System Capital Long Short Strategy

Quarterly Report

The investment team is very pleased to present our September 2024 newsletter. Comments and suggestions are highly welcome.

STRATEGY PERFORMANCE OVERVIEW

The strategy returned 15.3% for the quarter, bringing 1-year performance to 35.0%.

Position Type	Sept 24	Region	Gross Long	Gross Short	Net Long
Short Positions	16	Europe	63%	(16%)	47%
Long Positions	35	North America	38%	(18%)	20%
Index Positions	3	Asia	4%	0%	4%
		Australia/NZ	13%	(4%)	9%
Total Positions	54	Total	119%	(38%)	81%

	Month	3M	6M	1 Year	Cumulative Since Inception	Since Inception p.a.
System Capital L/S	5.1%	15.3%	14.0%	35.0%	57.2%	26.4%
MSCI World AUD Hedged	1.4%	4.5%	7.5%	29.2%	45.1%	21.3%
Stoxx 600	-0.3%	2.6%	3.8%	19.2%	35.2%	16.9%
ASX 200	3.0%	7.8%	6.7%	21.8%	31.5%	15.3%

Performance is in AUD (Hedged) and is before fees. Cumulative Returns and Annualised Returns from 26th Oct 2022 to 30th Sep 2024. Returns in AUD. Gross returns before management and performance fees. MSCI World 100% Hedged to AUD Index ASX200 Accumulation Index. Stoxx 600 Net Total Return.

SIGNIFICANT CONTRIBUTORS FOR THE QUARTER INCLUDED:

- **Playtech (Global gaming business):** Increased 61% following the sale of a core asset and the restructure of a Mexican JV arrangement. The company is due to return 70% of its market value back to shareholders via a special distribution and retain a highly strategic portfolio of B2B gaming assets. We remain shareholders.
- **Rightmove (UK classifieds):** Increased 15% as corporate interest from REA highlighted strong strategic value in the asset. We reduced our holding during the period but remain shareholders.
- **Flutter (Global gaming):** Rose 7% on continued operational excellence and strong CMD guidance. Flutter remains a core holding of the strategy. Please see our write up below.
- **Enel (Italian integrated utility):** Rose 11% on strong operational performance with free cash flow and earnings trending towards the higher end of full year guidance. We believe Enel is a key

beneficiary of increasing renewable capacity and power demand in Europe and has an excellent management team focused on capital efficiency. We view Enel's unique combination of transmission, generation and retail assets as particularly advantaged in earning integrated margins and earning superior economic returns for shareholders.

• **Equifax (US informational services):** Increased 21% following strong operational performance in the key EWS segment and more optimism around impending cuts in US interest rates. Please see our write up below.

AN INTRODUCTION TO THE STRATEGY

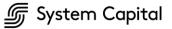
As this is the Strategy's inaugural quarterly newsletter, we would like to briefly cover the Strategy's investment strategy, the approach to risk and provide a deeper review of two portfolio stocks.

The Strategy is focussed on finding businesses that can generate attractive free cashflow returns and strengthen their competitive positioning over time. The portfolio is grouped around the following three focus areas:

Core Cashflow Franchises: Predictable cashflow businesses with high visibility over revenues and costs. The barriers to entry for competitors are growing because of the businesses' strategic asset base, network effects or operating scale advantages. Typically, these businesses are attractively priced based on a cashflow multiple basis today and have high single digit or low double digit free cash flow growth due to structural advantages in their business model. Companies like Ferrovial (toll road asset) and Enel (power generation, transmission and retail) are examples of core cashflow franchise stocks that we hold in the Strategy today.

Digital infrastructure: These businesses are essential to the functioning of the digital economy. They often have a high degree of pricing power, strong unit economics and exceptional returns on incremental capital. These stocks usually have a lower starting free cash yield than Core Franchises but are growing cashflows much faster, delivering a similar overall return. Importantly we look for businesses with a well-defined investment horizon and which have a high degree of earning visibility and predictability after the investment phase concludes. Equifax (US information services) and Tradeweb (Fixed income exchange and trade portal) are examples of digital infrastructure stocks we hold in the Strategy today.

Hidden Value: This category includes stocks which in our opinion have strong underlying moats and could fit into the core cashflow or digital infrastructure focus areas but where the capital structure, regulatory outlook or poor historic capital allocation has not allowed investors to see the underlying value of the franchise. This is the smallest allocation in our portfolio, and we typically look for exceptional returns together with a clear catalyst to resolving the issue(s). Schibsted and Basic Fit are examples of hidden value stocks that we hold in the Strategy today.



OUR APPROACH TO SYSTEMIC RISK

We classify systemic risks in our portfolio into three areas:

Risks which threaten the quality of the business: These include regulatory risks, which undermine allowed returns and encourage new competitors to enter, It also includes tariffs which can cut off key export markets or impose significant new costs on supply chains. To aid our understanding of quality risks we regularly meet with regulators, suppliers and customers of our portfolio companies and build our circle of competence in related industries over time. We manage quality risks by a combination of deep industry insight, scenario modelling and avoiding concentration to any one type of risk.

Risks that threaten the short-term earnings of the business: These include macro risks relating to unemployment or GDP growth. It also includes inflation risks to the extent they can impact operating margins in the short to medium term. We manage these risks by prioritising companies with high levels of revenue visibility through contracted revenues or high levels of non-discretionary customer spend. Often this is paired with a moderate to high degree of pricing power or clear structural advantages which make the business the lowest cost operator in the space.

Risks that impact return required for the stock market as whole: These are risk related to the cost of capital more broadly and the real rate of return on assets. We tend to deal with these risks by making sure all investments meet a high IRR threshold that does not move with short-term interest rates. We also prioritise companies with sufficient pricing power or structural cost advantages that can better mitigate an inflationary shock which increases required returns on assets.

This risk framework helps us focus on specific business, industry and macro risks that could impact our portfolio companies.

QUARTERLY MACRO REVIEW

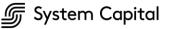
The third quarter of 2024 has seen several significant macroeconomic developments, with interest rates, the US elections, trade policies and regulatory developments taking centre stage. These all have the potential to impact our portfolio.

INTEREST RATES

The Federal Reserve began its easing cycle, lowering the target for its key lending rate by 50 basis points in September to the range of 4.75%-5.0%. This move came on the back of softening inflation data and a cooling labour market. The Fed signalled it remains attentive to risks on both sides of its dual mandate, suggesting a balanced approach to future policy decisions.

During the September quarter, growth was weaker than expected in Europe and the regional divergence continued. In manufacturing, the gap between Germany and the rest of region widened, as structural headwinds persist in Germany such as elevated power prices, rising competition from abroad and lower labour supply. Euro area headline HICP inflation printed at 1.8% annualised in September, down from 2.2% in August.

The ECB has implemented three interest rate cuts so far in 2024:



- June 2024: The first rate cut in almost five years, lowering rates from 4.0% to 3.75%
- September 2024: A 25-basis point cut, bringing the deposit facility rate to 3.5%
- October 2024: Another 25-basis point reduction, setting the deposit facility rate at 3.25%
- Expectations are for further ECB rate cuts towards a neutral rate of 2.5% in March 2025.

US ELECTIONS, TRADE & TARIFFS

The US presidential election campaign intensified in Q3, with economic policies taking centre stage. Both major party candidates outlined their visions for trade, taxation, and government spending. The incumbent administration emphasized its record on job creation and infrastructure investment, while the challenger focused on promises of tax cuts, tariffs on Chinese imports and deregulation. Market volatility increased as polls showed a tight race, and we continue to watch for potential policy shifts that could impact various sectors.

Trade tensions remained a key focus, particularly regarding US-China relations. While China's trade surplus with the US has declined, it has been offset by increased surpluses with other trading partners. Discussions around potential new tariffs on Chinese goods created uncertainty in global markets. Donald Trump, the Republican nominee, is advocating for a more aggressive tariff policy:

Proposing a 10% blanket tariff on all imported goods.

Calling for a steep 60% tariff specifically on imports from China (versus the 25% and 15% tariffs imposed currently).

Framing tariffs as a way to protect American industries and generate revenue.

Vice President Kamala Harris, the Democratic nominee, has a more nuanced stance on tariffs:

Criticizing Trump's tariff proposals, arguing they function as a "sales tax" affecting American families while at the same time not clearly indicating whether she would maintain existing tariffs implemented by the Biden administration.

Emphasizing a commitment to American leadership in innovative sectors while addressing unfair trade practices from competitors like China.

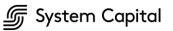
Concurrently, the EU and China are embroiled in a trade dispute, with the EU imposing provisional duties of up to 37.6% on electric vehicle imports from China in July 2024. China has responded by initiating anti-dumping investigations into EU pork and brandy exports.

REGULATORY DEVELOPMENTS

In the US, the Biden administration has been synonymous with more aggressive enforcement in all areas of antitrust, emphasized by Lina Khan. More recently the DOJ has submitted a broad outline of potential remedies following a federal court ruling in August 2024 that found Google had illegally monopolized the search market. Some of the proposed changes include:

The DOJ is considering "structural remedies" that could potentially lead to breaking up parts of Google's business including separation of Chrome, Android and the Play App Store.

Forcing Google to share search queries, clicks, and results with competitors.



Barring Google from entering into default agreements, preinstallation agreements, and revenuesharing arrangements related to search products.

Google has strongly opposed these proposals and has indicated it will appeal the original decision.

A second antitrust trial pitting Google against the DOJ began on 9th September, over whether the tech giant illegally monopolized the digital advertising industry.

Separately, the DOJ has recently filed a major antitrust lawsuit against Visa, accusing the company of monopolizing the U.S debit card market through anti-competitive practices. This investigation adds to the list of current regulatory investigations and lawsuits regarding Visa in a period of heightened scrutiny on the card networks.

The CFPB is another regulatory agency that has become more aggressive under the Biden administration. They have attempted to tackle multiple issues including overdraft fees, credit card late bills and mortgage closing costs. Their investigation into mortgage closing costs is an area we are following closely due to its portfolio relevance.

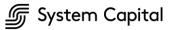
We closely monitor regulatory developments and risks relevant to our portfolio companies and the broader industry they operate in. The current broader regulatory scrutiny reiterates the strong importance we place on the value that portfolio company products provide to their customers and the broader ecosystem they operate within. We continue to be cognisant of macro risks and perform sensitivity analyses on portfolio companies where risks could directly impact their business.

STOCK REVIEW - EQUIFAX (EFX)

ABOUT THE COMPANY

Equifax (EFX) has two main corporate segments: its Workforce Solutions business (EWS) and US Credit Bureau (CB) business. The credit bureau is Equifax's original business and mainly involves selling consumer FICO scores to financial institutions. These scores are built using EFX consumer data and the proprietary FICO scoring algorithm. There are only two other competitors selling FICO scores based on consumer data (TransUnion and Experian), leading to an attractive competitive environment with a history of real pricing power. However, the real strength of Equifax lies in its EWS division.

EWS runs a database called The Work Number (TWN) that holds 180 million income and employment records in the US. Most of these are unique records gained through exclusive payroll processor agreements and employment processing work done for individual companies. EWS sells access to these records to three main customers: mortgage lenders, background screeners and governments. Accurate income and employment verification is mission critical to all three end customer groups. TWN creates value for both record uploaders and record downloaders. By uploading records to TWN, companies do not have to answer income verification requests for their employees and thus save costs. By downloading records, customers access information faster and more accurately than relying on paper pay stubs. Due to the unique nature of the records, there is limited ability to access this information elsewhere and as the database gains more records the competitive advantage increases.



WHAT ATTRACTED US TO IT

Due to EWS' advantaged position and first mover advantage the business has had a record of strong and profitable growth. In particular, the government vertical has grown especially rapidly as TWN's comprehensive database provides a strong competitive advantage in Federal and State Government tenders. For example, this is a quote from a recent Request for Proposal (RFP) by the San Diego Housing Commission for the provision of income and verification services to qualify for housing support.

"There are no alternative providers offering automated, instant access to the specific employer payroll records available on The Work Number".

We believe this is indicative of Equifax's privileged position across US government tenders.

When we first began to look at EFX, the stock had come under pressure due to declines in its mortgage business. Mortgage related revenue had historically been EFX's largest vertical exposure. As mortgage rates dramatically increased from 2022, mortgage purchase and refinance volumes plummeted to levels 50% below "normal". As a result, the reported earnings understated the potential earnings power in a more "normal" mortgage environment, providing further growth optionality in addition to the strong non-mortgage growth.

HOW ITS PLAYED OUT AND WHAT WE ARE LOOKING FOR

EWS has continued to add records at a very attractive rate that is ahead of long-term guidance. While government revenue growth has continued to be very strong (29% growth in the most recent quarter), there continues to be short term results volatility in the mortgage and talent verticals from weak hiring markets and a mortgage market that has yet to recover. Despite this volatility, both talent and mortgage verticals are still growing revenue. There is still an opportunity to gain more records, convert more paper-based customers and increase price as the value of the service increases – helping to drive strong double-digit earnings growth. A return to "normal" mortgage volumes could add over \$4 of EPS to this underlying growth algorithm.

The key areas we watch closely to monitor the company's success are record growth and underlying market outperformance. We believe each of these drivers are currently very healthy. As part of our continuous research process, we will engage with EFX, FICO and the other credit bureaus as we monitor the CB segment. We will also engage with end customers of EWS (e.g. background screeners) to monitor end demand and changes in the competitive landscape. Equifax remains a core holding of the strategy as it continues to trade below our estimates of fair value.

STOCK REVIEW FLUTTER (FLTR)

ABOUT THE COMPANY

Flutter is the world's leading sports betting and gaming operator, formed from the merger of Paddy Power and Betfair Group in 2016 and The Stars Group in 2020. It operates several brands including Paddy Power (retail and online), Betfair (online), Sky Betting and Gaming (UK, online), SportsBet (Australia, online), FanDuel (Daily Fantasy Sports and sports betting/iGaming in the US) and Sisal (Italy, retail and online).



WHAT ATTRACTED US TO IT

Flutter offers one of the highest quality investment opportunities in a structurally growing global online gaming market. Its proprietary capabilities result in a high margin and popular product suite, capable of driving market share gains and a structural win margin advantage.

Our study of the ecosystem of competitors and suppliers highlighted Flutter as best placed to capitalise on the industry's growth story through their leading competitive playbook known as the "Flutter Edge".

In particular, Flutter's high growth US business, Fanduel has attained market leadership over the past 3-4 years. When it comes to online sports betting (OSB), what we believe matters is the difficult combination of acquiring customers, retaining customers and monetising customer spend or "handle". We view FanDuel as the No. 1 sportsbook but not just because it is No. 1 on revenue market share metrics (superior customer acquisition and retention quality) but because it also simultaneously achieves the highest gross win margin ("hold") and net win margin in the market. We believe FanDuel has achieved this dual margin and market share superiority through their leadership in technology, pricing, customer acquisition and product advantages including in the all-important parlay product.

Given its scale advantages Flutter is best able to defend against potential industry headwinds in the form of high taxation and increased regulation, with Flutter the No. 1 operator in the countries that make up ~90% of their revenues. The cash generative nature of the business lends itself to an increasingly flexible balance sheet for M&A and future capital returns.

HOW IT'S PLAYED OUT AND WHAT WE ARE LOOKING FOR

To this point Flutter's US business, FanDuel has sustained its market share advantage in OSB and grown its market share to now be the No. 1 player in iGaming. Through its market leading parlay products and superior parlay gross win margins FanDuel has strengthened its No. 1 position. New entrants in the US now face significant scale and product challenges in order to compete.

Flutter has used its product and pricing knowledge to further its market share in other countries such as the UK, Italy and Australia. Management has been proactive in implementing player protection and safer gambling measures in the UK and elsewhere, enabling Flutter to navigate changes in the regulatory environment more effectively than its competitors.

At its recent CMD, Flutter laid out impressive growth targets which highlighted a superior product roadmap, market leading and expanding net win margins at Fanduel and a range of cost saving and synergy benefits in relation to recent M&A deals (Snaitech in Italy and NSX in Brazil). We continue to look out for Flutter maintaining its No. 1 position in each of its key markets, ongoing management execution of its strategy and further capital returns to shareholder in the form of buybacks and dividends. Flutter remains a core holding of the strategy as it continues to trade below our estimates of fair value.

Important Information

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