Blackwattle Large Cap Quality Fund

August 2024

Blackwattle Investment Partners

About the Fund

Our investment philosophy is to own businesses with a competitive advantage and good corporate governance, priced below intrinsic value.

The fund aims to outperform the S&P/ASX 200 Accumulation Index (after fees and before taxes) over the long term. Quality companies at low or reasonable valuations underpin overweight positions while poor quality companies with high valuations facing near-term pressures underpin underweight positions. Risk is managed through portfolio diversification, strict exposure limits and process discipline utilising our proprietary valuation and portfolio construction tools.

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 Large Cap Quality
Inception Date	August 2023
Typical number of stocks	30-55
Cash limit	10% (typically +5% to -5%)
Cash Distributions	Semi Annually
Redemptions	Daily
Constrained Capacity	$5.0b (or up to 25bps of the benchmark)
Objective	The Fund aims to outperform the S&P/ASX 200 Total Return Index (after fees and before taxes) over the long term.

Portfolio Managers

Ray David B.Eco, Gdip Fin
20+ years' investment experience. Previously Portfolio Manager Long-Short Schroders, and Director of Emerging Companies UBS.

Joe Koh B.Bus, CFA
25+ years' investment experience. Previously Portfolio Manager Long-Short Schroders, and for Regal across Absolute, Market Neutral and Long-short funds.

Fund Performance[1]

Blackwattle Large Cap Quality Fund Performance (net of fees) as at 31 August 2024

	1 month	3 months	6 months	1 Year p.a.	2 Years p.a.	3 Years p.a.	Inception p.a[2]
Fund (Net)	0.32%	5.31%	7.27%	15.54%	-	-	14.53%
Benchmark[3]	0.47%	5.74%	6.97%	14.90%	-	-	14.57%
Active Return	-0.15%	-0.43%	0.30%	0.64%	-	-	-0.03%

[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 8th August 2023.
[3] S&P/ASX200 Accumulation Index

Top 5 Active Holdings

Market Commentary

The ASX 200 accumulation index returned 0.47% in August. As we've come to expect, August has become a volatile month for equities as investors digest a deluge of earnings results and outlook commentary.

On balance, results were solid, but there was a divergence of fortunes. Companies with strong market positions and pricing power aided by structural tailwinds reported a continuation of growth, while domestic and global cyclical companies reported weaker results due to slowing economic conditions.

The clear themes emanating from earnings season were:

1. **Moderating labour wage inflation** and market conditions – indicating a slackening in labour markets.
2. **A resilient but discerning consumer** prioritising travel/leisure and smaller ticket item purchases.
3. **Easing food inflation**, with promotional activity increasing – as cost-of-living pressures has led to greater competitive intensity.
4. **Population growth underpinning resilient demand for housing**, but high costs are crimping developer margins and pressuring affordability.
5. **Persistent weakness in China** is impacting Australian exports, especially commodities such as lithium and inputs into steel manufacturing.
6. **Increasing corporate activity,** with several companies signalling acquisition intentions, and others reviewing non-core asset sales due to poor returns from previous deals. (Banking is proving to be an attractive career in all market conditions!)

Australia's economy remains in relatively good shape, which continues to support high corporate profits, buoying equity valuations. The consumer's resilience has defied our expectations and partly reflects the ongoing drawdown of savings built up from the pandemic. Australian interest rates have also risen more slowly, and population growth from migration has also been a contributing factor.

On the other hand, companies exposed to China and New Zealand delivered noticeably weaker performance. In China, the Government has shown a continued willingness to let the property market deflate. Due to softening global conditions, China is also being plagued by excess capacity in many industries, such as battery manufacturing, chemical processing, and steel manufacturing.

ASX companies reporting better-than-expected results were met with strong share price gains, while companies missing expectations or choosing to re-invest underperformed. Like international markets, weakening global conditions have led to a narrowing of market winners, namely businesses with exposure to technology, digital properties, and healthcare.

This has led to an ongoing bifurcation in valuation multiples between the top and bottom quintiles of the market. This bifurcation reflects the market's reluctance to look beyond cyclical weakness, but also the growth of passive and quantitative investment strategies.

We continue to debate whether this is a cyclical phenomenon or a structural change in markets, a change we believe is leading to less market efficiency, and the persistence of valuation anomalies. Either way, these factors are disproportionately influencing returns across the ASX, creating opportunities for patient investors (of which few remain) who can weather short-term volatility.

Portfolio Commentary

The Blackwattle Large Cap Quality Fund returned 0.32%, broadly inline with the benchmark return.

Notable contributors to performance included **Resmed (RMD +11%)**, following a strong Q4 2024 result. For the 12 months to 2024, Resmed reported +10% revenue growth and income of +38%, dispelling market concerns about the impact of weight loss drugs on its patient cohort.

Mask growth was +15%, led by Resmed's efforts to drive resupply growth through their software solutions, and the launch of the AirFit F40. Patient inflows to the sleep channel have accelerated as those seeking obesity treatments (GLP-1 drugs) are also being diagnosed with diabetes and sleep apnea.

To quote CEO Michael Farrell

"*This analysis demonstrates that GLP-1s are having a positive impact on patients both seeking and adhering to positive airway pressure therapy. The latest numbers are an improvement from what we have presented previously. For patients prescribed a GLP-1 medication, the latest data show a 10.7 absolute percentage points higher propensity to start PAP therapy over those without a GLP-1 prescription.*"

Car Group (CAR +9%) delivered a strong result, with revenue and income both up +17%. Car Group is an outlier, being one of the few Australian companies to execute a successful international expansion strategy. This is in stark contrast to REA Group (REA) and Seek (SEK), which have impaired over $0.9bn over the last decade from international investments.

Car Group's acquisition of Webmotors (Brazil) is a great case study where ownership was progressively increased after observing market trends and structure. Total capital deployed for Webmotors has been $442m for a business that is now generating revenue and EBITDA of $182m and $66m respectively, implying a cash ROC of 15% that is growing at double-digit rates.

While it is early days for CAR Group's largest acquisition to date, Trader Interactive, there are promising signs. Firstly, it's a clear leader with 3.0x the audience leadership of its nearest vertical leader, and its product offering is nascent compared with Australia, which presents opportunities to grow revenue from products that have been successful in Australia such as media, premium ad packages, data, as well as growth from new categories like Boating.

Mineral Resources (MIN) detracted from performance after disappointing on capital expenditure guidance for FY25. Group expenditure of $1.9bn was above the market's expectation, with a further $0.6bn spend on stage 1 Onslow, and ongoing waste stripping in the lithium operations.

Understandably, investors have become concerned about the balance sheet as the 62% iron ore price has dropped to US $92/t and lithium prices have tanked below production costs.

As per our long-term forecasts, we believe iron ore will drift lower but sustain a level where Onslow Iron will still generate good returns for shareholders. In our view, lithium prices are nearing trough levels, and long-term prices are likely to rise near US$1000/t -US$1200 SC6, which is the all-in breakeven costs for marginal producers in China and Africa.

To quote Chris Ellison

"Just for the record, no one is making money in this market. Let's be really, really clear on that. There's (sic) no lithium companies making money."

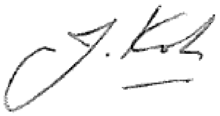
Pure play lithium companies Pilbara Minerals (PLS) and IGO Limited (IGO) are also not cash profitable when considering capital development. Yet their market valuations currently imply a range of $10M-$12M per tonne of SC6 production. After adjusting for mine property differences and applying these metrics to Mineral Resource's lithium assets, this would imply a valuation of c$4bn for Wodgina, Mt Marion and Bald Hill. Implicitly, this means the rest of Mineral Resources' enterprise value is ascribing 4x-5x EBIT for the Onslow Iron, Mining Services and Road Infrastructure divisions, even with lower iron ore prices at full name plate production.

Outlook

Our portfolio positions continue to favour companies with pricing power and growth options trading on reasonable valuations. While weak macroeconomic conditions in China will continue to challenge commodity producers, our largest resources portfolio exposures are predominantly in low-cost producers with tier one assets and strong balance sheets that offer attractive through-the-cycle valuation support.

As always, we are invested alongside our clients.

Ray David

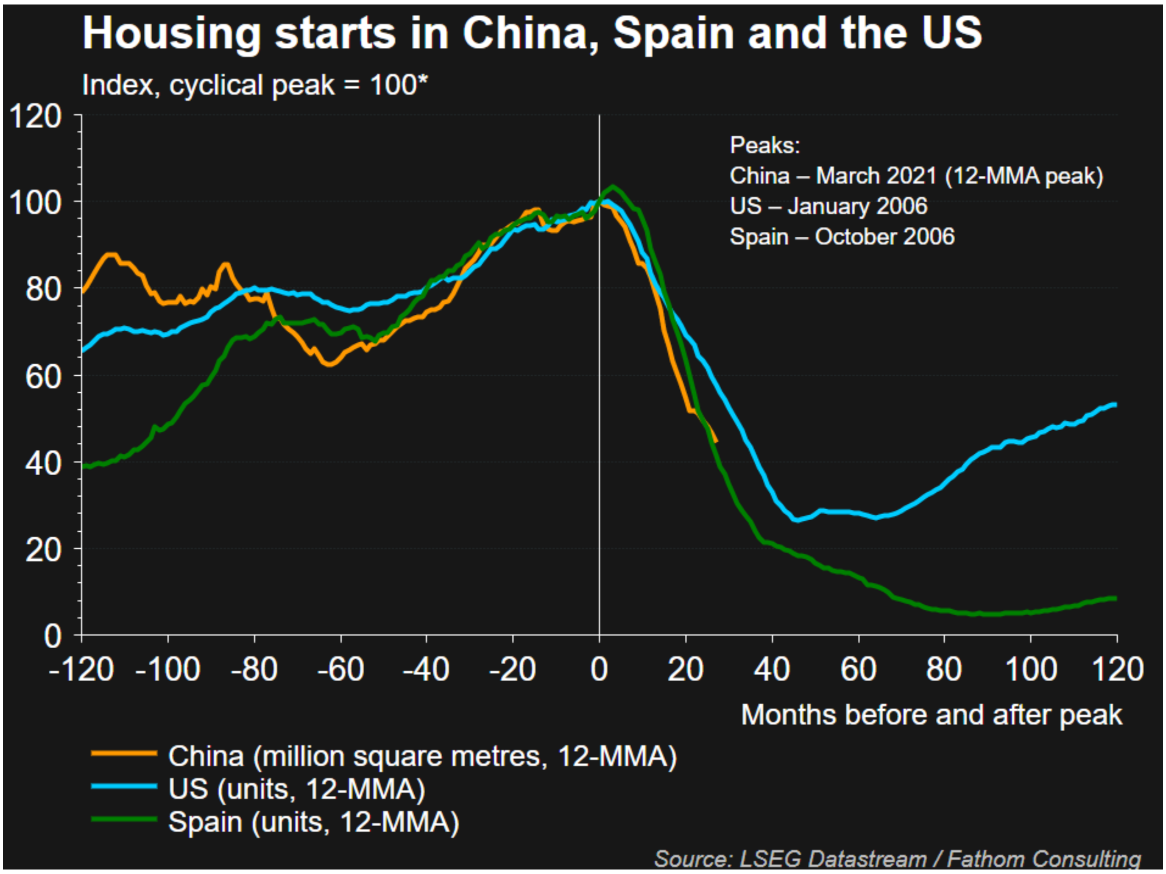


Joseph Koh

David Meehan

Chart of the Month

Housing starts in China are following previous deflationary cycles



How to Invest

To invest click on the link www.blackwattlepartners.com/invest/
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