



Auscap Newsletter

Auscap Long Short Australian Equities Fund

OCTOBER 2023

AUSCAP ASSET MANAGEMENT LIMITED

On The Road To Refocus On What Matters Most

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For most high-quality businesses, what is occurring inside the business is often more important over time than the current macroeconomic or cyclical issues that are preoccupying the minds of market participants. With this in mind, Auscap's investment team have spent most of the last month on the road, across San Francisco, Los Angeles, San Diego, Nashville, Chicago, Atlanta, Alabama, Detroit, Sao Paulo, Perth, the Goldfields and the Pilbara. This newsletter covers some of the highlights from the team's recent travels.

Mineral Resources

We recently attended a site tour of Mineral Resources' (MIN) operations in Western Australia. It strongly reinforced for us the multitude of organic growth options at the company's disposal, many of which are already in the process of being executed. Over the next two years, it is likely that every part of the business will grow substantially.

Lithium

MIN's lithium business remains the most attractive part of the investment proposition to us, given the strong global momentum that continues behind the transition to electric vehicles. We visited the Wodgina mine, which has been gradually ramping up towards full production since coming out of care and maintenance in mid 2022. The company has been mining ore from Stage 1 of the mine, whilst simultaneously removing over-burden to access fresh ore for Stages 2 and 3. This fresh ore should be available from December, leading to a step-change in production.

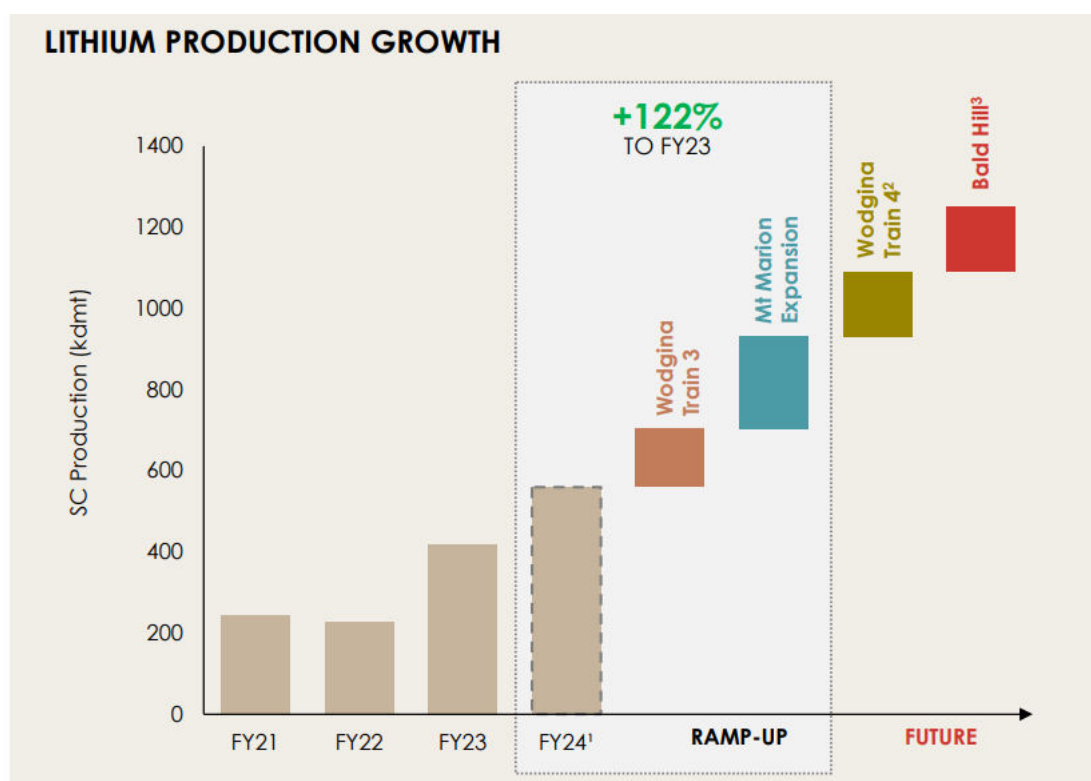


Stage 1 mining at Wodgina. The white rock is high grade lithium spodumene. Source: Auscap

The company has also been using this time of lower production to refine their processing plant to maximise recoveries and production rates. They now expect each processing train will be capable of producing 330,000t/year of 5.5% lithium concentrate, against design capacity of 250,000t/year of 6.0% lithium concentrate. With all three existing trains ramped up, this should lead to potential production at around 1,000,000t/year. We note that the land beside train 3 is already cleared and ready for construction of a fourth train, which has not yet been sanctioned, but seems a near certainty. Trains 5 and 6 also appear highly likely in the fullness of time. The incremental capital for these brownfields expansions will be modest, relative to starting a new mine from scratch.

We visited MIN's Mt Marion lithium mine, in the Goldfields area around Kalgoorlie. This operation has been in operation for much longer than Wodgina but has also been undertaking a project to significantly expand production. This will likely be complete around the middle of calendar year 2024. After some delays and frustrations, results over recent months have significantly improved. Currently Mt Marion has a much smaller reserve than Wodgina, but MIN is ramping up its exploration, both at the site and at various other surrounding properties that the company controls. MIN is also in the process of acquiring the nearby Bald Hill mine and processing plant from receivership. Future operations in the Goldfields area may incorporate multiple processing sites, and a range of resources, which are likely to further grow through exploration.

The chart below is from MIN's lithium presentation and represents their share of projected future spodumene production from the various mines. Relative to FY23, production is expected to approximately triple, if we include Wodgina Train 4 and Bald Hill. Further growth beyond this is possible at both Wodgina, through trains 5 and 6, and in the Goldfields.



Source: Mineral Resources

Iron Ore

MIN also showcased their Onslow iron ore project, which is seeking to mine and export an initial volume of 35Mt/year. The project is innovative in that it is seeking to open a pathway to market for a deposit which has previously been considered stranded, given lack of infrastructure to get it to the coast and onto ships. MIN is building their own 150km private haulage road from the mine site to the coast at Onslow, with the plan to use driverless autonomous road trains to transport the ore. Then at Onslow, MIN is building an innovative small scale port, that will load purpose-built trans-

shippers, which will in turn take the ore out to the larger transportation ships 40km offshore. The infrastructure build is currently ~40% complete, with a timeline for completion of June 2024.

MIN has forecast a free-on-board (FOB) cost of getting the ore onto ships of A\$40/t, which would transform their iron ore business into a much lower cost operation than their current projects. It is hard to judge the veracity of this forecast from the site tour, and the market appears to have some scepticism. However, we were impressed with what we saw, and are willing to back the track record of management in project delivery.

Furthermore, MIN expects to increase production to 50mt/year within 2-3 years, both increasing profits and making low unit costs easier to achieve. From what we observed of the scalability of the infrastructure being constructed, we would not be surprised to see tonnages well in excess of this 50mt being achievable in the future for relatively modest additional capital expenditure.



Port infrastructure under construction at Onslow. Source: Auscap

Other Observations

With the commencement of operations at Onslow, combined with growth in lithium, MIN's Mining Services business is set for very significant growth. In FY23, this business generated EBITDA of \$484m. MIN now expects it to be operating at a run-rate of \$1,100m EBITDA by December 2024. These are very attractive high-quality earnings given their annuity-like characteristics and long-term contracts. The company is also hoping to sign off on the construction of a significant 165TJ/day gas plant, to be fed from development of their recent gas discoveries. A plant of this size will only be viable if MIN is permitted to export a significant volume of gas, and it is uncertain whether the Western Australian Government will allow this. So currently the potential size and profitability of this business is unknown. But it is worth noting it has emerged from nothing a few years ago and, if Government approval is received, will be a very material operation.

The volatility of the commodity markets in which MIN operates is significant and can lead to short term volatility in its share price. But the ability of the company to identify and execute on high-returning growth projects has been consistently impressive for its 15+ year life as a listed company. We continue to back this quality growth to continue.

Reliance Worldwide Corporation

Reliance Worldwide Corporation (RWC) is a leader in the design, manufacture and supply of water flow and control products and solutions for use in the “behind the wall” plumbing sector. With a history dating back to 1912, Reliance Worldwide listed on the ASX in 2016. RWC’s dominant product is its “SharkBite” push-to-connect fitting, which allows pipes to be connected rapidly without the need for soldering, clamps, rings or tools. Despite RWC listing as a “market darling”, investors have since questioned RWC’s significant customer concentration, with Home Depot representing a very large share of revenue at IPO, lack of SharkBite patent protection, perceived cyclicality, and exposure to input commodity cost pressures, particularly brass. Since IPO, RWC has been hard at work gradually addressing all of these issues: the majority of global sales are now to the less cyclical repair & renovation end market, its product and geographical exposure has been diversified through new products and acquisitions, and its customer base has improved, albeit Home Depot and Lowe’s remain very material customers. Earlier this year, RWC also announced the launch of its new “SharkBite Max”, a higher quality fitting with patent protection, premium pricing, 20% less brass content than the first generation SharkBite and product assembly located much closer to its major US customers.

The launch of the new SharkBite Max product, as well as the launch of a PEX-a product and the shift in manufacturing functions from Australia to the United States, has been a considerable operational undertaking. Having already visited two of RWC’s Melbourne manufacturing sites, in September we visited RWC’s key Cullman assembly site in the US as well as its recently commissioned distribution centre along with the RWC executive team. We came away viewing the initiative as tracking to plan, whilst being impressed by RWC’s automation and operational leverage opportunities as the manufacturing process of the SharkBite Max product continues to move to the United States.

Similarly, we also left positive on the opportunity for RWC’s new PEX-a (cross-linked polyethylene) pipe offering. PEX pipes in general are taking share, due to their cost and environmental benefits relative to the currently dominant copper pipes, with the flexibility of PEX-a pipes relative to PEX-b making them better suited to expansion fittings. A major US customer is currently not buying PEX-a products from RWC. If they were to change that position, this could represent material upside to the group.

Whilst RWC is exposed to cyclicality, RWC’s latest guidance is for revenues to be down by a low single digit percentage in FY24 and for margins to be stable. Should this occur it would be a decent result in a difficult market and due in part to RWC’s defensive repair and renovation exposure and the margin benefits from the recent management initiatives discussed above. However management have noted that the high-margin European business is finding conditions particularly challenging right now, and cost pressures are continuing, particularly with labour. RWC currently trades on a ~12.5x P/E multiple of analyst’s forecast earnings, significantly below many domestic and international peers. RWC has tripled earnings per share since listing, and the group should benefit from any cyclical recovery in its end markets. The long-term incentives of RWC’s CEO require compound earnings per share growth of 4-15% over the next three years to vest. We are positive over the medium term on our investment in RWC.



RWC’s Cullman Distribution Centre. Source Auscap

Carsales

Founded in 1997, Carsales.com (Carsales or CAR) is a collection of digital businesses at various stages of maturity. Carsales dominates its home Australian market, with over 4x the unique audience of its nearest competitor. It also owns 100% of Encar, the number one online auto classifieds business in South Korea. As of October 2022, Carsales now owns 100% of Trader Interactive, the biggest player in the US non-automotive classifieds market, focused on Trucks, Equipment, Recreational Vehicles and Motorbikes. As of April 2023, Carsales has also increased its ownership of leading Brazilian automotive marketplace webmotors from 30% to 70%. Carsales has a long track record of very strong earnings growth and return on capital. Auscap's investment thesis in Carsales was covered in our January 2023 newsletter and at the November 2022 Sohn Hearts & Minds Conference.

Following a period of considerable M&A, just under half of Carsales' EBITDA is now generated from international markets, so the growth opportunity of Trader Interactive and webmotors is very topical. In this context, it was good to visit the executive teams of both businesses in their home geographies. After hearing from the Trader Interactive management team in San Francisco, we were impressed by the team's progress in aggressively rolling out Carsales' intellectual property in the very large US market. This included media initiatives such as programmatic advertising, lead amplifier products, dynamic pricing, cash offers, digital transactions and brand awareness initiatives. These initiatives, combined with Trader Interactive's low dealer penetration, should underpin Trader Interactive's earnings growth for years to come.

There were also two further positive surprises from the visit. Firstly, Trader Interactive is now pushing into the US marine market, which has an addressable market second in size only to trucks when compared to Trader Interactive's four existing verticals. This is a logical extension for Trader Interactive, due to Carsales' Australian leadership position in the marine market and Trader Interactive's previous experience in the US marine marketplace. Secondly, there are clear opportunities with large inventory suppliers in some verticals to become customers of Trader Interactive, increasing their market penetration.

Sao Paulo is the base of webmotors' Head Office and many dealership customers. Carsales has just bought an additional 40% stake in webmotors off its joint venture partner, Santander. Santander's continued association with the business is clearly apparent. Webmotors continues to operate out of Level 7 of Santander's Head Office, the majority of webmotors' executive team are ex-Santander, a Santander executive presented at the investor event and two of webmotors' key new credit opportunities, Pioneer Auto and Santander's exclusive partnership with major OEM Stellantis, heavily leverage the Santander relationship. We remain optimistic about webmotors' growth prospects, premised on the national expansion opportunity, the runway for the "Cockpit" dealer software offering, the opportunity of rolling out Carsales' yield enhancing products in Brazil and Brazil's improving macroeconomic outlook.



Webmotors' Head Office (within Santander's Head Office) and Next Motors, a Sao Paulo dealership. Source Auscap

Auscap Long Short Australian Equities Fund

Fund Performance*

Period	Auscap	All Ords
September 2023	(5.8%)	(2.8%)
Financial Year To Date	4.9%	(0.7%)
Since Inception (Dec 2012)	346.6%	149.5%
Annualised Returns	14.8%	8.8%

Fund Exposures

September 2023 Average	% NAV	Positions
Gross Long	96%	36
Gross Short	0%	0
Gross Total	96%	36
Net / Beta Adjusted Net	96%	116%

Portfolio Commentary*

The Fund returned negative 5.8% net of fees during September 2023. This compares with the All Ordinaries Accumulation Index return of negative 2.8%.

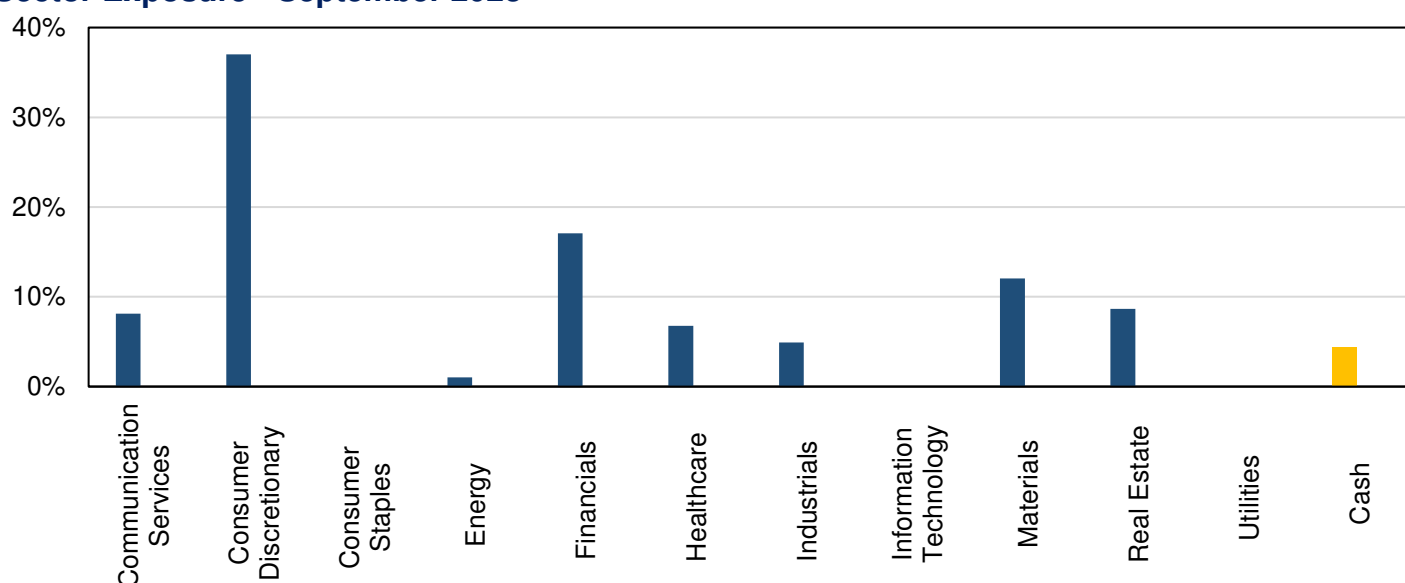
Fund Calendar Year Returns*

CY13	51.9%	CY19	18.1%
CY14	23.2%	CY20	10.6%
CY15	36.0%	CY21	43.2%
CY16	2.2%	CY22	(12.4%)
CY17	17.1%	CY23+	8.5%
CY18	(18.5%)		

Top 20 Investments^

ARB Corp	Motorcycle Holdings
Breville Group	NIB Holdings
Carsales.com	Nick Scali
Eagers Automotive	Pilbara Minerals
HMC Capital	PSC Insurance
HomeCo Daily Needs REIT	PWR Holdings
HUB24	REA Group
JB Hi-Fi	Reece
Macquarie Group	Reliance Worldwide
Mineral Resources	ResMed

Sector Exposure - September 2023#



* Performance figures are calculated for the Monthly Class net of all fees and expenses and assuming the reinvestment of all distributions. Note, as at 1 January 2021, the Series Class was consolidated into the Monthly Class. Past performance is not a reliable indicator of future performance.

^ Top 20 long investments in alphabetical order as at 30 September 2023.

* To 30 September 2023.

Average Sector Exposure during September 2023.

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