Ironbark

Ironbark Apis Global Small Companies Fund

BENCHMARK
MSCI ACWI Small Cap Index AUD

OBJECTIVE
The Fund seeks to outperform the Benchmark (after management fees and costs but before performance fees) over the long term (typically 5 to 7 years).

APIR	DAM7739AU	**ARSN**	656 347 018
INCEPTION DATE	30 November 2022	**FUND SIZE**	$1.2m
MANAGEMENT FEE	1.1500% p.a.	**EXIT PRICE**	$0.9954
BUY / SELL SPREAD	+0.30% / -0.30%		

Net performance (%)

	1 month	3 months	1 year	3 years p.a.	5 years p.a.	7 years p.a.	10 years p.a.	Since inception p.a.
Fund	**-1.18**	**n/a**	**n/a**	**n/a**	**n/a**	**n/a**	**n/a**	**-1.18**
Benchmark	-4.29	n/a	n/a	n/a	n/a	n/a	n/a	-4.29
Active	*3.11*	*n/a*	*n/a*	*n/a*	*n/a*	*n/a*	*n/a*	*3.11*
Ironbark Apis Global Small Companies Composite[1]	--	**13.47**	**-13.84**	**21.25**	**n/a**	**n/a**	**n/a**	**21.24**

Top 5 holdings[2]

Stocks	Country (domicile)	Sector
Osaka Titanium Technologies	Japan	Materials
Silicom	Israel	Technology
Furuya Metal	Japan	Technology
Kinx	South Korea	Technology
Imdex	Australia	Materials

Sector allocation (%)[3]

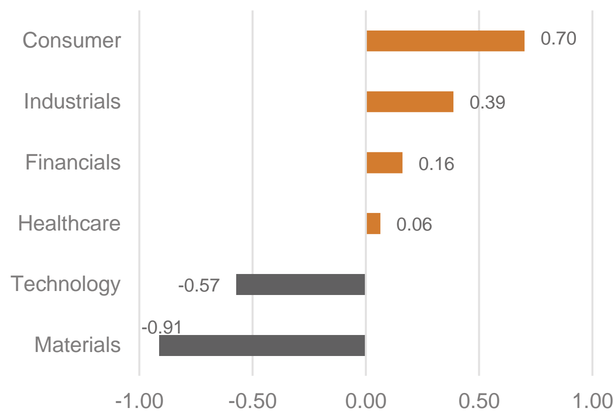
	Allocation
Consumer	12.58
Financials	2.04
Healthcare	12.45
Industrials	20.64
Materials	19.93
Technology	23.41

Regional allocation (%)[3]

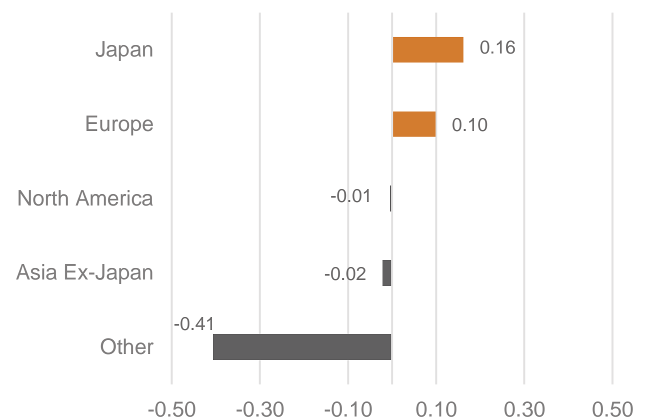
	Allocation
Asia ex-Japan	22.60
Canada	2.56
Europe	34.86
Japan	19.55
United States	6.33
Other	5.15

Past performance is not indicative of future performance. Net performance figures are calculated using exit prices, net of fees and reflect the annual reinvestment of distribution. Returns are rounded to two decimal places. Slight variations to actual calculations may occur.
[1]Performance periods from 1 January 2020 to 30 November 2022 for the Ironbark Apis Global Small Companies Composite represent the actual net returns of the Apis Global Discovery Fund in USD terms, converted to AUD terms. The Apis Global Discovery Fund follows the same strategy as the Fund, the inception date of the Apis Global Discovery Fund was 1 January 2020. Performance periods from 1 December 2022 to month-to-date are the actual net returns of the Ironbark Apis Global Small Companies Fund. Source: Apis Capital Advisors and Morningstar Direct.
[2]Source: State Street Australia Limited.
[3]Allocations are based on the representative account for the Fund. Source: Apis Capital Advisors.

1-month sector contribution (%)[1]



1-month regional contribution (%)[1]



[1]The contribution to returns data is based on the representative account for the Fund. Source: Apis Capital Advisors.

All currency references in the commentary below are in US dollar terms unless stated otherwise.

Performance Review

The Ironbark Apis Global Small Companies Fund (the 'Fund') returned -1.18% (net) for the month, outperforming the MSCI ACWI Small Cap Index AUD return of -4.29% by 3.11%.

During the fourth quarter of 2022, the market had a positive recovery, rebounding by 11.1%. The strategy of the Fund performed positively, bringing the year almost in line with the MSCI ACWI SMID Cap Index after trailing for the first three quarters.

For the Fund's strategy, all regions were negative for the year, however strong recoveries in Asia (contributing over 9%) and Europe (6.6%) during the fourth quarter helped rebound from losses earlier in the year. On a sector basis, all sectors were positive in the fourth quarter, with technology and materials leading, contributing 6% and 4.9%, respectively. Healthcare added 2.9% in the quarter, generating positive returns each month within the period. The investment manager highlights a couple of notable names below.

At a stock level, the top performer during the quarter (also over the calendar year) for the Fund's strategy was Osaka Titanium. Although down for the year, the second-best performer over the quarter was Opiant Pharmaceuticals which received a buyout offer in November. There were no significant detractors in the quarter, although there were several notable losses during the year for the Fund's strategy. The leading underperformer was Endor, which detracted more than 2%. While sales for Endor have doubled this year and operating margins have returned to near 20%, chip shortages and supply chain issues have led to stock-outs, crimping sales during the critical Christmas quarter. The investment manager expects all supply chain issues to be resolved by the second quarter of 2023, with continuing progress in sales and profitability. Outside of Endor, there were another 11 stocks that detracted more than 1%. Of those, the investment manager has exited two positions and trimmed one, – elsewhere, they see the thesis unchanged but value significantly better.

Portfolio outlook and positioning

Asia continues to be the largest area of exposure, primarily driven by Japan which has seen exposure reach 20%, up from 11% at the start of the year. The primary driver of this increase is one stock, Osaka Titanium, as it is a new name and a "core" 7% position. Europe has held its position as the investment managers' second-largest regional exposure. Here, the profile is similar to Japan and is generally comprised of companies with niche, mostly export-orientated businesses that are not cyclically exposed.

Dentium and EDAP-TMS, two healthcare names highlighted in greater detail below, are cases in point. Dentium is a Korean up-and-comer in dental implants and has enjoyed strong growth and profitability even during the pandemic. The China re-opening will be another catalyst. EDAP-TMS, a French medical equipment company, is the leader in a new treatment modality primarily for prostate cancer. Product sales are accelerating as hospitals move on from COVID and doctors the investment manager has spoken to expect their product use to increase dramatically in the next few years.

While the investment manager has no strong view on market direction in general, they do have high conviction in several themes which have arisen through their bottom-up work on individual names. Among the themes detailed in 'Investment Highlights' below, electrification will require massive investments. The investment manager also sees secular improvements within aerospace and defence spending. The investment manager believes there are many opportunities in onshoring/friend-shoring. Various government spending bills, such as the Inflation Reduction Act and the Chips Act, stand to enrich many companies. Some of the biggest beneficiaries of these acts are non-U.S. companies, which the investment manager does not believe is well understood. Lastly, the investment manager believes oil & gas are compelling themes – especially long-neglected areas offshore.

Investment Highlights

Electrification

The “electrification of everything” is another trend that the investment manager expects to drive opportunities for companies globally in the years to come. While there is much debate about how quickly we can move away from fossil fuels (and the investment manager suspect it will be a long time), right or wrong, governments are hell-bent on “green” energy, and trillions of dollars are being printed to generate it. As petrol-based engines are replaced by electric motors, new semiconductor materials such as silicon carbide and gallium nitride are needed to manage high-power devices. Specialty mining materials such as rare earth metals for magnets or graphite and lithium for batteries need to expand exponentially to reach the investment managers electrification goals. More traditional metals, such as copper, could also short-circuit our “zero carbon” ambitions. The amount of copper used in EVs is estimated at 2-3x of that required in traditional combustion engine vehicles, and power generated by windmills and solar panels is estimated to require 5x the copper per MW versus traditional energy-sourced natural gas. Forecasters estimate we will need 50 million metric tons of copper annually by 2035 vs. 21 million metric tons produced today. With the average mine requiring 16 years to become commercially viable and (ironically) green opposition to almost every major new mine proposed, something must give.

There are endless ways to play these trends. While the investment manager will consider direct mining opportunities, their preference is more “picks and shovels” or companies that provide niche tools and services that help extract metals. The investment manager holds companies with production equipment for battery plants. The investment manager owns companies that dominate the fabrication tools needed to make power semiconductors.

Electrification (continued)

The investment manager also sees opportunities in updating the electric grid, which has suffered decades of neglect and will require significant upgrades to deliver this remote (e.g., offshore wind or desert-located solar farms) and intermittent energy back to the populations that need it.

Aerospace & Defence

At the height of the pandemic in early 2020, the investment manager invested in OMAB, a Mexican airport operator, on the thesis of a post COVID recovery in air travel. Over two and a half years later, the investment manager continues to find attractive opportunities related to the “recovery” theme, most notably their investment in Osaka Titanium. Since then, air travel has steadily recovered as countries have eased their travel restrictions and international travel has picked up. According to the US Department of Transportation, 2022 domestic revenue passenger miles through September were back to 93% of their 2019 level, while international remains at 73%. Similarly, TSA-reported checkpoint numbers for December were at more than 90% of their 2019 level. Most countries around the world are showing similar trends. Even China has now abandoned its zero-COVID policy and reopened for tourism this month. Overall, the industry consensus is for a full recovery by 2024 and a return to a long-term growth rate of approximately 4% thereafter. Anecdotally, anyone who has recently flown in the US likely witnessed sky-high prices and packed planes reflecting load factors (utilisation rates) that have returned to peak levels.

The investment manager has previously discussed the impact of the Russia-Ukraine war on the supply side of the aerospace industry, particularly to titanium sponge production, but this ongoing recovery in air travel is a key reason why the investment manager is optimistic about the demand side. The pandemic led to a collapse in aircraft demand with annual deliveries falling from over 1,700 units at both Boeing and Airbus down to under 800 at the trough. The investment manager is now seeing notable signs of a rebound. While actual deliveries remain historically low (due in part to the titanium supply disruption), the industry’s backlog has returned roughly to its pre-COVID level. New aircraft orders over the last 12 months are twice the number of orders placed in 2019. This concurrent rebound of demand and ongoing disruption of supply should bode well for critical suppliers like Osaka. Taking a step back, the ingredients for an upcycle were fermenting well before COVID as global air traffic growth has been 5.3% since 2008 versus fleet growth of 2.9%. This shortage of aircraft has only been exacerbated by pilot shortages and the need to retire older aircraft. These trends are set to continue to at least 2030.

In the defence sector, the market is similarly undersupplied with spending set to ramp considerably in Europe and elsewhere, reversing a downcycle that has been in place for decades. In Japan, politicians plan to increase the annual expenditure by approximately 60%, from approximately 1% to nearly 2% of GDP, beginning in 2023. Germany has similar targets of 2% of GDP. This is a sector known to be heavily regulated with a reputation for mediocre growth and returns. That has not always been the case, however. Defence spending can increase quickly, driving stocks in the industry up just as fast. Historical examples abound during periods of conflict. The investment manager sees the current environment as particularly notable, with both Germany and Japan committing to re-arm themselves. Furthermore, the follow-on spending growth from the rest of Europe and the world will grow defence expenditures by tens and hundreds of billions of dollars. Niche operators, such as a German radar manufacturer in our portfolio, will be strong beneficiaries.

Onshoring

There is a general push to bring foreign manufacturing back home or to at least shift sourcing to friendlier countries. Multiple disruptions have highlighted the vulnerability caused by offshoring, including the Russia-Ukraine war and its associated supply disruptions, COVID-related supply disruptions, the Chinese trade war and intellectual property battle, and the fossil fuel transition. While each of these factors is notable in its own right, they have all created an overwhelming desire for countries to reverse decades of offshoring.

The investment manager has been positioned to benefit from this in a variety of ways. Consider electric vehicles, which are heavily subsidised and are expected to receive a $7,500 (in USD terms) rebate as part of the Inflation Reduction Act ("IRA"). Local manufacturing will be required to receive this subsidy, benefiting names like the investment managers Japanese battery equipment producer at the expense of its Chinese competitor. Domestic lithium production will also be encouraged at the expense of less reliable foreign sources. The IRA has also offered some very substantial subsidies for domestic green energy manufacturing.

Companies in Norway, Korea, and elsewhere are now committing substantial sums to invest in US solar panel manufacturing, a market that has previously been over 80% supplied by China. Consider that a solar wafer used in solar panel manufacturing is being given an 8-cent-per-watt subsidy, a figure that accounts for over 50% of the value of a wafer in the market today. One Korean solar company with a facility in Georgia estimates that it will receive cash subsidies of 8.5 billion Korean won over the course of 10 years as a result of investing 3.5 billion in new capacity (a 20%+ annual return on subsidies alone). Ironically, the best way for the investment manager to invest in this theme is not through US-traded companies with limited exposure to the IRA, but rather companies trading overseas.

The CHIPS and Science Act is another piece of legislation explicitly written to drive more US onshoring. Companies like TSMC based in Taiwan are, for the first time ever, committing to build billion-dollar semiconductor facilities in the US which will benefit a long tail of suppliers, many of whom trade in Asia. China is expected to counter this with a 1 trillion RMB subsidy for its domestic chip industry (and Korea recently proposed its own giant subsidy). These are just a few onshoring examples, but many others exist across Europe and Asia, as each region has been affected by the disruptions listed above. The investment manager thinks their global strategy is particularly well suited to benefit from this transition, and today the investment manager owns numerous positions directly impacted and supported by these onshoring subsidies.

Offshore Energy

One sector the investment manager is increasingly enthusiastic about is offshore drilling, which they believe is set up to benefit from a uniquely extended up-cycle. Roughly one-third of the world's oil comes from offshore, but in the last 15 years there has been a major lack of investment in offshore drilling infrastructure due to cheap oil, COVID, renewables, etc. The world's fleet of deep-sea drilling ships is about half what it was just 10 years ago. Many of these drillers experienced financial difficulties and had to scrap old ships or redeploy them into green energy projects – they cost a lot to maintain. They also lacked the balance sheets and/or the customer demand to build new ones. These drill ships are neither cheap nor quick to build: a new one can cost over $1 billion and takes 4-5 years to construct.

As oil supply has quickly become a serious geopolitical concern due to Russian aggression, offshore oil projects are ramping up fast. As a barometer of demand, 75 "rig years" are expected to be awarded in the next 18 months, double the expected level just two years ago. The high demand, paired with the lack of drill ship supply, is causing day rates (the price paid by oil & gas companies to offshore drillers) to skyrocket. Day rates are now in the $400,000-500,000 per day range and expected to go higher, compared to around $200,000 per day just a couple of years ago.

Companies in the space are having their rigs booked out 5 or more years at elevated rates - a sort of "ship grab" instead of a "land grab." Most of these companies have struggled the last few years with significant debt burdens and have depressed valuations. Many are still trading at or below their historical multiples despite an incredibly optimistic outlook – in some cases, below 2 times cash flow. If the environment remains unchanged, these companies are set to generate massive cash flow and rapidly pay down debt. They also are not exposed to those annoying windfall taxes that have plagued traditional oil & gas companies. The drillers most poised to benefit, in the investment managers opinion, are the ones with idled/stacked ship capacity they can bring back into operation at high rates.

Individual portfolio names

Dentium (Korea – $775 million market cap)

Dentium is a Korean medical device company specialising in dental implants. Focused on the value segment, the company has consistently grown revenue by more than 20% with best-in-class margins. Despite strong financial performance, the stock currently trades at 8.7x price-earnings ratio, well below its peer group at 16.7x. The investment manager views Dentium as significantly undervalued given the stability of their topline growth and margin strength, with significant upside likely in the near-term.

As the second largest dental supplier in Korea, Dentium's growth is driven by its international business, which represents about 80% of sales and has historically focused on developing markets. As those core markets mature and the company continues to execute its strategy to shift away from distributor relationships to direct-sales, topline and margins are expected to improve. With the backdrop of strength in those core markets, the biggest potential for them going forward remains the large and underpenetrated Chinese dental implant market. China's market is currently valued at over $1 billion (and growing at a historical compound annual growth rate of 15%), itrepresents more than half of Dentium's 2021 sales. While the investment manager recognises the overhang from the pending volume-based procurement (VBP) process ('aka' Chinese price pressure) this year, the investment manager sees Dentium as well-positioned for likely discounts under that policy, that are now expected to be in the range of 30-40%. The investment manager believes these will have more impact on higher-priced competitors. The investment manager's confidence in Dentium's position is bolstered by historical examples of orthopedic implants where demand significantly increased following VBP. Additionally, Dentium's focus on improving margins through their in-house manufacturing facilities in Vietnam and China provide economies of scale as utilisation increases and helps preserve or even expand margins on their products in the future. The investment manager views Dentium as a consistent, fast-growing company with industry-leading margins that is 50% undervalued by the market. The investment manager believes there are dynamics specific to Dentium, particularly in the Chinese market, that separate them from other dental implant companies and believe growth can compound for many years to come.

EDAP-TMS (France – $420 million market cap)

EDAP-TMS is a medical device company focusing on "high-intensity focused ultrasound" (HIFU) to treat prostate cancer. With a doubling of the CMS (government insurance) payment taking effect at the start of 2023, the investment manager sees the stock as significantly undervalued and on the verge of breaking out with plenty of upside.

Their device, Focal One, is a minimally invasive automated system that uses HIFU to selectively remove cancer cells while preserving surrounding tissue and structures. With efficacy rates rivalling the prevailing standard of care options of prostatectomy or radiation, a key advantage of EDAP's device is the significant reduction of adverse outcomes such as impotence or urinary incontinence, both very common with traditional therapies. Additionally, their device is more versatile and precise than competing devices. The Focal One does not require an expensive and often unavailable MRI suite for the procedure and can address cancers in both the anterior and posterior portions of the prostate, whereas the competition is limited to the anterior segment, where only about 21% of prostate cancers occur.

While the technical and logistical advantages make Focal One the clear best choice for providers looking to add HIFU to their armamentarium, it is the reimbursement changes for HIFU prostate therapy that will be the key driver. Taking effect this month, the new reimbursement increases the amount CMS will pay for the procedure from $4,506 to $8,711, shifting the procedure from "breakeven at best" to a significant money-maker for doctors based on the current cost of nearly $1,200 (versus approximately $8,000 for the competition). The investment manager sees this driving both system placement and procedure volume. Already showing positive signs in their recent press release, they cited an all-time high number of nine Focal One placements in the fourth quarter of 2022. The investment manager models double-digit top line growth and significant operating leverage over the next 10 years with more than 100% upside to the investment manager's price target.

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