Firetrail Absolute Return Fund

FEBRUARY 2019

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.

ABSOLUTE RETURN FUND

The Absolute Return Fund is a market neutral strategy with minimal correlation to equity market direction. It aims to generate positive returns in all market environments. 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 RBA cash rate over the medium to long term.

FUND PERFORMANCE TO 28 FEBRUARY 2019

	Net Fund	Benchmark	Net Excess
1 Month (%)	(1.10)	0.11	(1.21)
3 Months (%)	(2.72)	0.37	(3.09)
Inception (%)	(2.83)	1.44	(4.27)

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.

FUND DETAILS

Unit prices	31 February 2019
Application price	$0.9756
Redemption price	$0.9659
NAV price	$0.9708

Fund Details	
APIR Code	WHT5134AU
Benchmark	RBA Cash Rate
Inception date	14 March 2018
Fund size	$202m
Management fee*	1.50% p.a.
Performance fee*	20% of outperformance

*Please read the Product Disclosure Statement for more details

PORTFOLIO POSITIONING

Top 3 Overweight Holdings (Alphabetical)
Amcor Ltd
Woolworths Group Ltd
WorleyParsons Ltd

FUND EXPOSURE

	Portfolio Exposure
Long Equity	142%
Short Equity	142%
Net Equity Exposure	0%

PORTFOLIO COMMENTARY

The Fund returned (1.10%) for the month ending 28 February 2019, underperforming the RBA cash rate by 1.21%.

The underperformance in the month was driven by both long and short positions in the fund.

During the month of February, the ASX200 rallied 5.2%, but earnings forecasts for the market in aggregate declined 0.1%. The Australian market price performance outperformed the strength in offshore markets (S&P500 up 3.0%, FTSE100 up 1.5%). Since the lows just before Christmas last year, the ASX200 has now risen 13%, to be back at a Price to Earnings ratio of 15.5x – above the 10 years average for the ASX200. This places it close to the highest 1 year forward Price to earnings ratio we have seen over the past 1- years of 16.8x. The concerns of the market in December were numerous – China trade wars, Brexit, upcoming Australian elections. These haven't gone away, but the intensity of each has eased.

Contributors during the month included:

A long position in waste manager Cleanaway (CWY) rose 20% in February. A consensus- beating report was driven by 15% organic earning growth, as well as outperformance on the synergies form their recent acquisition of competitor TOX. Over the last 2 years CEO Vik Bansal has added significant operational and financial rigour to reinvigorate the once sleepy rubbish collector. Contract wins, margin improvement and further synergies will continue to drive the growth over the next few years.

A long position in A2 Milk (A2M) contributed as the company gave a strong revenue performance and outlook for the second half. A2 Milk rose 14% as it announced that revenue rose 41% during the half, and that this growth rate would broadly continue this rate. This gave not only a strong sign of the confidence in their infant formula brand in China, but also the increasing awareness of A2 Milk in North America. The company is continuing to focus on building an "in-country" presence in China, as well as increasing US distribution channels.

Detractors during the month included:

A long position in small cap data centre operator Next DC (NXT) detracted over the month after the company reported an in-line result. We believe the underperformance was due to the result not being accompanied with an announcement of a new major customer deal. In our view these deals are still coming – however with the nature of "hyperscale" cloud computing, the deals are lumpier and larger. Our confidence was reiterated from the company signalling that they would accelerate a significant portion of capital expenditure in their second Sydney data centre.

A long position in agrichemical distributor Nufarm (NUF) detracted as the continuing impacts of drought were felt across Australia. Whilst Nufarm did not report during the month, its shares were sold off as the likelihood of high rainfall across the key Australian agricultural regions in the next few months decreased (according to the Bureau of Meteorology). Despite this being a likely short-term earnings headwind, we remain with high conviction in our Nufarm position. Over the course of the year we eagerly await progress in the development of its canola-based Omega-3 formulation.

The fundamental short portfolio included contributors from building materials names, whilst detractors included agricultural businesses and healthcare. A number of shorts were closed out during the month as the catalyst events of earnings reports passed. We will look to increase the size of the fundamental short portfolio progressively as we move towards "conference season" in April and May, and the August results season.

ONE INTERESTING THING THAT HAPPENED THIS MONTH…

Were the debates that occurred in the market on the relative importance of cashflow versus earnings in results. Various explanations were offered up for lower than usual "cash conversion". Cash conversion is a measure of the relationship between earnings on the income statement and operating cashflow. At balance sheet date the timing of payables (company cash outflows), receivables (company cash inflows) and inventory positions can have a significant impact on the reported cashflow. For example – if a large customer pays their bill on January 2 versus 31 December, a company can be left with a cash hole in the accounts…. but the cash hasn't disappeared.

Treasury Wines was a case in point after its poor 53% cash conversion result from receivables rising by $235m year on year. Does this mean they sold a lot in December to hit the result? Or is there a significant increase in demand? We are yet to know the answer. Treasury Wines expected the questions and went on to explain for the 7 months to January cash conversion was 85%, a much more respectable result.

The bears have been pointing out that cash never lies, and that it can be an early sign of weakness in a company's operations. Conversely, the bulls maintain that companies shouldn't tidy their cash position for a point in time and just focus on growing earnings. All will be revealed in August however, as numerous companies have promised us a great cash performance in the 2nd half.

MORE INFORMATION

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Firetrail INVESTMENTS