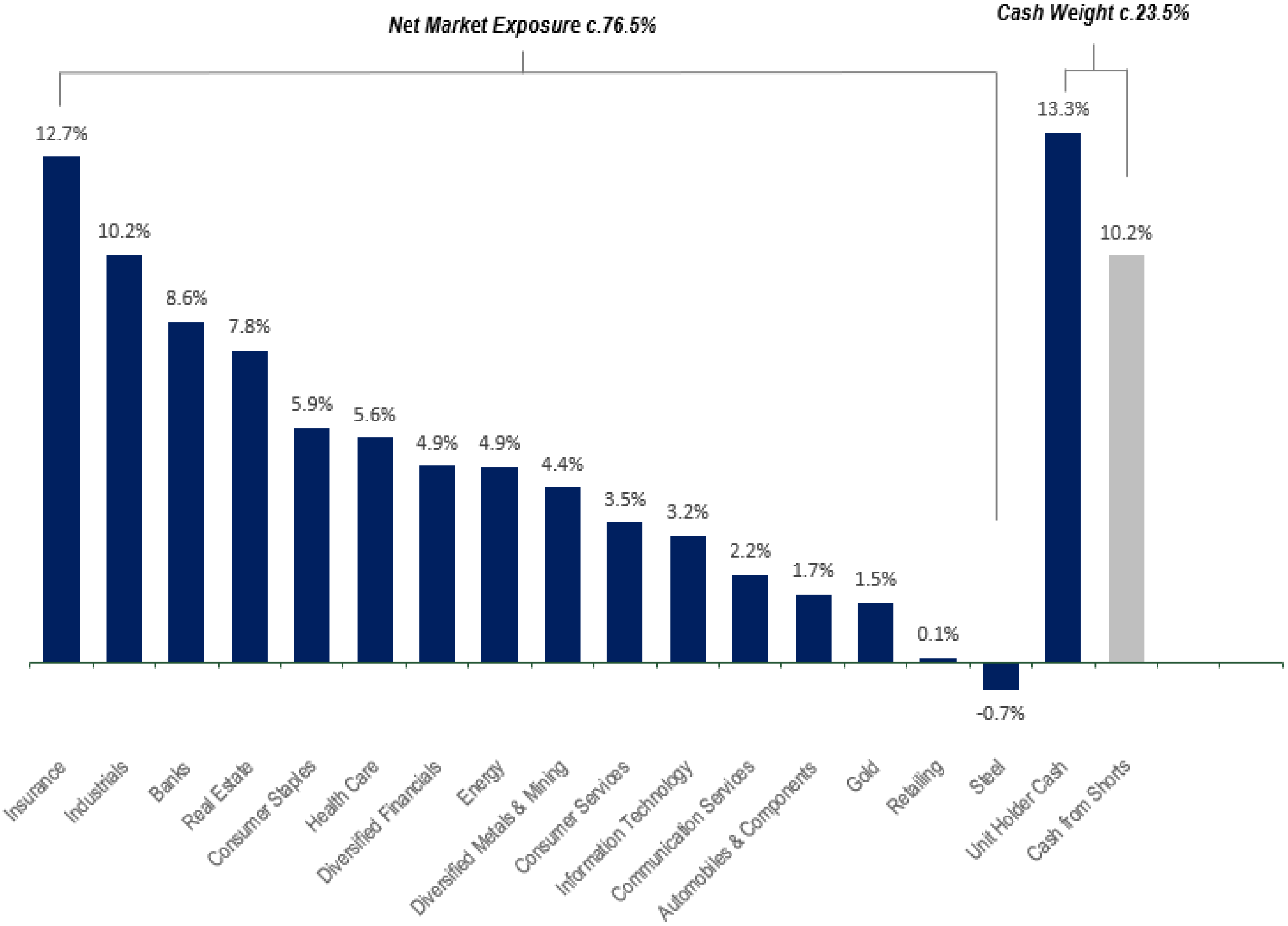
INDIAN PACIFIC
FUNDS MANAGEMENT

Monthly Performance Report
December 2022

Performance (net)	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sept	Oct	Nov	Dec	CYTD
2018		1.0%	-1.2%	2.1%	-0.2%	1.6%	0.3%	4.3%	-0.9%	-4.9%	-1.5%	-2.1%	-1.7%
2019	2.6%	5.1%	0.0%	3.3%	1.1%	-0.2%	2.7%	-2.0%	1.5%	1.3%	1.7%	0.3%	18.6%
2020	2.0%	-5.1%	-17.5%	8.4%	8.2%	4.4%	2.0%	4.3%	-0.9%	1.1%	6.5%	2.6%	13.9%
2021	-1.8%	2.4%	2.7%	3.9%	2.8%	1.7%	0.8%	2.6%	0.1%	1.5%	-0.5%	1.4%	19.1%
2022	-6.0%	0.5%	2.1%	-1.1%	-2.6%	-6.3%	5.7%	1.3%	-3.3%	5.7%	2.4%	-2.1%	-4.4%
Inception (Main Series)													51.2%

Portfolio Positioning



December 2022, Month in Review

The Fund returned -2.1% (net) in December taking our 2023 financial year to date performance to +9.6%, calendar 2022 performance to -4.4%, and since inception performance to +51.1% (All Ords -3.5%, +7.0%, and +20.4% respectively). Our average net exposure (our long portfolio less our short portfolio) averaged 71.3% in Calendar Year 2022, and our portfolio volatility (or standard deviation of returns) was 9.8% compared to the ASX300 12.6% (in 2021 standard deviation was 8.8% versus the ASX300 11.3%).

There were a number of company specific and macro factors that impacted the portfolio in December. **Our short portfolio had a positive month and cushioned the impact of a softer month for our long portfolio. We had two key contributors on the short side in December:**

Johns Lyng Group (JLG.AU, -15.1%) nothing annoys you more as a loyal shareholder than waking up one morning only to find out an insider has sold a large portion of their stock, and even worse, at a discount to market. By doing so, they are clearly choosing to cash in their "chips", in the knowledge that their actions are likely to hurt all other unit holders. When it comes to timing their sale one thing is also pretty obvious, company insiders know a lot more than outsiders about the prospects of company they run and they no doubt have a view on the rating the market is applying to the company's earnings. Management in market darling construction services company JLG.AU continued to send a signal to the market by way of their actions in December, with their COO (and board member) selling 4m shares ($24.8m worth or 31% of his holding) at a discount to market resulting in a 12.5% drop in the share price that day. There was reasonable precedence mind you with their CEO since 2003, selling the same amount back in October for 5c more than his COO, following his sale of 1m shares in May! Then there was the CEO of Australia, who sold almost half of his holding (1.8m of 3.98m shares) in August last year and the list goes on and on and on. Despite this, the stock remains a market darling trading on 30x earnings, and a loyal band of small cap institutions continue to soak up stock from insiders time after time. Having reiterated guidance numerous times alongside mnanagement selldowns we don't expect a downgrade in Feb or even in August, but good luck when the markets lofty longer term growth expectations aren't met. With JLG.AU paying under a 1% yield borrowing costs are very cheap here so we are happy to continue to run our short position.

Downer EDI (DOW, -28.2%) being a contractor to every sector and industry you possibly can, across multiple jurisdictions in the Asia Pacific region can be tricky at the best of times, let alone in inflationary and volatile weather environments such as these! DOW.AU do exactly this across road, rail, power, telco, mining, drilling, transport, planning, management, service, consulting, utilities and other industries in NZ, Asia and the Pacific. The company does a good job in a number of these sometimes essential services however employing quality experienced staff, systems, and ensuring accurate cost and margin outcomes is the name of the game in this space. In the end converting EBITDA to FCF is the proof in the pudding that the business is performing and on this front, DOW.AU has performed poorly numerous times over the years because they've either not earned a healthy margin for the work they've done, or they have had to invest significantly in capex in order to grow. A combination of these reasons along with a view on valuation are the reasons we were short DOW.AU. The alarm bells for the company really started ringing in December when the company announced a 20% drop in profit guidance only one month after their AGM, along with an admission that they had overstated earnings by $30-40m in prior years and identified some accounting irregularities. This issue has not been resolved, and with the incumbent, and well liked, CEO Grant Fenn now retiring, this looks like one of the most dangerous companies to own as they work through their accounting issues and the new CEO steps into the hot seat.

Against these wins, we had two main detractors on the long side in December:

Readytech (RDY.AU, -13.9%) our best performer in November was our worst in December after private equity group PEP withdrew their $4.50 cash and/or scrip bid, largely due to one institutional investor taking a position to block the bid. As we outlined last month, we are clearly big fans of RDY.AU, however we saw the bid as fair to full and made that view known to management and to the market (refer to the AFR article here). Unfortunately (for now) this was to no avail and one fund has prevented the rest of the register from accessing the bid. All is not lost though with the fundamentals remaining very strong for RDY.AU. The company has reiterated their FY23 and FY26 guidance numbers and key management remain in place. With the stock now trading back at a 25% discount to the bid price, we see RDY.AU trading on under 18.0x FY24 PER and 12.9x EV/EBITA which is a big discount to their broader tech/SaaS peer group in Australia and a very large discount to its closest competitor **Technology One** (TNE.AU), 38x FY24 and 18.0x EV/EBITA. With the stock back in the low $3's we see it as back in the "accumulate" zone and now that management and the major shareholder (Pemba Capital) have shown their hand as being open to a deal we think there is a very good chance that RDY.AU is taken out via another deal structure in CY23.

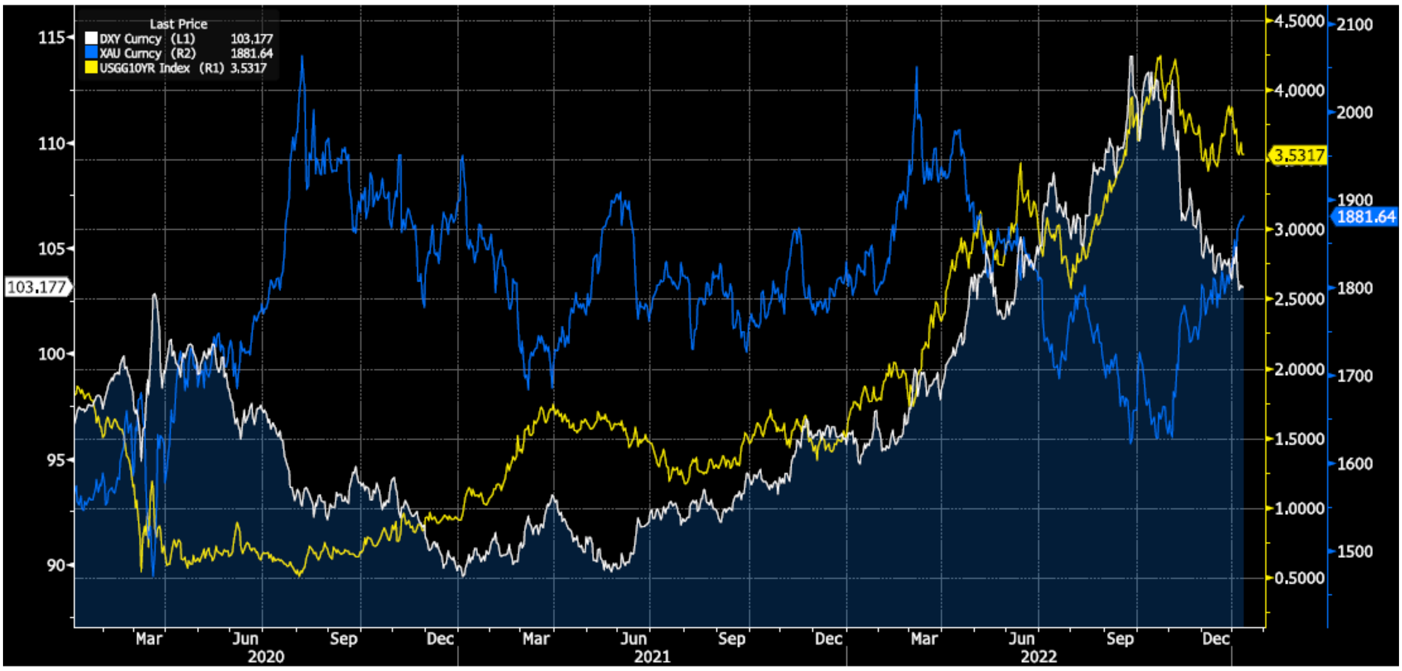
APM Human Services (APM.AU, -24% in Dec) despite having reduced our position significantly in APM from July-November last year APM was by far our biggest detractor in December. Two bits of news flow in the month shouldn't have had much of an impact on APM's share price, so don't explain the big drop (1) APM made a reasonably small acquisition (2) the UK Government announced that their "Restart" (back to work) Program is going to be reduced in size by around 40% which is a big reduction, however it is one of many big contracts APM is servicing. What we think drove the share price was a realisation amongst sell side analysts (and then buy side funds!) that FY2023 will have the opposite half year earnings skew to FY2022 in that it will be strongly second half weighted (which we have known for some time). With the market terrified of downgrades in February, and a likely soft looking first half by APM due to the timing of new contract revenue, the timing of new acquisitions (the big one being US business Equus which won't contribute much in the 1HFY23) and the need to scale (staff and offices) ahead of revenue wins in both Australia and the UK, the market is cautious about buying APM prior to their result. We see the stock as deep value at current levels, however with the knowledge that the 1H result could appear weak and with the obvious red flags overhanging the company (private equity involvement, potential selldown, a large amount of acquisitions etc) we are reluctant to go too hard here before digesting the Feb result and full year outlook. Having cut our holding in the mid $3's, and buying some back recently around $2.50 we now await evidence of a stronger 2HFY23 to determine whether we increase our holding.

On the Long side, we had two main winners in December, both on the resource side:

Strike Energy (STX.AU, +10.5%) as mentioned last month, we initiated a position in the Perth Basin via STX.AU (at ~26c) in November. We did so because (1) we have a high conviction that the WA domestic gas price is strengthening as we head into a supply/demand deficit in 2023 (2) STX.AU is the only pure play Perth Basin gas player that meets our investment criteria and (3) our detailed valuation work on STX.AU showed considerable upside from where the stock was trading. We will explain all of these points in a lot more detail in future reports but with inevitable M&A activity across the juniors in the Perth Basin really heating up in December, our thesis on Strike is playing out faster than we anticipated and the stock has bounced ~45% in recent months. Under the base scenario that we run (and the route we would prefer Strike to go down), whereby Strike doesn't pursue Project Harber at South Erregulla, we still see c.35% upside from the current share price despite the very strong share price. There is some risk though that once the flurry of corporate activity abates (probably in the next few months), that share prices for all players in the sector have some "consolidation" to do. For this reason we are holding our position purchased ~30% below current levels, awaiting an opportunity to increase our exposure. We would note that our holding in Santos (STO.AU) also gives us solid exposure to the strengthening WA gas price given they are currently the largest supplier of gas into the WA market (supplying 39% of WA domestic gas in 2022) and control some of the key processing and transmission infrastructure in the state.

Capricorn Metals (CMM.AU, +9.5%) as you'll see in the Figure 1 (below) the US dollar (white) has been softening since late October 2022 with expectations around future rate rises (yellow) easing since that time. With the physical gold price (blue) normally having an inverse relationship with the US dollar, this has driven strength across gold equities rather than anything specific to CMM.AU. As unit holders will know, we have been big fans here for a long time and we think there is line of site to become a 300k/oz producer (versus ~120k/oz currently) in the next 2-3 years which makes it one of the highest growth gold producers on the ASX. In turn CMM.AU will likely become a steady dividend payer. But after recent strength the stock is now trading in line with our medium term valuation, with some risk around the assumtions we have made on the cost and production front in that valuation. Hence, without a strong view on the direction of the gold price or USDAUD exchange rates (noting it's the A$ Gold price that matters for CMM.AU) we have exited our position in the stock.

Figure 1: US Dollar (white) and US 10-Year Bond yields (yellow) versus the USD Gold Price (Blue)



And lastly, on events in the portfolio this month:

Tourism Holdings (THL.AU and THL.NZ, -3.4%) THL.AU officially began trading in Australia on the 2nd Dec following their drawn out takeover of Apollo Tourism (ATL.AU, now delisted). The stock has performed well for the fund since we purchased it below NTA during the depths of COVID and the demand outlook for RV rentals is showing no signs of slowing with current industry feedback suggesting yields are up 60-70% versus pre-COVID levels in Australia and +35% in NZ. The dual-listing now opens the THL.NZ/THL.AU register to a much larger investor pool in Australia which increases the likelihood of a re-rate. Despite the recent strong share price we think there is still room for it to run and see no reason the stock can't rerate from the current modest circa 10x PER (on normalised ex-synergy earnings), or the current 1.5x Price/Book (remembering this management team has a strong track record of delivering mid-teens returns on funds employed). So, as you're driving around over summer, please smile every time you see a Maui, Britz, Mighty Camper, or Apollo RV on the road and take care not to bump into them!

Reflections on calendar 2022 and outlook for the year ahead:

2022 will long be remembered as the year that the inflation genie came out of the bottle, and the era of free-money came to an end. It's hard to believe that less than one year ago, in March 2022, the RBA still thought they needed to cut their cash target rate from 0.25% to 0.10%, having cut rates non-stop since 2011 (when the cash rate was 4.75%). The rest as we know is history, and the effects of the rapid change in rate expectations has been nothing short of brutal for financial markets, and will be felt for many years to come. US 10-year yields jumped from 1.5% to a peak of 4.25% in October, settling at 3.9% by year end as the Federal Reserve pursued an aggressive rate- hike path to rein in inflation. Inflation peaked at 9.1% yoy in June, global equities (MSCI All-Country Index) lost -20% of their value, the largest decline since 2008 on an annual basis, tech and crypto markets tumbled (NASDAQ -33%, Bitcoin -65%) as the “everything bubble” burst, and an index of global bonds slumped 16%.

In assessing the year that was for our fund, we're not satisfied at all at losing 4.4%. There was a lot of work done thoughout the year trying take advantage of the extreme volatility, while protecting our capital. While it feels very much like a year where we “spun the wheels” students of the market will know that equity markets tend to experience negative years every 4-5 years. The key in the down years is limiting your losses, sticking to your process, and taking advantage of over reactions on the downside rather than panicking. Our process which steers us being disciplined on valuation and sticking to the quality end of the market gladly saw us avoid the melt-down in the non-earners and “growth at any price” segments of the market, but we also missed some quick industry shifts (namely in healthcare and resources) which we have learnt from. For those observing us from the outside, importantly, we believe we have performed and behaved consistent to our product design. That is, to try to deliver strong risk adjusted returns by holding a core portfolio of quality companies over the long term, by having the ability to hold excess cash when we are cautious, and by holding a portfolio of short positions which helps buffer us in downturns.

As we start a new calendar year it is one with many obvious risks – the impact of existing inflation and increased rates being the main ones. This is different to last year when we were just beginning to see inflation emerge, and rates hadn't started rising. Inflation, at least year on year, is abating but not necessarily retreating in real terms. Companies we invest in have to grow revenue by more than their costs in absolute terms, or they will experience margin squeeze, and that will again be the challenge for many of them this year. The potential good news, when comparing this year to last, is that the bulk of interest rate “surprise” to the upside has probably played out this cycle (remembering that the current US Fed Futures curve is factoring in another 60bp of hikes, taking the Fed Funds rate to 4.90% by mid 2023 … which might be a touch light. Once markets become confident that rates are close to the top, risk appetite will return and this is the main debate in markets right now. Equity markets tend to bottom around 6-8 months prior to the peak in an interest rate cycle so you can understand why the market has been stronger in the last quarter. However given that this is now the “markets” consensus forecast, there are risks to equities should that timing be pushed out (or to a higher level).

As we all know timing the market is difficult, and while we do dial up our short positions in times of over optimism, and visa-versa at times when the market is oversly pessimistic, we will likely always hold a core of quality companies through the cycle at IPFM. While there will be many bumps in the road this year there is still reason to be optimistic and there are always ways to make money if you work hard enough! We also sleep well at night knowing that the companies we own all have strong balance sheets, with good management teams, in industries we like and understand, with opportunities to grow, at valuations we consider attractive. For these reasons we feel we have a portfolio capable of weathering whatever storm the market wants to throw at us in the year ahead.

Lastly, from a business perspective, we will have some very exciting news regarding a new team member joining us on 1 February, and we look forward to updating you once he has his “feet under the desk”. We also thank our key business partners, listed at the bottom of this report, for continuing to support us.

We look forward to working hard for you again in 2023 and thank you for allowing us to be the custodian of your hard-earned savings. We don't take it for granted.

Regards,

PHamersley

Preston Hamersley
Portfolio Manager

About the Fund

The Indian Pacific Fund is an Australian Equity long/short fund founded in February 2018. The fund has an absolute return focus (with long bias), has no cash limit, and can invest in both large and small cap companies. The investment process is a fundamental bottom-up investment process with a focus on balance sheet risks and identifying companies with strong cash flows, in good industries, with strong management teams. The fund was founded with the view that whilst markets rise in the long term it is always prudent to maintain the flexibility to hold more cash when markets are overly optimistic, and selectively short stocks if opportunities arise.

Holdings	Typically 15-25 long, selective short positions	**Investor Eligibility**	Wholesale Clients
Management Fee	1.0% of the GAV of the Fund, plus GST	**Prime Broker**	Morgan Stanley
Performance Fee	20% of Outperformance over RBA Cash, high water mark	**Fund Administrator**	Apex Fund Services Ltd
General Enquiries		**Contact the Fund Manager**	
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