Ironbark

QUATERLY REPORT
AS AT 30 JUNE 2022

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	**MANAGER APPOINTED**	1 October 2020
ARSN	093 497 600	**FUND SIZE**	$39.4m
INCEPTION DATE	31 March 2001	**EXIT PRICE**	$2.4809

Net performance (%)

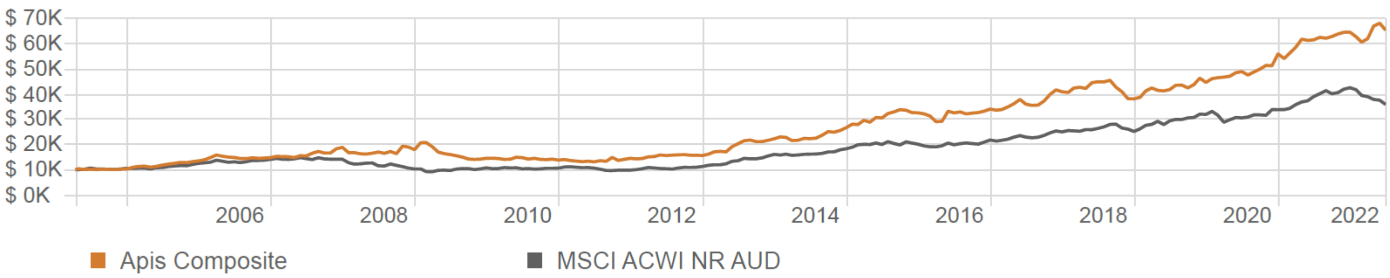
	1 month	3 months	1 year	3 years p.a.	5 years p.a.	7 Years p.a.	Since inception p.a.[2]
Fund[1]	**-4.05**	**5.47**	**6.26**	**12.63**	**7.95**	**6.44**	**6.87**
[1]Fund performance prior to 1 October 2020 is not attributable to the current investment manager, but the previous investment manager. Presented below is the longer-term track record of the current investment manager's strategy since its inception.							
Apis Composite[3]	--	--	--	**16.09**	**12.67**	**11.49**	**10.84**

Apis 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	8.00	1.78	-4.05							**1.25**
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**

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

Time Period: 16/04/2004 to 30/06/2022



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]Returns since inception represent the annualised performance from the first full month of operation.

[3]The inception date of the Apis Composite is 16 April 2004. Performance periods from 16 April 2004 to 30 September 2020 represent the Apis Offshore Capital Ltd USD track record converted to AUD terms, net of management fees and an annual performance allocation. Performance periods from 1 October 2020 to month-to-date reflects the actual net returns of the Apis Global Long/Short Fund. Source: Apis Capital Advisors and Morningstar Direct.

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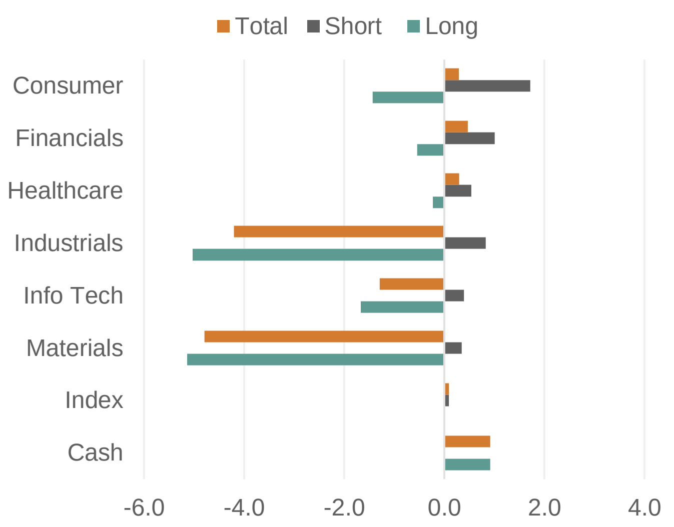
Sector exposure (%)[1,2]

	Long	Short	Gross	Net
Consumer	7.97	-17.20	25.17	-9.23
Financials	0.92	-4.17	5.09	-3.25
Healthcare	3.96	-6.53	10.49	-2.57
Industrials	33.29	-7.73	41.02	25.55
Info Tech	19.57	-5.03	24.61	14.54
Materials	23.29	-1.63	24.92	21.66
Other	0.00	-0.88	0.88	-0.88
Total	**89.01**	**-43.18**	**132.19**	**45.83**

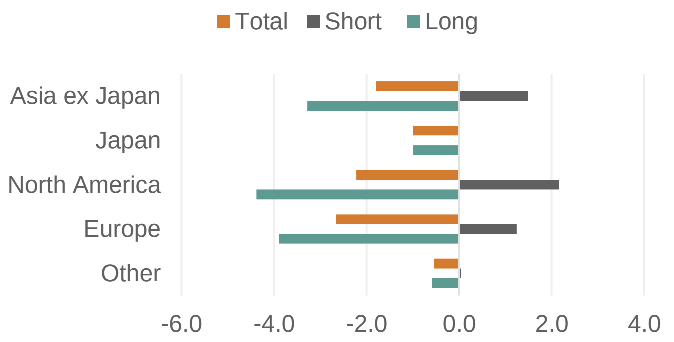
Monthly sector contribution (%)[1]



Regional exposure (%)[1,3]

	Long	Short	Gross	Net
Asia ex Japan	19.36	-10.54	29.90	8.82
Japan	13.26	-6.95	20.20	6.31
North America	24.67	-17.51	42.18	7.16
Europe	28.48	-8.19	36.66	20.29
Other	3.23	0.00	3.23	3.23
Total	**89.01**	**-43.18**	**132.19**	**45.83**

Monthly regional contribution (%)[1,3]



[1]Data is stated in USD terms and reflects the underlying fund. Totals may not equal due to rounding.
[2]'Other' includes exposures from Index and Cash.
[3]'Other' includes countries outside the regions stated above.

All currency references in the commentary below are in US dollar terms unless stated otherwise.

Performance Review

The Apis Global Long/Short Fund ('the Fund') returned 5.47% (net) for the quarter (in Australian dollar terms).

The portfolio's returns for the second quarter of 2022 were considerably better than equity markets in general thanks to the short side of the portfolio which contributed about 12% to performance for the quarter. "Streaks" of monthly performance are largely statistical noise, but it is notable how long this streak of positive short performance has lasted – 10 months through June.

Regionally, Asia ex Japan was relatively quiet. While positive short performance in North America was able to overwhelm negative long performance, the opposite was true in Japan and Europe. The two sectors that stood out during the quarter were consumer and cyclicals (materials & industrials). Shorts were particularly strong in consumer, adding over 5% to performance, while longs were a meaningful detractor in cyclicals, amounting to more than 10%.

Top performers during the quarter on the long side included Silicon Motion, Aixtron, and Ranger Oil. All were relatively small contributors, adding less than 0.50%. Detractors on the long side included IMDEX, Serica Energy, and Major Drilling. Each name detracted approximately 1.4%. The primary driver on the long side was general market "risk-off" sentiment. In the case of Silicon Motion, the company received a takeout offer currently valued at $93 of cash plus $12 of stock (in USD terms). The company trades at $83 (in USD terms) as of this writing. The market is skeptical of everything at the moment. On the short side, there were a handful of detractors, but nothing of substance worth noting. Short contributors were broadly distributed across the portfolio, with the top ten names adding 0.4% to performance on average. As mentioned last quarter and discussed further below, the investment manager continues to see attractive opportunities here – the "garbage-bubble" has yet to truly deflate.

Performance Review (continued)

Regarding exposure, the investment manager remains incremental and continue to “feed the winners and starve the losers.” This has led to a reduction in the net over the course of the quarter by about 10 percentage points. Part of this is a natural outcome of depressed markets as exposure to both longs and shorts will shrink during market contractions. This has manifested itself across both sectors and geographies relatively proportionally.

Investment Highlights

Aixtron SE (Germany – $2.8 billion market cap)

Silicon can’t take the heat – that’s where Aixtron steps in. Just about every microchip in the world is based on a silicon wafer. The next wave of technology, however, requires the ability to handle a much greater amount of power, and thus heat. The biggest example of this is SiC (Silicon-Carbide) chips used in electric vehicles. By using SiC chips rather than just silicon chips, Tesla was able to increase the battery life and extend the range of its cars by double-digit percentages. This technology is now standard in electric vehicles. Other examples include GaN (Gallium Nitride) chips that offer similar benefits.

This type of chip is called a compound semiconductor because it requires multiple elements to be deposited on a wafer. Aixtron has a near-monopoly on the roughly $2 million machine that makes this process possible. The company got its first big break back during the LED boom over a decade ago. Orders exploded higher, but Chinese knock-offs spoiled the party and it wasn’t until a similar technology (VCSEL) became indispensable for facial recognition on mobile phones that orders began to recover around 2017. The machine that Aixtron makes is unique because it allows for a very exact deposit of elements using pressure, temperature, and positioning to determine atomic-level precision. This is something the Chinese could replicate for crude LED lights, but not for compound semiconductors. While SiC and GaN are driving near-term double-digit growth, there is another blue-sky opportunity for Aixtron called micro-LED. This is a display technology that effectively puts microscopic LED lights on a wafer thereby allowing screens for watches, mobile phones, or possibly televisions to be lit by tiny LEDs, not unlike a microscopic version of the billboards seen along the highway. Preliminary orders have already begun because the value proposition is a screen that could save as much as 20% on power consumption – something any laptop user would greatly appreciate.

Aixtron’s orderbook is growing fast with the run-rate effectively doubling over the last 12-18 months.

Indivior (U.K. – $2.6 billion market cap)

Everyone has heard about the global opioid crisis. The investment manager has had a couple of positions in this area, one of which is Indivior PLC, a UK-based $2.6 billion market cap pharmaceutical company. Indivior has a history as a leader in the opioid abuse deterrence market – first developing Suboxone (buprenorphine/naloxone) tablets, then a sublingual film version of the same drug, both of which were blockbuster drugs with sales of approximately $1 billion at their peak. While both of those formulations are now generic, the investment manager’s excitement with the company is based on the accelerating growth of their newest product, Sublocade (buprenorphine). Although it was slow out of the gate when launched in 2018, it is benefitting from a revamped commercial strategy and failure of would-be competition. It is now back on track to reach blockbuster status in the coming years. It currently trades below peers and, in the investment manager’s view, is significantly undervalued by the market even in a tough environment for pharmaceuticals.

With fears of litigation and generic erosion now behind them, the focus now shifts to their flagship product, Sublocade. It is a single injection that provides month-long deterrence to opioid use with the core advantage of patient compliance. The natural question is “well if it’s so great, why was it so slow to launch?” The answer lies mainly in their initial commercial strategy to target prescribers rather than healthcare systems, a challenge that was compounded by the drug only being available at specialty pharmacies, further limiting access for many of those smaller clinics. Indivior’s commercial strategy has since pivoted to target larger hospital systems and government/public health contracts. Here they can purchase and store larger quantities, alleviating the need to find a specialty pharmacy. This expands access, making it much easier to prescribe. Additionally, the competitive landscape has changed with their nearest competitor, Camurus AB, having their extended-release opioid deterrent injection rejected by the FDA. This sets them back years, and, in the investment managers view, paves the way for Sublocade to gain a significant share of the multi-billion dollar US opioid treatment market and reach sales in excess of $1 billion in relatively short order.

The investment manager feels Indivior is on the precipice of an inflection. Its litigation issues are behind them, Suboxone’s market share is stable after initial generic erosion, Sublocade has a revitalised commercial strategy, and its competition facing an uphill battle to enter the market. In a sector that has been taking it on the chin for the last two years, the investment manager sees Indivior as just the kind of high-quality profitable company with a commercial pipeline that is inappropriately undervalued with plenty of upside potential.

Square Enix (Japan – $5.5bn market cap)

Square Enix is a Japanese video game company that owns a portfolio of enduring franchises with global audiences such as Final Fantasy, Dragon Quest, and Space Invaders. Recent headwinds in its legacy business have masked its true profitability, and investors have overlooked the underlying transformation of the company’s business model.

Square Enix (Japan – $5.5bn market cap) (continued)

Concerns are focused on Square Enix's legacy HD Games segment where a multi-year run of unsuccessful releases has led to underwhelming segment results. While some concern is warranted, the investment manager believes the issues will prove temporary. Square Enix recently sold its North American studios, which were largely responsible for the underperformance, and is refocused on its core franchises such as the upcoming Final Fantasy XVI. More importantly, the investment manager believes investors are overlooking the fact that the HD Games segment no longer drives the profits for the business. Square Enix generated 48% of financial year 2022 EBIT from the MMO (massive multiplayer online) segment, 24% from mobile, and 16% from its manga publishing business. Meanwhile, the HD Games segment has generated an annual EBIT loss over the past three years. In the investment manager's view, the segment is better thought of as a research & development cost centre (with profit optionality) where it experiments with new ideas and intellectual property that the other segments can eventually monetise.

What really excites the investment manager about Square Enix is the MMO segment, which has grown revenues at a 22% CAGR (compound annual growth rate) since 2017 and generates a 60% EBIT margin. Within the segment, the investment manager believes Final Fantasy XIV Online (FFO) is a true hidden gem. FFO is an online subscription game that was initially released in 2010 and has since grown subscribers to over 2.5 million (40%+ CAGR since 2017). As of June 2021, it had overtaken World of Warcraft as the most popular MMO globally and given World of Warcraft reached over 12 million subscribers at its peak, the investment manager believes FFO's player base is far from saturated.

Market outlook and positioning

Every stock picker makes implicit macro bets and these are typically mean-reverting, under-the-bell curve assumptions about the macro environment in the future. The investment manager is often asked about their views and while they generally assume benign environments with attention paid to leading indicators, they believe that the current environment is likely to be different than the low volatility, low-interest-rate environment of the past decades. The investment manager's working assumption is that the future global inflation environment is going to be higher and more volatile than in the past. The investment manager is not alone in this view, but it is worth pointing out that the cause of this may simply be a decade-plus of underinvestment in materials and energy, as well as a steadfast commitment to return capital to shareholders rather than invest in new supply capacity. The cherry on top of all this is geopolitical tension, which is leading to both trade and actual wars along with the onshoring of manufacturing. While much of this is cyclical, electrification and decarbonisation are secular drivers impacting the entire global economy and disincentivising investment in materials, and energy in particular.

The result is a severe mismatch between supply and demand. For evidence of how long this could last, simply consider the actions of various governments such as the UK which recently increased the tax rate on energy companies from 40% to 65% because of their windfall profits. In the US, one congressional proposal is to send everyone cheques to offset the rising price of fuel. This would mean the natural demand destruction high prices cause would be minimised, leading to potentially even higher prices.. In Europe there's talks about tens and hundreds of billions of Euros to be spent on energy investment and infrastructure. This could very well be an energy-driven inflation/economic cycle. Little precedent exists for supply-driven energy inflation cycles but several point to the 1970s as one poignant example.

The investment manager's views on inflation and the macroeconomic environment does not drive their stock picking. As always, they are focused on small global companies where their global perspective can bring them a competitive edge. To the extent factors such as raw material costs or labour inflation (and the ability to pass along those costs) impact valuation, however, the investment manager does carefully consider these issues. Of course, these issues also work their way into discount rates and future business visibility.

The silver lining is that this is the kind of market environment where "babies get thrown out with the bathwater". Investors have to sell for all sorts of non-fundamental reasons and that creates spectacular opportunities. In 1984, Buffett wrote an article ("The Super investors of Graham-and-Doddsville"), highlighting over half a dozen managers and their track records stretching back decades. One thing worth highlighting is that while the 1970s were a very volatile period with little net gain for the major indices, these stock pickers crushed it. Across the board, these managers found incredible bargains and delivered outsized gains over the course of a very difficult decade. If the environment we are headed for is going to look like the 1970s, the investment manager welcomes the opportunity to find these "babies".

On the Topic of Shorting…

As has been the case for many months now, the investment manager's shorts continue to perform well. For several quarters, the primary short contributors have come from what they call "battleground" shorts. These are typically fads or concepts that have great speculative appeal but are insanely bid up as investors focus on open-ended TAMs (total addressable markets) with innovative or "disruptive" business models. In the first half of 2021, this category of short was extremely challenging as retail and even some institutional investors bought into the dream. The list of areas ripe for scams is endless: crypto, cannabis, electric vehicles, batteries, fintech, autonomous driving, space rockets, home delivery, COVID-19, dog walking, scooter rentals, and quantum computing, just to name a few.

The investment manager believes shorting this 'junk' is fundamentally easy to justify. With many of these stocks already down 70-80%, however, one of the hardest questions is what to do now. The "trader" in the investment manager says they are oversold, but the fundamental "analyst" also says there's additional downside.

On the Topic of Shorting… continued

The starting point in this cycle was so high that in many cases there is probably an additional 70-100% downside yet to go. One simple screen the investment manager likes to employ is cash burn relative to net cash on the balance sheet.

One short candidate the investment manager found (although there are many like it) is a company in the electric vehicle space. The financials have numerous red flags, but even if you accept the numbers are real, they have cash of $150 million and are burning through the same every quarter. They will not survive 2022 without additional capital and their concept car is years from commercialisation. Capital market conditions are dire – equity would be dilutive, and debt would be very expensive if it can be raised at all. Even the company admits they need at least $1 billion in new capital to survive. Despite all these issues and the stock being down 70% from its high, the market cap remains at around $1.5 billion. Analogous funding situations at other companies have seen their shares fall 50% or more on the deal announcement, and the investment manager expects this time to be no different.

Overall, the mix of shorts has moved somewhat away from the beaten-down “battleground” shorts (except where financing is imminent) and toward other styles. These include “broken growth” (e.g. COVID 19 beneficiaries, stalled software names, or economically sensitive areas like building materials, etc.) or “melting ice cubes”, such as bricks and mortar retail, telecom, and office equipment which traditionally have done well for the investment manager over longer time periods. Despite recent market declines, there remains an element of speculation where stocks rally nonsensically. If this behaviour continues and the investment manager can manage risk around these rallies, shorting even “beat-up” stocks will continue to provide excellent opportunities to profit.

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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