

## FUND PERFORMANCE (AFTER FEES) TO 29 FEB 2024

	1M	3M	6M	1yr	2yr p.a.	3yr p.a.	SI <sup>3</sup> p.a.
Net Fund Performance <sup>1</sup>	1.7%	9.9%	7.1%	10.6%	5.6%	7.5%	7.4%
Benchmark Performance <sup>2</sup>	1.7%	10.1%	6.9%	7.8%	-0.4%	1.4%	3.6%
Excess Return	0.0%	-0.2%	0.3%	2.8%	5.9%	6.1%	3.8%

1. Return net of 0.89% p.a. management fee. 2. S&P/ASX Small Ordinaries Accumulation Index. 3. Inception date: 31 Oct, 2019. Past performance is not a reliable indicator of future performance, p.a performance is annualised.

The Longwave Small Companies Fund increased by 1.7% during February 2024, in line with the 1.7% increase in the S&P/ASX Small Ordinaries Accumulation Index benchmark.

## 1H F2024 REPORTING SEASON

Reporting season was mixed for the portfolio. Some wonderful companies continued to deliver over and above market expectations. At the other end, companies we think have the potential to be doing a lot better are either kicking own-goals or the execution of business improvement is more challenging than we thought. The overall scorecard is par relative to the index.

In a little over 12 months, Small Resources have underperformed Small Industrials by almost 30%. Some of this is the implosion of speculative lithium stocks, but there are difficult issues for small producers including but not limited to mine failure, production problems, cost inflation and of course weak commodity prices. All the reasons why many investors avoid the sector. We continue to look for quality businesses within resources – 2022 highlighted the benefits to total portfolio returns of this broad diversification – however the past 12 months remind us why this can be a difficult sector in which to remain invested through the cycle.

## THE IMPORTANCE OF MANAGEMENT

Sharing a strategic shareholder (Seven Group) has us looking at the new CEOs appointed to long-term under-performers Boral and Beach Energy with a different lens. In the less than two years since Vik Bansal joined Boral, the abrupt uptick in operational performance and share price (particularly against their languishing peers Fletcher Building and AdBri) is stark. Seven Group clearly agree as they announced a bid for the minority interest they do not own shortly after the results were released. It wasn't lost on us that incoming Beach Energy CEO Brett Woods shares some similar characteristics. A technically proficient operator from Santos with a focus on structural efficiency improvements and improving returns through self-help. Boral had underperformed the market for six years prior to Bansal's appointment, Beach Energy for four years before Woods. They are different businesses each with unique challenges, but we are guessing effective management is likely to be a common denominator at both.

Fletcher Building could hardly have had a less effective management team or board over the past few years, and Boral in particular shows investors the opportunity cost of having market leading assets (as we still believe Fletcher does in NZ), poorly managed and governed. It took a new owner in Boral for this to change and we suspect the opportunity and playbook is similar at Fletcher Building. Sell non-core assets (Australia) for a good price (they are decent assets in the right hands – and buyers of building materials businesses are around – just ask CSR and AdBri), reset the balance sheet, rule a line under sloppy risk management and renew board and management. The upside for the effort could be significant. Without some of these changes unlocking value looks hard. In his outgoing remarks, the Chairman made it very clear why this was never going to happen with the incumbents in place: *"The core businesses are doing really well. They are more focused and profitable, with improved earnings, margins, and returns. Looking forward, is our view that it is in the best interest of the business for us to hand over to a new Group CEO and a new Chair who will be able to focus on leading the organization forward"* – Bruce Hassell, FBU Chair on his resignation. We are not sure what business Bruce is looking at – but it certainly sounds nothing like Fletcher Building under his watch.

## TOP 10 HOLDINGS

Name (Alphabetical)
ARB Corp Ltd
Auckland International Airport Ltd
Beach Energy Ltd
Brickworks Ltd
Corporate Travel Management Ltd
CSR Ltd
GQG Partners Inc
Mainfreight Ltd
Netwealth Group Ltd
Super Retail Group Ltd

## FUND AND BENCHMARK SECTOR WEIGHT (%)

	Fund	BM <sup>2</sup>
Communication Services	4.0	4.7
Consumer Discretionary	22.4	18.5
Consumer Staples	1.3	2.7
Energy	7.8	7.0
Financials	12.2	10.2
Health Care	5.5	7.9
Industrials	15.2	8.5
Information Technology	6.0	6.4
Materials	17.1	22.0
Real Estate	4.7	12.3
Utilities	0	0
Cash	4.0	0.0

## STOCK ATTRIBUTION (ALPHABETICAL)

Top 5 - Contributors
ARB Corp Ltd
CSR Ltd
GQG Partners Inc
Imdex Ltd
Strike Energy Ltd

## Bottom 5 - Detractors

Brainchip Holdings Ltd
Corporate Travel Management Ltd
Sims Ltd
SSR Mining Inc
Ventia Services Group Pty Ltd

## THE CONSUMER

Overall, the consumer remained robust and companies are not seeing the recession fears analysts had assumed and many stocks had been priced for. This sector saw the most upgrades along with the Energy and Financial sectors.

One polarising consumer stock is Breville Group. For a decade (F2005 to F2015) Breville grew revenue (excluding the disposed homewares business) at around 5% p.a, and EBIT at 9% p.a as margins expanded. The stock traded at an average forward P/E of around 13x over this decade priced as a cyclical, mostly domestic, appliance maker. New management (still in place) accelerated focus on global markets and delivered revenue growth of almost 14% p.a between F2015 and F2023, albeit at a slight cost to margins resulting in EBIT growth of around 12% p.a. The market rationally rewarded a well-executed global expansion and the stock traded at a forward P/E that averaged 28x. It appears this new market entry growth has largely run its course. The business has fewer levers to pull on either margin or revenue growth and at 30x forward earnings, the stock is still priced for the glory days of future global growth rather than the more realistic return to mid-single digit growth. If investors applied the De Longhi P/E multiple (15x) to the consensus BRG F2025 EPS (A\$0.91 cps) the stock would be trading under A\$14 – a far cry from the A\$27 it trades at today, saying nothing of the downside risk to F25 EPS estimates given evidence of slowing growth.

We saw conflicting messages coming out of the travel sector. Some (Corporate Travel and Flight Centre) feel that the post COVID recovery is now complete and the next five years will be about gaining market share. Others (Qantas, HelloWorld, Auckland Airport, Tourism Holdings) still see more upside back to pre-COVID levels of spending. There are some good businesses here that we think can compound earnings at double digit rates for many years but the rising tide lifting all may be coming to an end sooner than we thought. Competitive advantages and execution will matter more than ever.

Since the pandemic, limited availability of new cars was seen in a) the novated lease providers inability to fulfill their order books and b) the retail auto dealerships able to significantly improve margins through mix (fewer cars going to fleet and novated buyers) and discounting (as in, there wasn't any). Novated lease providers were given a lifeline in the form of Electric Vehicle (EV) Fringe Benefit Tax (FBT) relief, but the eventual return of ICE and Hybrid car supply will help them address their full pipeline. Investors should also expect a decline in margins for retail dealerships as the benefits accrued to them from tight supply abate.

Growth in EVs stimulated by government policy resulted in a strong revenue and earnings increase at McMillan Shakespeare and SmartGroup. Higher prices in general for EVs means higher dollar margins per sale. Since Peter Warren Automotive listed in April 2021, the two novated leasing players have outperformed the three major auto retailers by 20-30% per annum.

The specialty retail sector is hard to generalize. The one trend we observe is stronger businesses (think JB HiFi, Super Retail, Lovisa, Premier Investments, Nick Scali) appear to handily out-execute their rivals regardless of the macro conditions. Turnarounds in the sector are difficult to affect – some of these lessons we learned the hard way with unsuccessful investments in The Warehouse and Kathmandu, and Adairs.

## HEALTHCARE

For a sector coveted for government backed certainty, small cap healthcare investing is anything but certain. Healius and Australian Clinical Labs appear to be doing their best to have investors question whether pathology is even a good business to be in anymore. Any business where revenue is capped and costs are uncapped (and subject to considerable inflation) can quickly find the economics inverting. Hoping the government restores your economics can be a painful journey – as Aged Care and Child Care companies have found over the past decade.

Despite what the market is pricing, Nanosonics does not appear broken to us. A new CFO has brought some timely discipline to expenses and the high value consumables continue to grow. Uncertainty over near term Trophon sales and CORIS commercialization costs are dragging down short-term group results, however we continue to believe on a medium-term horizon the core Trophon franchise – without anything attributed for the CORIS product – is worth considerably more than the current market cap.

Fund characteristics	As at 29 Feb 2024
NAV	A\$1.1416
Redemption unit price	A\$1.1382
Inception Date	31 Oct, 2019
Minimum Investment	A\$25,000
Management Fee	0.89% p.a.
Performance Fee	-
Risk/Return profile	High
Buy / Sell Spread	0.30% / 0.30%
Benchmark	S&P/ASX Small Ordinaries Accumulation Index
Distribution frequency	Half-yearly
Portfolio FUM (A\$m)	16.2
No. of Holdings:	114
Portfolio Managers	David Wanis, Jai Beathe & Melinda White
Strategy FUM (A\$m):	760.7

## INVESTMENT OBJECTIVE

The Fund aims to outperform the S&P/ASX Small Ordinaries Accumulation Index over the long term (after fees).

The Fund aims to provide long-term capital growth through investment in a diversified portfolio of high-quality Australasian small companies (outside S&P/ASX 100 Index at time of investment or expected to be within six months).

## INVESTMENT STYLE

Longwave's investment philosophy is underpinned by the belief that the stocks of high-quality small companies outperform the benchmark over time, and as such, an active approach to investing in high-quality stocks provides value to investors who might otherwise have invested passively. Longwave believes in the value of a deep and fundamental understanding of the securities in which we invest.



Signatory of:



Supporter of:



## MINING SERVICES

A sector almost as unloved as resources, mining service companies have been a long time improving their results to limited attention from investors. The results across the board ranged from solid (Monadelphous, NRW Holdings), better than expected and well ahead of what the market is pricing in (Macmahon, Perenti, SRG Global) to stellar (if not more well priced) in the case of Mader.

Our medium-term expectations are that ongoing commodity demand growth should be met by a more disciplined mining service sector and continued improvement in financial performance. MMA Offshore does highlight that eventually the market will take notice.

## TECHNOLOGY

In a market where sentiment was favourable to growth (eg. Weebit Nano, Brainchip, and Life360 performing well despite either borderline profitability, or none at all), many technology stocks missed the boat (eg. downgrades from Iress, Data#3, Hansen). The technology sector was a net contributor for the Longwave portfolio with its focus on organic growth and strong balance sheets. We saw upgrades from Codan, Audinate, and RPM Global.

## PORTFOLIO POSITIONING AND PERFORMANCE<sup>1</sup>

In addition to the significant performance skew away from Resources and towards Industrials, reporting season dramatically favoured Microcaps (+5.1%) and Midcaps (+5.3%) relative to Small Caps (+1.7%). This wasn't overly helpful for the portfolio given our positioning solidly in the small cap space (we have no stocks in the ASX100 at the moment, and those we do hold on top 100 promotion are fleeting as we have six months to sell them).

The portfolio was subject to a number of negative results and developments – including the disaster at the SSR Mining Çöpler mine in Turkey (-55%), and the surprise negative performance of the Corporate Travel UK Government contract, which the market never liked, but its underperformance contributed to both a near term earnings downgrade and a medium term undermining of confidence in management (-22%). Poor results from Sims Group (-16%), Coronado Global Resources (-17%) and Fletcher Building – which would have been down more than 8% if the bids for Boral and CSR hadn't resulted in the market over-looking the abysmal operating performance and starting to focus on the resignation of the Chair, CEO, and asset appeal. These were offset on the other side of the ledger by strong results from GQG Partners (+19%), Imdex (+25%), ARB (+22%), RPM Global (+24%) and a takeover offer for CSR at A\$9 per share (+27%).

Accounting obfuscation continues to gain acceptance, with 'Adjusted EBITDA' becoming the measure of choice driving share prices in the very short term. Makes life easier for management to ignore pesky costs like depreciation, amortisation, lease expenses, interest (on debt and leases), and tax – but investors are unwise to take their heavily massaged numbers at face value. Unfortunately, management are increasingly paid on these made-up numbers. In the long run, free cash flow per share and dividends are the two numbers with the greatest gravitational pull on long-term shareholder returns. We can't recall too many remuneration reports using these metrics as a management incentive.

<sup>1</sup> Illustrative only and not a recommendation to buy or sell any particular security.

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Link to the Product Disclosure Statement: [WHT9368AU](#)

Link to the Target Market Determination: [WHT9368AU](#)

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