

Yarra Emerging Leaders Fund

Gross returns as at 31 January 2021

	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	-0.67	9.59	2.83	8.50	8.72	10.73	11.45
Emerging Leaders Combined Benchmark†	-0.67	10.99	8.02	8.05	12.94	7.13	7.39
Excess return (before fees)‡	0.01	-1.40	-5.19	0.45	-4.21	3.60	4.07

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 January 2021

	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	-0.77	9.25	1.56	7.16	7.38	9.36	10.15
Emerging Leaders Combined Benchmark†	-0.67	10.99	8.02	8.05	12.94	7.13	7.39
Excess return (after fees)‡	-0.10	-1.75	-6.46	-0.89	-5.56	2.23	2.77

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 declined in January as global factors overshadowed stronger economic data domestically.

The Emerging Leaders Benchmark ended January -0.7% lower, taking its 12-month return to +8.0%. In comparison, the broader ASX 300 was flat as the banks provided support, with the sector leveraged to improving economic data domestically. Employment is now only 0.5% below December 2019 levels and home lending continued to surge, led by construction of new dwellings (+94% y/y).

Globally, the MSCI World Index and S&P500 retreated -0.7% and -1.0% respectively during the month due to uncertainty around the new COVID UK and South African variants, weaker US economic data and as retail investors coordinated high profile short squeezes on select stocks.

Within the benchmark, Consumer Discretionary (+3.1%) supported returns as companies like Breville Group (BRG, +13.5%), JB Hi-Fi (JBH, +6.5%) and Harvey Norman (HVN, +13.9%) continued to benefit from strong consumer demand for electronics and homeware goods.

Conversely, Information Technology (-4.7%) weighed on the benchmark. Tyro Payments (TYR, -21.0%) declined following an extended outage for its payment terminals,

while Link Group (-13.9%) fell after one suitor walked away from a takeover offer. Other main detractors at a sector level were Real Estate (-3.8%), Energy (-3.5%) and Transportation Infrastructure (-3.0%).

Portfolio review

Key Contributors

Bingo Industries (BIN, overweight) – the waste management company outperformed after receiving a non-binding indicative takeover offer from a consortium comprising CPE Capital and Macquarie Infrastructure and Real Assets (MIRA). The proposal came in two forms: a cash offer at \$3.50 per share, representing a 28% premium to last close, or a mix of cash and unlisted scrip at a lower upfront cash price. We remain overweight based on our positive long-term view of the company, which we see as attractive at current levels regardless of the outcome of the takeover bid. As the waste management environment normalises, BIN is well positioned to take market share given its vertically integrated business model, attractive growth projects (particularly within Infrastructure) and interstate expansion opportunities.

Incitec Pivot (IPL, overweight) – the company outperformed in response to improved fertiliser prices, with the ammonia February contract rising to \$US330/t – 40% above its average price in FY20. Our positive view remains premised on key commodities (urea and DAP) reverting to mid-cycle levels. Furthermore, other factors which had weighed on performance throughout FY19 and FY20 – weather-related issues, plant outages and COVID-related disruption – are now largely behind the company. Lead indicators suggest higher demand for the commodities and the explosives business is experiencing more stable pricing as mining demand normalises in North America. At 16.1 times two-year forward earnings, IPL trades well below the wider Industrials sector (at 25.0 times).

Polynovo (PNV, underweight) – the biotechnology company declined in value following a disappointing 1H21 trading update in which sales grew 31%, well below consensus forecasts for growth to double, with management also lowering expectations for 2H21 due to uncertain patient volumes. The update supported our underweight to the stock; that its market valuation (still at P/Sales of 31.0 times) doesn't sufficiently capture risks to the company's growth outlook. While its product has a strong value proposition, sound science and should win market share, we believe commercialisation risks are not captured in the multiple and further significant upside relies on PNV expanding from its current market (acute wounds) to others (chronic wounds, hernias) – involving significant uncertainty and execution risk.

Key Detractors

Nanosonics (NAN, overweight) – the medical disinfection device company underperformed without any material news during the period. 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 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.

Link Group (LNK, overweight) – the company underperformed after one of its suitors, SS&C, withdrew its offer. The PEP/Carlyle 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 268 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. We support LNK's move to

prioritise the trade sale process of PEXA, which in our view will unlock material value.

Beach Energy (BPT, overweight) – the oil & gas producer underperformed during the period after announcing a slightly weaker-than-expected 1Q21 result. Production came in 4-6% below analyst forecasts at 6.2MMboe, with the miss due to a number of factors including scheduled maintenance, unscheduled downtime and natural field declines. Nevertheless, FY21 guidance was unchanged at 26-28.5MMboe. We established a position in the company earlier in the period based on several factors. We see its valuation as appealing at an FY22 P/E of 10 times and 3.5 times EV/EBITDA, underpinned by low-risk gas contracts (which are likely to re-price higher) and its tangible organic growth platform (funded by a robust balance sheet). While FY21 and FY22 remain investment years for BPT to shore up future production volumes (Otway, Cooper, Western Flank), we see the medium-term investment proposition as attractive. We also support BPT's mandate to grow through further accretive M&A, the execution of which will likely require further equity.

Key Purchases

Beach Energy (BPT) – we established a position in the oil & gas producer during the period. We see BPT's valuation as appealing at an FY22 P/E of 10 times and 3.5 times EV/EBITDA, underpinned by low-risk gas contracts (which are likely to re-price higher) and its tangible organic growth platform (funded by a robust balance sheet). While FY21 and FY22 remain investment years for BPT to shore up future production volumes (Otway, Cooper, Western Flank), we see the medium-term investment proposition as attractive. We also support BPT's mandate to grow through further accretive M&A, the execution of which will likely require further equity.

Carsales.com (CAR) – we increased our position size in the automotive online classifieds company during the period. In the short term we expect demand for second-hand cars to remain elevated in both Australia and South Korea, driving upside to earnings versus consensus forecasts. In the long term our positive view is premised on the belief CAR should benefit from attractive earnings growth, conservative accounting (with low capitalisation of research and development investment) and undervalued international businesses

Key Sales

Incitec Pivot (IPL) – we reduced our position in the explosives and fertiliser maker following recent outperformance, but remain overweight. Our positive view remains premised on key commodities (urea and DAP) reverting to mid-cycle levels. Furthermore, other factors which had weighed on performance throughout FY19 and FY20 – weather-related issues, plant outages and COVID-related disruption – are now largely behind the company. Lead indicators suggest higher demand for the commodities and the explosives business is experiencing

more stable pricing as mining demand normalises in North America. At 16.1 times two-year forward earnings, IPL trades well below the wider Industrials sector (at 25.0 times).

NEXTDC (NXT) – we modestly trimmed our position for portfolio construction purposes, but remain overweight the data centre operator. We continue to believe NXT is structurally set to benefit from increasing adoption of cloud technology, and is accelerating its expansion to meet client demands by building new data centres which will support significant medium to longer term earnings growth.

Seven Group (SVW) – we modestly trimmed our position for portfolio construction purposes, but remain overweight the conglomerate. In our view the WesTrac (47% of its valuation) and Coates (25% of its valuation) businesses have strong long-term outlooks. The former, which provides equipment to the mining and construction industries, is set to benefit from customers both upgrading and purchasing new fleet following years of underinvestment. For the latter, we see improved utilisation and pricing of its equipment as infrastructure activity increases and is pushed out (extending the loan period for its products). Collectively, we see SVW as undervalued at 15.3 times forward earnings – a significant discount to the wider Industrials ex-Financials at 28.3 times

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 20.85 times forward EV/EBITDA and growth oriented domestic marketplaces such as SEK, CAR and REA which trade on significantly higher 268 times 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. We support LNK's move to prioritise the trade sale process of PEXA, which in our view will unlock material value.

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 (11 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.

Nanosonics (NAN) – our positive view towards the medical disinfection device company is 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 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

Key Active Underweights

Northern Star (NST) – we were underweight NST based on its stretched valuation metrics, at 6.7 times forward EV/EBITDA, and negative long-term view of the gold price. While we are positive towards the company's operations and its proposed merger with Saracen Minerals (SAR), we see significant downside risk to the commodity – at elevated levels of \$US1,800oz – amid an outlook for higher real interest rates (which are generally a headwind to the gold price). We maintain a small exposure to gold through diversified miner IGO Limited (IGO).

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, at 7.4 times forward EV/EBITDA, and negative long-term view of the gold price. While we are positive towards the company's operations, we see significant downside risk to the commodity – at elevated levels of \$US1,800oz – amid an outlook for higher real interest rates (which are generally a headwind to the gold price). We maintain a small exposure to gold through diversified miner IGO Limited (IGO).

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. 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-1970s 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 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, Real Estate and Consumer Discretionary.

Sector allocation

	Portfolio %	Benchmark %	Active %
Communication Services	15.49	8.39	7.10
Consumer Discretionary	9.34	14.51	-5.18
Consumer Staples	5.47	4.73	0.74
Energy	5.40	4.46	0.94
Financials	3.60	11.35	-7.75
Health Care	14.64	6.87	7.76
Industrials	12.37	9.97	2.39
Information Technology	6.93	6.96	-0.02
Materials	23.60	22.77	0.83
Real Estate	2.59	8.61	-6.02
Utilities	0.00	1.37	-1.37

Top 5 holdings

	Portfolio %	Benchmark %	Active %
Atlas Arteria	4.50	1.19	3.31
Link Administration	3.85	0.50	3.35
Independence Group	3.76	0.90	2.86
Nanosonics	3.61	0.38	3.24
Worley	3.60	0.71	2.88

Key active positions

Overweights	Portfolio %	Benchmark %	Active %
Link Administration	3.85	0.50	3.35
Atlas Arteria	4.50	1.19	3.31
Nanosonics	3.61	0.38	3.24
Underweights			
Northern Star Resources	0.00	1.87	-1.87
Tabcorp	0.00	1.73	-1.73
Evolution Mining	0.00	1.58	-1.58

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	0.43	5.47	5.57	6.92
Distribution return	1.13	1.68	1.81	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\$153.6 mn as at 31 January 2021	
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 January 2021.



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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