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**	$40.1m
INCEPTION DATE	31 March 2001	**EXIT PRICE**	$2.5727

Net performance (%)

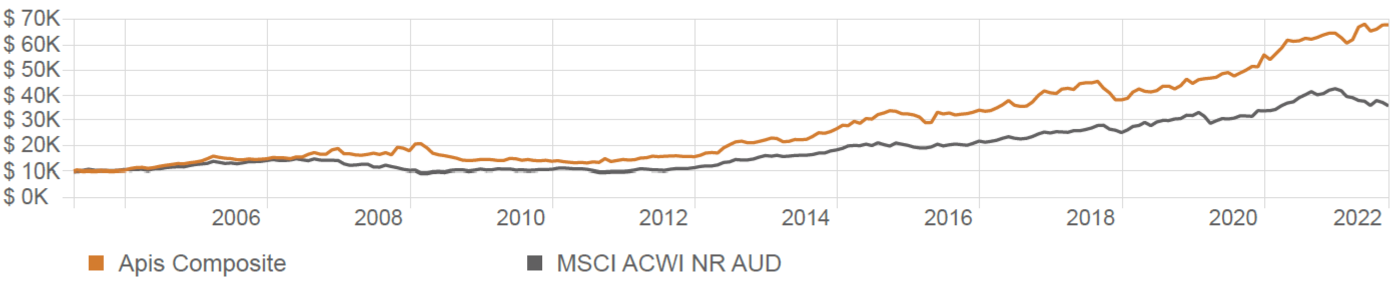
	1 month	3 months	1 year	3 years p.a.	5 years p.a.	7 Years p.a.	Since inception p.a.[2]
Fund[1]	**0.02**	**3.70**	**7.89**	**14.88**	**8.37**	**7.14**	**6.97**
[1]Fund performance prior to 1 October 2020 is not attributable to the current investment manager, but the previous investment manager. Presented below is the longer-term track record of the current investment manager's strategy since its inception.							
Apis Composite[3]	--	--	--	**16.87**	**12.73**	**10.43**	**10.90**

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	1.11	2.55	0.02				**5.00**
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**

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

Time Period: 16/04/2004 to 30/09/2022



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.

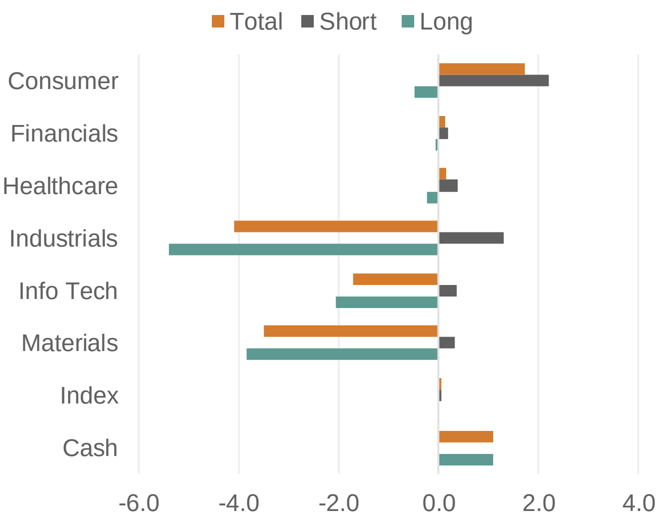
[2]Returns since inception represent the annualised performance from the first full month of operation.

[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.

Sector exposure (%)[1,2]

	Long	Short	Gross	Net
Consumer	6.15	-12.06	18.21	-5.92
Financials	0.91	-3.20	4.11	-2.29
Healthcare	5.58	-5.97	11.55	-0.39
Industrials	29.79	-9.54	39.32	20.25
Info Tech	18.91	-6.10	25.01	12.81
Materials	27.39	-1.62	29.01	25.78
Other	0.00	-0.81	0.81	-0.81
Total	**88.72**	**-39.29**	**128.02**	**49.43**

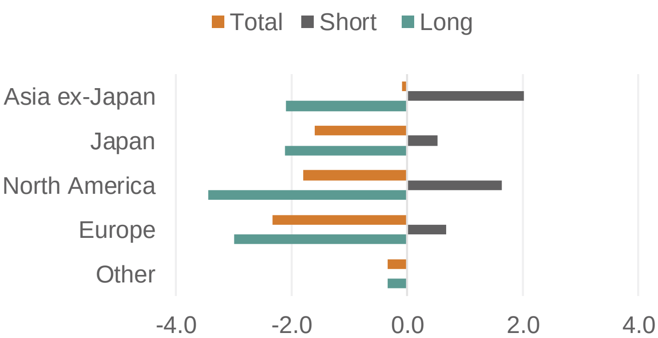
Monthly sector contribution (%)[1]



Regional exposure (%)[1,3]

	Long	Short	Gross	Net
Asia ex-Japan	17.12	-8.62	25.74	8.50
Japan	18.98	-6.61	25.60	12.37
North America	20.20	-16.68	36.88	3.52
Europe	29.99	-7.38	37.38	22.61
Other	2.44	0.00	2.44	2.44
Total	**88.72**	**-39.29**	**128.02**	**49.43**

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 3.70% (net) for the quarter (in Australian dollar terms).

Losses in the portfolio were about half of the market overall during the quarter, primarily due to net positioning and long-side outperformance, while shorts were positive but more in line with weak markets. Geographically, Asia contributed, with Korea and Taiwan notably strong. On the other end of the spectrum, longs in Europe dragged on performance by over 2%. Sectors were generally flat in the quarter except for Industrials which detracted 3%, all of which and more coming in the month of September.

Stock picking was overwhelmed by macro with energy-related names contributing positively to the period despite a substantial sell-off in September. The largest detractor was Solaria in Spain, a developer and operator of solar farms. Solaria fell victim to a growing trend of political interference. A portion of Solaria's business is exposed to spot prices, which have been very favourable due to the energy crisis in Europe. As a result of this "windfall" profit (which could be redeployed into more solar investments), the European Union ministers have proposed a cap on prices. These types of unanticipated risks are the reason Europe is viewed as cheap. These policies work to subsidize demand and slow the supply of needed energy, exacerbating the situation.

On the short side, there were no notable trends, although Asia stood out with 12 of the top 15 contributors. The Fund's biggest detractor (about 0.30%) in the quarter was a battery play that has garnered hundreds of millions of dollars in benefits through the Inflation Production Reduction Act. Again, political interference worked unfavourably here, complicating what was a straightforward investment case. The investment manager suggests the only winner from these subsidies will surely be the management.

Investment Highlights

Osaka Titanium Technologies (Japan – $750 million market cap)

Osaka Titanium is the largest capacity titanium sponge producer in Japan. It is the only publicly listed "pure-play" titanium sponge producer globally and is set to benefit from changing supply and demand dynamics created by the Russia-Ukraine war as nearly 30% of the global aerospace-qualified titanium sponge capacity sits in Russia. While Russian titanium is yet to be officially sanctioned, the war has sent aerospace manufacturers scrambling to lock down alternative supplies. Outside of Russia, approximately 7% of capacity sits in Ukraine and roughly another 16% in Kazakhstan. Nearly all the remaining global capacity exists at two companies in Japan,Osaka, and its competitor Toho Titanium. It is key to differentiate between aerospace-qualified and non-qualified titanium sponge, as China has significant capacity of non-qualified sponge but note that the qualification process typically takes three years for non-engine parts and up to five years for engine parts. China has failed to enter this market for 15+ years and there is no reason to believe that will change anytime soon.

The last cycle in this space was 2004-2008 when increased demand from the aerospace industry led to a shortage of titanium sponge. This inevitably turned into a glut when all the major players expanded capacity. It's been a brutal market since as titanium prices have hovered around the lows established in 2016 when the remaining US players idled capacity. The investment manager believes the demand side this time rhymes with the last cycle as the aerospace industry (about 70% of demand) continues to rebound post-COVID, but with new aircraft models today containing 2-3x more titanium than previous generations. The investment manager also expects the defence industry (approximately 10% of end markets) to add to demand with military budgets on the rise globally given the current geopolitical environment. On the supply side, the investment manager believes Russia's aggression will have lasting impacts on the supply chain. Even if everyone were to shake hands tomorrow, aerospace companies are likely to continue to shun Russian supplies for a host of reasons including reliability. The investment manager believes near-term capacity additions are also unlikely as managements have expressed reluctance to even think about adding capacity before prices sustain at a significantly high level, and the return of US capacity remains unlikely as costs have risen nearly 50% since that capacity was idled.

The last cycle saw several years of 20%+ price increases, and Osaka's stock peaked 4-5x from where it is today. Osaka has already increased prices for domestic customers by 30% this year and a similar or greater increase is expected for foreign customers in the fourth quarter. In August, Japanese titanium export prices averaged $9,656 per ton, 40% below their April 2008 peak. With costs roughly 50% higher, a similar peak today would imply prices reaching over $24,000 per ton. If attained over a four-year span, this would imply annual price increases of 25%, similar to the last cycle. Assuming full utilisation, the investment manager believes Osaka could generate ¥1,000 per share at those prices, implying a 3x price to earnings ratio and 10% dividend yield. The investment manager also notes that this gives no credit to the recent depreciation of the Yen, which if it were to hold through the cycle could add another 40-50% according to their estimates.

Energy Basket (various countries – $450 million to $6 billion market caps)

Across all the investment manager's capabilites, they currently have a handful of traditional energy-related positions. The investment manager initiated this exposure in the second half of 2021 after observing a historic mismatch between supply & demand. On the supply side, there had been major underinvestment for most of the prior decade. Consider, for example, that about 30% of all oil comes from offshore production, and every major offshore drilling operator filed bankruptcy in the past 5 years, resulting in about one third of drilling capacity being completely scrapped. On the demand side, two things struck the investment manager as particularly notable. First, the obvious recovery in the post-COVID economy was driving a predictable boost in demand. Airline travel is a case in point. Second, the investment in renewables was driving sudden and unpredictable surges in fossil fuel demand. Renewables are a market the investment manager knows well, having invested in the sector since 2005 across solar, wind, biodiesel, ethanol, hydrogen, carbon credits, battery storage, etc. You name it, the investment manager probably looked at it across multiple countries and up and down the supply chains for nearly 20 years. The reason renewables can worsen reliance on fossil fuels is that their production is highly volatile. Europe experienced this in late 2021 as low levels of wind and sunlight resulted in shortages of power. The reaction was a panic purchase of imported fuels and a re-ramp of coal-fired power along with the burning of liquid fuel to generate power. As witnessed, this reliance on spot purchases of fossil fuels exposes the power markets to the marginal prices of coal, gas and oil. Prices for all these products have spiked because of a lack of investment and planning. Ironically, the aggressive investments in renewables and lack of investment in fossil fuels have meant that every time renewable production dips, an unplanned purchase of fossil fuels is needed. This results in exorbitant power prices set by marginal transactions.

Unfortunately, as is now widely known, the Russia-Ukraine war badly exacerbated all these issues. The investment manager's view is that this supply-demand mismatch is going to take time to reconcile. While the general thrust of the investment manager's thesis is laid out above, there are important company-specific factors they have focused on in building up this exposure. The investment manager has selected companies with spot market price exposure and shunned those with long-term contracts. The investment manager has also tried to focus on regions friendly to producers; generally avoiding those obsessed with windfall taxes. Another important trait is focusing on those committed to returning cash to shareholders and by extension possessing healthy, often net cash, balance sheets. Across all of the investment manager's capabilities, this has led to natural gas names such as Kistos in the North Sea, Birchcliff in Canada and Golar LNG which is focused on liquifying stranded offshore gas. In coal, the investment manager owns Arch in the US, Whitehaven in Australia, ITMG in Indonesia, and Thungela in South Africa. The general profile of each of these names is an extremely low price to earnings ratio multiple.

Energy Basket (various countries – $450 million to $6 billion market caps) (continued)

Kistos, for example, is generating £1-2 million per day with a £425 million market cap. These companies also pay significant dividends which the investment manager believes is essential as the market is unwilling to give them any credit for their earnings. The investment manager believes this opportunity in traditional energy will remain so long as these supply-demand dynamics persist, and that does not appear to be ending anytime soon.

Container Shipping Shorts (Japan – $7 billion to $9 billion market caps)

One advantage the investment manager has with the geographic flexibility in their strategy is to find what they call analogue businesses that are outliers and arbitrage those differences when they do not make sense. One area the investment manager currently likes is Japanese container shipping companies. Currently, the investment manager is short Mitsui O.S.K. and Nippon Yusen, each of which is generating over 75% of profits from container shipping where rates have skyrocketed since mid-2020. However, this party is over with container rates down over 60% since January. While the large European container shipping companies like Maersk and Hapag-Lloyd have less exposure to container shipping (50% versus 75% at the Japanese), they have seen their stocks decline over 40-60%, while the Japanese shippers are only down 2-12% this year. Additionally, where the European container shippers have used this period of over-earning to clean up their balance sheets, the Japanese continue to carry significant net debt and have even placed large orders for more ships.

One major reason why the Japanese have not benefitted is that each company's container exposure is through a single joint venture (along with a third player, KK Lines) of Ocean Network Express. Each company's share of Ocean Network Express's profits is recognised through the equity method below the operating income line, but the actual cash received is less as it comes through a dividend from Ocean Network Express (30% payout ratio). This has meant less cash for Mitsui and Nippon to pay down debt and distribute to shareholders than headline earnings might suggest.

Outside of containers, both companies generate most of their revenues and operating income from various other shipping activities in the bulk and energy segments as well as logistics. These segments are each exposed to their own cycles, but the profits have been completely overshadowed by the container earnings. If container earnings are simply backed out, these businesses are left trading on over 20x earnings with negative free cash flow. With both stocks still trading at over 3x their pre-COVID levels, the investment manager believes that significant downside potentially remains.

Market outlook and positioning

Macro and geopolitical risks are only this high a couple of times each century and the markets no doubt reflect some amount of this uncertainty. Whether these risks are "in the price" or not is unknown, but from a bottom-up perspective, the investment manager can see that several of their top ideas, stocks they have followed for 10 to20+ years are getting nearer to fair value or even cheap. The investment manager is already nibbling on names that they appreciate structurally but previously left them out on valuation. While net exposures are on the low/mid-range of history, gross exposure remains low. With market drops in 2022 now reaching historically troubling levels, it does not seem the time to cut net exposure, but by keeping gross low, allows them to have the flexibility to take advantage of volatility which they do not expect will be going away anytime soon.

The investment manager does not typically talk much about foreign exchange rates, but it's worth noting the dollar index (an average of exchange rates) is up about 16% so far this year. As always, there are a host of reasons including a "flight to quality" and interest rate differentials across countries. Regardless, it is important to highlight that this is an extreme move. The index has not had a move this dramatic since the late 1980s. In Europe, the various stock market indices are down year-to-date by about 15-20% in local currency terms, but the figures are closer to 25-30% in dollar terms. In Japan, the market is only down about 5% in local terms, but nearly 25% in dollar terms. These are dramatic, once-in-25 years-currency moves. *The Economist* magazine calculates a tongue-in-cheek "Big Mac" index which attempts to measure the cost of a Big Mac burger around the world and then compare those prices to identify currency mis-valuations. Consider that a Big Mac in the US is currently around $5.15 but at the current Yen-Dollar exchange rate in Japan it's only $2.83. Half the price.

While it may be tough to fill a ship with Big Macs and send them to the US, plenty of other products can be shipped. As the investment manager looks across the list of potential investments in Europe and Asia, this opportunity is becoming significant. It will not only boost exporter's revenue through translation (the effect of simply converting dollar revenues to local reporting currencies) but also cheapen the products themselves and potentially drive more demand. It should also have the added benefit of allowing the US to import some deflation. On the other side, US exporters will need to be mindful as their products could be getting very uncompetitive overseas. Longer term, these dynamics level out, but near term, the investment manager sees nice tailwinds for export-orientated names such as Osaka Titanium of Japan, which was featured in the investment highlights section above.

Material matters

A new PDS for the Fund was issued on 30 September 2022, updated for FY2022 fees and costs and the new RG97 fees and costs disclosure regime.

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.

This information contains general information only and is not intended to represent specific investment or professional advice. The information does not take into account an individual's personal financial circumstances, objectives or needs. Before making an investment decision, you should consider obtaining professional investment advice that takes into account your personal circumstances and should read the current target market determination and offer document before making an investment decision to acquire or to continue to hold units in the Fund.

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