

FIRETRAIL ABSOLUTE RETURN FUND

MONTHLY REPORT | SEPTEMBER 2021

PERFORMANCE (AFTER FEES)

	Month	Quarter	6 Months	1 Year	2 Years p.a.	3 Years p.a.	Fund inception p.a. ²	5 Years p.a.	Strategy inception p.a. ⁴
Fund ¹	1.67%	2.36%	-4.22%	7.14%	14.19%	6.97%	6.69%	-	-
Strategy composite ³	1.67%	2.36%	-4.22%	7.14%	14.19%	6.97%	-	6.68%	12.43%
Benchmark	0.01%	0.03%	0.05%	0.11%	0.29%	0.65%	0.78%	0.98%	1.14%
Excess Return	+1.66%	+2.33%	-4.27%	+7.03%	+13.89%	+6.32%	+5.91%	+5.70%	+11.29%

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.

ABSOLUTE RETURN FUND

The Absolute Return Fund ("Fund") is a market neutral strategy with minimal correlation to equity market direction. It aims to generate positive returns in all market environments. 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 RBA Cash Rate over the medium to long term.

PORTFOLIO POSITIONING

30 SEPTEMBER 2021

Top 3 Overweight Holdings (Alphabetical)
Crown Resorts
Newcrest Mining
Santos

FUND DETAILS

Unit Prices	30 September 2021
Application price	\$ 1.2590
Redemption Price	\$ 1.2502
NAV Price	\$ 1.2546
Fund Details	
APIR Code	WHT5134AU
Benchmark	RBA Cash Rate
Inception date	14 March 2018
Fund size	\$373mil
Management fee*	1.50% p.a.
Performance fee*	20% of outperformance above an annual Hurdle

*Please read the Product Disclosure Statement for more details.

FUND EXPOSURE AT 30 SEPTEMBER 2021

	Portfolio Exposure
Long Equity	180.5%
Short Equity	(180.5%)
Net Equity Exposure	0.0%

Past performance is not a reliable indicator of future performance.

1. Firetrail Absolute Return 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 Absolute Return Strategy Composite ("Strategy") which has been operating since 30 June 2015. 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 Pure Alpha Fund (after fees) between 30 June 2015 to 23 November 2017. The Fund employs the same strategy as was used by the same investment team that managed the Macquarie Pure Alpha Fund as at 23 November 2017. Firetrail has records that document and support the performance achieved as the Macquarie Pure Alpha Fund. The composite returns for the Strategy and the RBA Cash Rate (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 30 June 2015.

PORTFOLIO COMMENTARY

The Fund returned positive 2.36% for the quarter ending 30 September 2021, outperforming the RBA Cash Rate benchmark by 2.33%. For the month of September, the fund returned positive 1.67%, outperforming the benchmark by 1.66%.

WHAT'S DRIVING MARKETS?

The Australian market limped to close flat for the September quarter despite a strong August buoyed by reporting season. Energy was the best performing sector (+8%), whilst Materials fell the most (-13%).

A few factors contributed to the market sell off during September:

- The US Federal Reserve reiterated its intention to completely wind back quantitative easing by mid-2022, a negative for asset prices.
- An increase in inflation expectations started to take hold. The US Fed sees inflation running at over 4% in 2021, above previous estimates.

Talk of tapering, and higher inflation coincided with increased expectation for interest rate rises. The market is now factoring in 3 hikes in 2023, up from 2 earlier in the year. Higher interest rates mean future expected cashflows are worth less today, a negative for valuations.

Closer to home, the Australian market was roiled by news of China's second largest property developer Evergrande staring down insolvency. The Chinese property sector is the largest consumer of steel. Concerns around the knock-on effect on broader China property activity hurt commodities. Iron ore collapsed from a high of US\$247/t to US\$110/t through September. Commodities linked to general economic activity such as Copper have also suffered falls in recent weeks.

A bright spot for the market and Firetrail Absolute Return Fund during the September quarter was Energy. Outperformance was driven by a burst in interest as demand for energy commodities in China and across Europe saw a dwindling of gas stores, sending prices soaring. Demand for other energy sources such as oil and coal have also surged ahead of the Northern Hemisphere winter. This is having a spill over effect into other energy derivatives such as soft commodities and fertilisers which are also enjoying a resurgence.

PORTFOLIO CONTRIBUTORS & DETRACTORS

The Firetrail Absolute Return Fund enjoyed a strong finish to the September quarter. Investing in the Fund requires a minimum 3-year timeframe. The Fund has never underperformed on a rolling 3-year basis, and we remain incredibly confident about the available prospects through FY22.

We currently see stocks leveraged to global growth and reopening providing greater opportunities overall. This is reflected in the Fund's value and cyclical tilt over more yield sensitive and growth sectors.

Stock selection continues to be our focus and helped drive the outperformance through the September quarter. Breaking it down further the portfolio was driven by the following:

- The long portfolio added +3.7% - Driven by positive contributions from our high conviction (mid-large cap) positions and small company positions.
- The short portfolio detracted 1.4% - Fundamental shorts performed well during the quarter as the portfolio benefitted from shorts in companies that downgraded earnings during August results season. However, risk shorts which are used to hedge equity exposure and thematic risk detracted from portfolio returns.

Some of the standouts from the September quarter included:

- **Ardent Leisure** was up 56% in the quarter. Ardent is an operator of entertainment assets across Australia and the US. The FY21 result was well ahead, with positive momentum continuing into the 1H22 led by Main Event in the US. Ardent remains a key reopening position for the Fund, with the valuation expected to continue to re-rate as the company executes on its growth strategy.
- **Home Consortium** returned 41% for the quarter as the market contemplated medium term AUM aspirations of ~10bn by 2024. HomeCo is transitioning from an asset-heavy real estate income trust to a high growth fund

manager and is earning a reputation for execution under the leadership of David Di Pilla. HomeCo was also included in a global index during the month.

- **Qantas** increased 21% in the quarter after providing the market with increased confidence around its balance sheet and liquidity position. The stock was further buoyed following a more rapid local vaccine rollout, paving the way for an earlier than expected resumption of both domestic and international travel.

Detractors to portfolio performance in the period included the following:

- **Crown Resorts** declined 23% for the quarter following concerns post the Victorian Royal Commission that Crown may be stripped of its Victorian Casino Licence. The Commissioners final recommendation is due mid-October. However, we believe the market is already factoring in high probability of a negative outcome regarding Crown's position in Melbourne. Our bear case scenario sees the shares well supported around \$9/share owing to Crown's Melbourne hotel assets and the leasehold on the Casino.
- **Newcrest** fell 11% in the quarter, reflecting a sluggish gold price and higher FY22 cost guidance that drove consensus earnings downgrades. Looking forward, we expect positive catalysts in the form of pre-feasibility studies on Lihir, Red Chris and Havieron to be delivered before the end of 2021.
- **BlueScope** shares were down 10% in the quarter despite a solid FY21 earnings result and upgraded FY22 guidance. Concerns around peak steel margins emerged in September following slowing Chinese data and a more hawkish US Fed Reserve sparking concerns around the global growth outlook. BlueScope's position as a global cyclical means it is at the forefront of such concerns. However, we believe the valuation already significantly discounts steel prices and margins into the future. On a through the cycle view the stock is compelling at sub-10x PE, with a solid balance sheet and scope for further buybacks.

INCITEC PIVOT DEEP DIVE

Incitec was one of the Absolute Return Fund's top performers in the September quarter. We remain confident around the near-term prospects for earnings. Longer term we are also increasingly more bullish on industry structure given the shifting sands around energy security and decarbonisation.

In a nutshell

Incitec is one of a handful of Australian integrated industrial manufacturing businesses. It produces and distributes Fertilisers and Explosives in Australia and the US. Nitrogen is typically combined with other elements such as hydrogen to produce products such as ammonia, ammonium nitrate, urea, and phosphate.

A key input of production is natural gas, which dictates the end commodity prices Incitec sells. The company has long term gas supply arrangements in Australia and accesses cheap gas in the US versus more expensive regions, providing a cost advantage when global energy prices are rising. The current environment of higher global energy demand and prices is fuelling a much more positive earnings backdrop, which we believe could drive a multi-year valuation re-rating.

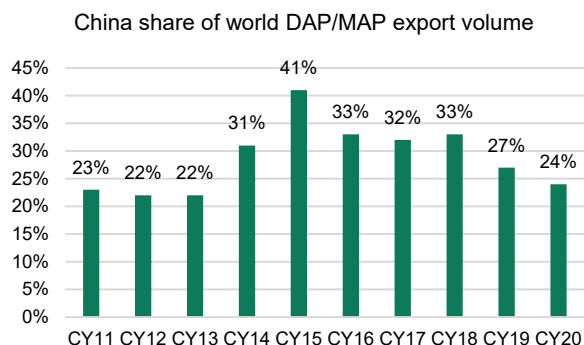
Earnings upgrades supported by commodity prices

The current up-cycle in fertiliser commodity prices is in its second year driven by higher soft commodities demand and prices. Prices for Corn, Soy and Wheat, for example, are up 15-30% over the past year. Elevated crop prices are underpinning farmer balance sheets and the willingness to pay for key inputs such as fertilisers.

While demand has led the current cycle, supply issues are likely to extend it. Gas, which is the key input, is seeing a surge in prices globally as the market tightens. This is unlikely to get better anytime soon with the key Northern Hemisphere winter demand period approaching and no meaningful new supply additions until later in 2022. Gas prices in Europe have surged above \$25-30/GJ. Fertiliser producers are idling plants, further tightening supply, and placing upward pressure on global prices.

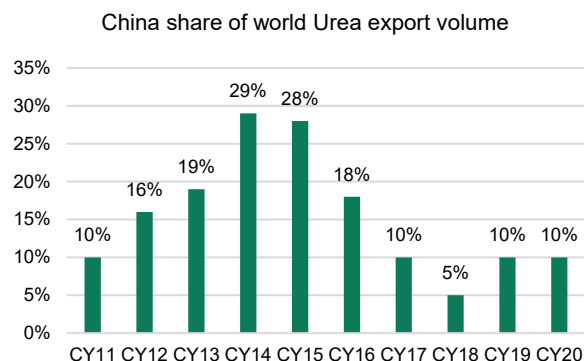
These demand-supply dislocations typically take time to mean revert, which provides a structural element to the current pricing outlook for Incitec's key products.

Figure 1. China’s share of world DAP/MAP export volume has declined



Source: CRU, Firetrail, September 2021

Figure 2. China’s share of world Urea export volume has declined



Source: CRU, Firetrail, September 2021

Improving industry structure underpins longer term earnings

Meanwhile in China we are seeing government intervention to halt fertiliser exports. Presumably this is driven by a desire to control local prices and secure domestic supply ahead of the upcoming key cropping season. China is an important supplier of fertiliser to global markets, previously accounting for as much as 40% of global exports of some commodities.

China’s absence from exports adds fuel to the fire near term. However, we question China’s longer-term ambitions as a low-cost exporter. As the charts below highlight, fertiliser exports have already been declining in recent years. A recent focus on decarbonisation in China’s Steel industry appears likely to spill over into other high polluting sectors such as fertilisers. Steel exports for example peaked at >150mt in 2016 but have declined to 40-50m in recent years as structural reform has been implemented. We believe increased focus on decarbonisation will drive further consolidation across other industries.

China uses coal gasification technology to produce the gas needed to produce nitrogen. Other inputs such as phosphates use highly intensive, high-cost mining techniques. The drive to decarbonise could mean China takes a backward step from its role over the past decade to export energy deflation.

Undemanding expectations

We believe 2022 earnings will build on current conditions and help underpin Incitec’s share price performance as market upgrades for higher commodity prices flow through. Consensus is currently sitting materially below spot prices for both ammonia and DAP in FY22 and FY23. Using the company’s stated sensitivities and consensus forecasts we see material earnings upgrades into FY22 if current prices persist.

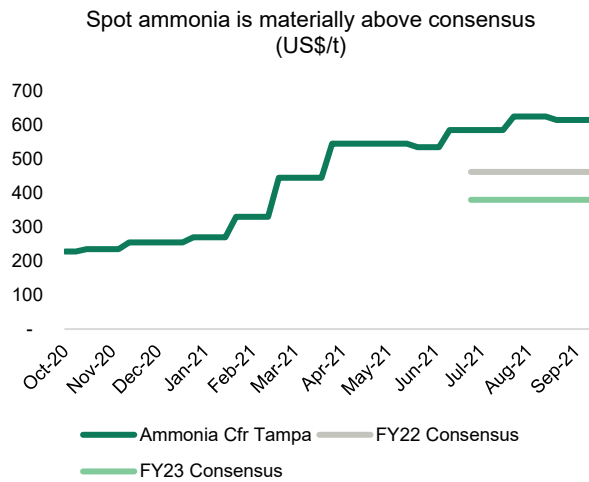
Valuation also looks compelling with the stock trading at a 20% PE discount to the market on current FY22 earnings forecasts compared to a 5-year average discount of 5%. This discount looks unwarranted given likely earnings upgrades discussed above.

Figure 3. Valuation looks compelling with the stock trading at a 20% PE discount to the market on current FY22 earnings forecasts compared to a 5-year average discount of 5%.

Commodity	Unit	Spot	Consensus FY22	Difference	EBIT sensitivity	EBIT uplift
Ammonia	US\$/t	665	460	205	US\$10/t = US\$3.7m	76
DAP	US\$/t	652	510	142	US\$10/t = US\$9m	130
Gas	US\$/MMBtu	6	4	2	US\$0.10/MMBtu = US\$1.3m	-26
Total	US\$m					180
FX	AUD:USD					0.72
Earnings uplift	A\$m					250
% Upgrade to FY22	%					37%

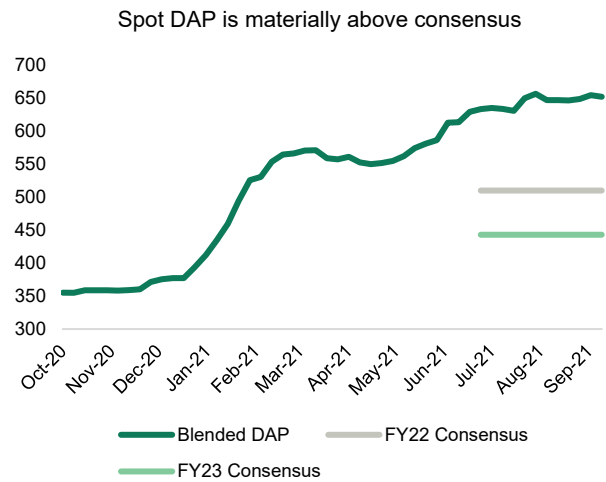
Source: Incitec Pivot, Firetrail, September 2021

Figure 4. Spot ammonia is materially above consensus



Source: Bloomberg, Visible Alpha, Firetrail, September 2021

Figure 5. Spot DAP is materially above consensus

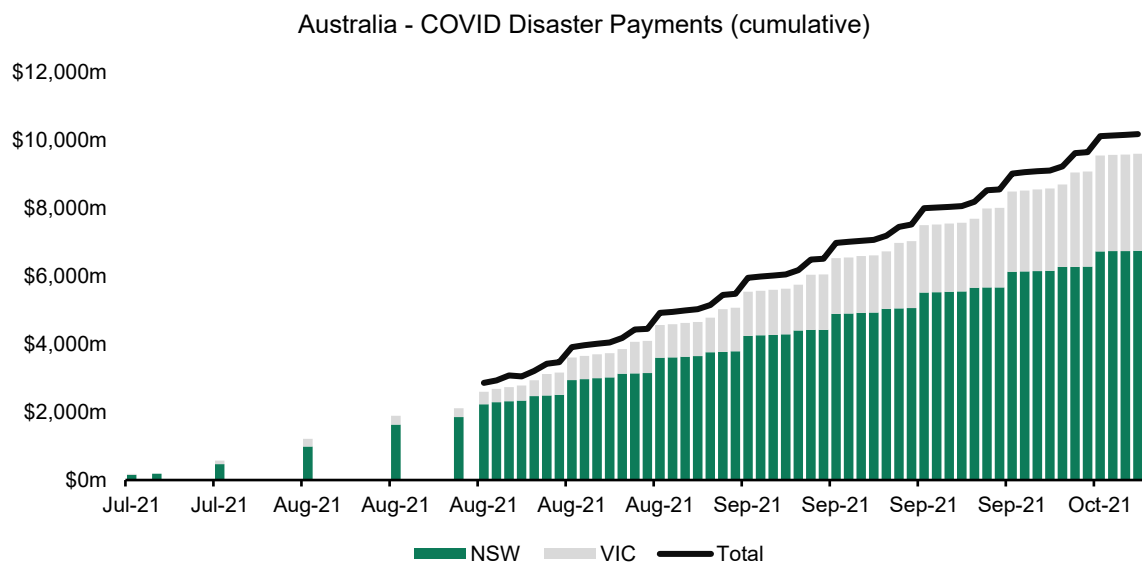


Source: Bloomberg, Visible Alpha, Firetrail, September 2021

ONE INTERESTING THING THAT HAPPENED THIS MONTH

During the month NSW received updates to its reopening plan, as it progressed towards the 70% double dose vaccination level. 'Freedom Day' is set for Monday 11 October, over 100 days after NSW went into lockdown. The government disaster payments have provided material support to businesses and individuals during this time. Businesses in NSW have received over \$5.3bn in government grants since 19 July (plus other relief for rents, payroll tax, etc). A further ~\$5.5bn has been paid in income support to individuals losing hours of work. Combined, these payments are equivalent to ~7% of NSW's quarterly Gross State Product!

Figure 6. Businesses in NSW have received over \$5.3bn in government grants since 19 July



Source: Macquarie, Firetrail, September 2021

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