System Capital Long Short Strategy

Quarterly Report June 2026

PLEASE FIND OUR JUNE 2026 NEWSLETTER BELOW. COMMENTS AND SUGGESTIONS ARE HIGHLY WELCOME.

STRATEGY PERFORMANCE OVERVIEW

The fund increased 1.1% for the quarter, bringing one year performance to -18.7%.

The quarter was marked by the significant outperformance of AI beneficiaries, broadly defined as stocks benefiting from the significant increase in AI data centre build outs or from the underlying demand for AI products. These included companies exposed to semiconductor manufacturing, electrical power, cooling, and optical and network equipment. There was also strong performance from high beta speculative companies with low levels of profitability, including robotics and space companies. Conversely stocks across software and information services were sold down, with the quality factor having significant underperformance across the board.

For the last 12 months we have grappled with how to invest in AI. Our investment process is focused on finding businesses that are structurally stronger over the medium term (broadly defined as 5 years). Underwriting the strength of a business that far out is typically less about short-term earnings momentum or capturing a temporary mismatch between supply and demand.

Rather, we are seeking companies that are already strongly advantaged and have a dominant product or service with a clear, predictable path to significantly improving that product or service over time. This should lead to a strengthening competitive position, attractive returns from new growth projects that leverage the same dominant asset, and stronger pricing power. Finally, we need a reasonable starting valuation to meet our 14%+ IRR cash hurdle. That is why our portfolio is typically more profitable and has faster revenue growth than the index but trades at a similar free cash flow multiple. It is fair to say with the exception of TSMC we have not found enough of these businesses in the AI universe.

Applying this framework across the AI stack has proven difficult for several reasons. Firstly, while current revenues for AI beneficiaries are extremely strong across the stack (chip designers, chip manufacturers, equipment suppliers, data centre construction firms etc) their revenues have predominantly been driven by hyperscaler spending (Microsoft, Google, Amazon and Meta). So far, hyperscalers have been able to fund this spending out of the cash flows from their dominant franchises (e.g Azure, Office, Search, AWS and Amazon retail). Expectations are for ~$800bln of capex spend this year and over $1.2tln of capex in 2027 (for reference the hyperscalers spent a mere ~$140bln in 2022 on capex).

Expectations are for this annual capex spend to continue to grow closer to $3 trillion by the end of the decade. This level of spending cannot be sustained by the existing profits of hyperscalers and must be financed by debt issuance, equity issuance or substantial new AI revenue from AI customers such as OpenAI and Anthropic. It is estimated the hyperscalers have a ~$750bln backlog attributed to the two frontier AI labs, leaving them as the dominant source of new AI revenue streams.

Getting comfort that these two frontier labs will be in a good enough financial position to fund this build out (through annual lease payments in the hundreds of billions of dollars) has been extremely difficult. Both labs have seen strong revenue growth this year (particularly Anthropic) as new frontier model releases with excellent coding capabilities are successfully deployed with premium token pricing. The revenue ramp has been driven predominantly by business related revenue as opposed to the initial consumer chat-based product. As a result, the continued growth of lab revenue is reliant on the rapid diffusion of AI tools into business environments, with substantial enterprise spend required to sustain the multi trillion capex bill. Labour substitution is often seen as the source of the multi trillion required revenue run rate. However, considering that the total wage bill in the United States for **all** workers is ~$12 trillion, we are uncomfortable underwriting a business case reliant on double digit plus unemployment rates, given the knock-on societal impacts and the likely regulatory and government intervention. Furthermore, despite AI's powerful coding capabilities, penetration into other areas of white collar is still nascent and true labour substitution would require a step change in functionality from the models.

Any slowdown in leading lab revenue would have knock on effects downstream. The lab flywheel is reliant on premium token pricing generating inference margins to sustain training costs and eventually profits. Currently, premium priced models have had exceptionally strong demand on the back of coding capabilities. However open weight models are rapidly catching up and often go to market with token costs an order of magnitude lower. The lab's ability to ship products beyond core coding application in a way that can be sustainably monetised and produce the cashflow to service these capital obligations is highly uncertain in a world with exceptional open weight models. Ultimately, we have not been able to model the ultimate value of AI labs themselves, and they represent the majority of AI revenue and importantly, the majority of contracted AI compute demand at the hyperscalers. We are strong believers in the power of AI to transform work and society and it is true that AI infrastructure is sold to many more players beyond the leading AI labs but the very high inference margin of the frontier labs is what sustains high levels of profitability across the value chain, in our view.

Finally, many AI infrastructure names have used the current extreme supply demand mismatch to take extreme price rises which makes it hard to get comfort around the level of sustainable revenue in a future supply demand equilibrium (memory stocks, electrical engineering business, fabricators and assemblers being some examples).

We are closely following the rapid developments in AI model capabilities as well as use cases and monetisation opportunities that are substantial and sustainable enough to support the required revenue. We are open minded to the vast potential of AI models including in the physical world and continue to look for businesses that meet System Capital's characteristics in the AI ecosystem. However, given the concentration of AI themes in the market and their reliance on rapidly changing lab economics, the portfolio is currently weighted towards businesses in other areas that possess both attractive growth characteristics and high visibility into their structural strengthening.

Position Type	Jun 26
Short Positions	22
Long Positions	37
Total Positions	**59**
Of which Index Positions	5

Region	Gross Long (%)	Gross Short (%)	Net Long (%)
Europe	49	-39	10
North America	83	-35	49
Asia	22	0	22
Australia/NZ	14	-5	9
Total	**169**	**-79**	**89**

	3M (%)	6M (%)	1 Year (%)	2 Year p.a.	3 Year p.a.	Cumulative Since Inception	Since Inception p.a.
System Capital L/S	**1.1**	**-15.4**	**-18.7**	**1.6**	**6.0**	**40.8**	**9.8**
MSCI World AUD Hedged	13.8	10.1	22.3	17.8	18.6	92.7	19.5
Stoxx 600	11.4	10.3	21.5	14.9	14.5	73.9	16.2
ASX 200	4.0	2.4	6.1	9.9	10.6	47.4	11.1

Performance is in AUD (Hedged) and is before fees. Cumulative Returns and Annualised Returns from 26 Oct 2022 to 30 June 2026. Returns in AUD. Gross returns before management and performance fees. MSCI World 100% Hedged to AUD Index, ASX 200 Accumulation Index, Stoxx 600 Net Total Return.

MARKET PERFORMANCE DURING THE QUARTER

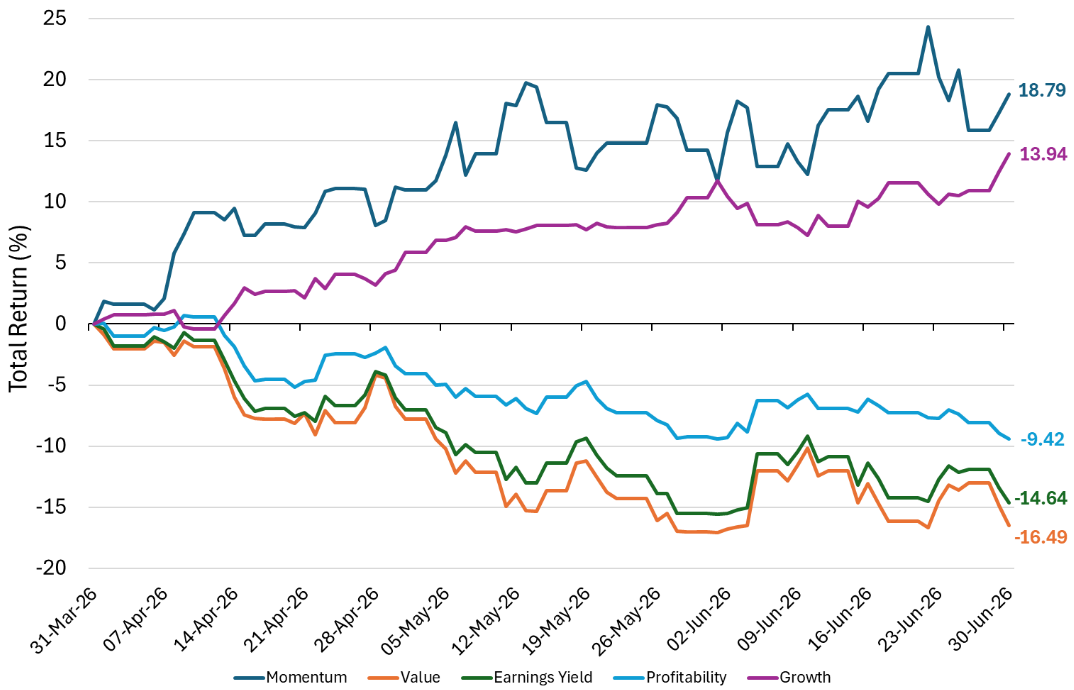
The second quarter was defined by the Iran conflict. The closure of the Strait of Hormuz led to highly volatile oil prices and interest rates through the quarter. Despite the war, equities spent most of the quarter moving higher. The S&P 500 rose in roughly 11 of the final 12 weeks of the quarter. However, gains were narrow: AI, semiconductors and data-centre infrastructure accounted for most of the index returns. Bullish sentiment reached extremes later in the quarter as stocks with outsized price momentum and exposed to the right momentum factors (high beta, AI beneficiaries and highly speculative stocks with low earnings quality) achieved exceptional returns. In the last week of June, a sharp AI/semis led decline in market occurred which has persisted into the second half of the year.

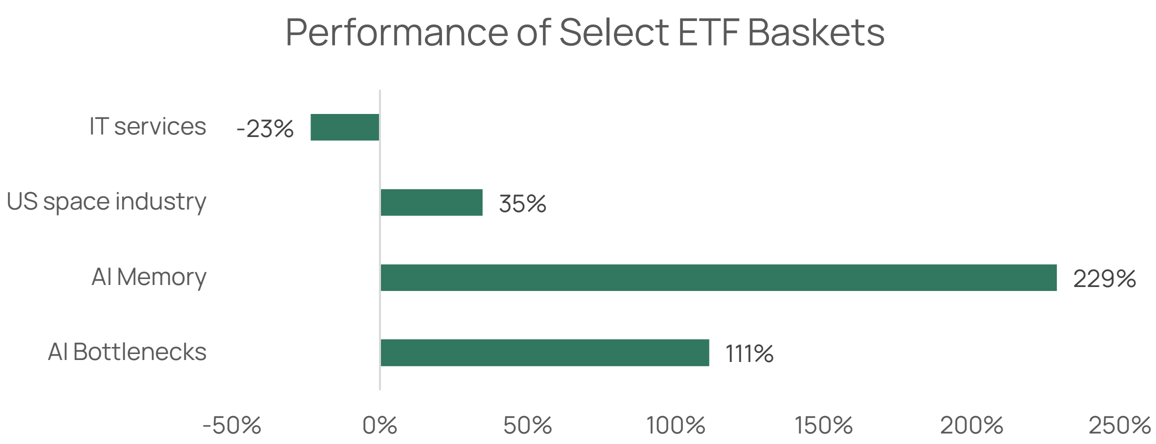
BY THEME

As in Q1, the bifurcation between AI beneficiaries and everything else was the main theme in Q2. Semiconductors, memory, data-centre infrastructure/cooling and power drove the bulk of index gains. Momentum was upgraded to the top-ranked equity factor for much of the quarter, while Quality underperformed during the AI rotation.

The flip side was a growing "AI loser" bucket. These included software and IT-services names seen as vulnerable to AI-driven cost optimisation or disintermediation, information services and fintech names swept into the same basket regardless of fundamentals, and parts of consumer and healthcare that investors were reportedly selling specifically to fund the AI trade.

Returns within the S&P 500 varied widely among factors, with Momentum continuing to lead all other factors, despite a pullback at the end of June, which has continued into July.





Source: JP Morgan

OUR PORTFOLIO

By contrast our portfolio is more weighted towards growth companies with high levels of profitability in the payments, classified, gaming and infrastructure sectors.

OUR PORTFOLIO BY FACTOR – RELATIVE TO MSCI WORLD INDEX

Factor	Active	Comment
Overweights		
Growth	77%	Portfolio is overweight companies growing faster than index
Profit	1%	Portfolio is overweight companies more profitable than index
Underweights		
Momentum	-167%	Strong price momentum across AI and small cap names currently where fund is underweight
Beta	-36%	Portfolio is lower beta than the market owing to infrastructure and some lower beta industrial names

OUR PORTFOLIO BY INDUSTRY - RELATIVE TO MSCI WORLD INDEX

Industry	Active	Comment
Overweights		
Specialised Finance	42%	Significant allocation to payments including Visa, Mastercard, Adyen and Equifax, FICO and MSCI
E-Commerce	13%	Amazon and classifieds businesses
Consumer Services	11%	Investment across several gaming businesses
Engineering	7%	Leading industrial and infrastructure businesses
Underweights		
Semiconductors	-12%	Underweight AI themes at present
Communication Equipment	-8%	Underweight AI themes at present
Diversified Banks	-8%	No active long positions together with shorts
Banks	-14%	No active long positions together with shorts

NAVIGATING THE AI DISRUPTION TRADE OVER THE LAST 6 MONTHS

Broadly speaking, we have made 3 key changes to the portfolio over the last 6 months as the AI trade has impacted our Digital Infrastructure positions.

Added to our highest conviction holdings. Several of these companies have suffered from the AI disruption trade, where businesses deemed "AI losers" have seen stock price declines. While there is certainly merit to some of the sell-off recipients, it has failed to discriminate between genuinely threatened business models and companies with durable structural moats and competitive advantages. Overall, the companies below are asset-light, essential to the functioning of the digital economy, have a high degree of pricing power, enjoy high ROICs, and have not shown a slowdown in earnings.

Stock	January weight	Current weight	Change
Visa	3.29%	7.77%	4.48%
Mastercard	3.35%	7.73%	4.38%
SMG Swiss Marketplace	2.00%	5.55%	3.55%
Paylocity	3.08%	6.36%	3.28%
Paycom	1.18%	3.47%	2.29%
MSCI	5.77%	6.53%	0.75%

Reduced our exposure to some names for which we have become more concerned by either macroeconomic risk (higher mortgage rates in the case of Equifax and FICO), or threat of disintermediation from AI (in the case of LSEG). While risks have increased, we continue to believe that they are structurally advantaged businesses with genuine moats.

Stock	January weight	Current weight	Change
Equifax	5.10%	4.55%	-0.55%
LSEG	4.81%	4.02%	-0.79%
FICO	5.77%	4.12%	-1.66%

Added paired shorts and shorted selected low-quality software-type businesses to hedge our exposure in the digital infrastructure space. Throughout the year, we have also made use of the short book to both bet on structurally disadvantaged businesses and hedge our exposures to industry or factor risks related to AI disruption. These names all operate in the same industry verticals as our core digital infrastructure long positions but have inferior competitive positioning, lower growth and higher valuation. Shorting them allows us to continue to invest in our high conviction ideas, while managing our risk exposure.

PORTFOLIO VALUATION

We believe the portfolio is very attractively priced at this point. Our long positions continue to show strong sales and cash flow growth along with structural strengthening, while trading at multiples considerably lower than their historical average. Our short book is also priced attractively, with weak and structurally declining stocks trading at relatively high multiples despite low sales and negative cash flow growth.

Portfolio Book	P/E FY27(Fcast)	EV/Est EBITDA 27	EBITDA Growth FY27	ROA	Est Sales YoY Gr
Long	21x	13x	17%	12%	13%
Short	18x	14x	-10%	5%	3%

All FY27 forecasts based on Bloomberg consensus forecasts.
Stocks with negative earnings or EBITDA excluded from analysis.
Short book excludes index positions.

NEW IDEAS – COCHLEAR(COH.AX)

ABOUT THE COMPANY

Cochlear is the global leader in implantable hearing solutions, with more than 60% market share in cochlear implants. Its main product is the Nucleus cochlear implant system, used to treat severe to profound hearing loss where conventional hearing aids provide insufficient benefit. Cochlear also sells sound processor upgrades and services to its installed recipient base, together with acoustic implants under the Osia and Baha brands. In FY25, cochlear implants represented 62% of revenue, Services 26% and Acoustics 12%.

A key strength of the business is the lifetime relationship with recipients. The internal implant is designed to remain in place for decades, while external processors, software and accessories can be upgraded over time. Reliability, clinical evidence, regulatory approvals and the familiarity of surgeons and audiologists with the platform create high barriers to entry. This combination has supported gross margins of 74% in FY25 and 73% in the first half of FY26, despite an increasing mix of lower-priced emerging-market devices.

WHAT ATTRACTED US TO IT

We initiated the position at around A$95 in April following a significant earnings downgrade which resulted in the stock falling by 42% in a single trading session. Cochlear reduced FY26 underlying net profit guidance from A$435–460 million to A$290–330 million, a decline of approximately 31% at the midpoint. At our entry price, the shares were trading at approximately 19 times the midpoint of revised FY26 earnings, which we considered attractive for a global market leader whose current earnings appeared materially below normalised levels.

The downgrade also included costs that should not all recur at the same level. Cochlear expects A$18–25 million of expenses from reshaping the cost base and up to A$10 million of potential provisions against Middle Eastern receivables. Lower production is expected to reduce factory overhead recovery by around A$20 million after tax. The latter is not strictly a one-off but should improve if volumes recover. We therefore believe the revised FY26 earnings base reflects a combination of genuine operating weakness, temporary disruption and restructuring costs rather than a permanent change in the economics of the business.

The larger attraction is the extent of adult under-penetration. Cochlear estimates that fewer than 5% of developed-market adults and seniors who could benefit from an implant have received one. Our demographic work suggests that, looking only at OECD markets, the 80-plus population where severe hearing loss is much more prevalent is projected to grow by approximately 39.5%, from around 73 million to 102 million by 2034. These figures are our calculations using the UN's 2024 population projections across the OECD's 38 current members.

Applying published age-specific hearing-loss rates to these demographics suggests that approximately 8–10 million people aged 70 or older across the OECD already have bilateral hearing loss above roughly 60 decibels, the audiometric level commonly used to identify people who should be assessed for cochlear implantation. One study found that 2.47% of people aged 70–79 and 6.8% of those aged 80 or older had a conventional cochlear-implant audiometric profile. A newer study found severe-or-greater bilateral hearing loss rising from 1.8% at ages 71–74 to 21.8% among people aged 90 or older.

The scale of this potential pool is significant relative to current industry volumes. Cochlear sold 53,968 cochlear implant units in FY25 and maintained more than 60% global market share, implying total annual industry volume of fewer than approximately **90,000 units**. The estimated OECD 80-plus audiometric pool is therefore **more than 70 times the entire industry's current annual unit volume**, even before considering younger adults or candidates outside the OECD. The comparison is not intended to suggest that all 7 million people will receive an implant, but it demonstrates how little penetration is required to support meaningful industry growth.

There is also increasing evidence that untreated hearing loss has consequences beyond communication. The 2024 Lancet Commission continued to identify hearing loss as a major potentially modifiable dementia risk factor. More recent observational evidence in people with severe to profound hearing loss has associated cochlear implantation with lower dementia incidence than hearing-aid use, although these studies do not prove causation. We believe growing awareness of the relationship between hearing loss, social isolation, cognitive decline and dementia can help shift treatment from being viewed as discretionary to being considered an important part of healthy ageing.

Finally, Cochlear has a potentially important product cycle. The recently launched Nucleus Nexa is the first cochlear implant with upgradeable firmware, allowing future improvements to be delivered through both the internal implant and the external processor. Cochlear is also conducting two regulatory studies for a totally implantable cochlear implant with a potential market launch around 2029. Removing the visible external processor could reduce stigma and daily handling requirements, potentially attracting adults who are clinically eligible but unwilling to adopt today's device.

HOW IT HAS PLAYED OUT

Cochlear's shares have recovered from our purchase price of approximately A$95 to around A$120 at the time of writing. However, it remains early in our investment. The recovery in the share price has occurred before clear evidence of a recovery in surgical volumes, Middle Eastern sales or profitability.

WHAT WE ARE LOOKING FOR TODAY

In the near term, we are looking for stabilisation in the Middle East as the regional conflict eases. Cochlear has warned of order cancellations, delivery delays and increased risk around receivable collection, including a potential A$10 million provision. A return of tender activity, product deliveries and cash collection would indicate that this part of the downgrade was principally timing-related rather than a permanent loss of demand.

We are also looking for a recovery in European procedures. Hospital capacity constraints have created growing waiting lists in the UK and Germany, while industrial action has limited surgical throughput in Italy and Spain. Waiting lists provide some evidence that procedures have been deferred rather than permanently lost. The important signpost will be whether hospital capacity improves, and delayed procedures convert into implant volumes over subsequent periods.

For the existing product portfolio, we want evidence that Cochlear can use Nexa's upgradeable firmware to create meaningful clinical differentiation. Initial adoption has been encouraging—Nexa represented approximately 80% of December implant units and contributed to market-share gains at the end of the first half—but the next test is whether software upgrades can improve hearing in noise, diagnostics, battery performance or stimulation strategies. Successful upgrades would strengthen the value of joining the Cochlear ecosystem and make it harder for competitors to displace the platform.

On profitability, we are looking for management's cost actions to stabilise the current 73% gross margin and establish a path back toward historical levels as product mix and factory utilisation improve. We do not require an immediate return to pre-COVID levels of profitability, but we do expect restructuring expenditure to decline, support costs to become more efficient and production overhead recovery to improve as volumes normalise.

Most importantly, we are looking for evidence that the totally implantable system can expand the category rather than simply replace conventional implants. Relevant signposts include clinical safety, reliability, battery performance, speech outcomes, regulatory submissions and evidence of interest from adults who previously rejected an external processor. With the OECD's 80-plus population projected to grow by 40% over the coming decade—and an existing potential audiometric assessment pool of roughly 7 million people—the ability of a fully implantable device to improve adult adoption would be the most significant potential driver of long-term value.

SIGNIFICANT CONTRIBUTORS FOR THE QUARTER INCLUDED:

TSMC

TSMC's shares rose 41% in 2Q2026. The demand for TSMC's leading edge logic chips continued to strengthen with the company reporting USD revenue growth of 40% for the first quarter and expanding margins. TSMC is the largest scaled manufacturer of leading-edge logic chips and as a result is the sole foundry for all major AI logic chips, in addition to having dominant positions in smartphone CPUs and networking chips. TSMC continues to rapidly innovate with higher density wafers and more advanced packaging tools for customers. Despite this dominant position in leading edge technology, TSMC has refrained from aggressively raising price, taking a long-term view that has led to the value of their leading edge wafers being substantially higher than the price they charge.

SAFRAN

Safran's shares rose 23% in 2Q2026. Safran reported continued strength in its core engine aftermarket franchise with spare parts revenue growing 29% and services growing 43% in the first quarter. Despite the strong underlying growth to start the year, the stock was pressured in the first quarter due to slowing flying hours and high jet fuel prices as a result of the Iran war. The stock moved back towards its pre-war high as the conflict ended towards the end of the quarter.

JAMES HARDIE

James Hardie's share price increased 46% in 2Q2026. JHX reported strong FY26 results in mid-May, and the stock rallied 39% from that point through quarter-end. Adjusted EBITDA beat both guidance and consensus, driven by stronger-than-expected contributions from the ANZ and Europe segments, while free cash flow comfortably exceeded expectations. Management flagged ahead-of-schedule cost synergies from the AZEK merger and commercial synergies progressing as planned. The FY27 guide pointed to James Hardie's largest segment, Siding & Trim, to return to organic growth in FY27, a notable signal of confidence despite a still-challenging macro backdrop. Additionally, the passage of a landmark US housing-affordability bill sparked a broad homebuilder rally, while progress toward a US-Iran ceasefire pushed oil prices lower and eased inflation and interest-rate expectations.

DETRACTORS FOR THE QUARTER INCLUDED:

TRADEWEB

Thesis:

Why it underperformed: Shares fell 15% in 2Q2026. The fall was largely due to strong growth in the previous comparable period as well as a broader sector derate due to the introduction of perpetual futures. Trading volumes through the quarter were slightly weaker than expected. This was heavily exacerbated by the abnormally strong April 2025 volumes creating a tough comparable.

What we did to re-underwrite (case / valuation): We continually monitor changes in volume and pricing trends amongst the key business lines at Tradeweb. Tradeweb continues to hold a dominant position in its core Rates franchise which is powered by continued government debt growth, electronification of markets and a mix shift towards higher yielding emerging markets. While the launch of perpetual futures creates regulatory and product uncertainty for certain exchange operators, Tradeweb has a highly sophisticated institutional customer base who require specific fixed income products and protocols. The business trades at historically low valuations (23X FY2026 Cash P/E) with a long runway for double digit earnings growth and a healthy net cash balance sheet.

LIPPERT INDUSTRIES (LCII)

Thesis:

Why it underperformed: Shares fell 12% in 2Q2026, despite Q1 sales and earnings that beat expectations and led the company to upgrade full year guidance. The fall was largely due to higher interest rates as investors became concerned that recreational vehicle (RV) sales would be impacted by higher rates due to the Iran war.

Operationally, the company announced the resignation of the CEO and Chairman of the business, both longstanding members of the executive team. The end of the quarter saw a proposed merger with Patrick Industries. Like LCII, Patrick Industries is based in Elkhart, Indiana and is focused on the RV sector, specialising in the indoor fixtures and finishes of an RV. Like LCII, they are dominant within their verticals.

What we did to re-underwrite (case / valuation): We've written before about the LCII story and its dominant positions in several key components for the RV industry including the chassis, windows and axles as well as strong leadership positions in the marine sector. The investment was based on the accretive value of recent M&A transactions, the optimisation of their operating cost base (a cost out program is underway) and the continued gradual increase in market share in RV components owing to their strong structural position. Our financial model suggests free cash flow could grow at a double-digit rate over next 5 years, which is not adequately reflected in the 13x FCF FY2026 trading multiple. The resignation of the CEO and President and the proposed merger with a scaled and highly complementary competitor changes the investment case. We are engaging with the management teams of both businesses to try to understand the challenges and opportunities of the merger but have significantly reduced our position given the changed thesis the merger presents.

ASIC Periodic Reporting Requirements

The System Capital Long Short Fund (Fund) is classified as a hedge fund in accordance with the Australian Securities and Investments Commission Regulatory Guide 240 *Hedge funds: Improving disclosure.* We are required to provide this additional information to you on a quarterly basis.

Asset Allocation (as at 30 June 2026)

Exposure analysis	
Position	**% of net invested capital**
Long securities (including derivatives)	168.50
Short	-78.91
Cash	10.40
Gross equity exposure	247.41
Net equity exposure	89.60

Maturity profile

As at 30 June 2026, the Fund does not have any material liabilities.

Derivative counterparties engaged

The derivative counterparties engaged for the period 1 July 2025 to 30 June 2026 are provided in the table below.

Derivatives counterparty
Morgan Stanley & Co. Prime Broker International plc

Liquidity profile

The table below demonstrates the liquidity profile of the Fund as at 30 June 2026.

In summary, 100% of the Fund's assets can be liquidated within 10 days.

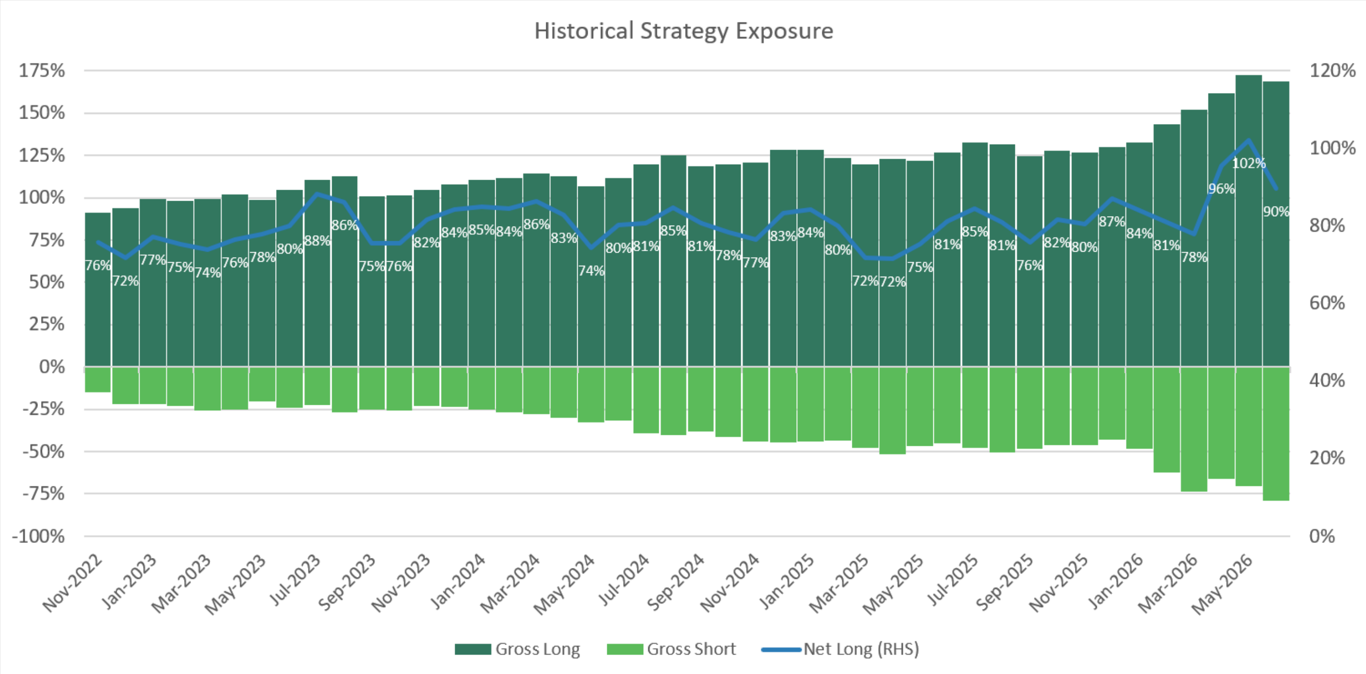
Time to liquidate	% of assets
Within 1-10 days	100%
>10 to 21 days	100%
> 21 days	100%

Leverage

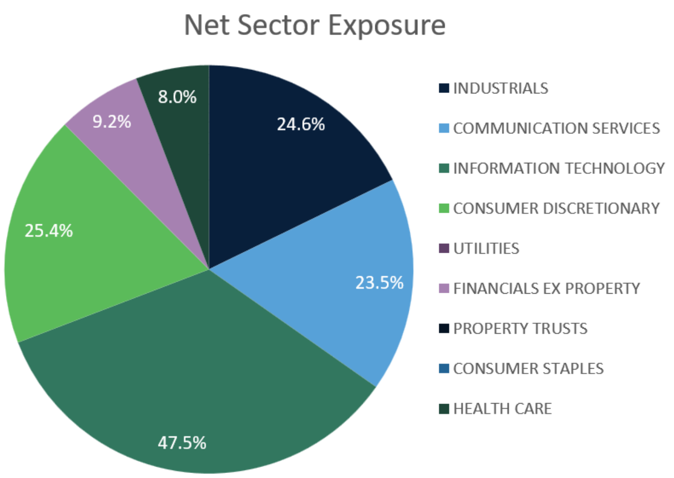
System Capital may use leverage to increase the exposure of the Fund to investment markets. Leverage will generally be obtained through the use of derivative instruments. Although the maximum allowable leverage permitted in the Fund is 150% of the Fund's NAV, the Fund's positions in long securities and derivatives and overall net equity exposure will generally not exceed 150% of the Fund's NAV. The Fund must provide collateral to secure its obligations under the relevant agreements.

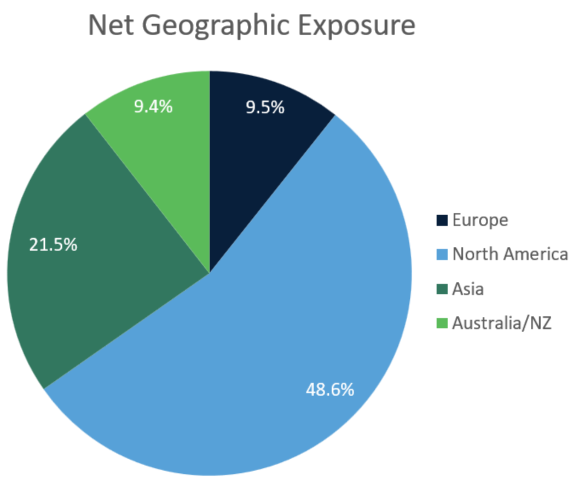
As at 30 June 2026, the Fund is long exposure of 168.50% and short exposure of -78.91%. The gross equity exposure of the Fund is 247.41% and net equity exposure of the Fund is 89.60%.

STRATEGY EXPOSURE



SECTOR AND GEOGRAPHIC EXPOSURE





PORTFOLIO TOP 10 ACTIVE STOCKS (ALPHABETICAL)

Issuer	Issuer Name
ADYEN NL	Adyen NV
AMZN US	Amazon.com Inc
CLNX ES	Cellnex Telecom SA
MA US	Mastercard Inc
MSCI US	MSCI Inc
PCTY US	Paylocity Holding Corp
SAF FR	Safran SA
2330 TW	Taiwan Semiconductor Manufacturing Co Ltd
VEND NO	Vend Marketplaces ASA
V US	Visa Inc