigns a score on the US household at point of debt origination (mortgage, auto, credit cards). With high interest rates, FICO's volumes have naturally come under pressure, but the company commands a 90%+ market share in credit scoring and charges $1 per loan.

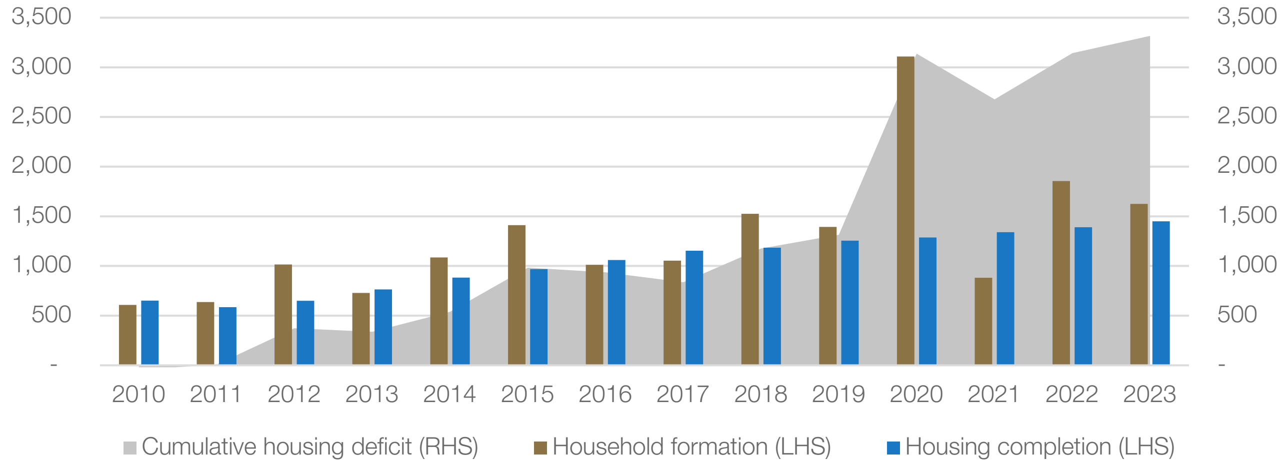
The value of the FICO score is immense to the system, it allows the financial institutions to uniformly assess credit risk, provides a standardized methodology for the Federal Reserve to assess credit risk and has become the default operating system for the US credit market. As a result, after 30 years of keeping prices flat, FICO has commenced price hikes in recent years, but the scores remain a minimal cost to the system often measured between 15-25 basis points of total origination costs with significant upside potential. The market has consistently underappreciated the pricing power of the business model and continues to do so, with an additional tailwind if there was a recovery in US household debt (which has tended to grow at 5-6% per annum). FICO's ability to double pricing remains highly probable as its starting cost position is very low.

The Operating System of the US credit system

Source: FICO Presentation

While talking about the Global Financial Crisis (GFC) seems like a long distant memory, today, we are still observing the aftermath of the US housing collapse of 2008-09, with tight credit standards and lack of build of US homes. Over the past 14 years, has been a significant under-supply of US homes when you compare US household formations versus US housing completions. To some extent, this has been necessary to clean out the excess inventory in the system but today, US housing completions are under-shooting US household formation, so we are not keeping up with replacement demand. The Federal Reserve must control inflation as per its dual mandate, but higher rates have kept supply from meeting demand, pushing up US home prices and possibly in the future leading to higher shelter inflation. Regardless, the situation remains favorable for the industry dynamics and while that part of the market has come under pressure due to higher rates, the industry needs to build more homes providing favorable structural opportunities for the building material and construction sectors.

US Housing Cumulative Deficit 2010-23 ('000)



Source: Census Bureau, National Association of REALTORS, Internal Analysis

Thank you for investing alongside us,

Blackwattle Global Team

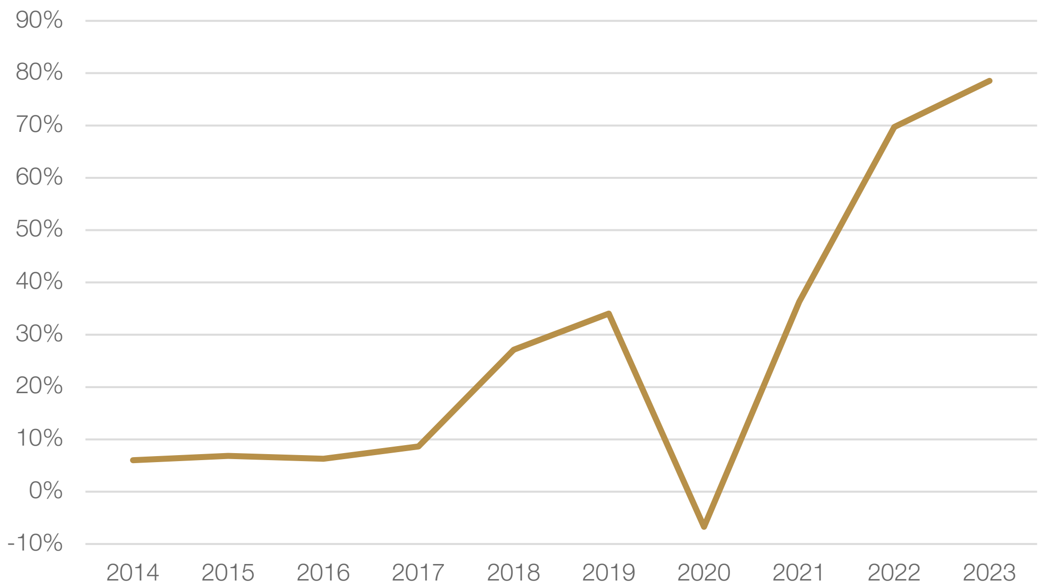
Feature Stock – Hilton Worldwide Holdings

"The best business is a royalty on the growth of others, requiring little capital itself." – Warren Buffett

Warren Buffet discussed this timeless mental framework which still rings true in the current environment. Hilton Worldwide Holdings (Hilton) is a revenue royalty business, whereby it earns a royalty revenue on the growth of global travel spend. Hilton's extensive and growing network of brands and properties offers a significant and self-reinforcing value proposition to both guests and hotel owners, which creates a competitive moat around the business.

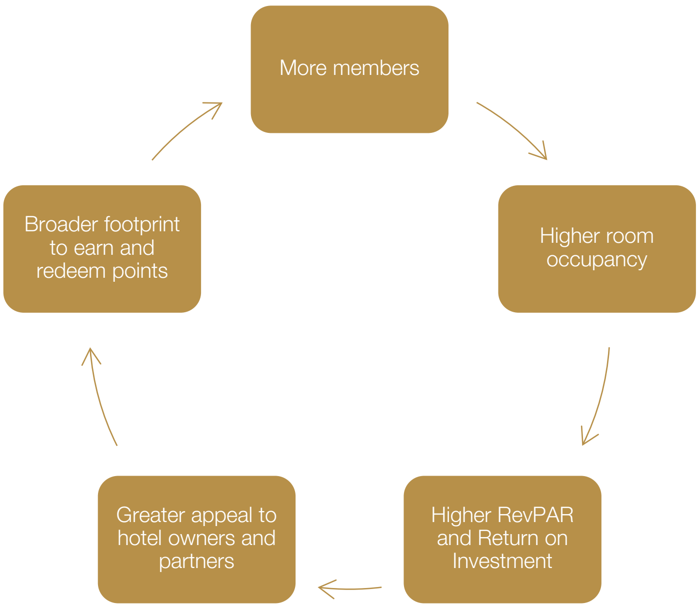
Hilton's profitability transition has been remarkable over the past decade, pushing returns to record highs and well placed to capitalise on future growth. The capital-light nature of the business model has allowed Hilton to re-invest in the growth of its now 188 million membership programs, which has led to over 65% of all room occupancy to be Hilton members and further allowed hotel owners wanting to partner with Hilton for further growth.

Hilton Profitability (Return on Capital)



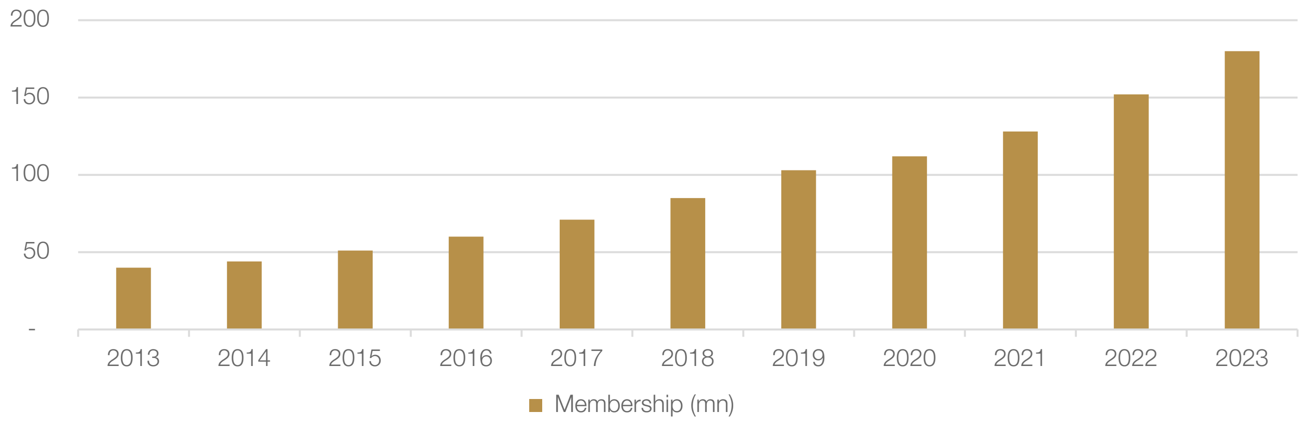
Source: Hilton Annual Report

Hilton's durable growth is underpinned a remarkable resilient business model, which creates a powerful flywheel effect. The flywheel model works as follows: 1) Hilton maintains great brand recognition across its various portfolio of hotels with significant footprint 2) Which has the company building a large loyalty membership base 3) Hotel owners benefit from higher room occupancy and room rates, which incentivises them to re-invest 4) This translates to higher share of industry hotel unit growth overtime. 5) Hilton can grow rapidly without the burden of heavy capital expenditure, leaving more cash for buybacks and dividends.



Source: Blackwattle Global Research

Hilton Loyalty membership has grown 16% CAGR



Source: Hilton Investor Presentation

Hilton has the potential to grow its cashflow at around 10% per annum at 80% incremental margins while buying back around 5% of its shares annually, which translates to mid-teens earnings growth per share. Due to its strong positive flywheel effects, Hilton has organically built a healthy development pipeline of new, of which a large portion is under construction, which alone would be worth around $45 per share a recent share price of around $210.

The company recently held an Investor Day in Washington D.C., where the management team articulated their competitive advantages and growth potential. At Blackwattle, we believe incentives drive outcomes. CEO Chris Nassetta has significant skin in the game, owning $750 million in Hilton stock. This aligns his interests squarely with those of the shareholders.

How to Invest

To invest click on the link www.blackwattlepartners.com/invest/ or call 02 7208 9922.

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