

FIRETRAIL AUSTRALIAN HIGH CONVICTION FUND

MONTHLY REPORT | JUNE 2023

PERFORMANCE (AFTER FEES)¹

	Month	Quarter	1 Year	3 Years p.a.	5 Years p.a.	Fund inception p.a. ³	10 Years p.a.	Strategy inception p.a. ⁵
Fund ²	(0.09%)	2.08%	13.59%	12.51%	4.82%	5.68%	-	-
Strategy composite ⁴	(0.09%)	2.08%	13.59%	12.51%	4.82%	-	10.45%	9.18%
Benchmark	1.76%	1.01%	14.78%	11.12%	7.16%	7.79%	8.23%	7.06%
Excess Return	-1.84%	+1.06%	-1.19%	+1.40%	-2.33%	-2.11%	+2.23%	+2.12%

1. Past performance is not indicative of future performance

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 ASX 200 Accumulation Index over the medium to long term (after fees).

PORTFOLIO POSITIONING – 30 JUNE 2023

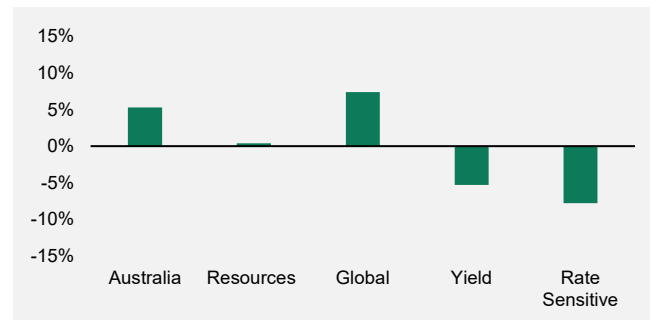
Top 3 Overweight Holdings (Alphabetical)
CSL Ltd
Newcrest Mining Ltd
Santos Ltd

FUND DETAILS

Unit Prices	30 June 2023
Application price	\$1.1856
Redemption Price	\$1.1820
NAV Price	\$1.1838
Fund Details	
APIR Code	WHT3810AU
Benchmark	S&P/ASX 200 Accumulation Index
Inception date	14 March 2018
Risk/Return Profile	High
Number of Holdings	27
Fund size	\$629mil
Management fee*	0.90% p.a.
Performance fee*	15% of outperformance above an annual Hurdle

*Please read the Product Disclosure Statement for more details

THEMATIC POSITIONING – 30 JUNE 2023



Source: Firetrail. Relative to the Benchmark

Past performance is not a reliable indicator of future performance.

The Product Disclosure Statement ('PDS') and the Target Market Determination ('TMD') of the Fund is available at www.firetrail.com. Any potential investor should consider the PDS and TMD before deciding whether to acquire, or continue to hold units in, the Fund.

2. 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. 3. Fund inception is 14 March 2018. 4. 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. 5. Strategy inception 29 November 2005.

PORTFOLIO COMMENTARY

The Fund returned negative 0.09% (after fees) for the month ending 30 June 2023, underperforming the ASX 200 Accumulation Index by 1.84%.

The Fund returned 2.08% (after fees) for the quarter ending 30 June 2023, outperforming the ASX 200 Accumulation Index by 1.06%.

CONTRIBUTORS TO RETURNS

Positive contributors to monthly returns included AGL, QBE Insurance, and Bluescope Steel. Negative contributors included BHP, CSL, and SEEK. We discuss each further in our commentary below.

POSITIVE CONTRIBUTORS

AGL

AGL outperformed in June after providing FY2024 earnings guidance ~15% above consensus forecasts and clarifying future capital expenditure intentions. Of the \$20 billion that AGL has earmarked for investment on the energy transition, roughly half will be on AGL's balance sheet, and only \$4 billion will be spent between now and 2030. This capex profile enables AGL to pay out 50-75% of profits as dividends, providing a strong, sustainable yield for investors.

QBE Insurance

QBE Insurance outperformed during the month. Positive sentiment was influenced by a rise in global bond yields. The most relevant bond yields for QBE's investment portfolio are 2-year bond yields, which rose 50 basis points in the US and Australia, and nearly 100 basis points in the UK.

Bluescope Steel

Bluescope outperformed in June as steel spreads in its US steelmaking business continued to hold above through-cycle levels. Spreads have been supported by price increases from two of Bluescope's major competitors.

NEGATIVE CONTRIBUTORS

BHP (underweight)

BHP outperformed on continued speculation of further China stimulus targeted at the property sector. We are observing developments in China closely. However, we continue to believe stimulus measures will be aimed at achieving stabilisation rather than spurring a material lift in activity.

CSL

CSL shares underperformed after the company released an update on FY2023 and FY2024 earnings expectations. FY2023 guidance was moved to the top end of the previous range. However, expected profit growth of 13-18% in FY2024 fell short of market expectations. We are seeing very strong improvements in the cost of inputs for CSL's plasma business. However, we expect this to take 9-12 months to flow through to improved margins in the P&L.

SEEK

SEEK underperformed during the month as a number of brokers revised FY2024 earnings forecasts lower. May job ad volumes declined 1% month-on-month and are now down 22% year-on-year. While the economic environment will pose short-term headwinds, we believe SEEK is materially undervalued on a medium-term view considering its quality growth characteristics.

COMPANY AND INDUSTRY NEWS

The ASX 200 rose 1.8% in June, driven by strong returns for materials, technology and financial stocks. The dominant global themes during the month were the anticipation of further China stimulus and increased central bank hawkishness due to sticky inflation. After rising ~50 basis points in June, two-year Government bond yields now sit above 4% in Australia and above 5% in the US.

In Australia, consumer-facing businesses continued to report weaker sales trends, with profit warnings from a number of companies including Harvey Norman, Adairs, Baby Bunting and Domino's Pizza. Continued consumer weakening is now becoming consensus thinking, albeit views still diverge around the impact. The consumer continues to be resilient in many service categories, but goods demand has been noticeably weak. The labour market also appears to be holding up assisted by population growth. 76,000 jobs were added in May and the unemployment rate declined from 3.7% to 3.6%.

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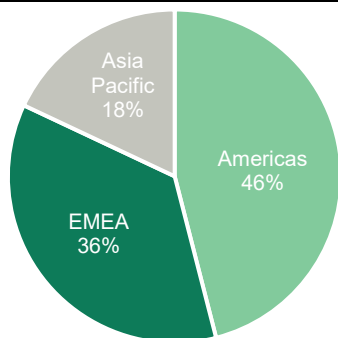
STOCK DEEP DIVE – WORLEY

Worley is a contracting firm that provides engineering expertise to clients around the world. We initiated a new position in Worley during the quarter due to our view that end-market demand and an improved competitive environment will enable Worley to grow earnings materially over the next three years. We outline our thinking below.

Worley’s end markets are firing

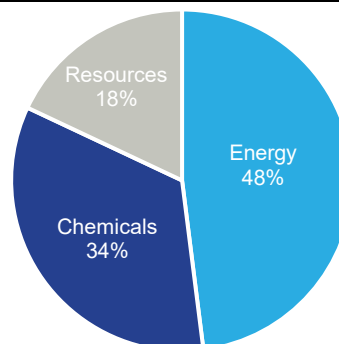
Worley is one of the three largest global engineering firms. It generates annualised revenue of over A\$10 billion, predominantly earned in the US and EMEA.

Figure 1: Worley 1H 2023 revenue by region



Source: Company reporting, June 2023

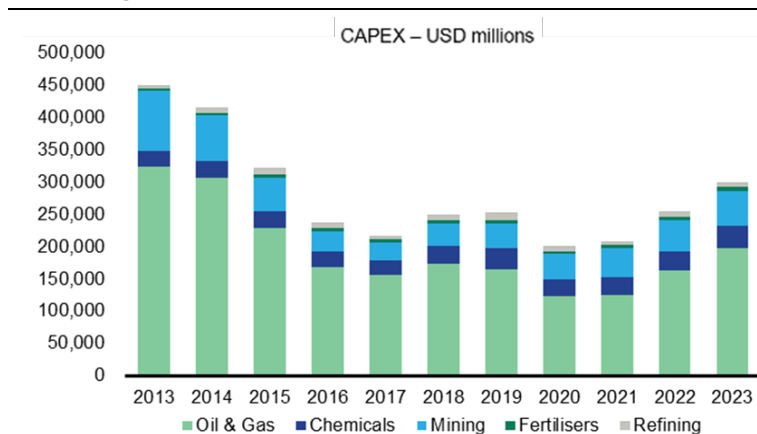
Figure 2: Worley 1H 2023 revenue by sector



Source: Company reporting, June 2023

Worley’s revenue is tied to capex investments made by its key customers in the oil & gas, chemicals and mining sectors. After a decade of declines, customers are starting to spend again. Figure 3 shows the aggregate capital expenditure across 40 large, listed companies from Worley’s key client segments. Capex appears set to recover to an 8-year high in 2023. This is still well below previous peaks.

Figure 3: Capital expenditure is starting to rebound (aggregate spend across 40 large, listed companies from Worley’s key client segments)

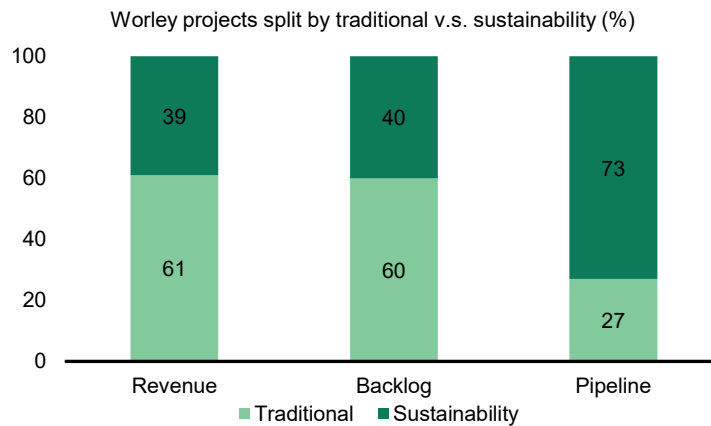


Source: Firetrail, June 2023

The mix of investment spend is changing. Currently, 40% of Worley’s revenues and backlog are derived from projects related to sustainability. For example, carbon capture and battery materials. Worley is targeting 75% of group revenues to be derived from sustainability projects by 2026, which is supported by a pipeline skewed to sustainability projects as shown in Figure 4.

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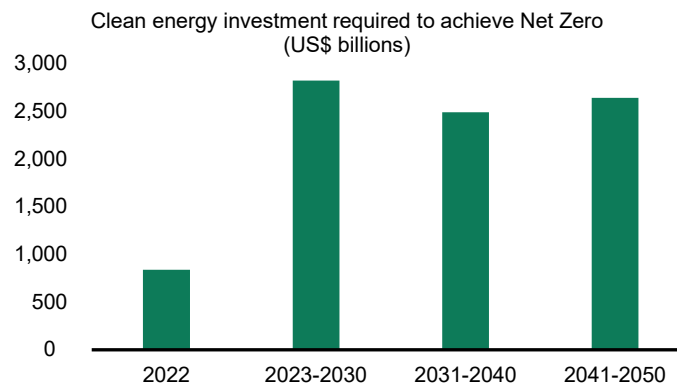
Figure 4: Worley’s mix of projects is shifting towards a higher proportion of sustainability-related projects.



Source: Firetrail, company presentations, June 2023

The outlook for spend on energy transition projects is understandably very strong. Investment spend on clean energy projects needs to step up materially to accelerate the transition away from fossil fuels. BloombergNEF estimates that the level of investment in energy transition projects needs to lift three times its current levels from 2023-2030 to set us on a path to hit net zero targets.

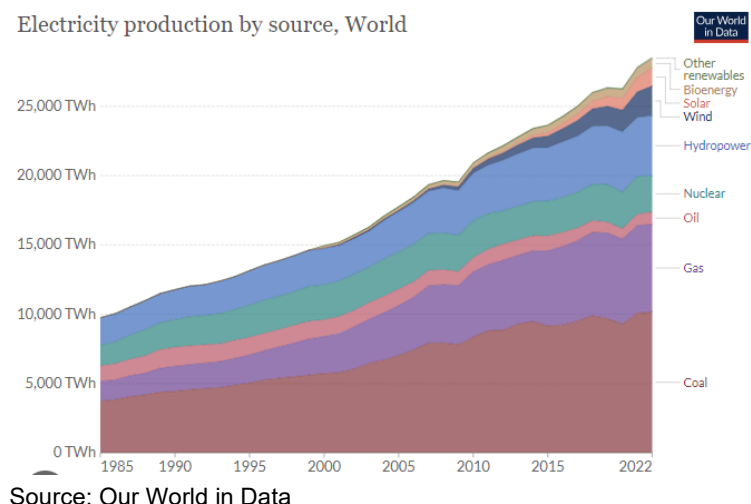
Figure 5: Annual energy transition investments need to grow at 3x the current pace from 2023-2030 to achieve Net Zero targets



Source: BloombergNEF, Firetrail, June 2023

At the same time, investment in traditional energy sources is needed to continue to support world’s overall energy needs. Over the past 30-40 years, global electricity production has grown by more than 2% p.a. and is expected to continue growing at over 1% p.a. into the future.

Figure 6: Total energy production will continue to grow. Investment in tradition energy sources is needed to support this



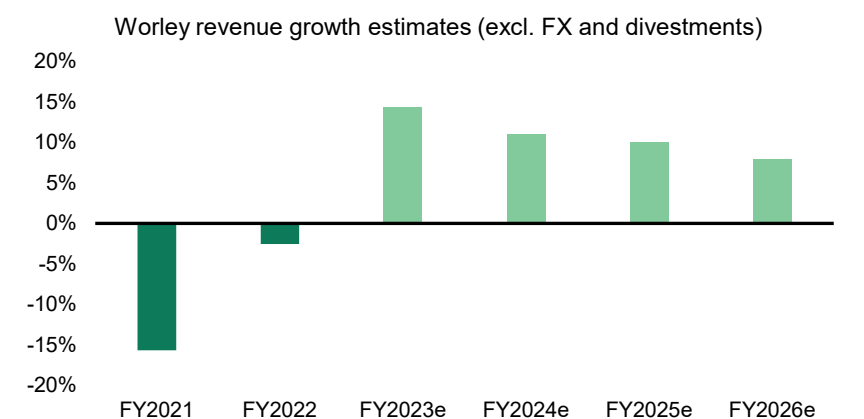
With regards to investment in traditional energy, it is not enough to just maintain historic levels of spend. Investment needs to be accelerated to account for:

1. A historic underinvestment in energy over the past decade; and
2. The loss of Russian pipeline gas, which accounted for ~25% of the global natural gas market.

On the second point, Worley has already been a direct beneficiary. The company has been awarded a 20mtpa LNG project being run by Venture Global. We estimate the project will generate US\$2-3 billion of revenue over the next three years.

We expect the abovementioned dynamics in sustainability and traditional sectors will drive a continued increase in global capex spending. As a result, we forecast Worley’s revenues to grow 14% in FY2023 and ~10% p.a. in FY2024 and FY2025. We believe these estimates could prove conservative if current trends continue.

Figure 7: We forecast organic revenue growth of 14% for FY2023 and ~10% p.a. for FY24-25 but believe these estimates could prove conservative



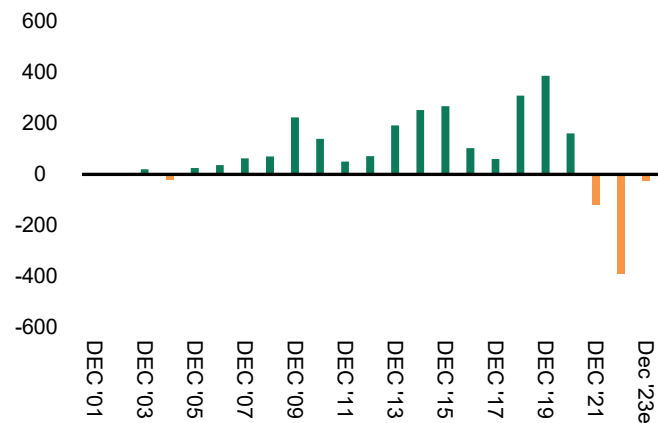
Source: Firetrail, June 2023

Competitive environment has improved markedly

We acknowledge that the contracting industry is typified by low barriers to entry. A small number of loss-making contracts can lead to value destruction. However, we believe medium-term conditions in Worley’s major markets are conducive to sustainable, profitable growth.

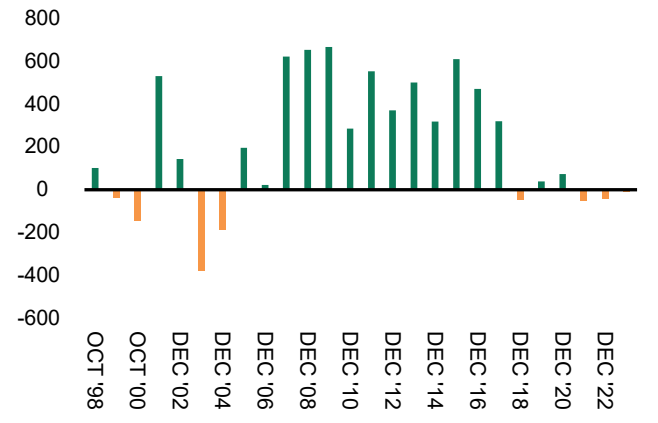
Worley is one of only three truly global engineering firms that have the expertise to take on many of the projects that are currently coming to market. The other two are Wood Group and Fluor. Despite revenues of US\$5 billion and US\$14 billion respectively, both Wood and Fluor have generated minimal or negative cash flows over recent years due to problem projects. Worley has fared better, generally due to a lower risk tolerance when selecting projects.

Figure 8: Wood Group Free Cash Flow (£ millions)



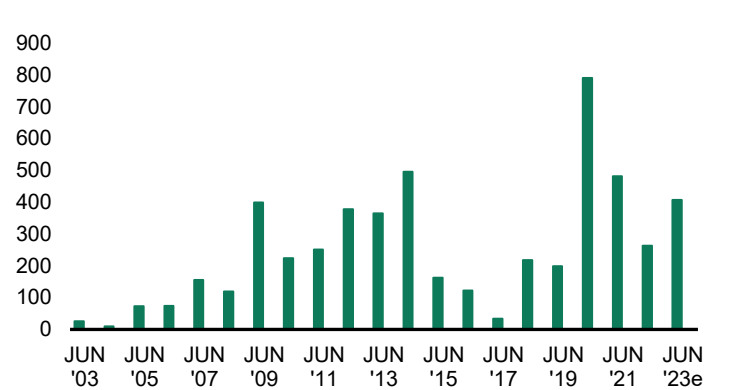
Source: Factset, Firetrail, June 2023

Figure 9: Fluor Free Cash Flow (US\$ millions)



Source: Factset, Firetrail, June 2023

Figure 10: Worley Free Cash Flow (AUD millions)



Source: Firetrail, June 2023

The good news for Wood, Fluor, and Worley is that the volume of work they are being asked to tender for at the moment is allowing them to:

1. Be selective about the projects they compete for;
2. Write more “reimbursable” contracts, which pass a lot of cost risk onto the client; and
3. Lift prices across the board.

Comments from the CEOs of each of the major contractors over the past few months suggests they are taking advantage of these supportive conditions.

- Worley: “in 25 years, I have never seen conditions so buoyant across all our lines of business. We’re no longer willing to take low margin work, because we don’t have to.”
- Wood: “the work we are currently bidding, we see the opportunity to increase pricing.”
- Fluor: “margins on new awards have been at or above plan for the last five quarters.”

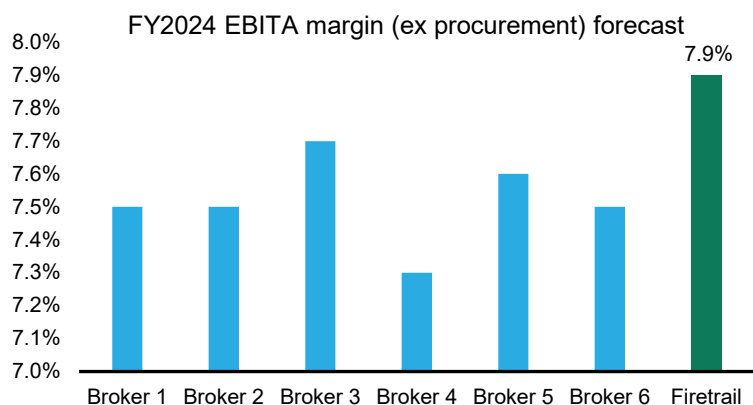
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Margin improvement could surprise to the upside

In February 2023, Worley guided to 7.5%+ EBITA margins in FY2024. We believe this medium-term guidance underpins the confidence Worley has in its current backlog which has been signed up on favourable pricing terms.

We forecast higher EBITA margins than consensus estimates in FY2024 and beyond. Our assumptions drive a forecasted >20% p.a. earnings growth rate over FY2023-FY2026, underpinning substantial upside based on our three-year P/E-relative valuation framework.

Figure 11: Firetrail forecasts higher EBITA margins than consensus estimates for FY2024 and beyond



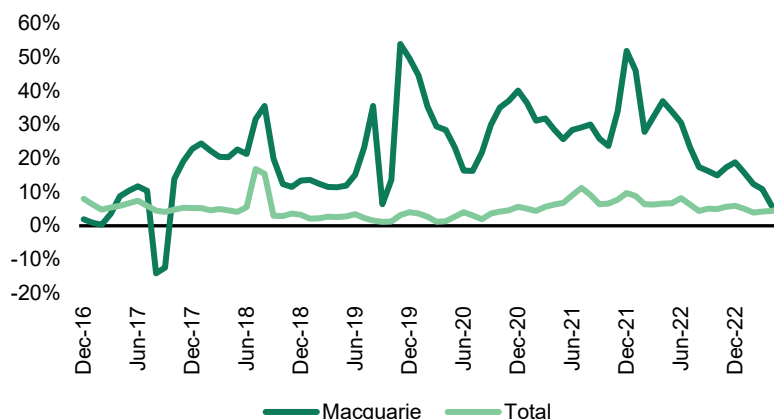
Source: Visible Alpha, Firetrail, June 2023

ONE INTERESTING THING THAT HAPPENED THIS MONTH...

Macquarie has been a powerhouse in the Australian mortgage market in recent years, increasing market share from 0.5% in 2013 to over 5% currently. However, the poor returns on offer in this market have now impacted Macquarie’s appetite to write more business, with growth pulling back from 5x system growth in 2022 to just 1.2x in the three months to 31 May 2023.

The pullback in growth, along with the withdrawal of cashbacks and some modest upwards repricing across the market, suggests that lenders are becoming more rational in how they price mortgages. Unfortunately, this appears to be, at least partly, because the deposit side of the balance sheet is now encountering increased competition. We continue to monitor key drivers of major bank margins very closely.

Figure 12: Macquarie mortgages growth versus system growth (two month basis, annualised)



Source: APRA, Firetrail

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Link to the Product Disclosure Statement: [WHT3810AU](#)

Link to the Target Market Determination: [WHT3810AU](#)

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