Yarra Emerging Leaders Fund

Gross returns as at 31 December 2020

	1 month %	3 months %	1 year %	3 years % p.a.	5 years % p.a.	10 years % p.a.	Since inception* % p.a.
Yarra Emerging Leaders Fund	2.83	12.70	6.26	8.99	8.42	10.70	11.53
Emerging Leaders Combined Benchmark†	3.07	15.38	13.13	8.17	12.09	6.99	7.45
Excess return (before fees)‡	-0.24	-2.67	-6.87	0.82	-3.67	3.71	4.08

Past performance is not a reliable indicator of future performance. Taxes payable by investors have not been taken into account. The figures shown have been provided for illustrative purposes – they are unaudited and subject to change. The total returns shown are gross of all management costs, meaning they do not reflect the deduction of any investment management fees and expenses which would reduce returns and assume reinvestment of all distributions. Investment in the fund is not available on a fee free basis and this should be factored into any analysis of past performance.

Net returns as at 31 December 2020

	1 month %	3 months %	1 year %	3 years % p.a.	5 years % p.a.	10 years % p.a.	Since inception* % p.a.
Yarra Emerging Leaders Fund	2.72	12.35	4.94	7.64	7.08	9.33	10.23
Emerging Leaders Combined Benchmark†	3.07	15.38	13.13	8.17	12.09	6.99	7.45
Excess return (after fees)‡	-0.34	-3.02	-8.19	-0.53	-5.01	2.34	2.78

Past performance is not a reliable indicator of future performance. Taxes payable by investors have not been taken into account. The figures shown have been provided for illustrative purposes – they are unaudited and subject to change. The total returns shown are prepared on an exit to exit basis – they include all ongoing fees and expenses and assume reinvestment of all distributions.
* Inception date Yarra Emerging Leaders Fund: September 1997
† Comprising 50% S&P/ASX Midcap 50 Accumulation Index and 50% S&P/ASX Small Ordinaries Accumulation Index
‡ Excess return: The difference between the Fund's return and the benchmark return.

Market review

Australian equities rose alongside global markets in the December 2020 quarter, driven by positive vaccine news, higher commodity prices and a decisive US election outcome.

The Emerging Leaders Benchmark returned 15.4% for the quarter, taking its 2020 return to +13.1%. In comparison, the broader ASX 300 returned 13.8% for the quarter and +1.7% for the year. Markets surged globally after three major COVID-19 vaccine candidates were announced as highly effective in extensive trials, and after Joe Biden was declared the winner of the US Presidential Election.

Sectors which were hit hardest by COVID-19 rallied sharply. Energy (+24.8%) was the strongest performer as Brent Crude lifted 29% to US$52 per barrel, led by Worley (WOR, +20.3%) and Beach Energy (BPT, +36.7%).

Other strong performers included the Regional Banks (+46.9%), Retail REITs (+23.8%) and Media & Entertainment (+24.6%). Consumer Discretionary (+11.4%) also rallied, though it faded late in the quarter as border restrictions were reimposed across Australia in response to new COVID clusters.

Conversely, sectors which had proved resilient during the downturn – Gold (-11.4%), Utilities (+1.0%) and Health Care (+4.6%) – underperformed. At a stock level, the worst performers included Regis Resources (RRL, -25.3%) and Mesoblast (MSB, -55.7%). Information Technology (+19.4%) was the exception, driven by Afterpay (APT, +47.5%) as the Buy-Now, Pay-Later market leader entered the S&P/ASX 20 Index.

Portfolio review

Key Contributors

Link Group (LNK, overweight) – the share registry company outperformed after receiving two takeover offers from a consortium comprising Pacific Equity Partners (PEP) and Carlyle Group and, subsequently, a competing takeover offer from US company SS&C Technologies. LNK rejected both the consortium and SS&C's offers (at $5.40 and $5.65 per share respectively) on the grounds that they did not represent compelling value, but granted both parties due diligence. Subsequent to month-end SS&C withdrew its offer. The consortium's offer – which remains on the table – values LNK's base business on 14.6 times FY22 earnings which compares to 16.1 times for listed peer CPU. The implied valuation multiple of PEXA is 15.5 times EV/EBITDA compared to globally listed equity exchanges which trade on more than 20 times forward EV/EBITDA and growth oriented domestic marketplaces such as SEK, CAR and REA which trade on 26 times forward EV/EBITDA. Our positive view of PEXA is premised on infrastructure like characteristics of the property settlement exchange upon maturity supplemented by numerous growth opportunities in immediate adjacencies.

Nanosonics (NAN, overweight) – the disinfection medical device maker outperformed after issuing a well-received trading update. Both its consumables and hardware business lines have rebounded in FY21 to date from the COVID-impacted months of FY20, with sales up +25% and +16% respectively. Despite US hospitals handling record COVID cases, second-wave impacts have been less severe due to better equipment and preparation. We remain overweight the company, premised on the growing acceptance of its proprietary product translating into higher earnings growth. NAN's product, Trophon, is the global market leader with over a 50% market share in North America. As regulatory change relating to disinfection protocols continues to drive adoption of NAN's products, the sale of consumables for its devices generates a high-quality, annuity-style revenue stream. NAN also has a strong balance sheet – it is in a net cash position – to fund future growth and support ongoing product innovation.

Evolution Mining (EVN, underweight) – the gold miner retraced prior outperformance, largely in line with peers, as the gold price ended flat at $US1,888 during the period. We are underweight EVN based on its stretched valuation metrics (7.7 times forward EV/EBITDA), with our preferred exposures instead being Regis Resources (RRL), Saracen Minerals (SAR) and diversified miner Independence Group (IGO). RRL trades at a relatively attractive valuation given its cash flow and earnings profile, SAR has meaningful production growth through its recent Superpit acquisition and reliable operating performance from its other mines, while IGO has a 30% exposure to gold through its Tropicana mine, which we regard as a world-class reserve.

IGO Limited (IGO, overweight) – the nickel and gold miner outperformed after announcing the acquisition of a non-controlling interest in the Greenbushes lithium mine in Western Australia for $US1.4bn. The purchase is funded through a combination of $A1.1bn in new debt facilities, an equity raising of up to $A766mn and existing cash. We support the acquisition for several reasons. Not only does it give IGO exposure to a high-quality, long-dated asset (>20 years mine life), but it also completes IGO's suite of battery commodities with the company already producing nickel, copper and cobalt. We also think the purchase price was reasonable, with Greenbushes likely to be NPV and EPS accretive by FY23, assuming well below mid cycle lithium prices. We also hold a positive view of IGO's Nova asset – a world-class reserve which supports an increasing production profile – and expect its Tropicana gold asset to be divested in the short term, supporting the balance sheet.

Mesoblast (MSB, underweight) – the biotechnology company underperformed after terminating its trial for a COVID-19 treatment on the grounds it wouldn't meet its primary endpoint and, separately, announced disappointing trial results from its long-running heart failure treatment. The news supported our underweight to the company based on its speculative risk profile: not only is the company currently loss making, but it remains highly uncertain whether its treatments will receive regulatory approval and achieve successful commercial launches

Key Detractors

Afterpay (APT, underweight) – the payment solutions provider outperformed after announcing a strategic partnership with Westpac Bank (WBC), under which APT will be able to offer transaction and savings accounts from FY21 to its Australian customers. The company also announced a 1Q20 business update ahead of consensus expectations, with gross merchandise volume (GMV) up 155% y/y to $4.1bn and customer net adds up 1.3mn to 11.2mn. Lastly, the stock was promoted to the S&P/ASX 20 Index during the period, effective 21 December. Our negative view of APT premised on several factors. In the short term, we believe APT's valuation does not reflect the uncertainty associated with COVID-19 despite the company's strong balance sheet position. While APT's loss rates are low so far, it remains extremely early in the bad debt cycle (where APT is exposed as an unsecured consumer lending business). In addition, APT's long-term risks remain, including heightened regulation (e.g. expense verification), increased competition (such as from PayPal) and the sustainability of the company's attractive margins.

Xero (XRO, underweight) – the accounting software provider outperformed during the period without any materially positive news. The firm announced a $US700mn convertible notes offering which, given XRO's current strong free cash flow from cost savings during COVID, increased speculation that XRO is about to undertake M&A. We are underweight the accounting software provider because we believe its strong growth outlook is fully factored into its valuation, but its potential risks are not. XRO trades at 23.0 times EV/sales, reflecting lofty expectations for subscriber growth to accelerate as the company continues to expand overseas and for add-on products and services to drive higher average revenue per user (ARPU). However, international expansion carries significant risks due to greater competition in more fragmented markets, with significant ongoing product reinvestment required for XRO to maintain its advantages relative to peers.

Saracen Minerals (SAR, overweight) – the gold miner partially retraced outperformance as the gold price remained flat at $US1,888 during the period, but outperformed peers as it announced a merger with Northern Star (NST). We see the business combination as logical, with highly complementary operations (the Superpit joint venture) and organisational cultures, and the synergy metrics as attractive (A$1.5-2.0bn pre-tax NPV). On valuation, we see the potential for NST to re-rate to peer

Newcrest Mining (NCM, 6.7 times forward EV/EBITDA) given its comparable size and growing production profile in Western Australia and Alaska.

Elders (ELD, overweight) – the agribusiness partially retraced strong outperformance from prior periods despite delivering a better-than-expected FY20 result. EBIT came in at $119.4mn – 8% ahead of forecasts – largely due to market share gains in livestock and a higher real estate contribution. While the company didn't provide earnings guidance, it reiterated its target for 5-10% EBIT and EPS growth through the cycle and a ROIC of 15%. However, livestock prices are expected to decline from elevated levels in 2021. We remain overweight the company. We are supportive of its recent acquisition of Australian Independent Rural Retailers (AIRR), which expands ELD into the rural merchandise market and is expected to be earnings accretive in FY21. More broadly, we continue to see cyclical upside, the potential for further accretive acquisitions, a simplified capital structure relative to prior years and modest valuation. The company has strong corporate appeal given its attractive business segments, and we see its 12-month forward P/E multiple of 12.4 times as supportive.

Regis Resources (RRL, overweight) – the gold miner underperformed during the period following a disappointing 1Q20 production update. RRL produced 81,500 ounces of gold at an AISC of $A1,400 per ounce for the quarter, driven by a pit wall slip and lower-than-expected grades. However, management maintained FY21 guidance for 355-380,000 ounces at an AISC of $A1,23-1,300 per ounce as production is weighted to 2H20. We view RRL as being relatively attractive versus its peers due to its valuation (at a forward P/E of 7.1 times and EV/EBITDA of 3.5 times), well below the wider sector. Furthermore, RRL has a relatively strong cash flow and earnings profile, despite lower production growth and an optically higher AISC. Lastly, RRL's 2mn ounce McPhillamys project – which is currently moving through the NSW approval process – represents additional upside which is not recognised by the market at this time.

Key Purchases

Tassal (TGR) – we established a small position in the salmon and prawn producer during the period. The company has a high fixed cost base, solid volume growth outlook (by increasing both salmon numbers and size) and the potential for margin expansion (as productivity improves and salmon pricing remains positive). Though export markets face short-term uncertainty due to China trade tensions and supply chain disruptions relating to COVID-19, we see these headwinds as fully reflected in the valuation (at 13.3 times forward earnings) and to be offset by strong growth in the domestic retail and wholesale market.

IGO Limited (IGO) – we took part in the diversified miner's capital raising during the period to fund its $US1.4bn Greenbushes acquisition. The purchase is funded through a combination of $A1.1bn in new debt facilities, an equity raising of up to $A766mn and existing cash. We support the acquisition for several reasons. Not only does it give IGO exposure to a high-quality, long-dated asset (>20 years mine life), but it also completes IGO's suite of battery commodities with the company already producing nickel, copper and cobalt. We also think the purchase price was reasonable, with Greenbushes likely to be NPV and EPS accretive by FY23. We also hold a positive view of IGO's Nova asset – a world-class reserve which supports an increasing production profile – and expect its Tropicana gold asset to be divested in the short term, supporting the balance sheet.

Deterra Royalties (DRR) – we established a position in DRR as it demerged from portfolio position Iluka Resources (ILU) and listed on the ASX during the period. We hold a positive view of DRR's Mining Area C (MAC) royalty, which entitles the company to receive 1.232% of iron ore revenue generated from BHP Group (BHP)'s Mining Area C mine and, in addition, an annual capacity payment of $1mn for every million tonne increase in exports from the area. In our view the royalty was undervalued at an FY22 EV/EBITDA of 12 times and offering a 6% FY22 dividend yield

Key Sales

Regis Resources (RRL) – we reduced our position in the gold miner to fund our preferred exposure Saracen Minerals (SAR). However, we remain overweight the company. We view RRL as attractive due to its valuation (at a forward P/E of 7.1 times and EV/EBITDA of 3.5 times), well below the wider sector. Furthermore, RRL has a relatively strong cash flow and earnings profile, despite lower production growth and an optically higher AISC. Lastly, RRL's 2mn ounce McPhillamys project – which is currently moving through the NSW approval process – represents additional upside which is not recognised by the market at this time.

Elders (ELD) – we reduced our position in the agribusiness company following recent outperformance, but remain overweight. We are supportive of its recent acquisition of Australian Independent Rural Retailers (AIRR), which expands ELD into the rural merchandise market and is expected to be earnings accretive in FY21. More broadly, we continue to see cyclical upside, the potential for further accretive acquisitions, a simplified capital structure relative to prior years and modest valuation. The company has strong corporate appeal given its attractive business segments, and we see its 12-month forward P/E multiple of 12.4 times as supportive.

Collins Foods (CKF) – we trimmed our position in the fast service restaurant company early in the period following outperformance but remain overweight. We hold a positive view of both its KFC and Taco Bell businesses as well as the company's strong balance sheet. Following its resilient performance during the COVID-19 downturn (due to drive-through and home delivery services), the KFC Australia division (80% of sales) is well placed to grow the number of its stores, like-for-like sales and improve its margins. CKF also has an attractive growth platform in Germany and the

Netherlands, which, while delayed, offers the potential for store numbers to more than triple over the long term

Key Active Overweights

Link Group (LNK) – we remain overweight the company because we continue see compelling value in its base share registry business and electronic conveyancing business PEXA. The Carlyle/PEP consortium's offer values LNK's base business on 14.6 times FY22 earnings which compares to 16.1 times for listed peer CPU. The implied valuation multiple of PEXA is 15.5 times EV/EBITDA compared to globally listed equity exchanges which trade on more than 20 times forward EV/EBITDA and growth oriented domestic marketplaces such as SEK, CAR and REA which trade on significantly higher forward EV/EBITDA multiples. Our positive view of PEXA is premised on infrastructure like characteristics of the property settlement exchange upon maturity supplemented by numerous growth opportunities in immediate adjacencies.

Nanosonics (NAN) – our overweight position is premised on the growing acceptance of the company's proprietary product, translating into higher earnings growth. The product, a disinfection medical device called Trophon, is the global market leader with over a 50% market share in North America. As regulatory change relating to disinfection protocols continues to drive adoption of NAN's products, the sale of consumables for its devices generates a high-quality, annuity-style revenue stream. NAN also has a strong balance sheet – it is in a net cash position – to fund future growth and support ongoing product innovation.

Atlas Arteria (ALX) – we maintain a high-conviction overweight position based on ALX's strong liquidity and balance sheet position, which leaves it well placed to weather the COVID-19 related downturn in revenues for FY20, and a positive long-term view. ALX holds attractive, long-duration assets and trades at a discounted valuation (12 times normalised EV/EBITDA), which more than captures the disruption from COVID-19 as travel restrictions and lockdowns reduce traffic volumes in the short term. We continue to believe the intrinsic value of ALX's assets will eventually be realised following the simplification of its ownership structure in the past two years, resulting in significant upside.

Worley (WOR) – our positive view of the company is premised on our belief that WOR is in a strong position to withstand an economic slowdown and lower oil prices, with significant refinancing headroom and business diversification across different markets. We believe WOR's valuation provides significant support at current levels, with the stock trading on 12.9 times two-year forward earnings – a cyclical low multiple despite its more resilient earnings base.

Healius (HLS) – we are overweight the health care company based on a positive view of its pathology and diagnostic imaging divisions and continue to see its valuation as supportive. The recent sale of the medical centre business addresses concerns about HLS's balance sheet (with net debt falling to 1.7 times in FY21) and enables management to focus on and invest in the pathology and diagnostic imaging businesses, which are return on invested capital (ROIC) accretive and have significant margin opportunities. We do not believe this is captured by consensus with HLS trading at 19.4 times forward earnings – below peer Integral Diagnostics (IDX) at 23.0 times

Key Active Underweights

Northern Star (NST) – we were underweight NST based on its stretched valuation metrics (7.2 times forward EV/EBITDA), with our preferred exposures Regis Resources (RRL), Saracen Minerals (SAR) and diversified miner Independence Group (IGO). However, NST has announced a merger with SAR, with SAR shareholders receiving 0.3763 NST shares for every SAR share. We see the business combination as logical, with highly complementary operations (the Superpit joint venture) and organisational cultures, and the synergy metrics as attractive (A$1.5-2.0bn pre-tax NPV). On valuation, we see the potential for NST to re-rate to peer Newcrest Mining (NCM, 6.7 times forward EV/EBITDA) given its comparable size and growing production profile in Western Australia and Alaska.

Tabcorp (TAH) – we are underweight the gambling services provider because we believe earnings expectations are too optimistic and regard the market's valuation, at 24.3 times 12-month forward P/E, as stretched. Our key concern is the outlook for the conventional wagering business, which operates in a low growth industry and with high levels of competition, placing intense pressure on its traditional retail distribution strategy.

Evolution Mining (EVN) – we are underweight EVN based on its stretched valuation metrics (7.7 times forward EV/EBITDA), with our preferred exposures instead being Regis Resources (RRL), Saracen Minerals (SAR) and diversified miner Independence Group (IGO). RRL trades at a relatively attractive valuation given its cash flow and earnings profile, SAR has meaningful production growth through its recent Superpit acquisition and reliable operating performance from its other mines, while IGO has a 30% exposure to gold through its Tropicana mine, which we regard as a world-class reserve.

Magellan Financial Group (MFG) – we are underweight MFG because we believe its valuation overstates the sustainable earnings growth outlook. While the company has a very strong franchise and is highly cash generative, it has now largely gone ex-growth with its core global product now closed to new institutional investors. MFG trades at 20.7 times forward earnings, which we believe is excessive for a business that is now increasingly reliant on underlying market investment performance (i.e. Beta) for future growth, particularly in the current environment.

REA Group (REA) – we are underweight the real estate online classifieds company on the grounds that its positive outlook is fully factored into its valuation (at 54.6 times forward earnings), and more compelling opportunities in the space exist elsewhere. We currently own Carsales.com

(CAR) and SEEK (SEK), which in our view trade at more compelling valuations, are market leaders in their industries and have strong growth prospects outside of Australia

Market outlook

The recovery phase for the Australian economy is now well underway. Despite the concerning trends for new COVID-19 cases in the US and Western Europe as a new more contagious variant spreads, global economic data has continued to show solid improvement through Q3 and into Q4 2020. While it is reasonable to expect this positive data momentum will moderate as renewed lockdowns commence through Europe, Australia remains in a much stronger position despite recent clusters emerging from hotel quarantine failures. Economic recovery is occurring even faster than our relatively optimistic forecasts and economic growth now looks set to contract by less than 3% in 2020 before expanding by a forecast 5.5% in 2021.

The driving force of the recovery into 2021 will be consumption growth. The combination of the highest household saving ratio since the mid-1970 in concert with resilient asset prices, declining unemployment, rising hours worked and improving consumer confidence is expected to underpin a 7.0% rise in consumption growth in 2021. Although concerns have persisted over fiscal fade via lapsing fiscal stimulus measures, our analysis has long suggested that the extension of some fiscal programs, the pull forward of income tax cuts and the recovery in labour income as furloughed workers return to work is sufficient to avoid a bout of fiscal fade weighing in household income growth.

A secondary force assisting the recovery is the upswing in new housing approvals, new housing orders, and housing finance approvals. Despite a sharp drop in net migration and earlier concerns over house price declines, sentiment regarding housing has been buoyed by record low interest rates, a shift in responsible lending onus back to the borrower and large government incentives for construction.

Our expectation is that looking beyond the US election, additional expected fiscal stimulus in the US, additional expected QE in major offshore markets and a new QE program in Australia will leave a pro-growth fiscal and financial conditions environment for Australian economic growth and earnings growth.

The RBA's explicit aim of QE is to lower Australian longer term bond rates and lower the A$. We expect the RBA to be partially successful in moderating the appreciation of the A$, however, upward pressure on the A$ will likely remain as the global economic recovery continues. We expect the A$ to finish calendar 2020 at 75c and 2021 at 80c.

We see significant value in certain sectors but believe others to be overvalued based on our earnings and cash flow expectations. We are most overweight stocks within the Health Care, Communication Services and Industrials sectors, but are underweight Financials, Information Technology and Real Estate.

Sector allocation

	Portfolio %	Benchmark %	Active %
Communication Services	14.74	8.26	6.48
Consumer Discretionary	9.20	13.99	-4.79
Consumer Staples	5.31	4.64	0.66
Energy	4.09	4.58	-0.49
Financials	3.63	11.36	-7.73
Health Care	14.81	6.83	7.99
Industrials	11.91	9.92	2.00
Information Technology	7.86	7.25	0.62
Materials	24.17	22.92	1.25
Real Estate	2.63	8.92	-6.28
Utilities	0.00	1.34	-1.34

Top 5 holdings

	Portfolio %	Benchmark %	Active %
Atlas Arteria	4.58	1.21	3.37
Link Administration	4.42	0.57	3.85
Nanosonics	4.20	0.44	3.76
IGO	3.70	0.89	2.81
Worley	3.59	0.71	2.88

Key active positions

Overweights	Portfolio %	Benchmark %	Active %
Link Administration	4.42	0.57	3.85
Nanosonics	4.20	0.44	3.76
Atlas Arteria	4.58	1.21	3.37
Underweights			
Northern Star Resources	0.00	1.82	-1.82
Tabcorp	0.00	1.68	-1.68
Evolution Mining	0.00	1.65	-1.65

Portfolio holdings may not be representative of current or future investments. The securities discussed may not represent all of the portfolio's holdings and may represent only a small percentage of the strategy's portfolio holdings. Future portfolio holdings may not be profitable.

Income and growth

	1 year %	3 years % p.a.	5 years % p.a.	10 years % p.a.
Growth return	3.78	5.95	5.28	6.89
Distribution return	1.17	1.69	1.80	2.44

The Growth Return is measured by the movement in the Fund's unit price (inclusive of fees), ex-distribution, and can be positive or negative as the unit price can fluctuate with changes in the underlying market value of the Fund's assets. The Distribution Return is the amount that is paid to unitholders by way of income distribution in a 12-month period. It does not include capital distributions.

Features

Investment objective	To achieve medium-to-long term capital growth through exposure to small and medium sized Australian companies that are considered to possess strong capital growth potential. In doing so, the aim is to outperform the benchmark over rolling 3-year periods.	
Recommended investment time frame	5 - 7 + years	
Fund inception	September 1997	
Fund size	Pooled Fund A$156.1 mn as at 31 December 2020	
APIR codes	JBW0010AU	
Estimated management cost	1.25% p.a.	
Buy/sell spread	+/- 0.20%	
Platform availability	Asgard BT Wrap Hub24	Macquarie Wrap Consolidator

Investment performance comparison of $50,000

After fees, since inception of the Yarra Emerging Leaders Fund, September 1997 to December 2020.

For illustrative purposes only. Past performance does not guarantee future results, which may vary. The total net fund returns shown are prepared on an exit to exit basis (i.e. they include all ongoing fees and expenses and assume reinvestment of all distributions). They do not take personal taxation into account. The comparison with the benchmark (comprising 50% S&P/ASX Midcap 50 Accumulation Index and 50% S&P/ASX Small Ordinaries Accumulation Index) is for comparative purposes only. Index returns do not allow for transactional, management, operational or tax costs. An index is not managed and investors cannot invest directly in an index.

Applications and contacts

Investment into the Yarra Emerging Leaders Fund can be made by Australian resident investors only.

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Disclaimers

The Yarra Emerging Leaders Fund is substantially invested in the Yarra Emerging Leaders Pooled Fund ('Pooled Fund'). References in this document to the underlying assets or investments of the Fund generally relate to the assets held in the Pooled Fund. The Fund's benchmark comprises 50% S&P/ASX Midcap 50 Accumulation Index and 50% S&P/ASX Small Ordinaries Accumulation Index.

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