

Blackwattle Small Cap Quality Fund

August 2024



Blackwattle
Investment Partners

About the Fund

The fund aims to deliver outperformance through the cycle, irrespective of market direction or factor leadership. Our goal is to achieve higher relative returns with lower volatility.

As fundamental investors, we employ in-depth bottom-up research to identify the best quality Small-Cap opportunities. We manage diversified portfolios, seeking returns from all sectors.

We prioritize active risk management and consider capital preservation at every stage of our investment process.

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 Small Cap Quality Fund
Inception Date	September 2023
Typical number of stocks	30-60
Cash limit	20% (typically 0-10%)
Cash Distributions	Semi annually
Redemptions	Daily
Constrained Capacity	\$750m (or up to 25bps of the benchmark)
Objective	The Fund aims to outperform the S&P/ASX Small Ordinaries Accumulation Index (after fees and before taxes) over the long term

Portfolio Managers



Robert Hawkesford

20+ years investment experience. Most recently in a small team at Ellerston Capital managing the institutional Australian Small Cap portfolio. Member of Ellerston's ESG and Broker Review Committees.



Daniel Broeren

20+ years investment experience. Extensive long and short experience. Most recently Portfolio Manager, Watermark Funds Management (Australian Long/Short). Previously Portfolio Manager of the Invesco Small Companies Fund.

Fund Performance¹

Blackwattle Small 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)	0.73%	3.48%	8.63%	-	-	-	20.01%
Benchmark³	-2.02%	-0.01%	1.52%	-	-	-	10.90%
Active Return	2.74%	3.49%	7.11%	-	-	-	9.11%

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 12 September 2023.

³ Small Ordinaries Accumulation Index

Top 5 Holdings



Market Commentary

The ASX Small Ordinaries Accumulation index fell -2.02% in August. Small Cap Resources fell -2.24% while Small Cap Industrials fell -1.94%. Weakness in Resources was led by Energy, with uranium companies faring the worst, as utility buyers continue to delay purchases. Oil & Gas companies were also sold on concerns about slower global economic growth. Industrials fell in line with reporting season EPS revisions of around -2%, with the most significant falls seen in Industrials and Tech.

Portfolio Commentary

The Blackwattle Small Cap Quality Fund outperformed the ASX Small Ordinaries Accumulation index by 2.7% in August.

Key Contributors to performance in August were Nuix (NXL), Regis Healthcare (REG), and Zip Co (ZIP).

Nuix is a provider of specialised software used to investigate and analyse large pools of data. Its share price rose 38% in August following the announcement of better-than-expected earnings guidance for FY25. Our position in the company is based on our expectation of 'improving quality', as the company emerges from an organisational rebuild. In the last two years incoming CEO Jonathan Rubinsztein has established a new senior leadership team and a new culture that matches the quality of the company's products. Nuix is a clear leader in its field, has enviable blue-chip clients and it aided by strong sector tailwinds given the world's increasing data usage. Despite the recent share price run we see plenty more upside as the stock still trades at a significant discount to global peers.

Regis Healthcare rose 22% in August after delivering a solid but largely expected result. The share price move more reflects a significant change in the outlook for operators in the aged care industry. While the challenge of providing care for an aging population has been long known, governments have kicked the can down the road for the next government to deal with. But with the first baby boomers now moving into care the consequence of insufficient investment is upon us. The current government has no choice but to increase the funding of aged care operators to encourage the buildout of more beds. We believe the next decade is likely to be a golden era for aged care operators.

Zip Co rose 26% in the month, continuing its run of good form since announcing a \$267m capital raise to remove corporate debt in July. Zip's recent journey has been one of improving quality, with reduced industry competition, strong US growth (US 4Q24 Revenue +47% vs pcp) and retail partner validation – including Google Pay and Stripe integration in the US – now supported by a >\$100m annualized EBITDA run-rate, positive cash flow and a clean balance sheet. Despite Zip's strong recent performance, we still see significant opportunity for growth in the US where Buy-Now-Pay-Later (BNPL) penetration is only 2%, versus ~15% in Australia and ~20% in Europe.

Key Detractors to performance in August were Siteminder (SDR), Paladin Energy (PDN), and Polynovo (PNV).

Siteminder shares fell 10% in the month despite the company delivering an in-line result. The fall in share price appears linked to the outlook for travel expenditure, as some global and domestic travel agents reported emerging softness in leisure demand. While this relationship between SDR and travel agent demand is sometimes made, the reality is that 90% of SiteMinder's demand is subscription driven (per hotel partner), and not linked to the hotel's underlying revenues.

Paladin Energy dropped 14% over the month, largely in response to a fall in the uranium spot price. Having said that, at a PDN share price of \$8.50, the implied Uranium price is US\$50/lb, which is well below the current term rate of US\$79/lb. This suggests the recent share price move is overdone. While PDN's share price is being led by the commodity price in the short-term, the company's long-term prospects have been improved greatly following its recently announced acquisition of Fission Uranium (FCU.TSX), a high-grade development project in Canada. The deal gives PDN a quality growth option, which it can fund via cashflow from its already producing Langer Heinrich asset. Because the project was unfunded under Fission's ownership, the deal unlocks significant value for PDN shareholders. We expect this to be fully appreciated as the uranium price settles.

Polynovo fell 13% in August after delivering an inline result. The reason for the share price drop is unclear as FY25 is shaping up as a good year for the company. PNV's Barda trial has completed recruitment and should be releasing data shortly. We expect these results to drive further adoption in the core US market. Competitor Integra continues to be impacted by product recalls. We understand inventories of Integra's products are only now being depleted, which should see PNV benefit more substantially.

Outlook

With August reporting season behind us, investors are now refocusing their attention on the health of the economy and the future direction of interest rates as the next driver for equities. In this regard, inflation is easing, and unemployment is gradually rising but still well below pre-Covid long-term averages, supporting the case for a soft landing and a gentle commencement of RBA rate cuts in the coming months. Given the strong share price performance of several companies within the portfolio during August, rising global volatility, and share market valuations sitting one standard deviation above long-term averages, we are taking the opportunity to rotate some of the portfolio into companies where we see more value. Importantly, the portfolio remains overweight quality cyclicals and quality growth companies with competitive advantages and superior management teams that can outperform regardless of the rates environment.

Dan & Rob

How to Invest

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

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