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July 2024 update

Dear Blue Boat Partners,

Set out below are the preliminary estimated portfolio results for the 2024 financial year and since the inception of the fund.

Blue Boat Performance vs Indices Total Returns: 3 April 2017 – 30 June 2024:

	Blue Boat Gross Return	Blue Boat Net Return	ASX 200	MSCI All Country
FY24	21.6%	20.4%	12.1%	19.9%
Since inception	73.2%	55.1%	75.6%	110.9%
CAGR	7.9%	6.2%	8.1%	10.9%

Source: Bloomberg. The returns for Blue Boat and ASX are presented in AUD, MSCI in USD. Index returns include net reinvested dividends. CAGR is the compound annual growth rate since fund inception 3 April 2017.

Blue Boat has had a successful financial year, with some of our earlier contrarian positioning translating into positive returns. The top contributors to FY24 performance were: Spotify, Lovisa, Beacon Lighting, Step One Clothing and Jackson Financial.

We recall that 12 months ago, investors were concerned that sticky inflation and rising interest rates would put severe pressure on consumer confidence. This, in turn, would negatively impact consumer-facing company earnings and bank credit quality. Additionally, higher yields meant that bonds became relatively more attractive compared to equities. The sentiment around investing in the share market could be described as subdued at best.

The picture today serves as a reminder that such macroeconomic-based predictions are a poor gauge for what lies ahead in stock markets. Interest rates and US treasury bond yields are substantially higher than they were last July. Consumer confidence has remained soft throughout the year. And yet, high-growth equities are setting record-high prices, and retail sales have exceeded expectations. Banks have reported negligible increases in mortgage arrears, and asset quality remains at historically high levels.

As value investors, we struggle with some of the assumptions required to justify valuations in popular segments of the market today. However, we continue to find ample opportunities to invest capital in our favoured investment categories: small-cap companies, which tend to be illiquid and under-researched, and large companies undergoing a period of difficulty or cyclical weakness. Within these two categories, high-quality companies are frequently offered at attractive valuations, which is where we seek to take advantage.

FY24 was the third consecutive year that the ASX Small Ordinaries Index underperformed the ASX 200. Historically, the ASX Small Ordinaries Index has been a strong outperformer, particularly when looking exclusively at small-cap industrial companies. We continue to search for opportunities in this part of the market, where we believe the recent underperformance is cyclical and unlikely to remain.

One barometer of sentiment towards small-cap companies is the state of the IPO market. Australia's IPO market has been virtually frozen for the past two years. Compared with FY22, capital raised via IPO's was down circa 90% in FY23 and down circa 80% in FY24. During this period, the number of companies listed on the ASX has declined, a rare situation that has arisen due to more takeovers and de-listings than IPOs. However, with Guzman Y Gomez's recent very successful IPO, there is evidence of renewed investor interest in this area of the market.

Institutional investors tend to avoid small-caps due to their size, stock liquidity, and relative business immaturity. In contrast, large high-quality companies can fall out of favour with investors for a wide variety of reasons. Industry or sector cyclicality is often the most significant contributor, but internal issues exacerbate the perceived deterioration of the companies in question. Almost every large successful company has, at one time or more, fallen deeply out of favour with the market. Even beloved stocks such as Microsoft and Apple each have had extended stints in the stock market 'sin-bin' while they sorted out their issues.

High-quality company fundamentals will usually prevail in the long-run over short-term organisational mismanagement, cyclical headwinds, or macro-economic fears. When priced in permanently, these negatives tend to present attractive buying opportunities, which are of interest to Blue Boat.

We have observed the astonishing speed at which several large, US-listed technology companies have moved from being perceived as challenged companies with deteriorating potential in 2022 to being priced for perfection in 2024. We lament not being more assertive in buying these great companies then, but our investment in Spotify in late 2022 has been a leading contributor to the FY24 performance for Blue Boat. We have seen Spotify improve and expand its product offering to customers, simultaneously reduce its cost base, and implement price increases, all without impacting customer growth. This taught us the power of tech platform businesses with dominant market share and led to our purchase of Tencent in January 2024.

Tencent progressed nicely this quarter, and its profitability showed considerable improvement. A major contributor was the progress made to enhance the monetization of its WeChat platform. The company has demonstrated that thanks to its large database and AI tools, it is now better than ever at targeting ads. This delivers more relevant content to users, better return on investment for merchants, and immediately stronger profitability for Tencent.

Tencent's market-leading competitive position in social media is entrenched. The company's results are showing material improvements in future profitability potential, and together with their expanded share buyback program, we are very pleased with this position in the portfolio, which was a positive contributor this quarter.

In June, we initiated a new position in Lululemon Athletica, a Canadian active-wear clothing business listed in the USA. In the past 20 years, Lululemon has grown its sales by 263x, a staggering 32% annual growth rate. Lululemon has benefited from a trend of clothing casualization and active-wear crossing over into mainstream casual clothing. Their products are functional, fashionable, and high quality. Demand for Lululemon has surged globally, and it appeals to both male and female customers across multiple age demographics.

80% of sales are to North American customers, which have slowed after the pandemic and the subsequent consumer boom. The market has focused on this slowdown, ignoring the other 20% of international sales. Outside North America, Lululemon sales are proliferating and showing no signs of slowing down in-store and online. We view the American sales softness as cyclical, but the global expansion as structural.

Lululemon stores have one of the highest sales per square metre of any company globally, comparable with Apple and Tiffany and Co. It is a high-margin, high-quality compounder with a very long growth runway outside America. So far in the calendar year 2024, Lululemon is the second worst-performing stock in the S&P 500, down 41%, which has presented an attractive entry point for Blue Boat.

Defining a quality company is a very difficult task. One way we judge a company's quality is by how they allocate or manage their capital. Serial issuers of new shares are rarely quality compounders, nor are companies that prioritize their dividend above appropriate reinvestment. For this reason, headline dividend yield is often a misleading and overrated metric to judge a company by, while the track record of dividend growth is underrated.

Companies that buy back shares aggressively when conditions suit, and companies with a track record of strong dividend growth routinely appear among the top-performing investments worldwide. We believe this is an important indication of quality.

Just over half of the Blue Boat portfolio is allocated to companies with a strong record of dividend growth. On average, these companies have increased their dividends per share by 22% annually in the past 10 years. This demonstrates that our portfolio company managers are doing a tremendous job of productively reinvesting capital for growth and generating cash flow.

Over 40% of the portfolio is held in companies undertaking significant buyback programs. These managers are taking advantage of the opportunity to repurchase their shares at depressed prices at an average rate of 5% per annum. Over time, this reduction in share count can be advantageous for remaining shareholders and is a sign of good capital management from our companies.

Looking ahead, we see a complex world with abundant risks that could disrupt the market. This view is not unusual. In fact, we can't think of a year where that wasn't the case. At Blue Boat, we are looking at companies, not markets, particularly contrarian situations where we can buy a business that is fundamentally mispriced. We are also focussing on the equally difficult task of holding our winners through times when the consensus deems them overpriced or fickle. After all, as Charlie Munger said, "*The big money is not in the buying and the selling but in the waiting*."

Another quote we found appropriate to investing, particularly our style, came from Roger Federer's inspiring commencement speech at Dartmouth University. Roger noted that over the course of his incredible professional tennis career, in which he won roughly 80% of his matches, he won just 54% of the points. This is very similar to the long-term record of stock market days, where approximately 52% are positive and 48% are negative. However, that slight advantage replicated over a long period of time leads to 68% of years being positive, 88% of decades being positive, and 100% of 20-year periods being positive.

Roger's message was that when you lose roughly every second point, you can't dwell on your losses; you need to be totally focused on the point ahead. Similarly, in markets, we believe it's essential not to get swayed by the daily gyrations and rather stay fully aware of our investment's fundamentals and future opportunities.

We are invested in some wonderful businesses trading at attractive prices and think our portfolio is well-equipped to handle what may lie ahead in FY25.

A very exciting development is that we are pleased to announce that Blue Boat has formed a partnership with Rawlings Bolton, an independent trustee and fund administration group, which is a subsidiary of Bentleys Queensland. Going forward the fund will operate under an AFSL and Bentleys (QLD) Advisory will now act as Trustee and Rawlings Bolton will act as Fund

Administrator, providing a higher standard of independent governance and reporting for the fund's investors. That leaves us to focus on the investment management of the fund and the delivery of strong returns to our Blue Boat partners. With this change, Blue Boat is now able to accept investments from new sophisticated investors interested in joining the fund. If you would like to discuss, please get in touch. Thanks for all your support and we look forward to this next phase and a prosperous FY25.

Yours sincerely,

David Nelson and Tim Evans