Firetrail Absolute Return Fund

FEBRUARY 2020

PERFORMANCE (AFTER FEES)

	Month	Quarter	FYTD	1 yr	Fund incept[2]	3 yrs (pa)	Strategy incept (pa)[4]
Fund[1]	-0.47%	1.94%	7.56%	1.28%	-0.82%	-	-
Strategy composite[3]	-0.47%	1.94%	7.56%	1.28%	-	3.56%	10.90%
Benchmark	0.06%	0.19%	0.57%	1.05%	1.27%	1.32%	1.49%
Out/Underperformance	-0.53%	1.75%	6.99%	0.23%	-2.09%	2.24%	9.41%

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 ("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.

PORTFOLIO POSITIONING 29 FEBRUARY 2020

Top 3 Long Holdings (Alphabetical)
Amcor PLC
Telstra Corp Ltd
Virgin Money UK PLC

FUND DETAILS

Unit prices	29 February 2020
Application price	$0.9877
Redemption price	$0.9778
NAV price	$0.9828

Fund Details	
APIR Code	WHT5134AU
Benchmark	RBA Cash Rate
Inception date	14 March 2018
Fund size	$213
Management fee*	1.50% p.a.
Performance fee*	20% of outperformance

*Please read the Product Disclosure Statement for more details

FUND EXPOSURE 29 FEBRUARY 2020

	Portfolio Exposure
Long Equity	165.6%
Short Equity	(165.6%)
Net Equity Exposure	0%

Past performance is not a reliable indicator of future performance.

1. Firetrail Absolute Return Fund ('Fund'). Net Fund returns are calculated based on exit price with distributions reinvested, after ongoing fees and expenses but excluding taxation. **2.** Fund inception is 14 March 2018. **3.** The Fund has been operating since 14 March 2018. To give a longer-term view of our performance for this asset class, we have also shown returns for the Firetrail Absolute Return Strategy Composite ('Strategy') which has been operating since 30 June 2015. Strategy performance has been calculated using the monthly returns (after fees) of the Fund from 14 March 2018 to current date, as well as the monthly returns of the Macquarie Pure Alpha Fund (after fees) between 30 June 2015 to 23 November 2017. The Fund employs the same strategy as was used by the same investment team that managed the Macquarie Pure Alpha Fund as at 23 November 2017. Firetrail has records that document and support the performance achieved as the Macquarie Pure Alpha Fund. The composite returns for the Strategy and the RBA Cash Rate (Benchmark) exclude returns between 24 November 2017 and 13 March 2018. During this period the investment team did not manage the Strategy. As such, the annualised performance periods stated are inclusive of the combined composite monthly returns, and do not include the period when the team were not managing the Strategy. For example, the annualised return over 3 years for the Strategy and benchmark are inclusive of 36 monthly performance periods available in the composite return period, excluding the period between 23 November 2017 and 13 March 2018. For additional information regarding the performance please contact us through the link on our website. 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. **4.** Strategy inception 30 June 2015.

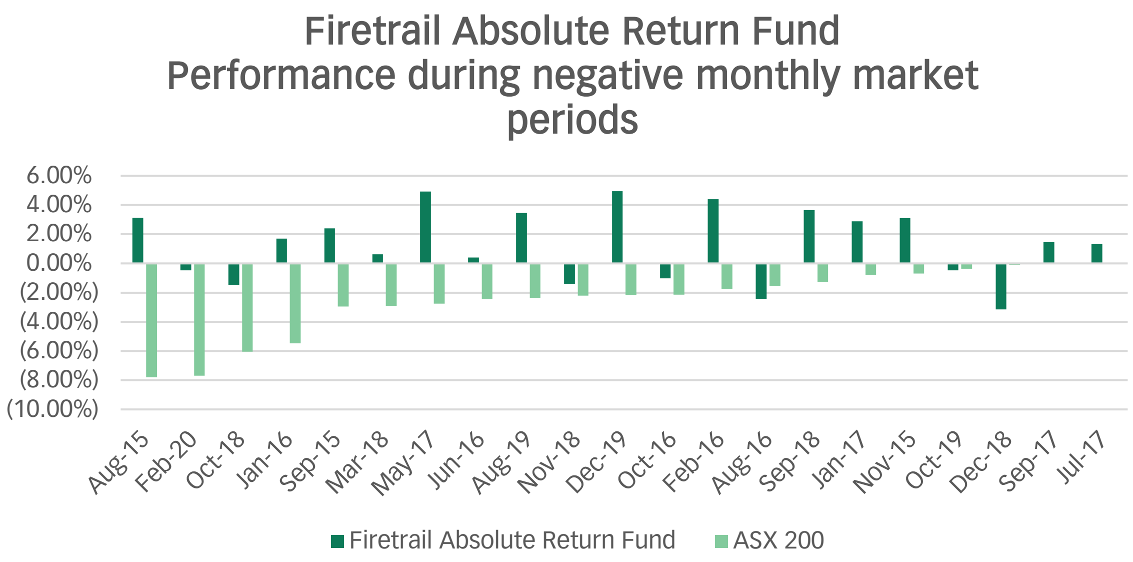
PERFORMANCE COMMENTARY

The Fund returned (0.47%) during February, underperforming the RBA Cash Rate benchmark by (0.53%).

Positive returns were driven by fundamental short positions and the fundamental long positions were a detractor.

February was a turbulent month in global equity markets as the impacts of the spread of COVID-19 (coronavirus) were felt around the world. The ASX 200 Accumulation index fell 7.69% during the month, with other global equity indices falling by a similar quantum. As we enter March, coronavirus clearly remains an evolving situation, and both monetary and fiscal stimulus are likely around the world to offset the economic impacts. Share markets will likely continue to be volatile as positive economic stimulus news is weighed against updates on the impact of the virus.

As mentioned in last month's report – it's not the market moves but the moves within the market that drive returns of the Firetrail Absolute Return Fund. We remind investors that the Firetrail Absolute Return fund is **strictly market neutral** and is an "alternative" investment product. Each day the net exposure (long positions minus short positions) is kept very close to zero. Beta is also kept very close to zero. We do not attempt to time markets or adjust exposure in the fund. It is for this reason that the correlation with equity markets runs close to zero. This can be shown in the chart below where we have looked at the strategy's performance in all the down months for the ASX200 since the strategy was started – including the strategy as it was run prior to Firetrail's inception by the same portfolio managers (Patrick Hodgens and James Miller).



We have undertaken significant additional analysis on our fundamental long positions to understand the impact that the various COVID-19 scenarios could have on the portfolio. This was undertaken under a framework of operational impact, cashflow/balance sheet impacts, industry impacts, and the required scenario for each company that could result in an equity analysis. A focus on cashflow is critical, as for most businesses it would be a drain on liquidity resources that could result in a dilutionary (and likely value-destroying) equity raising. As we look through the top 20 long positions in the fund, we currently only see equity raising risk for 2 of these stocks, in the case of a protracted outbreak scenario that has impacts lasting into calendar year 2021. For many of the stocks, the balance sheet, cashflow and industry positioning is such that we believe their position may be strengthened over the longer term due to the outbreak. Having said that – there will be earnings impacts for stocks that is being quickly priced in by the market.

The final risk management tool we utilise for the construction of the portfolio is the monitoring of our proprietary thematic risk buckets to ensure we aren't taking on too much macroeconomic risk of any one type. For example – the themes let us know how the portfolio is exposed to say China stimulus, or the impacts from global interest rate moves. As stock pickers, we don't attempt to perfectly neutralise any theme – we simply ensure we aren't taking too much risk in any one theme.

TOP CONTRIBUTORS FOR THE MONTH

A long position in Insurance software provider **FINEOS** followed up its solid January performance again in February (+19%) as it reported a strong interim result. FINEOS's management team upgraded its revenue guidance for the year to EUR84m-86m from the previous EUR80-82m (and from the August 2019 original prospectus forecast of EUR74m). From our research we believe that FINEOS has a large pipeline of work, and the largest issue for the company is scaling appropriately to fulfill client demands. The backlog of insurance providers having to update their software systems in response to adapting legislation and the changing competitive environment continues to grow. 7 of the top 10 group life and health insurers in the United States are now using FINEOS in some shape or another. FINEOS is not only growing staff numbers, but also further standardising its key cloud software packages in order to meet demand.

Cleanaway Waste Management, (+11%) Australia's largest waste management company was up during the month, benefitting our long position in the stock. The stock outperformed after giving EBITDA guidance that resulted in small upgrades to consensus. The market had been concerned heading into Cleanaway's result due to the transition the global waste industry is experiencing. In particular, prices for commodity wastepaper products had declined significantly – however, Cleanaway had been going through a process of ensuring that its contracts with customers were structured appropriately such that it was largely insulated from these commodity price moves.

The fund also benefitted from a net long position in gold stocks – including long positions in **Evolution Mining** and **Newcrest Mining**. Evolution has an excellent operational team with low cost operations whilst Newcrest Mining has one of the longest asset lives in the global industry. In a volatile market we believe these are the two best gold stocks to own, rather than some of the lower tier miners running higher operational risks (as well as liquidity risk in their more thinly traded shares).

The abundance of earnings updates provided for the **Fundamental short** positions to outperform in aggregate. In particular, opportunities were found in the building materials and technology sectors. Fundamental shorts are always based on a catalyst, such as stocks missing earnings estimates during reporting season.

TOP DETRACTORS FOR THE MONTH

EML Payments, a small companies long position, (-31%) fell after it reported results – primarily, it appears, as the market was concerned around a small delay in the completion date of its recent PFS acquisition. EML Payments offers prepaid stored value products (think debit cards), increasingly in an electronic format. The completion date was pushed out about a month, as it passes through the various processes of the UK regulatory bodies. We see limited reason for concern here. Despite the strong performance over the past year (even after the fall during the month), valuation upside is significant. We remain focused on engaging with the management team to understand their key growth opportunities, including into the US gaming market.

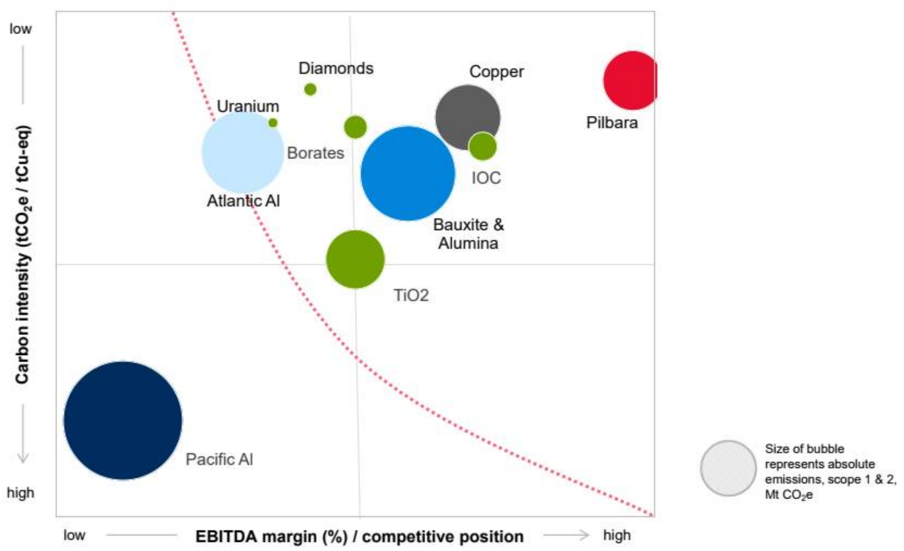
A large cap long position in Urban infrastructure provider **Downer** (-23%) also detracted from performance in the month. During the month the company was wrapping up the tail end of the two construction projects for which it announced losses for in January (Carapateena minerals processing plant and the Orbost Gas Plant). We expect cashflow conversion for the company to rebound significantly in the second half, regardless of external market macro conditions. The core divisions of Downer – Transport, Utilities and Facilities are largely performing at or above expectations, and we believe there is a pathway to an appropriate exit of low margin/high risk construction work. As we also think to possible beneficiaries of fiscal stimulus, Downer is one name that consistently comes to mind. A significant slice of revenue is sourced from state and federal governments and fiscal stimulus such as increased work on roads/rail is a timely and effective methodology for rejuvenating the domestic economy.

ONE INTERESTING THING THAT HAPPENED THIS MONTH…

The sharply increased focus on environmental concerns from our portfolio holdings as we met the management teams throughout the month, even when compared to their last reporting periods in August. Whether this is in response to the bushfires, or increased pressure from shareholders, or a combination of other factors including them is somewhat irrelevant – this is a trend that is here to stay. Our approach to Environmental (and Social / Governance) issues is for each analyst within our team to **own** the ESG issues within each company, then to **measure** those issues (as they are investment issues!), and then actively **engage** with companies on their ESG issues.

As an example – mega-cap miner of high-quality assets, **Rio Tinto,** (which had already exited its coal business) takes the carbon intensity of its assets into account when making investment / divestment decisions. As can be seen in their climate change portfolio matrix below from their results presentation, clearly their Pacific Aluminium business (operator of aluminium smelters) is the odd one out.

Rio Tinto climate change portfolio matrix



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