Firetrail INVESTMENTS

Firetrail Australian High Conviction 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.

AUSTRALIAN HIGH CONVICTION FUND

The Australian High Conviction Fund is a concentrated portfolio (approx. 25 companies) of our most compelling equity ideas. 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 ASX200 accumulation index over the medium to long term.

FUND PERFORMANCE TO 28 FEBRUARY 2019

	Net Fund	Benchmark	Net Excess
1 Month (%)	5.56	5.98	(0.42)
3 Months (%)	8.64	9.95	(1.31)
Inception (%)	(0.50)	8.01	(8.51)

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	28 February 2019
Application price	$0.9935
Redemption price	$0.9885
NAV price	$0.9910

Fund Details	
APIR Code	WHT3810AU
Benchmark	S&P/ASX 200 Accumulation Index
Inception date	14 March 2018
Number of Holdings	24
Fund size	$338m
Management fee*	0.95% p.a.
Performance fee*	15% of outperformance

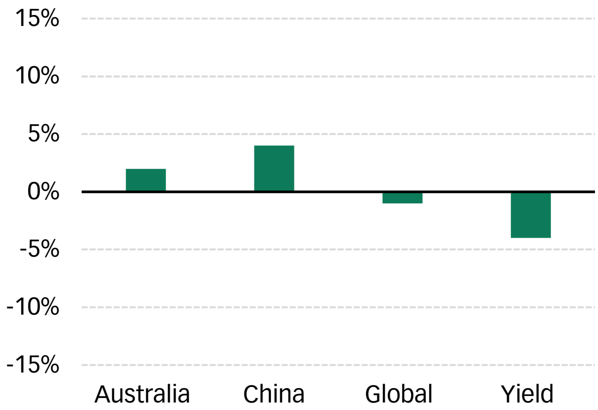
*Please read the Product Disclosure Statement for more details

PORTFOLIO POSITIONING

Top 3 Overweight Holdings (Alphabetical)
Commonwealth Bank of Australia
Woolworths Group Ltd
WorleyParsons Ltd

THEMATIC POSITIONING

Relative to the Benchmark



REPORTING SEASON COMMENTARY

February is a busy time as companies report their results to give an idea on business performance and the outlook. At Firetrail, the team attended more than 90 corporate meetings over the period.

Some of the key themes that came out of reporting season included:

Capital returns high on the agenda

- Many corporates took the opportunity to return franking credits via higher than expected dividends (Wesfarmers, Flight Centre and the miners BHP, Rio Tinto, Fortescue) and off-market buy backs (Caltex)
- All companies on this list rose strongly on the day of their result
- We do note that after strong performance on the day of announcement, many companies gave up any excess returns afterwards indicating more of a sugar hit rather than a sustained re-rating of equity

Government intervention remains a key issue

- Banks, Electricity companies and Health insurance providers are walking the tightrope of appeasing the Government while protecting both customers and shareholders
- Over the rest of the year, there is a Federal election and a NSW state election (23rd March 2019) and as a result, investors should brace for more policy uncertainty
- We believe all parties will attempt to curry favour from voters with populist policies, and we believe one particular theme could be stimulating the average consumer with financial benefits

Consumer slowing but not broken

- Consumer companies such as JB HiFi, Super Retail, Wesfarmers and Flight Centre were cautious on the consumer, but their results showed there is no disaster
- There is clearly a tension between the wealth effect (negative as house prices fall) and the income effect (remains OK with unemployment remaining very low)
- If anything, the one thing most agreed on was that wet weather on key trading days in December impacted sales, with the start of 2019 being better

PORTFOLIO COMMENTARY

The Fund returned 5.56% for the month ending 28 February 2019, underperforming the ASX200 Accumulation index by 0.42%.

Portfolio returns benefited from positions in Cleanaway, Amcor and James Hardie which all delivered results that were in line or better than market expectations.

Australian waste company Cleanaway, delivered strong results ahead of consensus with growth delivered across all divisions (collecting waste, disposing waste and more technical services). The integration of recently acquired business Tox Free continues on track. The company looks ‘expensive’ on traditional P/E ratio metrics. However, the momentum in the business and the defensive nature of the end markets justifies a premium. In addition, global peers with slower earnings growth are trading at material premiums when looking at EV / EBITDA metrics, implying there is still further investor returns ahead for Cleanaway investors.

Global packaging company Amcor delivered a boring result, and that is why we liked it. The company had become oversold as the market focused on earnings downgrades related to raw material inflation. We note Amcor has contractual pass through, and so any headwind from higher raw materials will be recouped in the following months. A common misperception around Amcor is that the global revolt against plastic is set to be a headwind for the company. Instead we believe it will be a tail wind. Amcor do not make plastic bags and plastic straws. They make high quality and innovative packaging solutions serving two key purposes. The first is a barrier to store and transport goods (food, drinks, health equipment etc). The second is to help brands. At a recent Coca Cola Amatil investor day, we were reminded that the average consumer will walk into their local convenience store for a drink and make a decision in three seconds based on what is presented. Packaging is key. With low expectations, and modest but reliable earnings growth ahead, Amcor continues to look good value.

Portfolio detractors included Nufarm (did not report), Woolworths and Reliance Worldwide.

Strategy underperformance during the month was in large part due to a position in crop protection company Nufarm. While there was little news on Nufarm, weather conditions across their markets have remain mixed with Australian farmers, in particular, enduring very hot and dry conditions in the past few months. Nufarm is a globally diversified business growing across key markets. With large returns on offer from the monetisation of Omega 3 from a canola fish feed solution (see more here: https://www.firetrail.com/2018/12/17/1-stock-pick-2019/). The investment case for Nufarm remains strong and we see material upside. Clearly the performance of our investment has been disappointing, but we strongly believe patience is the best strategy where companies are executing through difficult market conditions.

Woolworths detracted after delivering results below expectations. Most divisions were slightly weaker including Liquor (Dan Murphy's and BWS) and discount department store Big W. 'What Matters' for Woolworths however, is the Food division accounting for 65% of earnings. In the December half, Food sales growth was 2.9%, below recent trends of more than 3.5%. The half was impacted by the phasing out of plastic bags and competitor Coles' uber successful 'Little Shop' which captured the attention of children and the wallets of their parents. We underestimated the earnings impact on Woolworths with profits growing at just 4% (vs trends in the high single digits). However, investing is a forward-looking sport and the outlook for Woolworths' earnings growth remains strong. After years of investment and a rebasing of pricing, Woolworths is a focused organisation in a fairly rational supermarket industry. At the result, Woolworths also announced the intention to return up to $1.7bn of capital by April, underlining the continued focus on shareholder returns.

Global plumbing company Reliance Worldwide fell relative to the strong market. The result itself was fairly benign given a January pre-update, but there were quite a few moving parts including a better look at newly acquired UK plumbing firm John Guest, as well as a view of the business in a steadier state after recently winning large home improvement player Lowes. Importantly, John Guest grew revenue at 7%, while the core Reliance business grew revenue at 14%. We believe there were two reasons why Reliance Worldwide underperformed during the month. The first was poor cashflow conversion. The terms for one of their big customers were temporarily generous as they bought lots of stock from Reliance and have now normalised. We do not think there is a big issue there. Secondly, the Chairman sold his remaining 10% of the company, accompanied by his commitment to step down. This is the 3rd sell down by the Chairman and his family and we think read-throughs to the health of the business are unfounded. With Reliance dominating their category, and the category at just 10% penetration, there is a long growth runway ahead and with the stock trading at just 21x PE, we increased our position.

Portfolio Changes

During the month, we added to our positions in Reliance Worldwide, Downer EDI and Clydesdale Bank. In all cases, after seeing the results, the companies are delivering and with compelling valuations on offer, we decided to allocate more capital to these opportunities.

On the sell side, we trimmed some Rio Tinto after some very strong performance and exited our small position in Caltex with management turnover across the business resulting in a loss of conviction.

ONE INTERESTING THING THAT HAPPENED THIS MONTH…

Some serious questions marks were raised over the continued growth of US tight oil / shale by the godfather of US Shale, Mark Papa. You can google him, but he was Chairman of one of the most successful shale companies, EOG for more than 14 years. Now as Chairman of US shale company Centennial Resources, he delivered an amazing conference call in late February. In the call, he believed the drillers are seriously struggling with tighter and tighter well spacing, meaning less productivity per well as wells are sucking oil from each other. The view that tight oil isn't unlimited plays into our thesis on Worley Parsons, which is that investment in conventional sources must return from current low levels. There were plenty of other insights, but the key quote was this: *"In the current world where we sit today, $55, simply put, we're just not going to bang our head against the wall and attempt to grow production in that kind of world." Mark Papa, Chairman Centennial Resource Development, 27th Feb 19, Q4 2018 conference call*

MORE INFORMATION

General enquiries 1300 010 311
Existing client enquiries 1300 360 306
www.firetrail.com

Firetrail
INVESTMENTS