Blackwattle Mid Cap Quality Fund

January 2025

Blackwattle Investment Partners

2024 Letter to Investors

Dear Blackwattle Investor,

This is our inaugural annual letter to investors in the Blackwattle Mid Cap Quality Fund ("the Fund") at the end of our first full calendar year of investing.

Firstly, we would like to thank you, our investors, for supporting us in our Blackwattle journey. We strive to repay this faith over many years of investing performance. While Quality is our North Star for investing, Alignment is our North Star for founding Blackwattle alongside our peers. The structure of our Fund is intentionally designed to maintain our Alignment with our investors over the very long term. The Fund has been capacity constrained, as we believe this improves our ability to outperform[1]; we are focused on generating alpha as opposed to asset gathering. We are invested in the Fund with all of our liquid net worth, alongside our investors; we either win together or lose together.

The Fund is a concentrated, yet diversified portfolio of, what we believe to be, the highest and most improving quality companies on the ASX. The Fund was incepted on the 8th of August 2023, and whilst we are proud of our performance to-date, we highlight that we are still early in the journey of compounding returns through Quality Investing. Outperforming consistently over the long-term is difficult for all fund managers. We believe this can be achieved through a focus on investing in the highest quality businesses, as these businesses tend to compound their competitive advantages and ultimately shareholder returns through market cycles.

Fund Performance[1]

Blackwattle Mid Cap Quality Fund Performance (net of fees) as at 31 December 2024.

	2024 Calendar Year	Inception p.a[2]
Fund (Net)	18.88%	16.57%
Benchmark[3]	11.68%	9.47%
Active Return	7.20%	7.10%

[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, returns greater than 1 year are annualised' or "calculated on an annualised basis.
[3]S&P/ASX300 Accumulation Index - S&P/ASX20 Accumulation Index
*Inclusive of Goods and Services Tax (GST) and net of any Reduced Input Tax Credits (RITC)

Whilst we target long term ownership of high-quality companies, we have also become more dynamic in the recycling of capital as stock ideas compete for capital under our twin goals of maximising Risk/Reward and Quality. The Fund has owned 40 different stocks over 2024 in a concentrated portfolio of ~25 stocks. Whilst managing to a prudent turnover level of ~50%, this approach to recycling our best ideas is one of the key reasons for our improved performance compared to the portfolios we previously managed. This is a valuable ongoing enhancement to our investment process.

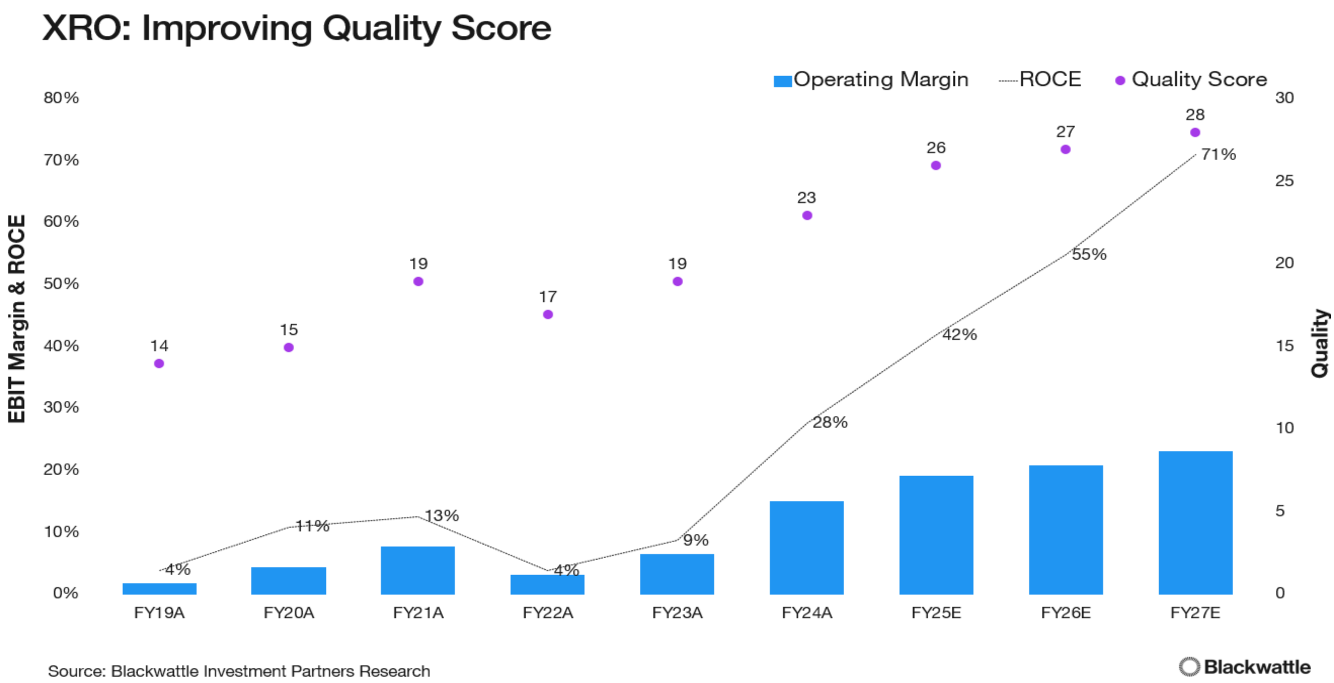
Over 2024, the Fund has received 4 takeover bids (ALU, PSI, ORA, LTM), with 2 completing (ALU, PSI) and LTM receiving shareholder and regulatory approvals in connection with the proposed acquisition. Our best performers in 2024 have been growth stocks which have delivered strong earnings upgrades (XRO, RMD and GYG). On the flipside, our worst performers have been either China-related resource stocks (WHC) or stocks which have downgraded (such as ORA).

Xero (XRO) is a great example of our Quality investing framework. XRO is a market-leading, global accounting SaaS platform. We have owned XRO since inception, with our 'improving quality' thesis being that XRO's new CEO Sukhinder Singh-Cassidy had been hired early 2023 to deliver cultural change, from unprofitable sales growth to a balance of growth and profitability. Whilst XRO had some of the Quality attributes we were looking for (market leading products, high visibility and recurring revenue and solid barriers to entry), we did not believe this had translated into strong financial quality, with weak metrics such as a FCF and EBIT margins. This change can take time, for example the November 2023 1H24 Result underwhelmed high expectations.

[1] Angelidis, Babalos & Fessas. The economic gain of being small in the mutual fund industry: U.S. and international evidence, (2021). Comparing the average performance of a large fund vis à vis its average performance when it was small, the small funds outperforms the large funds by 7.08% per year.

However, we maintained our conviction given the ~15% headcount reduction and management's reiterated focus on the Rule of 40[2] (R40). The FY24 result in May 2024 finally demonstrated the financial strength of the business, achieving the aspiration of the R40 well ahead of the market's expectations. This continued into XRO's 1H25 result in November 2024 and over the past 2 years, XRO's Quality Score (generated from our proprietary **Quality Scorecard Tool** based on multiple quality criteria) has significantly improved.

In our opinion, XRO now sits firmly in the top quartile of high-quality businesses on the ASX, and if XRO can continue to execute towards our expectations, we forecast XRO's Quality Score to take XRO to the top decile of the rankings in the next 2 years.



We often receive questions relating to the definition of Quality. Our **Quality Scorecard Tool** incorporates multiple quality criteria, using financial and accounting ratios to evaluate Quality across business models and industries. A key aspect of our approach is our perspective on concentration risk. While concentration—relying heavily on a key customer, supplier, or regulator—can drive strong outcomes in the short term, it poses significant risks to a business model or industry position in the long run. A Quality business, in our view, is one that minimises these risks by diversifying its customer base, supplier network, and regulatory exposure. Diversification enhances bargaining power, creates more opportunities, and fosters more sustainable financial outcomes.

XRO is again a great example of concentration, serving a significant and highly fragmented customer base in multiple, geographically diversified markets with structural regulatory tailwinds, and with enough scale to negotiate with suppliers. These are to an extent intangible and not obvious to Quality investors who follow fundamental financial quality drivers or quantitative output. Only once we peel layers of the research 'onion', sometimes over many meetings over many years, do these sources of risk reveal themselves, and we see our process as highly valuable in weeding out these hidden risks. In our experience the downside from the unraveling of these risks is worse than enjoying the limited upside they might offer

Outlook

Looking to 2025, we continue with the theme from recent monthly commentary that this remains a highly uncertain economic environment: a 2nd Trump presidency, US fiscal and debt issues, stubborn global inflation, continued China and EU economic weakness and geopolitical risk in the Middle East all present risks and opportunities. Bond markets have been volatile and appear to be warning of inflationary risk and/or fiscal vigilance in 2025. Equity markets at all-time highs are more sanguine, looking towards a 'Goldilocks scenario' of strong economic growth together with more rate cuts in 2025.

[2] The Rule of 40 is a principle that states a software company's combined revenue growth rate and free cash flow margin should equal or exceed 40%.

We try not to predict and make macroeconomic forecasts. Instead, we remain focused on picking the highest and most improving quality stocks across industries to construct a bottom-up, high-quality, diversified portfolio which can perform through most phases of the market cycle. We look forward to 2025 as an opportunity for our high-quality companies to demonstrate their ongoing strength, and that these competitive advantages may translate into compounding shareholder returns.

We wish you all a happy New Year, and again thank you for investing alongside us in the Fund.

Yours sincerely,

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