Apis Global Long/Short Fund

OBJECTIVE

The Fund's investment objective is to provide investors with risk adjusted, absolute returns through diversified exposure to global equities over 3 to 5 years.

APIR	HFL0108AU	**FUND SIZE**	$38.7m
ARSN	093 497 600	**EXIT PRICE**	$2.3523
INCEPTION DATE	31 March 2001		

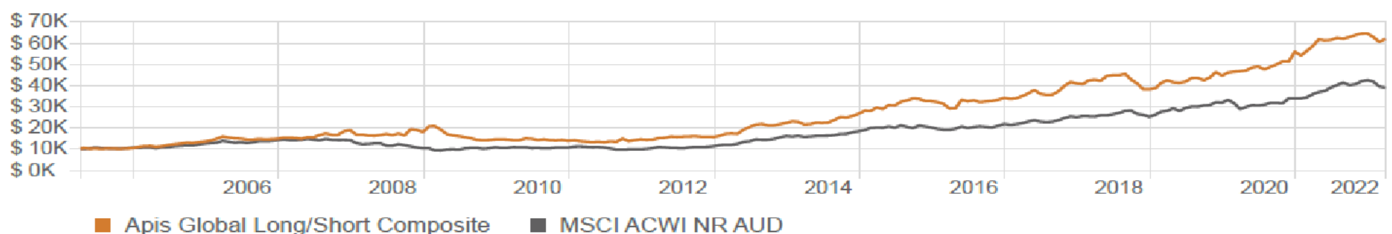
Net performance (%)

	1 month	3 months	1 year	3 years p.a.	5 years p.a.	7 Years p.a.	Since inception p.a.[2]
Fund[1]	**2.27**	**-4.00**	**5.81**	**11.28**	**6.66**	**5.82**	**6.69**
[1]Shaded Fund performance prior to 1 October 2020 is not attributable to Apis Capital Advisors, but the previous investment manager. Performance of the Apis Global/Long Short Composite is below for reference.							
Apis Global Long/Short Composite[3]	**2.27**	**-4.00**	**5.81**	**13.46**	**12.16**	**11.13**	**10.67**

Apis Global Long/Short Composite 1 month rolling returns[3]

CY	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	CYTD
2022	-2.77	-3.46	2.27										**-4.00**
2021	-3.25	3.90	4.19	5.44	-0.74	0.34	1.62	-0.58	1.09	1.59	1.07	0.07	**15.42**
2020	3.31	0.82	0.50	0.73	2.98	0.96	-2.80	2.55	2.30	2.90	-0.23	9.15	**25.27**
2019	1.60	6.42	2.93	-2.19	-0.56	1.24	4.15	0.10	-2.51	3.07	5.84	-3.61	**17.11**
2018	-0.67	4.26	0.76	-1.09	5.36	0.87	-0.10	1.37	-5.93	-4.37	-6.67	-0.13	**-6.86**
2017	-1.31	0.81	3.06	3.55	4.73	-4.93	-1.32	0.32	4.48	7.13	4.44	-1.77	**20.17**
2016	-1.27	-2.55	-7.22	0.41	13.84	-2.04	1.18	-2.41	0.97	0.71	1.67	2.49	**4.58**
2015	5.29	-0.66	6.12	-2.56	6.49	-0.63	5.83	2.00	2.69	-0.70	-2.83	-0.26	**22.07**

Investment growth of $10,000 since inception[3]

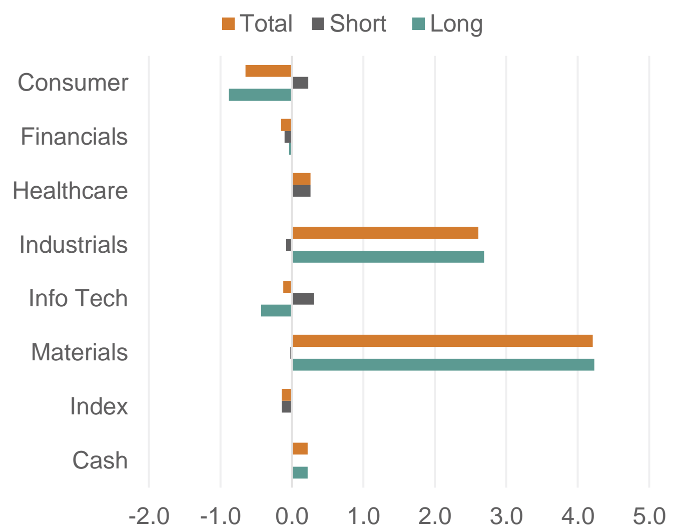


[1]Past performance is not indicative of future performance. Net performance figures are calculated using exit prices, net of fees and reflect the annual reinvestment of distributions.
[2] This figure represents the annualised performance from the Fund's inception on 31 March 2001 and the Apis Global Long/Short Composite's inception on 16 April 2004.
[3]For periods between 16 April 2004 to 30 September 2020, the Apis Global Long/Short Composite reflects the Apis Offshore Capital Ltd, ('Underlying Fund') USD track record converted to AUD terms. The Underlying Fund returns are stated net of management fees and an annual performance allocation. The Underlying Fund's inception date is 16 April 2004. Performance from 1 October 2020 to date reflects the actual net returns of the Apis Global Long/Short Fund. Source: Apis Capital Advisors and Morningstar Direct.

Sector exposure (%)[1,2]

	Long	Short	Gross	Net
Consumer	8.72	-15.98	24.70	-7.26
Financials	1.65	-2.73	4.38	-1.08
Healthcare	3.14	-5.60	8.74	-2.46
Industrials	30.25	-7.14	37.39	23.11
Info Tech	20.38	-3.87	24.25	16.52
Materials	28.90	-0.61	29.51	28.30
Other	0.00	-1.37	1.37	-1.37
Total	**93.05**	**-37.29**	**130.34**	**55.77**

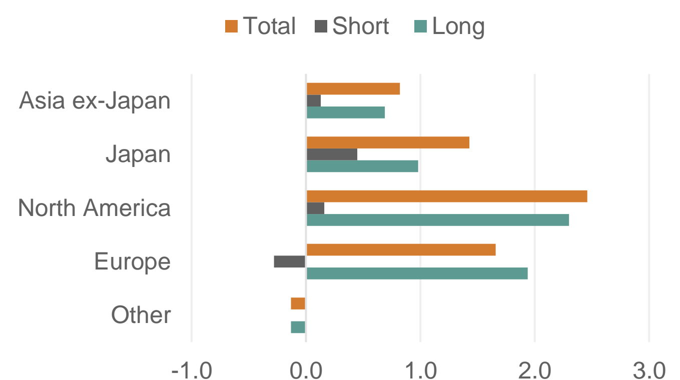
Monthly sector contribution (%)[1]



Regional exposure (%)[1,3]

	Long	Short	Gross	Net
Asia ex Japan	21.37	-7.66	29.02	13.71
Japan	17.00	-5.53	22.53	11.47
North America	28.06	-17.39	45.45	10.66
Europe	24.34	-6.71	31.05	17.63
Other	2.29	0.00	2.29	2.29
Total	**93.05**	**-37.29**	**130.34**	**55.77**

Monthly regional contribution (%)[1,3]



Performance Review

The Apis Global Long/Short Fund returned -4.00% (net) for the quarter.

Most of the credit goes to the short side, which contributed over 6.0% and offset long losses. This continues astreak of monthly positive short performance, which now dates to September of last year.

Regionally, North America was especially strong with gains both long and short, adding about 4.2% (gross), while Asia detracted almost as much, contributing to the flat overall result. Sectors were generally steady, with two big exceptions – technology fell over 5.6% (gross) primarily due to semiconductor long positions, while gains in the materials sector compensated by adding over 5.1% (gross).

Six of the top 7 long performers were materials names led by Serica (adding 1.7%), highlighted below. On the downside, three semiconductor names were top detractors, led by Vicor, which missed earnings estimates due to supply chain issues (a common refrain of late). Vicor has unique intellectual property on power management semiconductors for data centres and electric vehicles (EVs), which the investment manager believes holds tremendous potential. Still, the investment manager lowered the position to "farm" as these issues will take a least a few quarters to resolve. As mentioned, shorts continue to be fruitful, with most of the credit going to profitless unicorns whose survival depends on the continued influx of capital.

[1]Data is stated in USD terms and reflects the Underlying Fund.
[2]'Other' includes exposures from Index and Cash.
[3]'Other' includes countries outside the regions stated above.

Investment Highlights (in USD terms)

Golar LNG (US – $2.7 billion market cap)

Golar is a company that was first held in the portfolio over 15 years ago.. They are largely responsible for creating three markets in the liquefied natural gas (LNG) industry: (1) the spot market for LNG shipping, (2) the floating/storage/regas market, and (3) the floating LNG production market. After years of mis-execution and financing difficulties, the company recently simplified its business with a couple of spinoffs and is now effectively a pure-play on floating LNG production.

Floating LNG production or “FLNG” is a market that today consists of 3-5 ships producing LNG today wherein the ship anchors itself over a well in the ocean and liquifies the gas. This is a tremendous engineering feat and theoretically allows an extraordinary amount of stranded gas (unable to reach a pipeline) to be liquified and transported to market. These ships can be built in 2 years for hundreds of millions, whereas the traditional alternative (think Cheniere) takes $10 billion and a decade of environmental approvals and construction. Golar’s timing has been impeccable, the demand for gas was already strong, and now with Europe’s needs, it has exploded. Golar has one ship operational, and another scheduled for delivery in 2023. Expectations are that the company could quickly win at least one more order, if not multiples.

The investment manager forecasts $500 million of EBITDA without any new ships and an enterprise value of about $3 billion, putting the shares on just 6x EBITDA. The company also has the healthiest balance sheet in its history, allowing it to finance future orders. Golar trades at a 40-50% discount to onshore liquefaction peers like Cheniere despite a better growth outlook. The investment manager thinks it should trade at a premium and look forward to additional ship orders that could drive significant earnings growth.

NexTier Oilfield Solutions (US – $2.4 billion market cap)

NexTier provides pressure pumping equipment and services – commonly known as “frac fleets” – to North American oil companies, mostly in Texas. After a well is drilled, pressure pumps deliver fluids at extremely high pressure to fracture the rock and release oil & gas. The investment manager was drawn to this industry well before any impact from Russia’s war on Ukraine because nearly unprecedented tightness in supply combined with a change in the market structure made for a favourable backdrop. Most investors previously viewed pressure pumping as a commoditised business subject to the boom and bust of oil drilling activity. That is partially still true, but a few things have occurred which make us view the industry – and specifically NexTier – more favourably.

One is consolidation: the market has gone from the top 10 players holding 70% of the market in 2019 to just the top 5 accounting for about 75%. Another is underinvestment and retiring of equipment – many players retired equipment (and bought almost no new equipment) during the COVID 19 induced downturn in activity to lower maintenance costs and conserve cash. In hydraulic horsepower terms, available capacity has declined by 30-40% since peaking in 2018. Most players have said they don’t plan to add more fleets in the near term, and even if they wanted to, the lead time has extended to almost nine months. Drilling rigs are used to drill new wells, after which pressure pumps are needed. As a measure of tightness in the market, pressure pumps are almost fully utilised even though drilling rigs are operating at less than half the previous peak in 2014. As a result, pressure pumping prices are on the rise.

The final market aspect that has changed is the emergence of “dual-fuel” equipment, which can use both diesel and natural gas. As oil companies, especially publicly listed ones, face more scrutiny over their carbon footprints, many are seeking out – and paying up for – more environmentally-friendly equipment. This leaves NexTier incredibly well-positioned, as they spent the last two years counter-cyclically investing in upgrading their fleet and now have one of the largest dual-fuel fleets on the market. NexTier can now focus on generating cash flow versus other players that still need to invest in updating their equipment. Valuation is highly dependent on the pricing that NexTier achieves. Still, the investment manager thinks at a minimum, the stock has a free cash flow yield of 10% and potentially much more as drilling activity increases. Pressure pumping is a major bottleneck to growing oil production in the US, which could drive pricing power well above expectations.

Serica Energy plc (UK – $1.5 billion market cap)

Serica is a straightforward story. The company is a small producer (about 30,000 barrels per day) of 90%+ natural gas in the North Sea, which it sells directly into the gas grid in the UK via pipeline. The investment manager came to the company largely after screening for gas producers before the war in Ukraine for the simple reason that the UK (and Europe) had been too aggressive in their green energy transition. As a result, prices for electric power began spiking in 2021 due to the volatile nature of unstable renewable power taking a greater share of the electric power supply. Gas, of course, is a simple antidote for this and is the least polluting of the fossil fuels; electric power generators naturally leaned into this market to plug the hole. Serica, accounting for a single digit share of UK gas, carries no debt and has about 80% of its sales exposed to the spot market for spiking gas prices.

At the time of purchase, the investment manager was modelling 50-100% free cash flow yields. Despite the recent strong run in the company’s share price, these yields have remained as gas prices have held and forward curves have risen. Using these forward curves, Serica could conceivably (liquidity allowing) hedge forward production sufficient to buy back the company’s entire equity more than once. While it’s common to find energy producers in North America that look like Serica, the story is altogether different in Europe as the industry has been hollowed out. Years of pressure to reduce fossil fuel reliance have left just a few pure producers like Serica, nearly all heavily hedged and missing out on the strong prices.

After more than a decade of navigating a complex regulatory environment, Serica may now be catching a wind at its back as the UK recently proposed some significant regulatory changes that would help speed further development for Serica and its peers.

Market outlook and positioning

As Lenin once said, “there are decades when nothing happens and weeks when decades happen.” We may look back and realise that decades happened in the first quarter of 2022. While some important changes have been simmering for some time, the war in Ukraine has brought many of them to the surface. These include:

1. The dollar/fiat currencies to weaken, and status may be seriously challenged. Dollar hegemony has been debated and challenged by alternatives such as the Yuan for some time, but recent events may significantly accelerate the search for these alternatives. The unprecedented cancellation of Russia’s currency reserves tells every adversary that the US, EU, and Japan are willing to weaponise the global payments system. Doing this to Afghanistan, Iran, or Venezuela is one thing but doing it to Russia is, by every measure, on a whole other level.
2. Russia is now demanding payments for energy in Rubles. Putin has effectively required the EU to defend the Ruble or risk losing access to their gas. What is Russia doing with the Rubles? Buying physical gold– which, in its own way, takes them back to the gold standard. Seeing what is happening to Russia, it is possible to imagine China or the Middle East following a similar path, especially if they foresee an adversarial relationship. Unlike Russia, these countries currently hold a lot of US Treasuries, well over $1 trillion.
3. Canada also weaponised its banking system to end a trucker strike in another worrisome sign. Being shut out of the banking system for a murderous war is one thing, but to have your accounts confiscated with no recourse and no due process because you disagree with your Prime Minister? Although it would likely be a long transition, the role of alternatives like the Yuan, gold, or even crypto could grow enough to have significant implications for assets historically priced in dollars. The Fund has little direct exposure to dollar alternatives; however, the exposure to basic materials will act as a mitigant if dollar reserve status should fade.
4. Energy and materials prices are likely to remain high. The powder keg for a commodity spike was filled well before the war started. Years of underinvestment in energy & commodities combined with electrification had driven inventory and production to record lows across a plethora of commodities. The war took a tight market and made it impossibly imbalanced. As Sean Maher of Entext said, “Russia doesn’t produce much that anyone wants, like iPhones, but a lot that everyone needs like energy, metals, grains, fertiliser...” Russia produces 40% of Europe’s natural gas, 28% of global nickel, 20% of palladium, 25% of traded wheat, and 15% of traded corn. Germany, for example, relies on Russia for half of its coal, 55% of its gas, and 35% of its oil. It remains to be seen how much of these commodities leave the world markets, but without a doubt, their cost will rise, and logistics will grow tangled. As any commodity investor knows, it takes no more than a percent or two mismatch between supply and demand to send prices skyrocketing or spiralling.

Within the power market specifically, well-intended but naive climate policies have created an overreliance on unstable renewables, and we were witnessing energy price spikes as a result back in 2021. Combined with the shutdown of nuclear plants, these policies are ironically conspiring to increase the reliance on coal – the dirtiest energy source of them all. Europe’s response to recent events is to double down on even more wind and solar (the investment manager is happy to invest on the back of this theme by revisiting 2020 winners such as Solaria Energía). In the meantime, they will have to re-think nuclear and find other gas sources. It's unlikely that any of these solutions will arrive fast enough to avoid ongoing shortages and price spikes for the foreseeable future. The investment manager holds numerous long-term beneficiaries of this renewed focus on energy security, including positions discussed above.

Unfortunately, many of the policy responses are worsening the situation. States like California are providing $400 gas cards, and Germany is cutting fuel taxes, suppressing the natural demand destruction that higher prices would otherwise prompt. Some politicians are calling for windfall taxes on “greedy” oil companies, discouraging investments that would grow supply. These are but a few of the policies the investment manager has observed across the food and energy markets that are likely to extend the current mismatch between supply and demand.

Caring about humans’ basic sanctity and prosperity will require a slowdown in “E” and emphasis on the “S” in ESG. According to the International Energy Agency, an offshore wind energy plant requires 12 times the mineral resources to build versus an equivalent gas plant. Electric Vehicles (EVs) require 5-6 times the copper of a traditional internal combustion car and double the semiconductors. The cost of these inputs is soaring. Policymakers may eventually reduce our carbon footprint but doing so will entail costs the average consumer cannot afford without government assistance. Pete Buttigieg had a “let them eat cake” moment when he suggested Americans should drive EVs to deal with high gasoline prices. Most Americans cannot afford a $60 thousand car, and the US electrical grid is in no way ready for a massive influx of EVs.

It’s an embarrassment for humanity that in 2022 the world can see such a war as in Ukraine today. However, the only thing hated more by investors than fossil fuels are defence stocks. Ukraine makes it evident that brutality and human suffering of an unimaginable degree can occur without defence. Several European countries are initiating massive increases in defence budgets after decades of near indifference. As George Soros said, “I don’t play the game by a particular set of rules: I look for changes in the rules of the game.” The investment manager thinks the rules of ESG are changing as “S” begins to take focus over “E” and industries such as defence and cleaner fuels such as natural gas or nuclear power benefit. Positions have been added across the portfolios in Germany and Israel in the defence industry in addition to our energy names.

Market outlook and positioning (continued)

Onshoring of everything. Globalisation is in trouble. “Capital-light,” “Outsourcing,” and “Just-in-time” may be practices that improve rates of return, but long-term reliance has made nations feel vulnerable. For example, it’s only now dawning on us all how important Taiwan Semiconductor is to our way of life. Nine semiconductor plants are being built in Phoenix, expected to cost over $90 billion to build. Beyond semiconductors, the investment manager expects a steady shift of other manufacturing to move closer to home. China is dominant in many green technologies, such as solar or EV batteries.

Companies now mindful of their fragile supply chains are reluctant to allow China to control areas they see as more and more strategic. Government COVID 19 policies have compromised even less strategic areas such as textiles. Geographic redundancy and higher general safety stocks will be utilised to manage these issues, even if costs suffer. As discussed last quarter, the investment manager sees positions such as Hirano Tecseed in the battery manufacturing supply chain as beneficiaries of this desire to build domestically.

All the above changes contribute to the investment manager’s general view that prices will stay high. Expensive energy, onshoring and reduced faith in fiat currency has encouraged us to look where pricing power is strongest. What makes these areas of “real stuff” so exciting is not only are prospects good, but valuations are extremely low. Energy and materials have been gutted to the degree that they have gone from 17-18% of the S&P index a decade ago to 4-5% today. The investment manager has a list of names that have net cash, low single-digit P/Es, and double-digit dividend yields, so long as commodity prices remain firm.

While the Fund owns a few direct commodity producers in fossil fuels or metals such as Serica the investment manager’s preference is for “picks and shovels” such as NexTier or Golar LNG that provide essential equipment or services needed to support the energy and mining companies. Years of investment neglect need to be compensated.

In the Fund, there is currently 15% directly invested in energy/commodity producers and an additional 20% in industrials that service such companies. The investment manager is aware that although they believe the setup for commodity and commodity-related industrial exposure is excellent, they also understand that their worldview must be flexible. In good times the consequences of being wrong are less than in times of scarcity. The investment managers ability to remain pragmatic and frequently re-assess their beliefs will be necessary.

Material matters

There have been no material changes to the Fund in terms of key service providers, the risk profile, investment strategy or changes to individuals in the investment team who play a key role in the investment decisions of the Fund.

The Fund is classified as a hedge fund in accordance with the Australian Securities and Investments Commission, Regulatory Guide 240 'Hedge funds: Improving disclosure'. This classification is based on the fact that the Fund currently exhibits two or more characteristics of a hedge fund, being:

• complexity of investment strategy or structure;

• use of leverage;

• use of derivatives;

• use of short selling;

• charges a performance fee.

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