

Quality Compounders



Q1 FY24 Investor Update

“The key to investing is not assessing how much an industry is going to affect society, or how much it will grow, but rather determining the competitive advantage of any given company, and above all, the durability of that competitive advantage.”

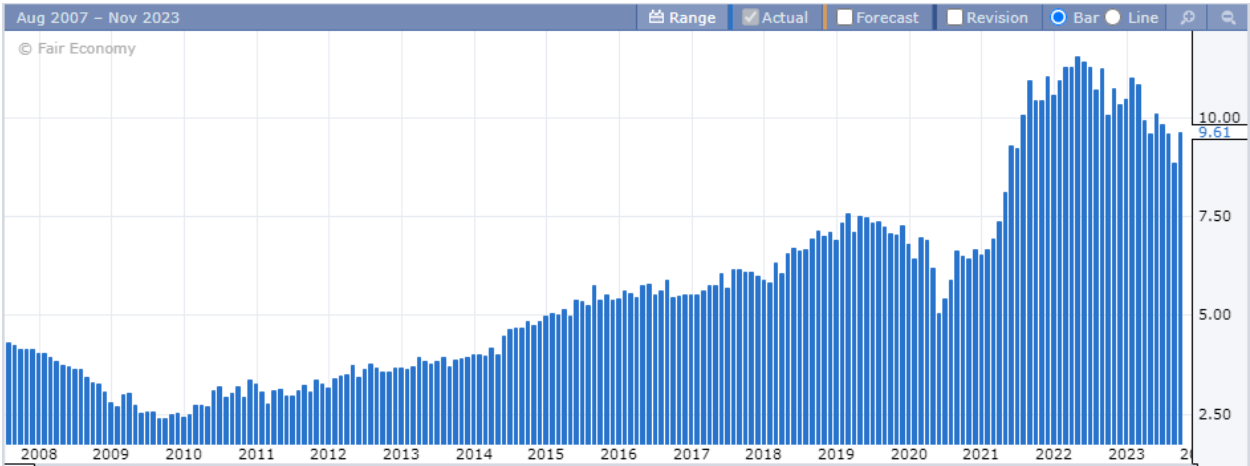
– Warren Buffett

Quarterly Commentary

The Quality Compounders team (Sam, Alex, Lachlan, and Shaun) are all personally invested in the stocks we recommend, and we are more passionate than ever to find and learn about new businesses and meet with passionate founders. We love doing what we do, and we thank you for trusting us to manage your capital, we will continue working as hard as we can to get you the best results we can over the long term.

The portfolio return for the period ended 30 September 2023 was -0.3% vs the All-Ordinaries index of -0.8%, The annualized return since inception is now 18.2%. The top performer for the quarter was **ProMedicus +27%** after announcing an enormous contract with a large hospital network called Baylor Scott & White for \$140M over 10yrs.

Inflation rates around the world continue to generally decline particularly in Europe and the USA, albeit with upside resistance during the last 2 months from increased oil prices. The major impact on markets in the past month has been the strength in employment, particularly in the US with larger than expected job openings. The strength in employment has driven interest rate *expectations* higher due to anticipated ongoing wage inflation. As you can see below job openings can be volatile monthly and are still generally trending lower over the past 2 years:



Current Portfolio – Top 5 holdings

Top Holdings	% Fund
Pro Medicus Ltd	21%
Netwealth Group Ltd	13%
Lovisa Holdings Ltd	11%
WiseTech Global Ltd	8%
Constellation Software Inc.	8%

During this quarterly we have included an outline and review of the portfolio of ASX companies that are underperforming which are creating the majority of drag on the portfolio:

CUV.ASX – Clinuvel Pharmaceuticals. We have owned and researched CUV since 2018 and since that time earnings have grown from \$15M to \$44M (almost 4x) and revenue has grown from \$25M to \$78M (3x), whilst the share price has declined from \$35 to \$14 (-60%), We have no explanation for this, nor have any of us ever witnessed in our careers a company that has organically grown earnings at this rate while its share price has performed like this. We do have confidence that the share price will recover at some point due to the weight of earnings and cash. This will either attract a takeover or a re-rate at some point. At this valuation it is trading well below the cost to create an FDA approved drug (typically they cost \$1.5B and CUV has a valuation of \$540M). We don't recommend any changes to this holding.

TRJ.ASX – Trajan Group Holdings. TRJ made their largest acquisition in their history called Chromatography Research Supplies Inc. (CRS) in June 2022. This business was forecast to add an additional A\$4.7M NPAT (The entire business only achieved \$1.9M NPAT for the year), this has resulted in the shareholders being frustrated by a seemingly underperforming business. Management are not being candid about matters like this which has created a lack of confidence and a lineup of large investors exiting their shareholdings. We would like to stick with management for another year.

OCL.ASX – Objective Corporation Ltd. OCL reported a well flagged slower growth period. The company guided to a slower growth year in FY23 with the accelerated end to the last of the Perpetual Right to Use (PRTU) contracts. This means there is a timing effect as this convert to more regular revenue than lumpy contracts. The market has received a few mixed messages from OCL as the company has now moved to capitalize some of its R&D (a stance they have held for a long time) The business still has \$60M of cash and is producing \$30M of NPAT per annum. We have long-term confidence in the OCL playbook by observing Tyler Technologies (TYL.NYS). In 2011 Tyler had a \$1B market cap, \$28M NPAT and traded on 36x earnings (almost exactly where OCL is today). Since 2011 TYL has compounded NPAT at 21% per annum and the stock has produced a 27% compounded return. We believe OCL will produce something like TYL over the coming 10years.

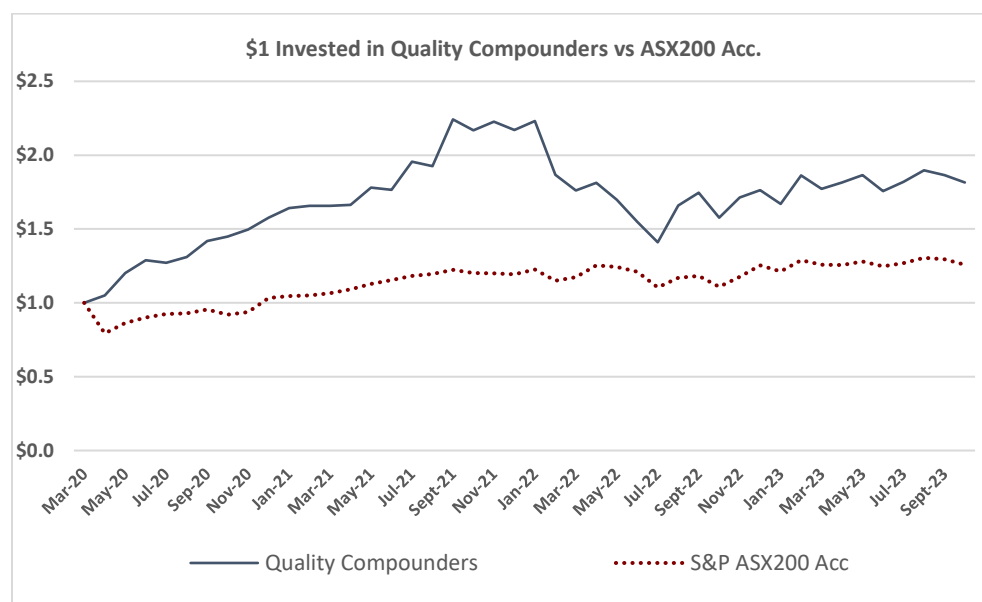
NAN.ASX – Nanosonics Ltd. NAN has an install base of 32,500 Trophon units worldwide. This install base produces recurring revenue of ~\$130M per annum at 90% gross profit margins. This is an incredible business, and it must not be forgotten how sticky and difficult businesses like this are to get to a stage like this. For example, it took NAN ~13years post FDA approval to build this install base, this is a large barrier to competitors. And this is why they trade on large valuations of ~40x NPAT. We remain confident in the long-term opportunity for NAN given their dominant position in a niche market. The market has temporarily lost faith in their ability to build new products. We think this is like FPH during 2012 when they were building their Nasal High Flow products the stock has been a 15x since then.

Things we have been working on

We have recently been reviewing the full year results from all the ASX listed businesses in the portfolio that released their FY23 results in August, we are happy with the continued growth delivered by the portfolio. The Australian stocks in the portfolio produced a median EPS growth of 19.4% and a median Return on Equity of 23.5% over the FY23 year:

	EPS Growth	ROE
CUV	47.0%	21.0%
LOV	17.0%	95.0%
MAQ	110.0%	8.0%
NAN	600.0%	13.0%
NWL	21.7%	59.0%
OCL	4.7%	31.0%
PME	34.9%	50.0%
PWH	4.8%	26.0%
TRJ	0.0%	1.5%
WTC	8.3%	13.2%
Median	19.4%	23.5%

Quality Compounders Performance Q3 FY23



	Sept23 Qtr	FY 2024	Since Inception (1 st Feb 2020)
Quality Compounders:	-0.13%	-0.13%	+82%
ASX200 Accumulated:	-0.69%	-0.69%	+26%

	FY20	FY21	FY22	FY23	FY24
Quality Compounders	27.1%	54.0%	-27.9%	29.1%	-0.3%
All Ords Acc. Reinvested	-7.6%	27.8%	-6.5%	14.8%	-0.8%
Outperformance	34.6%	26.2%	-21.5%	14.3%	0.5%

Summary and Outlook

Thank you for trusting us to manage some of your precious capital, we are as passionate as ever to keep compounding knowledge and capital and think we have some really good ideas to further improve performance of this portfolio over the coming 12 months.

Regards,

Quality Compounders Team

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