

FIRETRAIL AUSTRALIAN HIGH CONVICTION FUND

MONTHLY REPORT | JUNE 2024

PERFORMANCE (AFTER FEES)¹

	Month	Quarter	1 Year	3 Years p.a.	5 Years p.a.	Fund inception p.a. ³	10 Years p.a.	Strategy inception p.a. ⁵
Fund ²	2.06%	0.13%	4.94%	3.68%	6.36%	5.56%	-	-
Strategy composite ⁴	2.06%	0.13%	4.94%	3.68%	6.36%	-	9.29%	8.95%
Benchmark	1.01%	(1.05%)	12.10%	6.37%	7.26%	8.46%	8.10%	7.33%
Excess Return	+1.05%	+1.18%	-7.17%	-2.69%	-0.90%	-2.90%	+1.20%	+1.62%

1. Past performance is not indicative 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.

AUSTRALIAN HIGH CONVICTION FUND

The Australian High Conviction Fund ("Fund") is a concentrated portfolio 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 ASX 200 Accumulation Index over the medium to long term (after fees).

PORTFOLIO POSITIONING – 30 JUNE 2024

Top 3 Overweight Holdings (Alphabetical)
CSL Ltd
Newmont Corp
Santos Ltd

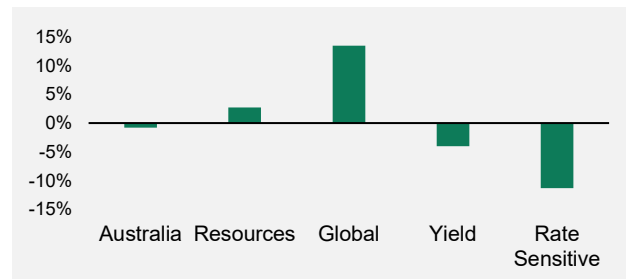
FUND DETAILS

Unit Prices ¹	30 June 2024
Application price	\$1.1793
Redemption Price	\$1.1757
NAV Price	\$1.1775
Fund Details	
APIR Code	WHT3810AU
Benchmark	S&P/ASX 200 Accumulation Index
Inception date	14 March 2018
Risk/Return Profile	Very High
Number of Holdings	30
Fund size	\$498mil
Management fee*	0.90% p.a.
Performance fee*	15% of outperformance above an annual hurdle

¹Please note, prices listed above are excluding distributions

*Please read the Product Disclosure Statement for more details

THEMATIC POSITIONING – 30 JUNE 2024



Source: Firetrail. Relative to the Benchmark

Past performance is not a reliable indicator of future performance.

The Product Disclosure Statement ('PDS') and the Target Market Determination ('TMD') of the Fund is available at www.firetrail.com. Any potential investor should consider the PDS and TMD before deciding whether to acquire, or continue to hold units in, the Fund.

2. Firetrail Australian High Conviction Fund ('Fund'). Net Fund returns are calculated based on exit price with distributions reinvested, after ongoing fees and expenses but excluding taxation. 3. Fund inception is 14 March 2018. 4. 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 Australian High Conviction Strategy Composite ('Strategy') which has been operating since 29 November 2005. 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 High Conviction Fund (after fees) between 29 November 2005 to 23 November 2017. The Fund employs the same strategy as was used by the same investment team that managed the Macquarie High Conviction Fund as at 23 November 2017. Firetrail has records that document and support the performance achieved as the Macquarie High Conviction Fund. The composite returns for the Strategy and the S&P/ASX 200 Accumulation Index (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 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. 5. Strategy inception 29 November 2005.

PORTFOLIO COMMENTARY

The Fund returned 2.06% (after fees) for the month ending 30 June 2024, outperforming the ASX 200 Accumulation Index by 1.05%.

The Fund returned 0.13% (after fees) for the quarter ending 30 June 2024, outperforming the ASX 200 Accumulation Index by 1.18%.

COMPANY AND INDUSTRY NEWS

The ASX 200 rose 1.0% in June, driven by strong returns for financial, consumer staples and healthcare sectors. It was a tougher month for commodities, energy and materials. In the US, the S&P rose 3.5% and the Nasdaq was up 6% propelled by another good month for the Magnificent 7. European markets were more subdued, with the FTSE and Euro Stoxx indices both down around 2%.

On the economic front, the first presidential debate saw a substantial swing away from Joe Biden. The re-election of a Republican President would most likely bring with it an increased level of government spending. This trend of ongoing fiscal stimulus is also evident in Australia, with stage three tax cuts and electricity subsidies both effective from 1 July. The RBA's "narrow path" appears to be getting narrower, with signs of softening demand but persistent inflation as highlighted by the May CPI. The market now believes a rate hike is a 23.6% chance at the RBA's August meeting versus 39.1% just one month ago.

CONTRIBUTORS TO RETURNS

Positive contributors included CSL, Suncorp, and Guzman y Gomez. Negative contributors included a nil holding in CommBank, and holdings in ResMed and South32. We discuss each further in our commentary below.

POSITIVE CONTRIBUTORS

CSL

CSL shares outperformed in what was generally a good month for more defensive sectors like healthcare and consumer staples. CSL's Seqirus division supplied batches of avian flu vaccine to a number of countries during May, but at this stage we do not expect the associated earnings to be material.

Suncorp

Suncorp shares outperformed following Federal Treasurer approval of the sale of its Bank division to ANZ. At the end of the month, IAG updated FY 2024 guidance which suggested Suncorp should see strong reported and underlying margins in the June 2024 half.

Guzman y Gomez

Guzman y Gomez shares outperformed following a successful Initial Public Offering on 20 June. We believe Guzman y Gomez presents a strong proposition for both customers and franchisees in Australia, which should see it grow stores and earnings materially over the next 5-10 years.

NEGATIVE CONTRIBUTORS

CommBank (nil holding)

CommBank shares continued to outperform on reasonably stable pricing trends in the mortgage and deposit markets and a continued benign bad debt outlook. While some segments of the economy are experiencing increasing stress, at this point the implications for major bank loan losses do not appear to be significant.

ResMed

ResMed shares underperformed following the release of complete data from Eli Lilly's SURMOUNT-OSA trial testing the impact of GLP-1s on sleep apnoea patients. Eli Lilly claim that 40-50% of patients in the GLP-1 arms of the trial achieved "disease resolution". We note that this is not a clinical definition, and our channel checks suggest the percentage of patients that could ultimately stop using CPAP is far lower. We continue to hold the view that the benefit to ResMed from higher awareness of sleep apnoea will offset most if not all of the negative impact from GLP-1s.

South32

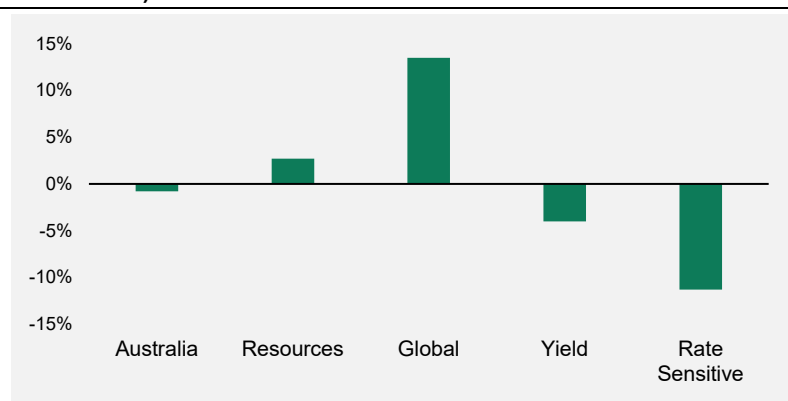
South32 shares underperformed following a strong period of outperformance over April and May. The price movements of South32's key commodities were mixed, with alumina up another 6% but aluminium and copper down 5%.

PORTFOLIO POSITIONING & CHANGES

With underweight positions in Yield and Rate Sensitive categories broadly offsetting each other, our main thematic exposure is an overweight holding in global stocks. Our positioning across each category can be summarised as follows:

- Overweight:
 - Cyclical companies exposed to commodities where supply is constrained in the medium term, such as Santos.
 - Healthcare companies with strong market positions and defensive underlying demand drivers, such as CSL and ResMed.
 - Market leaders including Domino's Pizza who are well placed to strengthen their competitive position through the cycle.
 - Financials with leverage to interest rate rises including Suncorp.
 - Undervalued companies with defensive attributes including Newmont.
- Underweight Australian banks and iron ore where we don't see compelling opportunities.

Figure 1: Thematic positioning as of 30 June 2024 (relative to Benchmark)



Source: Firetrail, June 2024.

The main changes we made to the portfolio over the June quarter were:

- Initiated positions in ALS Ltd, Fisher & Paykel Healthcare and Infratil.
- Increased position sizes in Bluescope Steel and National Australia Bank.
- Reduced position sizes in Seek, Suncorp, The Lottery Corporation and Treasury Wine Estates.
- Exited positions in Lynas Rare Earths and Orora.

The portfolio remains highly concentrated with 71% active share and 60% stock-specific risk.

STOCK DEEPDIVE: FISHER & PAYKEL HEALTHCARE

During the quarter we added Fisher & Paykel Healthcare (F&P) as a new position in the High Conviction Fund. The key foundations of our thesis for F&P are:

1. a compelling market penetration story;
2. robust research and development investment supporting a rich product pipeline; and
3. a management team that is very focussed on creating long-term value for shareholders.

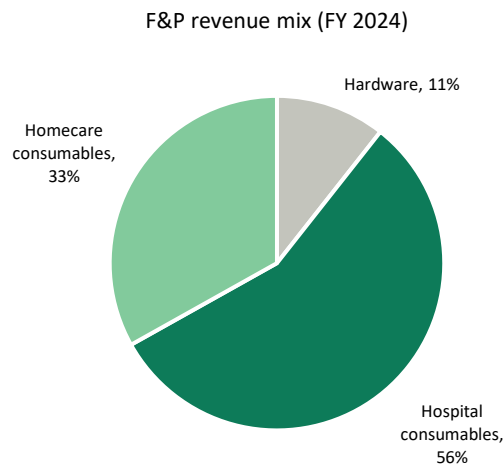
What does F&P do?

F&P manufacture products focused on treating a range of respiratory diseases and disorders. It was spun out of Fisher & Paykel Industries in 2001 to create an entity that was separate to the Fisher & Paykel Appliances business.

F&P earns some revenue from selling hardware such as ventilators, but the majority is derived from the sale of masks and other consumables used with this hardware. In the hospital setting, the main areas F&P focuses on is non-invasive ventilation and nasal high flow therapy, with the latter providing a key long-term growth opportunity. In the home, F&P sells consumables attached to devices used to treat sleep apnoea, competing against the likes of ResMed and Philips.

Companies mentioned are illustrative only and not a recommendation to buy or sell any particular security

Figure 2: The majority of F&P's revenue is from the sale of hospital consumables

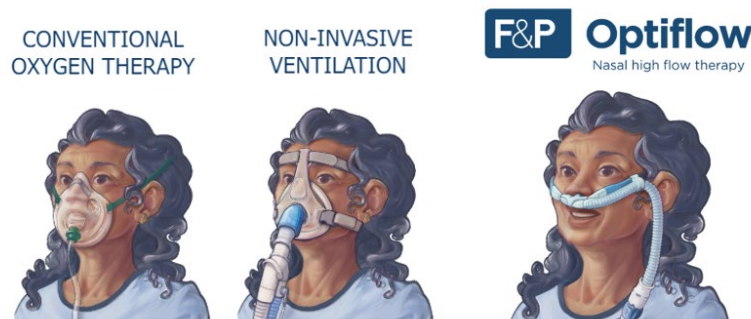


Source: Firetrail, June 2024.

Growth opportunity in Nasal High Flow therapy

Nasal High Flow (NHF) is F&P's most meaningful growth driver. Despite being around for ~20 years, NHF is still a relatively new and underpenetrated therapy for the treatment of respiratory conditions. The simplest way to describe NHF is the supply of a high flow of oxygen to patients through a thin nasal cannula that sits under the nose. F&P's consumable offering in this space is called Optiflow, and the associated hardware is called Airvo.

Figure 3: Nasal High Flow (NHF) is F&P's most meaningful growth driver



Source: F&P, June 2024.

The advantages of NHF over conventional oxygen and non-invasive ventilation (NIV) are that it provides a higher flow rate and a higher concentration of oxygen. The cannula is also much more comfortable than a full-face mask and enables the patient to talk, eat and drink.

Figure 4: Nasal High Flow therapy provides a higher flow rate and a higher concentration of oxygen

Comparison of oxygen therapies			
	Conventional oxygen	Non-invasive ventilation	Nasal high flow
Oxygen flow (litres/min)	05-Oct	~15	Up to 70
Oxygen concentration	~50%	90-100%	90-100%

Source: Firetrail, June 2024.

Companies mentioned are illustrative only and not a recommendation to buy or sell any particular security

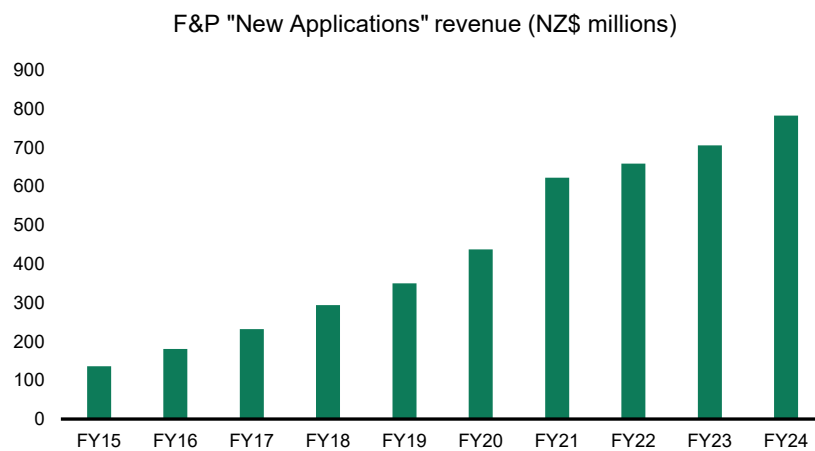
The disadvantages of NHF are that it delivers less pressure and is more expensive compared to NIV. Also, as a relatively new therapy it is still working up evidence to gain widespread acceptance and support its use, but this is increasing.

NHF sits within F&P's "New Applications" segment. Revenues have grown more than 5 times over the past decade, a compound average growth rate of 21% per annum. While sales did receive a boost during COVID due to the high level of respiratory hospitalisations, F&P has continued to grow in recent years off this elevated base. Outside of the direct sales uplift, the COVID period benefitted F&P's NHF business indirectly through:

- i. Increased awareness of the benefits of NHF therapy, which we believe will drive wider adoption across the hospital setting, and
- ii. Significant sales of NHF hardware, which effectively removes the upfront capex burden that may have prevented hospitals from broadening the use of NHF previously.

We estimate the penetration of F&P's addressable market for NHF is still below 15%, providing plenty of headroom for continued double-digit growth over the medium-long term.

Figure 5: F&P's "New Applications" segment revenues have grown more than 5 times over the past decade

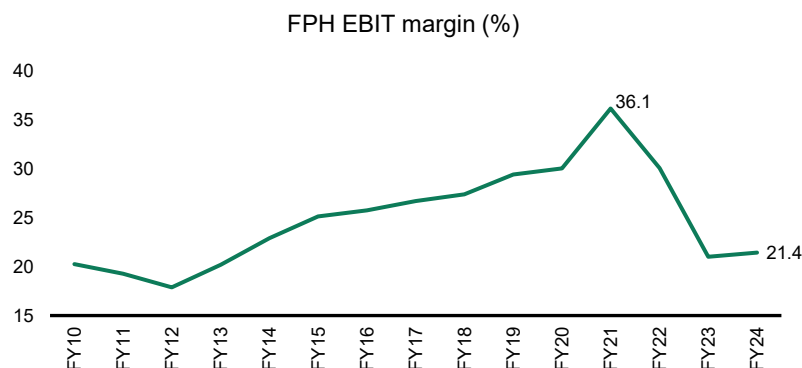


Source: Firetrail, June 2024.

Medium-term 30% margin target

F&P has long held a medium-term EBIT (Earnings Before Interest and Taxes) margin target of 30%. Over the decade leading up to COVID it displayed steady improvement each year, reaching its target just before COVID supercharged earnings. However, as demand normalised and cost pressures intensified, EBIT margins fell back to 21% in FY 2023.

Figure 6: EBIT margins have improved over the decade until COVID



Source: Firetrail, June 2024.

Note: FY19 EBIT margin adjusted for non-recurring expenses

The drivers of the ~8% margin decline relative to FY 2019 have been:

- i. Gross margin decline of 6% due to higher freight costs, wage inflation, the ramp up of a new facility in Mexico and loss of general operational efficiency.
- ii. A rise in sales, marketing, research and development costs of ~70% compared to revenue growth of ~60%. F&P unashamedly continued to invest through a bumpy sales environment in 2022-23 to support medium-long term growth.

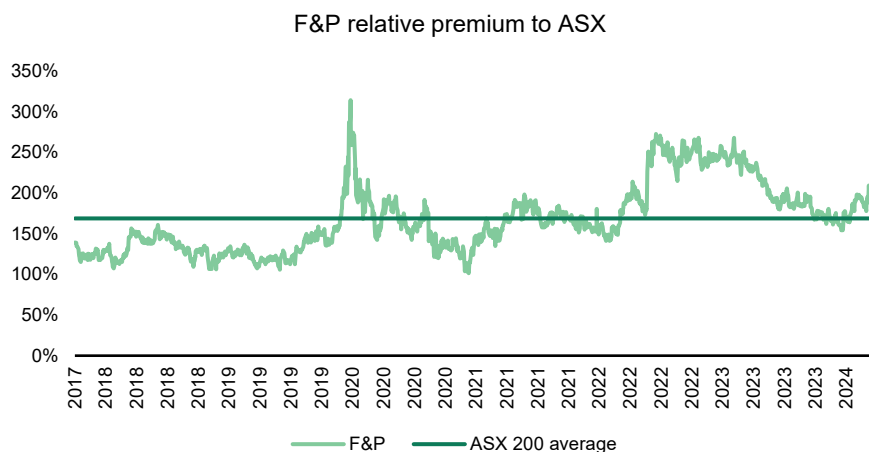
While drivers like freight costs remain unpredictable currently due to Red Sea disruption, we can see a path of recovery to 30% margins over the next four years as other inflationary pressures ease and F&P grows into its cost base.

Valuation

F&P's valuation looks expensive at face value, with a 1-year forward PE (price to earnings multiple) of 50x. However, at Firetrail we focus on where earnings will be in three years and where the market could be wrong.

Due to strengthened organic tailwinds for NHF therapy post-COVID, we estimate F&P can grow revenues at an average rate of 15% per annum over the next three years. A mid-teens level of revenue growth should bring with it material margin improvement, which delivers average earnings growth of 25% per annum. On this basis, consensus will need to upgrade earnings by ~15% in coming years and F&P's FY 2027 PE will be 30x. While this is still reasonably high in an absolute sense, F&P's history suggests it can trade at a ~150% premium to the ASX 200 which implies 25-30% valuation upside from the current share price.

Figure 7: F&P's valuation looks expensive at face value, however, we see 25-30% valuation upside from the current share price

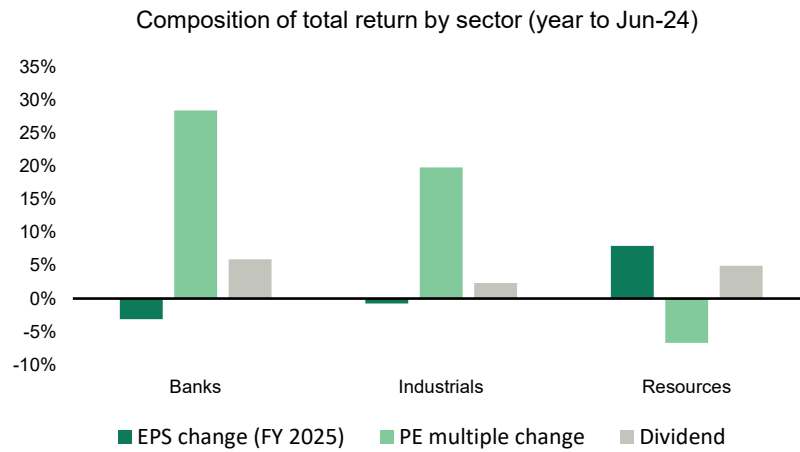


Source: Firetrail, FactSet, June 2024.

ONE INTERESTING THING THAT HAPPENED THIS MONTH...

Reflecting on what drove the Australia equity market over the financial year revealed some interesting trends. The overarching theme was clearly multiple expansion, with the ASX 200 PE on a 1-year forward basis expanding from 15.1x to 16.8x.

By sector, banks experienced the largest re-rate despite modest earnings downgrades. Westpac provided the starkest example of this dynamic. Westpac's PE expanded from 11.0x to 14.5x (+32%) despite earnings downgrades of 4%. Industrials saw modest upgrades driven by a broad range of stocks including Aristocrat, Cochlear, James Hardie, ResMed and Xero, offset by downgrades across some traditional defensives such as Woolworths, Telstra and Transurban.

Figure 8: Earnings multiple re-ratings were seen across the market

Source: FactSet, Firetrail, June 2024.

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We interview Firetrail's Portfolio Managers and Equity Analysts about a stock we have invested in to provide you with the **Firetrail Equity Edge**.

The questions are always the same:

- What is the company and what does it do to make money?
- What is the stock market missing regarding the company's outlook?
- What is the bear- and bull-case for the company?

All in under 10 minutes.

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Simply scan the QR code below or listen via your favourite podcast platform. Simply search for "Firetrail Equity Edge".



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Link to the Product Disclosure Statement: [WHT3810AU](#)

Link to the Target Market Determination: [WHT3810AU](#)

For historic TMD's please contact Pinnacle client service Phone 1300 010 311 or Email service@pinnacleinvestment.com

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