Firetrail Australian High Conviction Fund

SEPTEMBER 2020

PERFORMANCE (AFTER FEES)

	Month	Quarter	6 Months	1 yr	Fund incept (pa)[2]	3 yrs (pa)	5 yrs (pa)	7 yrs (pa)	10 yrs (pa)	Strategy incept (pa)[4]
Fund[1]	-2.46%	0.41%	21.48%	-9.39%	-2.21%	-	-	-	-	-
Strategy composite[3]	-2.46%	0.41%	21.48%	-9.39%	-	0.38%	7.46%	10.85%	8.95%	8.38%
Benchmark	-3.66%	-0.44%	15.97%	-10.21%	3.05%	4.84%	5.74%	7.33%	7.70%	6.09%
Excess Return	+1.21%	+0.85%	+5.51%	+0.82%	-5.26%	-4.46%	+1.71%	+3.52%	+1.25%	**+2.29%**

ABOUT FIRETRAIL

Firetrail is an investment management boutique which is majority owned by the Firetrail investment team. Additionally, the investment team is invested alongside clients in the investment strategies.

AUSTRALIAN HIGH CONVICTION FUND

The Australian High Conviction Fund ("Fund") is a concentrated portfolio (approx. 25 companies) of our most compelling equity ideas. The strategy is built on fundamental, deep dive research guided by the philosophy that 'every company has a price'.

INVESTMENT OBJECTIVE

The Fund aims to outperform the ASX200 Accumulation Index over the medium to long term.

PORTFOLIO POSITIONING 30 SEPTEMBER 2020

Top 3 Overweight Holdings (Alphabetical)
Newcrest Mining Ltd
OZ Minerals Ltd
Qantas Airways Ltd

FUND DETAILS

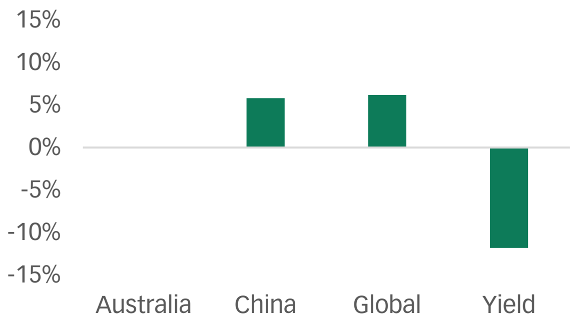
Unit prices	30 September 2020
Application price	$ 0.9128
Redemption price	$ 0.9082
NAV price	$ 0.9105

Fund Details	
APIR Code	WHT3810AU
Benchmark	S&P/ASX 200 Accumulation Index
Inception date	14 March 2018
Number of Holdings	28
Fund size	$343mil
Management fee*	0.95% p.a.
Performance fee*	15% of outperformance

*Please read the Product Disclosure Statement for more details

THEMATIC POSITIONING 30 SEPTEMBER 2020

Relative to the Benchmark



Past performance is not a reliable indicator of future performance.

1. Firetrail Australian High Conviction Fund ('Fund'). Net Fund returns are calculated based on exit price with distributions reinvested, after ongoing fees and expenses but excluding taxation. **2.** Fund inception is 14 March 2018. **3.** The Fund has been operating since 14 March 2018. To give a longer-term view of our performance for this asset class, we have also shown returns for the Firetrail Australian High Conviction Strategy Composite ('Strategy') which has been operating since 29 November 2005. Strategy performance has been calculated using the monthly returns (after fees) of the Fund from 14 March 2018 to current date, as well as the monthly returns of the Macquarie High Conviction Fund (after fees) between 29 November 2005 to 23 November 2017. The Fund employs the same strategy as was used by the same investment team that managed the Macquarie High Conviction Fund as at 23 November 2017. Firetrail has records that document and support the performance achieved as the Macquarie High Conviction Fund. The composite returns for the Strategy and the S&P/ASX 200 Accumulation Index (Benchmark) exclude returns between 24 November 2017 and 13 March 2018. During this period the investment team did not manage the Strategy. As such, the annualised performance periods stated are inclusive of the combined composite monthly returns, and do not include the period when the team were not managing the Strategy. For example, the annualised return over 3 years for the Strategy and benchmark are inclusive of 36 monthly performance periods available in the composite return period, excluding the period between 23 November 2017 and 13 March 2018. For additional information regarding the performance please contact us through the link on our website. Net Fund returns are in AUD terms. Net Fund returns are calculated based on exit price with distributions reinvested, after ongoing fees and expenses but excluding taxation. Past performance is for illustrative purposes only and is not indicative of future performance. **4.** Strategy inception 29 November 2005.

PORTFOLIO COMMENTARY

The Fund returned -2.46% for the month ending 30 September 2020, outperforming the ASX200 Accumulation index by 1.21%.

CONTRIBUTORS TO RETURNS

Positive contributors included **Qantas, Aristocrat** and **Amcor**. Negative contributors included **Virgin Money UK**, **Oil Search**, and underweight positioning in **CSL**.

COMPANY AND INDUSTRY NEWS

The market continues to go back and forth between optimism and pessimism about trends in COVID and the implications for economic growth. The only thing we continue to see is unwavering dedication from Governments to provide assistance to help get the economy back on its feet once mobility restrictions ease. The longer it takes to get back up and running, the more money that will be printed.

The biggest trend we are seeing is coming from Governments around the world. Post GFC, monetary policy has been the tool of choice. Post COVID, fiscal policy has been well and truly added. The focus is jobs and the fastest way to get people working is through housing and infrastructure. Time and time again, ex-China infrastructure has promised much, but delivered little. Grandiose promises during elections have often failed to materialise. The difference this time is that there is generally bipartisan support given the alternative to inaction would be a global depression. We are seeing housing booms around the world. The Portfolio is well positioned for continuing Government stimulus given our positioning in cyclicals including resources (focused on base metals and electric vehicle materials), energy (Worley / Oil Search), building (Bluescope / Lendlease) and construction (Downer).

Lendlease

This month, we focus in on Lendlease and outline the case for >$20 / share (vs $11). Lendlease is a classic 'What Matters' opportunity.

The Entry, then Exit of Engineering

On 21 December 2010, Lendlease acquired "leading Australian engineering and construction business" Valemus for $960m. In hindsight, the move into engineering would prove to be a massive mistake.

At the time, the rationale was that moving into engineering would:

- Open up growth in infrastructure and public private partnerships
- Diversify Lendlease beyond property

The business became non-core in 2019 after three disastrous project outcomes in QLD (Kingsford Smith Drive), NSW (NorthConnex) and VIC (Melbourne Metro). The key issue is that fixed price, lump sum turnkey contracting on mega projects transfers too much risk to the executing contractor. When things go bad, the contractor and their shareholders eat the cost overruns, leading to major losses.

On 19 December 2019, Lendlease announced the divestment of their Engineering business to Acciona. Disappointingly for investors, the largest problem project, Melbourne Metro, will remain in the hands of Lendlease.

On 9 September 2020, the sale to Acciona completed.

We believe the engineering business has been a major reason for not only financial underperformance, but also accounts for a large discount applied to the total business.

In addition to the sale of engineering, a recent strategy update included further simplification of the business including:

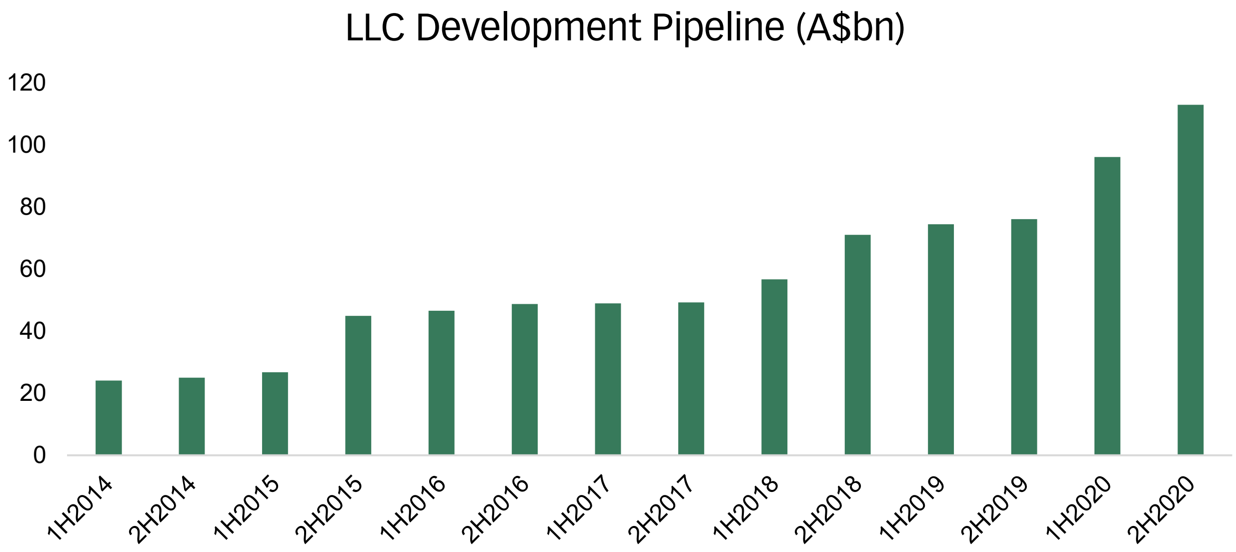
- Exit of engineering services – could be considered 'good engineering', and may fetch around $250m
- Sale of a stake in retirement – current book value is $1.3bn, and there is potential to move from current 75% to 25-50% over time
- Sale of telco towers which was completed at book value, a shade under $300m

These actions make a clear point. **Lendlease is getting simpler and more focused, and that is good for shareholders.**

What Matters 1: Development to accelerate

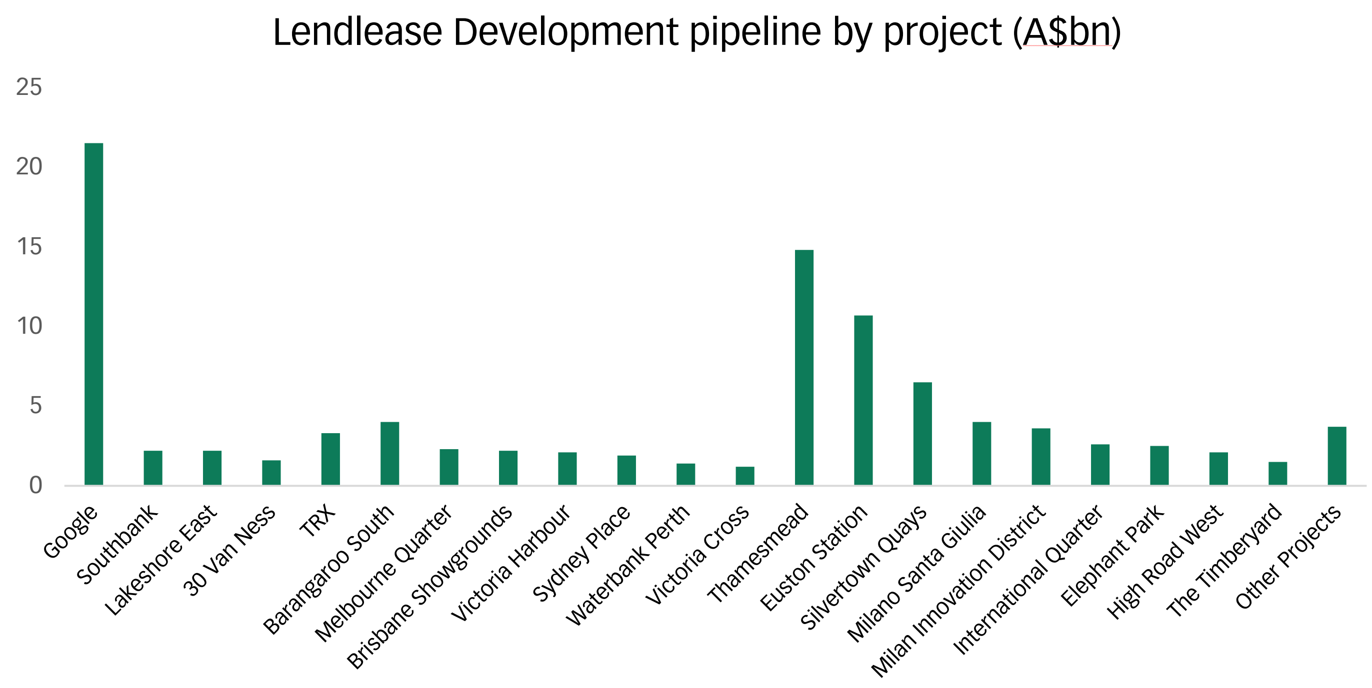
Accelerating development is a key area of shareholder value creation over the coming years.

Lendlease has made significant progress in securing a large development pipeline across their target gateway cities including Sydney, London, Milan, San Francisco, and Chicago. Importantly, the development pipeline is secured in a low capital fashion. That means Lendlease has not bet the business on capital intensive land bets and will not display the cyclicality of a traditional property developer.



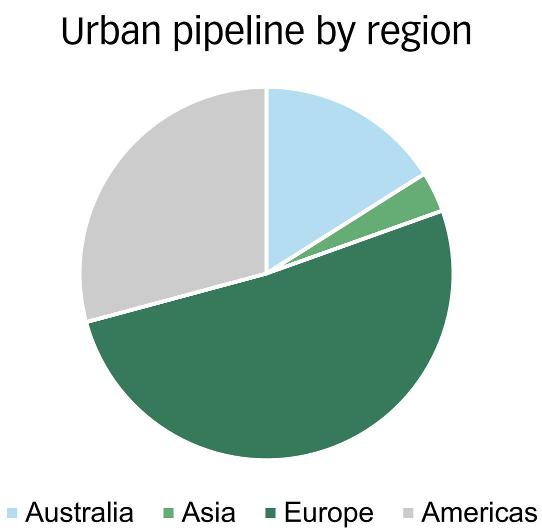
Source: Firetrail, Lendlease releases

The development pipeline features a number of high-profile projects such as the $20bn+ Google development. You can see the below make of the projects sorted by region (US, Asia, Australia, Europe) and sorted by size.



Source: Firetrail, Lendlease releases

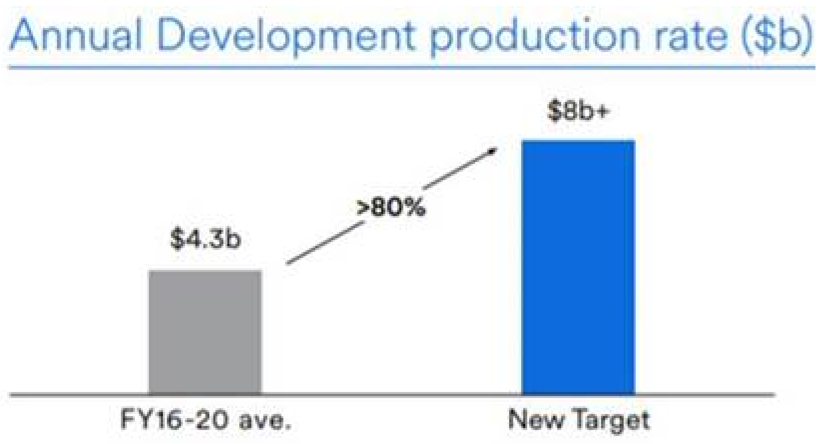
If you look at the pipeline by region, you can see major success outside Australia, most notably Europe (Milan and London) and Americas (San Francisco).



Source: Firetrail, Lendlease releases

To date, the development pipeline has not translated to earnings. It is future earnings that have been secured for the future.

At the recent Lendlease investment day, the company outlined plans to convert the new pipeline into earnings.



Source: Lendlease strategy day, 31 August 2020

Accelerating the pipeline is not a trivial task. Lendlease are going to need three things to make it work:

1. Planning approvals from Governments
2. Tenants willing to commit to leases, whether office or residential
3. Capital partners willing to invest in new assets

COVID has definitely slowed the tenant market down, particularly in office. However, the outlook for planning approvals and capital partners has improved vs pre-COVID. Beyond some of the challenges today, the acceleration of the development pipeline looks very promising.

What Matters 2: Investments to grow

Lendlease have missed some large opportunities to grow the investment business since the GFC. While the likes of Macquarie, Goodman and Charter Hall have all focused on growing funds management in assets such as infrastructure, logistics and office, Lendlease has lagged behind. The benefit of growing investment management is that the earnings become much more predictable and that leads to a higher multiple applied to the earnings.

From here on, we believe Lendlease can now grow their investment management business materially in two key ways:

1. Organically – Convert the development pipeline to investment management. The Lendlease development is focused on residential build-to-rent and office. Both asset classes remain attractive to institutional investors.

2. Inorganically – Lendlease has material development expertise and can acquire assets alongside their c.150 investment partners and add value to them.

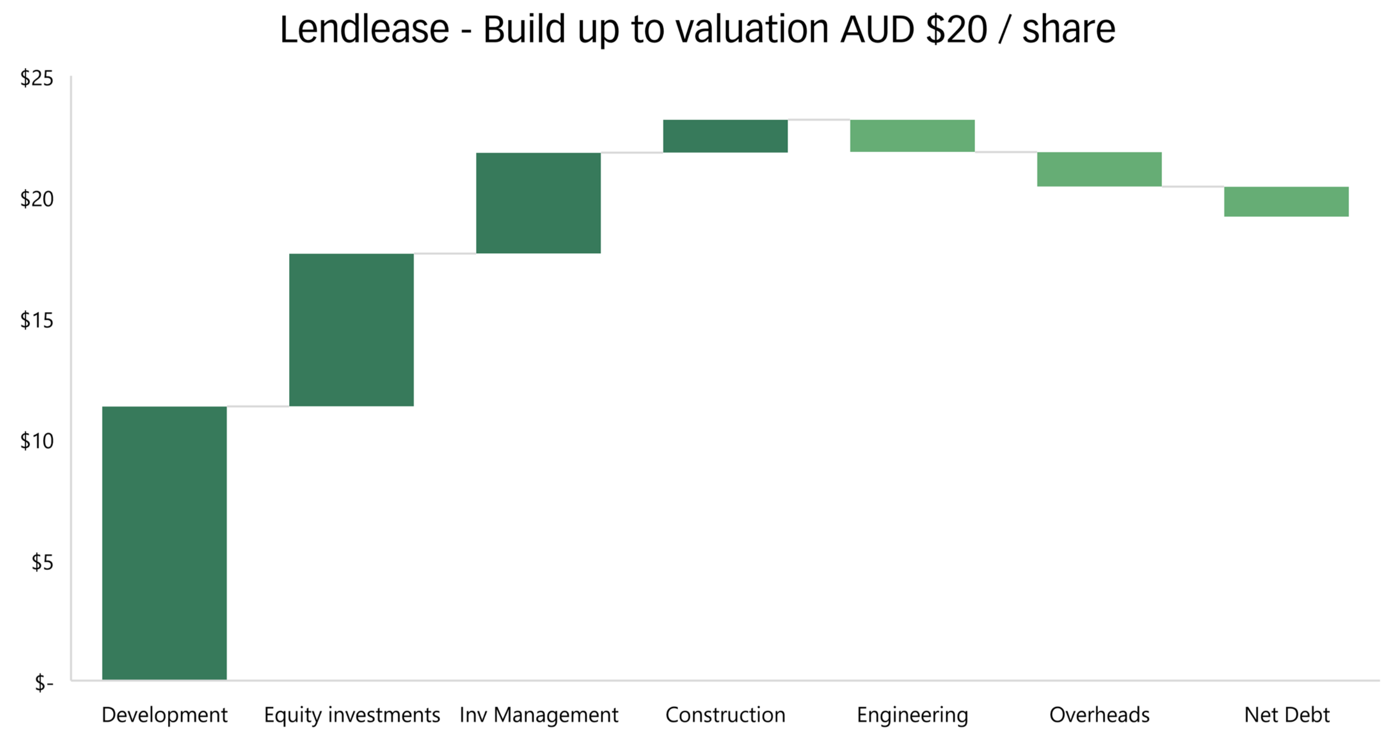
What could it look like?

On our numbers, IF Lendlease can grow from $36bn of FUM today to $80bn – Investment management earnings would more than triple and in today's money could equate to $7 / share. At month end, the Lendlease share price is $11, meaning there is material upside from growing investment management. Our forecasts do not assume that kind of upside, but that gives an insight.

In the Lendlease strategy briefing, they outlined a case to get to $100bn+ of FUM over the medium term, which includes $50bn of growth from development conversion, with the balance coming from inorganic activity.

Summing it up

The painful thorn of engineering has largely been pulled from the side of Lendlease, and the actions of management show a clear move to focus the business. The global development pipeline is now set to accelerate, driving earnings growth, and also feeding a higher multiple investment management business. While there are some short term COVID headwinds around office, it could equally be argued that COVID will provide tailwinds in Government approvals and capital demand for assets. For the patient investor willing to look beyond the now, there is material upside to Lendlease.



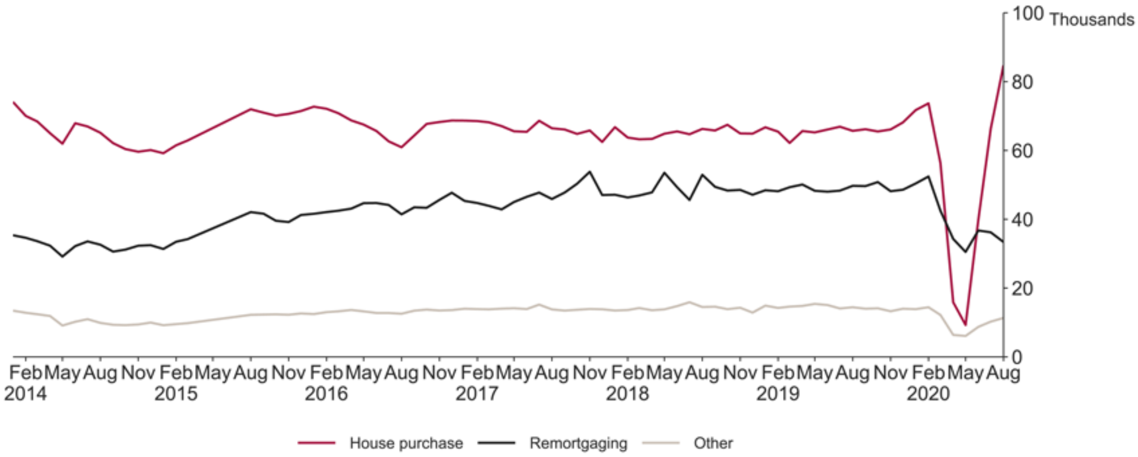
Source: Firetrail

PORTFOLIO POSITIONING AND CHANGES

We slightly added to cyclical exposure during the month including **Virgin Money UK** and **Oil Search**.

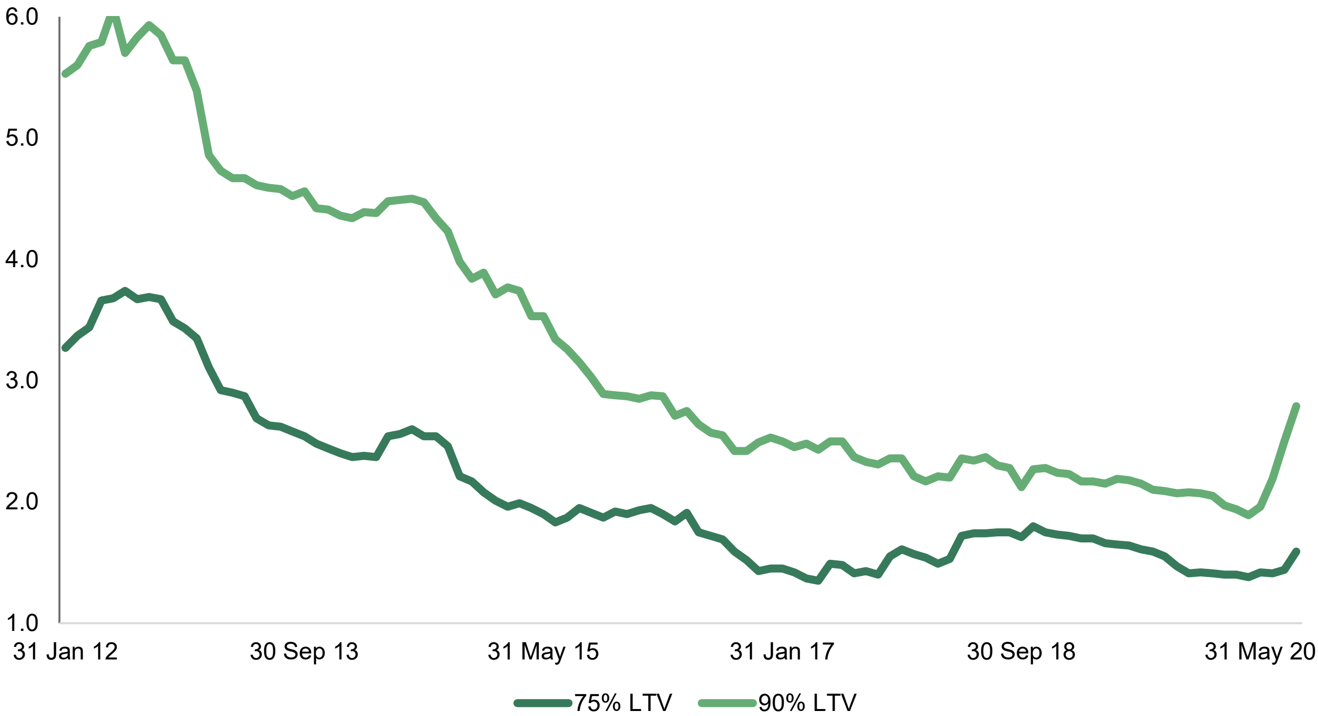
In the case of Virgin Money UK, concerns about UK lockdowns and Brexit led to material underperformance. On the other side of the coin, Virgin is benefitting from strong loan growth as well as rising margins. Our research suggests that mortgage pricing is going up across the industry as many banks struggle to handle the higher loan application volumes. The big question remains on bad debts and loan deferrals, but we do believe Virgin is well placed with a capital ratio in excess of 13%

UK Mortgage approvals (seasonally adjusted) – August approvals highest since October 2007



Source: Bank of England

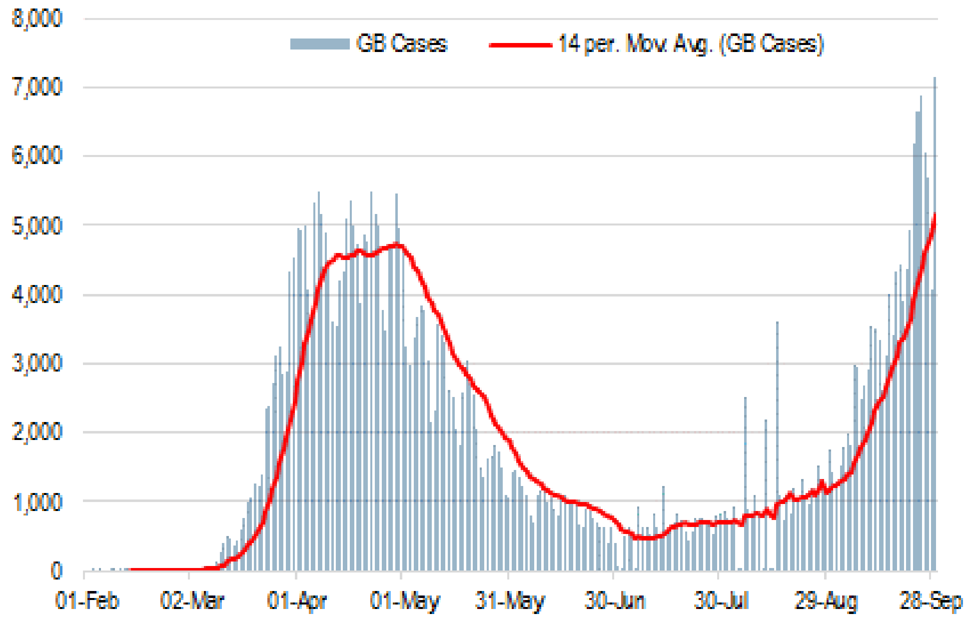
UK 2-year Fixed mortgage rates – rate bounce with approvals level



Source: Bank of England

We now have a number of case studies on offer on market behaviour around COVID. Panic rises as cases rise, mobility restrictions are implemented, and cases begin to subside. We are relying on Governments to continue to support things during the stress period, but we see nothing to suggest that will not continue to be the case. We are trying to be as counter cyclical as we can and use panic to our favour. Virgin continues to trade heavily distressed in our view (0.3x NTA) and it wouldn't surprise us to see a material re-rating if just a few things don't end up as bad as is currently priced in (Brexit, bad debts) let alone if there is some good news such as higher mortgage pricing.

UK COVID Cases – hitting new highs



Source: JPM

ONE INTERESTING THING THAT HAPPENED THIS MONTH…

Nufarm's Omega-3 oil was named as a finalist for the Global Aquaculture Alliance Innovation of the Year award. The recognition comes as the canola-based product, named Aquaterra, has the potential to double the world's supply of omega-3, the key ingredient to grow fish.

Nuseed partnered with scientific and industry leaders at all stages of product development. Leading feed innovators Skretting, BioMar and Salmofood have tested the performance of the oil through extensive feeding trials. World recognised salmon producers, including AquaChile and Multiexport, have also piloted the novel Omega-3 oil at a commercial scale. The results surpassed expectations and indicated Aquaterra improves fish health and welfare.

MORE INFORMATION

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