FIRETRAIL ABSOLUTE RETURN FUND

MONTHLY REPORT | MARCH 2021

PERFORMANCE (AFTER FEES)

	Month	Quarter	6 Months	1 Year	3 Years p.a.	Fund inception p.a.[2]	5 Years p.a.	Strategy inception p.a.[4]
Fund[1]	-0.02%	8.58%	11.86%	43.43%	9.30%	9.37%	-	-
Strategy composite[3]	-0.02%	8.58%	11.86%	43.43%	9.30%	-	10.36%	14.53%
Benchmark	0.01%	0.02%	0.06%	0.19%	0.88%	0.89%	1.16%	1.24%
Excess Return	**-0.03%**	**+8.55%**	**+11.80%**	**+43.24%**	**8.42%**	**+8.48%**	**+9.20%**	**+13.30%**

Past performance is not a reliable indicator of future performance.

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 31 MARCH 2021

Top 3 Overweight Holdings (Alphabetical)
Newcrest Mining Ltd
Serko Ltd
Virgin Money UK PLC

FUND DETAILS

Unit Prices	31 March 2021
Application price	$ 1.3146
Redemption Price	$ 1.3054
NAV Price	$ 1.3100
Fund Details	
APIR Code	WHT5134AU
Benchmark	RBA Cash Rate
Inception date	14 March 2018
Fund size	$326mil
Management fee*	1.50% p.a.
Performance fee*	20% of outperformance above an annual Hurdle of 3% above Benchmark

*Please read the Product Disclosure Statement for more details.

FUND EXPOSURE 31 MARCH 2021

	Portfolio Exposure
Long Equity	189.6%
Short Equity	(189.6%)
Net Equity Exposure	0.0%

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 SUMMARY

The Firetrail Absolute Return fund finished flat for the month of March, returning -0.02%. The Fund returned 8.58% for the March quarter, outperforming the RBA Cash Rate benchmark by 8.55%.

Positive contributors to performance included long positions in AirTasker, Bega and Crown Resorts. Detractors included an overweight position in Newcrest, CleanSpace and Chorus.

WHAT'S DRIVING MARKETS?

It was a solid quarter for the Australian equity market with the S&P/ASX 200 benchmark adding 4.26% to 31 March 2021. The key talking point during the quarter was the return of inflation (and whether it would rise further). Global bond yields rallied sharply. The Australian 10yr yield rallied to 1.74% from 0.98% at the beginning of 2021. Unsurprisingly this saw stocks exposed to an improving economic backdrop perform strongly. Financials led the charge with cyclically exposed sectors performing best. Rate sensitive segments of the market such as utilities and tech were the worst performing sectors for the period.

PORTFOLIO POSITIONING

The Firetrail Absolute Return portfolio is currently slightly tilted towards value or cyclically exposed names.

We continue to hold key positions in growth names such as Xero, SEEK, Megaport, and Fineos, which have large applicable market opportunities and secular long-term tailwinds.

This is balanced by our cyclically exposed names, such as Qantas, Bluescope, GWA Group and Incitec Pivot, which should benefit from rising bond yields, as well as our overweight holding in Gold.

PORTFOLIO CONTRIBUTORS

Fund outperformance through the March quarter was broad based. Pleasingly all four levers contributed to positive returns. **Key contributors** across the four Firetrail Absolute Return portfolio levers for the March quarter were:

- **High Conviction (Mid to Large Cap) Long Positions – Contributed +2.08%**
  Our key overweight in **Crown Resorts** delivered significant outperformance in the quarter following the bid to acquire 100% of the company by private equity group Blackstone. We discuss our position in Crown further in detail below.

- **Additional Small Companies and Corporate Events – Contributed +2.88%**
  The Fund added a position in **Genworth Mortgage Insurance Australia** during the quarter following a full selldown of its 52% holding by Genworth Financial. We saw removal of this overhang as one of the key catalysts for a re-rate of the stock towards book value. We estimate Genworth's book value per share around $3.40/share, implying the share selldown was undertaken at a c.30-35% discount. We believe resumption of dividends, a potential capital return later in the year (following conservative loan loss provisioning through COVID) and continued premium growth underwritten by the current housing credit growth boom should underpin further re-rating of the stock from here.

- **Fundamental Shorts Positions – Contributed +2.16%**
  Despite a very strong reporting season for earnings we still saw fundamental short opportunities in the current market environment. The key fundamental short contribution through the quarter came from selective shorts in multiple technology related names. These stocks enjoyed strong retail driven share price returns over the past year which have resulted in elevated valuations and significant earnings expectations. For a number of these names, earnings expectations looked too high, and we took the opportunity to short ahead of the February results season. We have subsequently reduced or closed a number of these technology names following strong returns through the March quarter.

- **Risk Short Positions – Contributed + 1.43%**
  Our risk short positions also added alpha in the period underpinned by our proprietary risk short algorithm which utilises a diversified portfolio of 100+ shorts to reduce unintended macroeconomic / thematic risks across the portfolio, as well as ensuring the portfolio remains market neutral with ~zero net market exposure and close to zero beta.

PORTFOLIO DETRACTORS

Despite the strong performance, the Firetrail Fund also had some detractors through the March quarter including:

- **Nuix –** A recent technology IPO that enjoyed a strong debut during the December quarter last year failed to meet high expectations during the recent February results season. Sales results missed, which was largely due to FX and the timing of some US government contracts due to last year's Presidential Elections. The stock was subsequently punished. We took the view that prospectus forecasts remain at risk, given the second half skew required, and as a result have exited the position.

- **CleanSpace –** Another recent IPO which enjoyed strong price performance on debut also failed to meet the market's expectation on earnings. CleanSpace reported March quarter sales results that were well below consensus forecasts. Revenue for the March quarter was $7m, with the run rate well down on the $40m sales reported in the 1H21. The decline was entirely driven by the healthcare segment, with only 2,500 masks sold in the March quarter versus 20,000 through the 1H21. Despite not providing FY21 guidance, we believe risks continue to remain to the downside, with the vaccine rollout in Europe/US likely to continue to put pressure on healthcare mask demand. As a result, we believe valuation upside remains limited, and exited this position in the quarter.

THIS QUARTER'S STOCK STORY

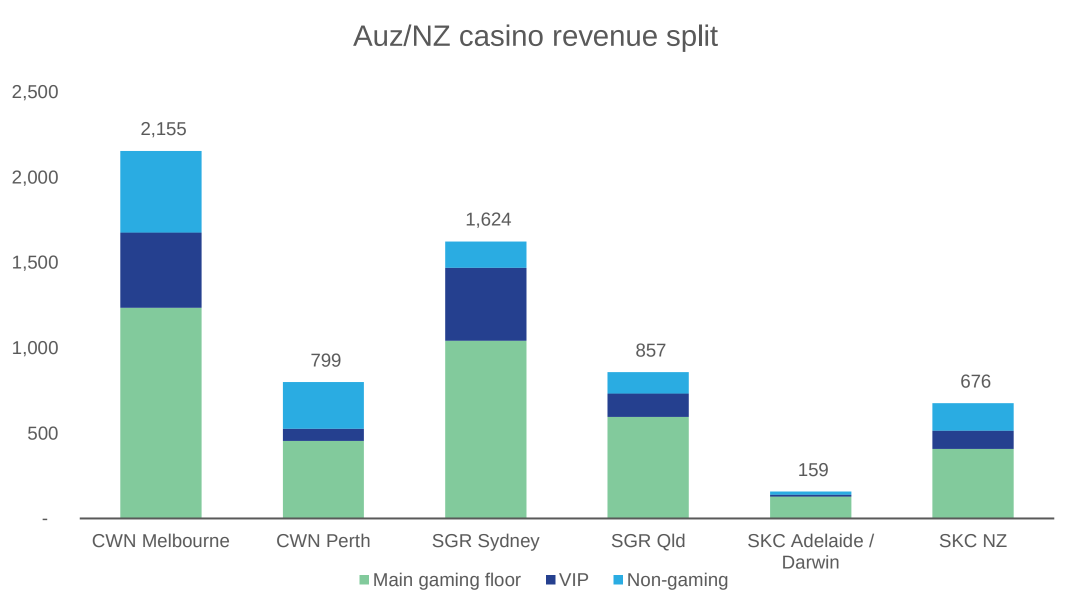
Given the headlines around **Crown Resorts** through the March quarter, we thought it timely to focus on this stock as our quarterly stock story. The Absolute Return Fund added Crown Resorts to the portfolio in November. We then added to this position on further due diligence, engagement with the board and site tours of the marque Melbourne property and the new tower in Sydney.

Company and industry overview

The Australian gambling industry is mature, with deep penetration among the population across slots and gaming tables. Growth rates are therefore similar to GDP and household disposable income growth. Casinos have been taking share of the overall gambling sector, albeit this has been largely driven by higher rates of growth among VIP style gaming.

The chart below highlights the key Casinos in the Australian marketplace. Casinos typically operate privileged assets under long term licenses. This provides a key barrier to entry and assets that exhibit monopolistic style earnings streams.

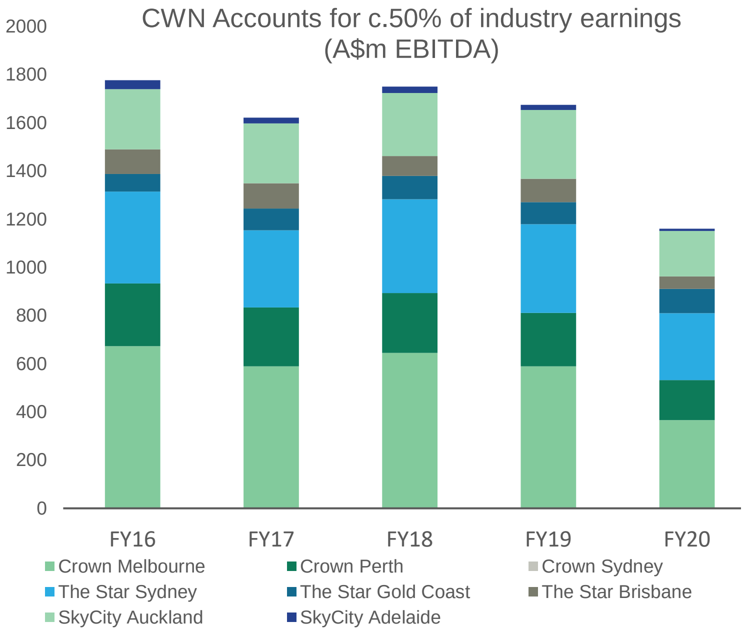
Fig 1.



Source: Company reports, Firetrail estimates, March 2021

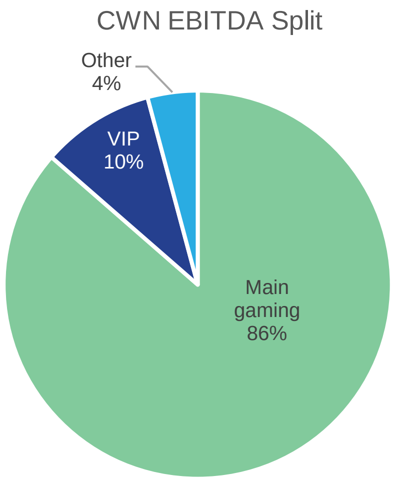
We believe Crown is the highest quality Casino in Australia with the best assets. We estimate Crown accounts for around half of industry earnings, see chart below, with 85% of earnings derived from higher margin, more predictable main gaming floor operations.

Fig 2.



Source: Company reports, Firetrail estimates, March 2021

Fig 3.



Source: Company reports, Firetrail estimates, March 2021

Why did Firetrail invest in Crown Resorts?

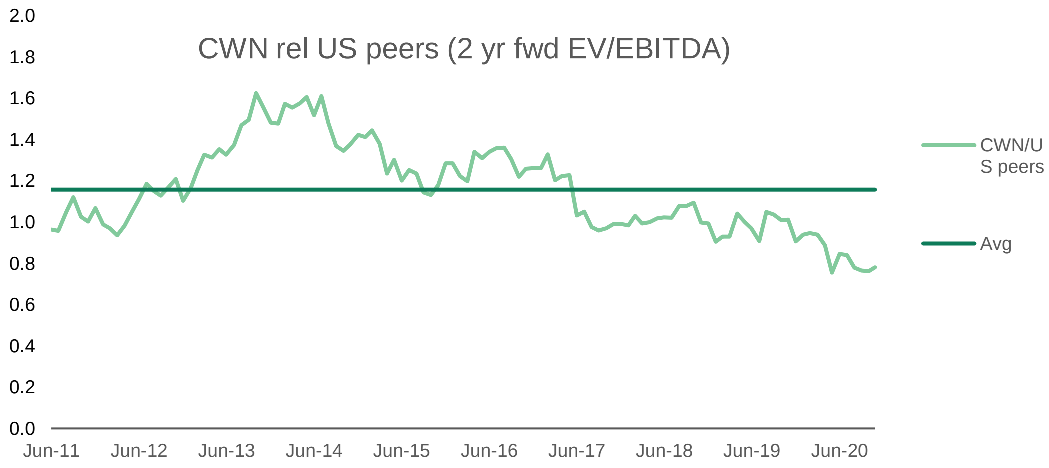
The NSW Independent Liquor and Gaming Authority's review of the suitability of Crown Sydney to hold a NSW gaming license created the opportunity for us to acquire a position in Crown Resorts last November. Our thesis is based on four key pillars:

1. ***Valuation*** – the opportunity to buy a portfolio of privileged assets at a significant discount to fair value.

This argument is supported by book value as well as Crown's relative valuation multiples.

We estimate the value of Crowns licenses and land and buildings, net of debt, at around $7.30/share. Pre the Blackstone proposal to acquire 100% of Crown, the stock was trading at only a modest premium to book value. Assuming Crown can retain its gaming licenses we believe we paid very little for the profit generating operating business. Earnings multiples continue to trade at a discount to Crown's historical relative range, suggesting the Blackstone bid continues to undervalue the earnings power of Crown's assets in Melbourne, Perth and ultimately Sydney.

Fig 4. Crown valuation relative to US casinos over time (pre-Blackstone bid)



Source: Factset, Firetrail, March 2021

2. Licenses, fines and social and governance change

The second pillar of our thesis rests on confidence Crown will ultimately overcome the current regulatory scrutiny centred around governance, how its dealt with VIP junket operators and money laundering. Extensive engagement with the Crown Board, and specifically Chairman Coonan, has provided confidence Crown understands the changes that are required to be deemed suitable to hold a gaming license in NSW, VIC and WA.

This is underpinned by some of the changes seen to date, including extensive Board and management renewal, the cessation of direct information sharing with representatives of Consolidate Press Holdings, the cessation of dealings with Junket operators unless approved by regulators and increased compliance and anti-money laundering investment.

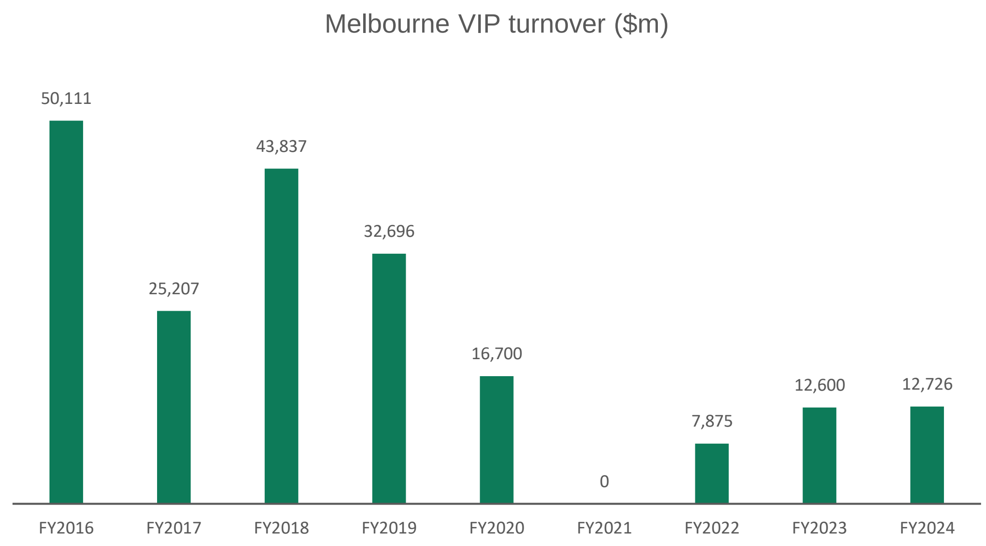
We also believe that once Crown is through the current uncertainty it should emerge as a positive **Social and Governance** story. New Crown will be a lot more transparent, shareholder friendly and ultimately should possess better earnings quality (less reliance on opaque VIP). We believe these are all catalysts for a multiple re-rating of the stock.

3. Earnings power will not be impaired

We believe the likely significant reduction in VIP earnings will not materially impact Crown's earnings power in a post-Covid operating backdrop. As you can see from previous charts VIP only accounts for around 10% of group EBITDA. This pales in comparison to the Main Gaming floor, which accounts for nearly 90% of EBITDA. Main Gaming is higher margin, we estimate EBITDA margins around c.3.5-4x VIP, mainly due to the absence of commissions.

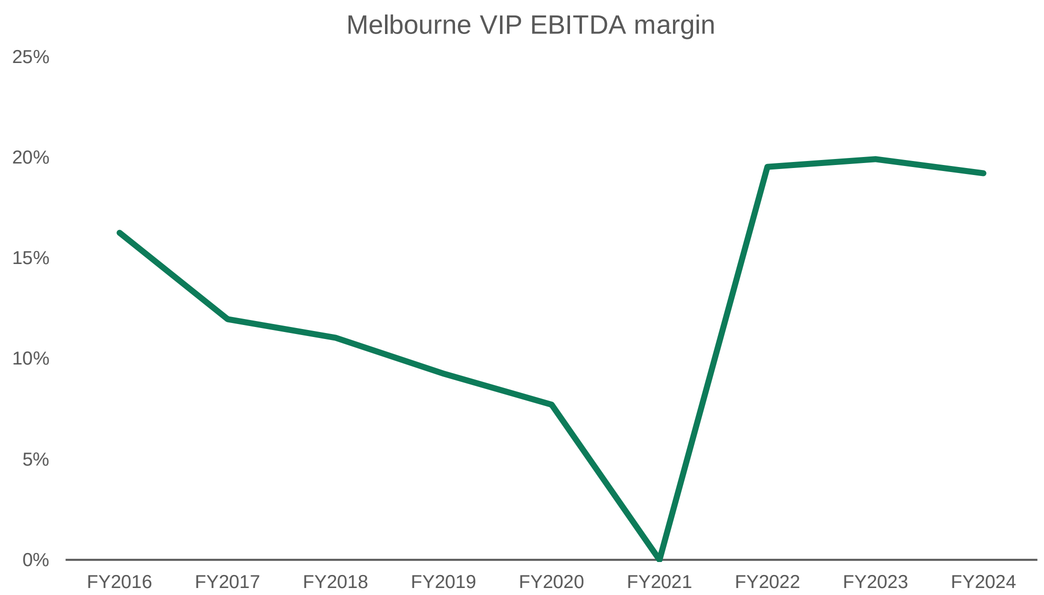
Under the previous VIP model Crown was paying junket operators (c.75-80% of VIP turnover) large commissions/rebates in order to attract gaming "whales" to its Casinos. Crown's decision to stop dealing with junket operators effectively means these VIP earnings are unlikely to recur. We believe these lost earnings can be easily overcome through a combination of cost outs, alongside increased focus on direct VIP marketing, where margins are higher because no commissions are paid to junket operators.

Fig. 5 VIP turnover will be materially lower going forward as Crown shuns Junkets…



Source: Firetrail, March 2021

Fig. 6 …But margins on what VIP remains will be higher due to a more direct model

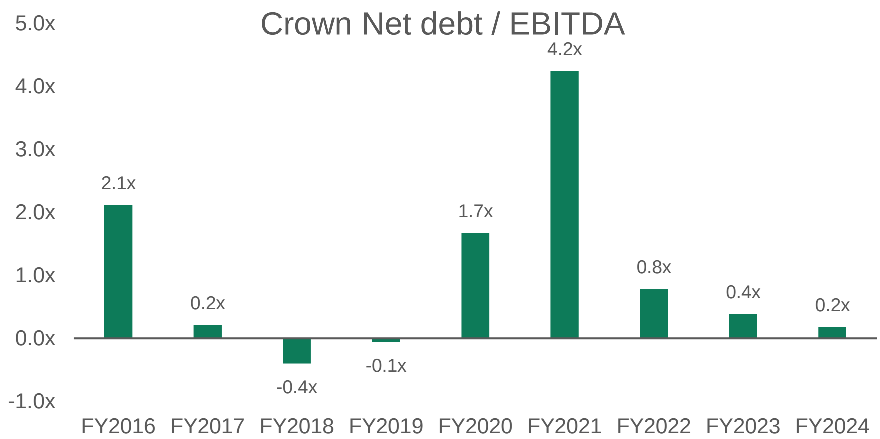


Source: Firetrail, March 2021

4. Cash, cash and cash… and improved returns

The final piece to our Buy thesis is the most exciting. Crown will effectively become a cash generation machine post completion of the Sydney Tower and Casino capex, which is expected to be completed through 2H21. Capex will effectively fall to $130-150m over the next 2yrs, compared to depreciation of around $300-330m. This will underpin significant free cashflow as casino earnings recover post-Covid disruptions, resulting in rapid deleveraging of the balance sheet. On our estimates Crown could be almost debt free by FY23, providing scope to undertake significant capital management in the form of buybacks over the next several years.

Fig 7.



Source: Firetrail, March 2021

Conclusion – it is going to take time to play out buy significant upside remains.

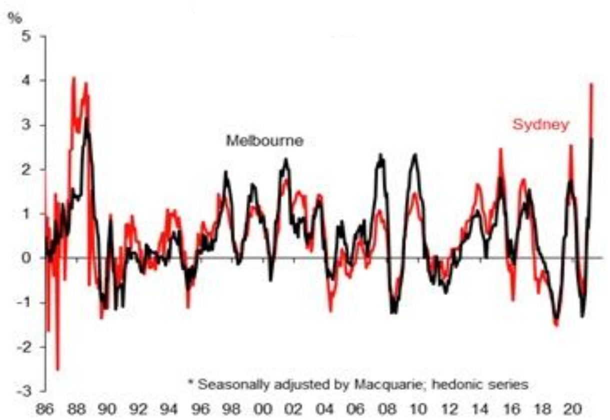
Blackstone's initial $11.85/share bid to acquire the remaining shares in Crown Resorts it does not already own vindicates our thesis on the stock, albeit we believe still significantly undervalues the assets. Our fair value on the stock is materially higher than the Blackstone bid. We believe the stock can continue to re-rate to this higher fair valuation over time just by continuing to execute on the transformation strategy currently in place. This will be aided by a post-Covid earnings recovery – the initial signs are that gaming revenues have rebounded strongly when Casino's move to more normal operating conditions.

Blackstone's bid is an opening salvo to show its hand while Crown is still weakened by a significant amount of regulatory and Covid related uncertainty. As things improve, we believe there is scope for this bid to increase on a risk adjusted basis. If there is not an increased bid and Blackstone walks, we believe Crown will re-rate anyway over time. As such it would not be wise to give away the house cheaply.

ONE INTERESTING THING THAT HAPPENED THIS MONTH…

Sydney home prices surged 3.6% in March, which was their fastest monthly increase in 33 years! According to CoreLogic data, since Sydney prices hit their bottom last September, they have now risen 8%. REA data for the first 12 weeks of the year also shows Aussie home sales are up 35% vs 2020, and up 60% vs 2019! The month ended with the biggest sales weekend in 3 years, with 88% of property in Sydney selling.

Fig. 8 Dwelling price growth (Monthly)



Source: Macquarie, March 2021

Fig. 9

Source: Corelogic, March 2021

MORE INFORMATION

General enquiries 1300 010 311
Existing client enquiries 1300 360 306

www.firetrail.com

Firetrail
INVESTMENTS