

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	\$47.8m
INCEPTION DATE	31 March 2001	EXIT PRICE	\$2.6604

Net performance (%)

	1 month	3 months	1 year	3 years p.a.	5 years p.a.	7 Years p.a.	10 Years p.a.	Since inception p.a. ²
Fund¹	-2.42	3.41	8.58	13.70	8.62	7.07	8.43	7.05

¹Fund 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.

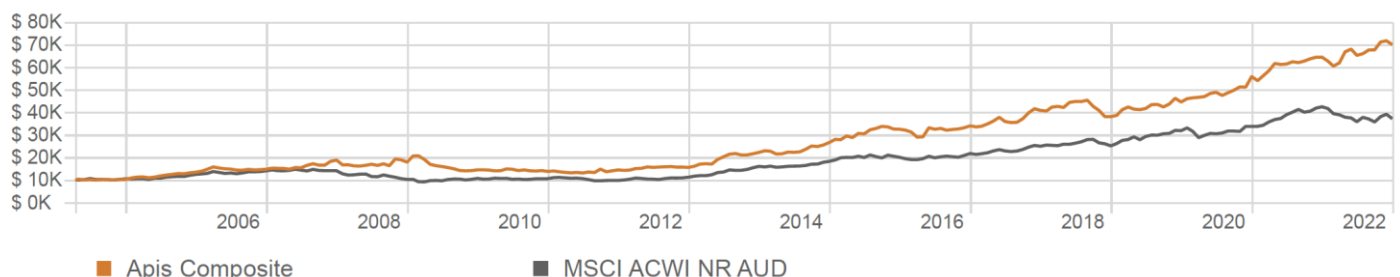
Apis Composite³	--	--	--	16.22	11.36	11.57	16.19	10.95
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Apis Composite 1 month rolling returns³

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	5.17	0.77	-2.42	8.58
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 inception³

Time Period: 16/04/2004 to 31/12/2022



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.

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

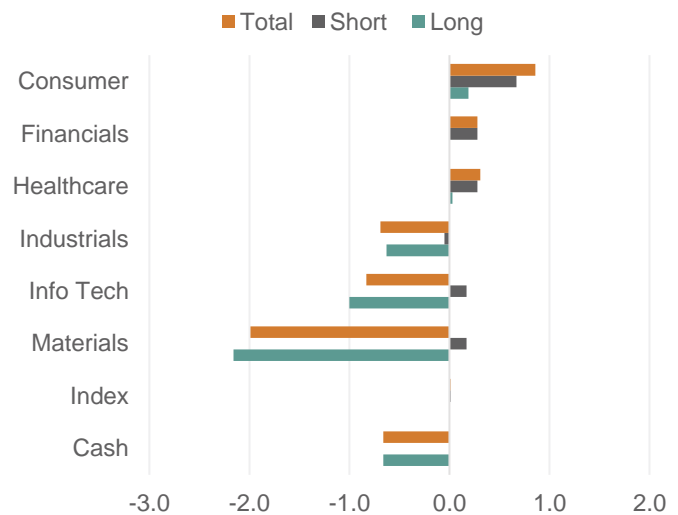
³The inception date of the Apis Composite is 16 April 2004. Performance periods from 16 April 2004 to 30 September 2020 represent the Apis Offshore Capital Ltd USD track record converted to AUD terms, net of management fees and an annual performance allocation. Performance periods from 1 October 2020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

CONTACT DETAILS

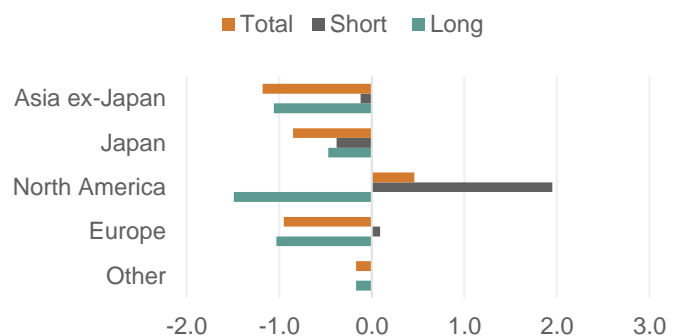
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Sector exposure (%)^{1,2}

	Long	Short	Gross	Net
Consumer	8.49	-10.01	18.51	-1.52
Financials	0.00	-4.98	4.98	-4.98
Healthcare	6.34	-6.80	13.14	-0.46
Industrials	28.72	-8.30	37.02	20.42
Info Tech	15.26	-4.75	20.02	10.51
Materials	30.79	-1.73	32.53	29.06
Other	0.00	-0.23	0.23	-0.23
Total	89.61	-36.81	126.43	52.80

Monthly sector contribution (%)¹

Regional exposure (%)^{1,3}

	Long	Short	Gross	Net
Asia ex-Japan	18.58	-7.98	26.57	10.60
Japan	22.11	-7.26	29.37	14.86
North America	14.66	-15.15	29.81	-0.48
Europe	32.14	-6.43	38.57	25.71
Other	2.12	0.00	2.12	2.12
Total	89.61	-36.81	126.43	52.80

Monthly regional contribution (%)^{1,3}


¹Data 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 3.41% (net) for the quarter (in Australian dollar terms).

Since the Fund's strategy launched more than 18 years ago, there have been five times when equity markets dropped in the year. Three of those years were modest, falling single-digit percentages during 2011, 2015, and 2018, while 2008 was a real doozy, crashing 42%. We'll characterize 2022 as solidly bad, with market indices generally down almost 20%. Of those five down market years, the investment manager was able to generate positive returns in three of them. Relative to general markets, 2022 will go down as one of the investment managers best as they outperformed the MSCI ACWI global benchmark by more than 20%. On that basis, 2022 would be considered one of the investment managers strongest years, as there have only been two other years where they have beat the benchmark to such an extent.

Stellar short performance and finding a few pockets of solid long performance were key to holding up against the general tide. For Q4, Europe contributed 4.8%, but all major regions were positive. For the year, North America added the most value, rising 8.1%, with losses on the long side more than offset by gains of 11.1% on the short side. Looking across sectors, the materials area stood out, adding 7.2%, with 6.7% of that coming from the long side. All sectors contributed to short performance for the year, but consumer was the leader, adding 9.9%.

Looking at individual stocks, Osaka Titanium in Japan added over 2.1% in the year. All five top longs were also in the Materials area, including two North American oil and gas companies and a couple of coal companies, one in Indonesia and a second in the US detractors were led by Vicor (detracting 1.5%) of the US, a power semiconductor company that could have a bright future but suffered supply chain and production capex delays that we fear will continue. Overall, ten names detracted more than 1%.

Performance Review (continued)

A few the investment manager got wrong, and another handful that fundamentally looked okay but were overwhelmed by risk-off behaviour. When the investment manager was wrong, they sold, but in the case of unchanged fundamentals, they generally try to hang in there and add if/when the momentum turns.

While it wasn't hard to find good fundamental shorts this year, it wasn't hard to find them in 2020 or 2021 either. The difference was that they actually went down this year, and the investment manager both recognised and capitalised on the changing environment. Just as the investment manager will hold suffering longs where the thesis remains intact and look to add when the environment shifts, the investment managers ability to limit short losses during speculative periods and press them throughout 2022 was key to their success. With markets falling 18-19%, the investment managers average short fell almost 50%. The investment manager hit rate was excellent, with over twenty names each adding more to performance than their worst detractor. SPACs, online gaming, EV-story stocks, "alt-energy," fintech, COVID over-earners, etc., all contributed nicely.

Investment Highlights – Long Themes

Electrification

The "electrification of everything" is another trend that the investment manager expects to drive opportunities for companies globally in the years to come. While there is much debate about how quickly we can move away from fossil fuels (and the investment manager suspect it will be a long time), right or wrong, governments are hell-bent on "green" energy, and trillions of dollars are being printed to generate it. As petrol-based engines are replaced by electric motors, new semiconductor materials such as silicon carbide and gallium nitride are needed to manage high-power devices. Specialty mining materials such as rare earth metals for magnets or graphite and lithium for batteries need to expand exponentially to reach the investment managers electrification goals. More traditional metals, such as copper, could also short-circuit our "zero carbon" ambitions. The amount of copper used in EVs is estimated at 2-3x of that required in traditional combustion engine vehicles, and power generated by windmills and solar panels is estimated to require 5x the copper per MW versus traditional energy-sourced natural gas. Forecasters estimate we will need 50 million metric tons of copper annually by 2035 vs. 21 million metric tons produced today. With the average mine requiring 16 years to become commercially viable and (ironically) green opposition to almost every major new mine proposed, something must give.

There are endless ways to play these trends. While the investment manager will consider direct mining opportunities, their preference is more "picks and shovels" or companies that provide niche tools and services that help extract metals. The investment manager holds companies with production equipment for battery plants. The investment manager owns companies that dominate the fabrication tools needed to make power semiconductors. The investment manager also sees opportunities in updating the electric grid, which has suffered decades of neglect and will require significant upgrades to deliver this remote (e.g., offshore wind or desert-located solar farms) and intermittent energy back to the populations that need it.

Aerospace & Defence

At the height of the pandemic in early 2020, the investment manager invested in OMAB, a Mexican airport operator, on the thesis of a post COVID recovery in air travel. Over two and a half years later, the investment manager continues to find attractive opportunities related to the "recovery" theme, most notably their investment in Osaka Titanium. Since then, air travel has steadily recovered as countries have eased their travel restrictions and international travel has picked up. According to the US Department of Transportation, 2022 domestic revenue passenger miles through September were back to 93% of their 2019 level, while international remains at 73%. Similarly, TSA-reported checkpoint numbers for December were at more than 90% of their 2019 level. Most countries around the world are showing similar trends. Even China has now abandoned its zero-COVID policy and reopened for tourism this month. Overall, the industry consensus is for a full recovery by 2024 and a return to a long-term growth rate of approximately 4% thereafter. Anecdotally, anyone who has recently flown in the US likely witnessed sky-high prices and packed planes reflecting load factors (utilisation rates) that have returned to peak levels.

The investment manager has previously discussed the impact of the Russia-Ukraine war on the supply side of the aerospace industry, particularly to titanium sponge production, but this ongoing recovery in air travel is a key reason why the investment manager is optimistic about the demand side. The pandemic led to a collapse in aircraft demand with annual deliveries falling from over 1,700 units at both Boeing and Airbus down to under 800 at the trough. The investment manager is now seeing notable signs of a rebound. While actual deliveries remain historically low (due in part to the titanium supply disruption), the industry's backlog has returned roughly to its pre-COVID level. New aircraft orders over the last 12 months are twice the number of orders placed in 2019. This concurrent rebound of demand and ongoing disruption of supply should bode well for critical suppliers like Osaka. Taking a step back, the ingredients for an upcycle were fermenting well before COVID as global air traffic growth has been 5.3% since 2008 versus fleet growth of 2.9%. This shortage of aircraft has only been exacerbated by pilot shortages and the need to retire older aircraft. These trends are set to continue to at least 2030.

Aerospace & Defence (continued)

In the defence sector, the market is similarly undersupplied with spending set to ramp considerably in Europe and elsewhere, reversing a downcycle that has been in place for decades. In Japan, politicians plan to increase the annual expenditure by approximately 60%, from approximately 1% to nearly 2% of GDP, beginning in 2023. Germany has similar targets of 2% of GDP. This is a sector known to be heavily regulated with a reputation for mediocre growth and returns. That has not always been the case, however. Defence spending can increase quickly, driving stocks in the industry up just as fast. Historical examples abound during periods of conflict. The investment manager sees the current environment as particularly notable, with both Germany and Japan committing to re-arm themselves. Furthermore, the follow-on spending growth from the rest of Europe and the world will grow defence expenditures by tens and hundreds of billions of dollars. Niche operators, such as a German radar manufacturer in our portfolio, will be strong beneficiaries.

Onshoring

There is a general push to bring foreign manufacturing back home or to at least shift sourcing to friendlier countries. Multiple disruptions have highlighted the vulnerability caused by offshoring, including the Russia-Ukraine war and its associated supply disruptions, COVID-related supply disruptions, the Chinese trade war and intellectual property battle, and the fossil fuel transition. While each of these factors is notable in its own right, they have all created an overwhelming desire for countries to reverse decades of offshoring.

The investment manager has been positioned to benefit from this in a variety of ways. Consider electric vehicles, which are heavily subsidised and are expected to receive a \$7,500 (in USD terms) rebate as part of the Inflation Reduction Act ("IRA"). Local manufacturing will be required to receive this subsidy, benefiting names like the investment managers Japanese battery equipment producer at the expense of its Chinese competitor. Domestic lithium production will also be encouraged at the expense of less reliable foreign sources. The IRA has also offered some very substantial subsidies for domestic green energy manufacturing.

Companies in Norway, Korea, and elsewhere are now committing substantial sums to invest in US solar panel manufacturing, a market that has previously been over 80% supplied by China. Consider that a solar wafer used in solar panel manufacturing is being given an 8-cent-per-watt subsidy, a figure that accounts for over 50% of the value of a wafer in the market today. One Korean solar company with a facility in Georgia estimates that it will receive cash subsidies of 8.5 billion Korean won over the course of 10 years as a result of investing 3.5 billion in new capacity (a 20%+ annual return on subsidies alone). Ironically, the best way for the investment manager to invest in this theme is not through US-traded companies with limited exposure to the IRA, but rather companies trading overseas.

The CHIPS and Science Act is another piece of legislation explicitly written to drive more US onshoring. Companies like TSMC based in Taiwan are, for the first time ever, committing to build billion-dollar semiconductor facilities in the US which will benefit a long tail of suppliers, many of whom trade in Asia. China is expected to counter this with a 1 trillion RMB subsidy for its domestic chip industry (and Korea recently proposed its own giant subsidy). These are just a few onshoring examples, but many others exist across Europe and Asia, as each region has been affected by the disruptions listed above. The investment manager thinks their global strategy is particularly well suited to benefit from this transition, and today the investment manager owns numerous positions directly impacted and supported by these onshoring subsidies.

Offshore Energy

One sector the investment manager is increasingly enthusiastic about is offshore drilling, which they believe is set up to benefit from a uniquely extended up-cycle. Roughly one-third of the world's oil comes from offshore, but in the last 15 years there has been a major lack of investment in offshore drilling infrastructure due to cheap oil, COVID, renewables, etc. The world's fleet of deep-sea drilling ships is about half what it was just 10 years ago. Many of these drillers experienced financial difficulties and had to scrap old ships or redeploy them into green energy projects – they cost a lot to maintain. They also lacked the balance sheets and/or the customer demand to build new ones. These drill ships are neither cheap nor quick to build: a new one can cost over \$1 billion and takes 4-5 years to construct.

As oil supply has quickly become a serious geopolitical concern due to Russian aggression, offshore oil projects are ramping up fast. As a barometer of demand, 75 "rig years" are expected to be awarded in the next 18 months, double the expected level just two years ago. The high demand, paired with the lack of drill ship supply, is causing day rates (the price paid by oil & gas companies to offshore drillers) to skyrocket. Day rates are now in the \$400,000-500,000 per day range and expected to go higher, compared to around \$200,000 per day just a couple of years ago.

Companies in the space are having their rigs booked out 5 or more years at elevated rates - a sort of "ship grab" instead of a "land grab." Most of these companies have struggled the last few years with significant debt burdens and have depressed valuations.

Offshore Energy (continued)

Many are still trading at or below their historical multiples despite an incredibly optimistic outlook – in some cases, below 2 times cash flow. If the environment remains unchanged, these companies are set to generate massive cash flow and rapidly pay down debt. They also are not exposed to those annoying windfall taxes that have plagued traditional oil & gas companies. The drillers most poised to benefit, in the investment managers opinion, are the ones with idled/stacked ship capacity they can bring back into operation at high rates.

Investment Highlights – Short Themes

Electric vehicles (EVs)

The investment managers view them as no different from traditional autos and, if anything, worse as investments given the lower barriers to entry. The past year saw the investment manager close out many shorts that have now become too small. Nikola, Canoo, Archimoto, Lordstown Motors, Workhouse, Sono Group, Faraday Future, etc., have all become penny stocks. While there are fewer remaining viable shorts in this area, the investment manager continues to find more than a handful whose existence relies heavily on significant future financings. Those others will eventually lose patience. Additionally, there is a diaspora of EV-related parts suppliers (some good, many bad) or charging-related service companies with head-scratching business models. Of course, danger lurks as many of these names attract retail attention. Another risk is government subsidies that prolong the decline, so the investment manager maintains small positions and are pragmatic to the idea that, like Tesla, one or two of these start-ups might actually succeed.

COVID Over-Earners

The COVID pandemic had a shockingly positive impact on a number of industries. In many cases, however, this earnings windfall is now fading fast. For example, in the automotive sector, used cars rose in price by 30% after having risen annually by just 2% over multiple decades. The profit impact on auto dealers was immediate, with profit-per-vehicle doubling or tripling historical averages. Combining this with operating and financial leverage, earnings per share rose as much as 500% at some auto dealers. Similarly, companies making work & play-at-home products such as laptops and gaming headsets saw comparable increases in earnings. Shipping is another area we have discussed previously, where temporary shortages in container ships drove 1,000% increases in share prices. Finally, nowhere has the COVID phenomenon been more visible than in homebuilding, where products like lumber had a price spike of 400% driving lumber company earnings up by similar amounts.

In each of these cases, a different supply-demand dynamic is at work which will ultimately determine the duration of each cycle. The investment manager believes that in a number of these cases, the boom will be followed by a sudden bust, or at the very least, a quicker-than-expected normalisation. In some cases, the companies are “doing the right thing” with their windfall and returning it to shareholders. However, others are convinced their windfall is part of a new, much higher earnings plateau. The investment manager disagrees and believes there are some excellent short opportunities in several of the aforementioned areas and others falling within the same general theme.

REITs

The investment manager is short a basket of REITs that they believe are facing secular headwinds and unsustainable business models in a high-interest rate environment. The investment manager has separated these into two groups. The first is office REITs, which the investment manager believes will continue to face long-term headwinds from the remote/hybrid work trend. In the investment managers view, Class B offices in mediocre locations with little-to-no amenities are particularly at risk. This remains apparent in New York where, according to SL Green’s recent investor day, occupancy has stubbornly hovered around 60% of pre-pandemic levels despite an actual 4% increase in office-using jobs. Furthermore, the divergence in quality can be seen in the transaction prices: the price per square foot of post-2007 vintage properties has increased by 54% versus 2019 prices, whereas pre-2007 properties have declined by 17%. The second group consists of retail REITs, which the investment manager believes will continue to feel the long-term pressure of e-commerce and are particularly vulnerable to a weakening economic environment. Many of these have already been major “COVID losers,” but the outlook for the group remains challenging as footfall lingers more than 10% below 2019 levels.

In addition to these challenges, both groups share extremely high debt levels relative to earnings power. You could argue in some cases that this debt is supported by asset values, but the investment manager believes the operating models have become overly reliant on capital markets. Most of these businesses have simply not generated enough cash from operations to cover ongoing property maintenance/additions, interest payments, and dividends (required to maintain REIT tax status). This has led to ballooning debt even before the pandemic and frequent asset sales. Rising rates make this practice even more unfeasible as debt gets more expensive and asset values decline. The investment manager has already seen more than a few dividend cuts and expect to see more. The investment managers focus remains on the companies they believe to be most vulnerable to these headwinds through their mix of low-quality assets, high variable interest rate exposure, near-term debt maturities, and upcoming lease expirations.

Market outlook and positioning

Coming into the year, speculation was rife, valuations were insane, private equity was frenzied, and interest rates were bound to increase – so is it any surprise the market did what it did? Now, rates might be peaking, and valuations are better, so perhaps stocks will improve. The investment manager will manage their exposures and do their best to pick stocks like they always do. They are confident that their unique universe of smaller-sized global companies will continue to offer opportunities regardless of the market environment.

While the investment manager has no strong view on market direction in general, they do have high conviction in several themes which have arisen through their bottom-up work on individual names. On the positive side, electrification will require massive investments. The investment manager also sees secular improvements within aerospace and defence spending. Various government spending bills, such as the Inflation Reduction Act and the Chips Act, stand to enrich many companies. Some of the biggest beneficiaries of these acts are non-US companies, which the investment manager doesn't believe is well understood. Lastly, the investment manager believes oil & gas are compelling themes – especially long-neglected areas offshore.

Negatively, the investment manager still sees bubbles in numerous areas that need further deflation. Housing is in trouble, yet many building materials businesses are forecast to grow. Transportation, especially some areas within shipping, look to be turning down just as ship orders begin adding capacity.

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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