

# Yarra Emerging Leaders Fund

## Gross returns as at 31 May 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	-0.27	5.71	28.07	9.78	8.09	11.60	11.58
Emerging Leaders Combined Benchmark†	0.60	7.60	31.55	9.83	11.47	8.09	7.62
Excess return (before fees)‡	-0.86	-1.90	-3.47	-0.05	-3.38	3.51	3.96

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 May 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	-0.37	5.38	26.49	8.42	6.75	10.22	10.28
Emerging Leaders Combined Benchmark†	0.60	7.60	31.55	9.83	11.47	8.09	7.62
Excess return (after fees)‡	-0.97	-2.23	-5.05	-1.40	-4.71	2.13	2.66

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 modestly in May as Gold, REIT and Consumer discretionary more than offset weakness across Information Technology and Consumer Staples.

The Emerging Leaders Benchmark rose 0.6% during the month, taking its 12-month return to 31.5%. The benchmark underperformed the broader ASX300, which returned 2.3% as the major banks provided support on the back of the federal government's big spending federal budget – with \$96bn of stimulus announced over 5 years – and Australia's strengthening housing market.

Gold (+13.1%) outperformed alongside the commodity, up 7.5% during the period to \$US1,900/oz. At a stock level the largest benchmark contributors included Northern Star (NST, +11.3%), Evolution Mining (EVN, +16.9%) and Perseus Mining (PRU, +18.4%).

Elsewhere, REITs (+2.0%) were supported by Unibail-Rodamco-Westfield (URW, +7.2%), Ingenia Communities Group (INA, +5.7%) and Waypoint REIT (WPR, +4.0%). Within Consumer Discretionary (+1.4%) Corporate Travel Management (CTD, +12.7%) was seen as a beneficiary of the US re-opening, more than offsetting Flight Centre (FLT, -9.1%) which declined amid new border closures in Australia.

Conversely, within Information Technology (-6.0%) EML Payments (EML, -41.9%) faced pressure after an Irish regulatory body raised concerns about its PFS Card Services business, while Nuix (NXL, -33.1%) announced its 2nd downgrade in two months following its IPO in December 2020.

Consumer Staples (-4.3%) was weighed down largely by Costa Group (CGC, -27.0%). The horticultural company announced 1H21 earnings would only be marginally above the previous year, despite cycling a weak 1H20 and reporting significant growth in 2H20.

### Portfolio review

#### Key Contributors

**Kathmandu (KMD, overweight)** – the outdoor adventure retailer outperformed during the period without any material company-specific news. That being said, the company is seen as a key beneficiary of easing travel restrictions, particularly overseas. Following the resolution of the COVID crisis, our thesis remains premised on a positive view of its two acquisitions, Rip Curl and OBOZ, and its attractive category exposure as well as market share and margin expansion opportunities.

**EML Payments (EML, underweight)** – the virtual and physical card payments company declined sharply after an Irish regulatory body raised concerns about its PFS Card Services business. The concerns relate to the business's Anti-Money Laundering / Counter Terrorism Financing risk and control frameworks and governance. We remain underweight the company based on regulatory risk, which we believe will continue to weigh on sentiment given the uncertainty around timing and the binary nature of the pending outcome. If EML's licence to operate is revoked, this would equate to around 27% of revenue at risk and a similar amount of EBITDA. We believe this is not fully reflected with the stock trading at 27.5 times forward earnings.

**Collins Foods (CKF, overweight)** – the fast service restaurant company outperformed during the period without any material news. We continue to 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 Detractors**

**Incitec Pivot (IPL, overweight)** – the explosives and fertiliser maker underperformed during the period as ongoing operational issues and a soft 1H21 result overshadowed stronger fertiliser prices. Management reported EBIT of \$110mn for the period – 35% below consensus forecasts – as unplanned manufacturing outages, import constraints and flooding caused lower volumes, outweighing the benefit from higher commodity prices. Notwithstanding the disappointing operational issues, we remain overweight the company as we believe the risk is skewed to the upside at current levels (at 14.2 times forward earnings). Lead indicators suggest higher demand for key commodities (urea and DAP) will sustain current spot prices, resulting in consensus upgrades. Meanwhile, the explosives business is experiencing more stable pricing as mining demand normalises in North America.

**Evolution Mining (EVN, underweight)** – the gold miner outperformed alongside the gold price, which rose 7.5% to \$US1,900/oz during the period. We are underweight EVN based on its stretched valuation metrics (8.9 times forward EV/EBITDA), with our preferred exposures instead being Regis Resources (RRL) and Northern Star (NST). RRL trades at a relatively attractive valuation given its cash flow and earnings profile. While NST's valuation limits our exposure to a small underweight position, we believe the company will benefit from higher-than-expected production and reserves/resources after taking full ownership of the KCGM SuperPit Mine in February this year.

**Nanosonics (NAN, overweight)** – the disinfection medical device company underperformed without any material news during the period. Our positive view towards the company remains premised on its leverage to the re-opening US economy and, moreover, 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 Purchases**

**Centuria Capital Group (CNI)** – we established a position in the REIT fund manager during the period. We see CNI's growth platform as attractive in a post-COVID-19 world. The company manages close to \$10bn in funds across a diversified portfolio, underpinned by \$4.5bn in listed investment vehicles (CIP and COF). We hold a positive view of its recently announced merger with Primewest Group (PWG) which, if successful, increases CNI's FUM to \$15bn, is up to 4% accretive and diversifies the business across new markets (Retail, Agriculture). The company trades on a 12-month forward P/E of 21.3 times, which is in line with peer Charter Hall Group (CHC, at 20.5 times) despite superior growth potential.

**Australian Clinical Labs (ACL)** – we took part in the pathology services company's IPO during the period. We found the pricing attractive with a market cap of \$809mn at IPO. At an EV/EBIT basis that equates to 11.5 times, 15% below main competitor Healius (HLS). Secondly, we hold a positive view of the management team, which we see as industry leading with a strong track record and level of experience. Lastly, ACL commands a sound balance sheet (at less than 1.5 net debt / EBITDA), allowing the company to pursue growth levels in NSW and Queensland where the business is currently under-represented.

**Northern Star (NST)** – we reduced our underweight to the gold miner during the period. While NST's valuation – at a 12-month forward EV/EBITDA of 7.0 times – limits our exposure, we believe the company will benefit from higher-than-expected production and reserves/resources after taking full ownership of the KCGM SuperPit Mine in February this year. More broadly, we see significant downside risk to the commodity amid an outlook for higher real interest rates (which are generally a headwind to the gold price).

#### **Key Sales**

**CSR (CSR)** – we reduced our position in the building materials company after a period of strong performance but remain overweight. We continue to believe the company is well positioned to benefit from Australian residential construction's recent strength. We expect its Building

Materials division (75% of group EBIT) to drive better-than-expected earnings in FY21 as a result of the improving Australian housing market, in particular from higher additions and alterations (A&A) activity, continued share gains and cost control initiatives. We expect this to support CSR's already strong balance sheet (with net cash of >\$150mn), supporting the outlook for further capital management initiatives following the special dividend in 1H21. Lastly, we find the valuation as attractive at 16.4 times forward earnings, a significant discount to the wider Industrials ex-Financials (at 28.0 times).

**Bluescope Steel (BSL)** – we reduced our position in the steel producer during the period following recent outperformance. In our view the current favourable conditions are unsustainable in the medium term, with steel prices likely to revert and housing volumes likely to normalise. That being said, we retain a small overweight position based on our view BSL is a high-quality cyclical company with attractive assets (both domestically and internationally) and a strong balance sheet.

**Deterra Royalties (DRR)** – we reduced our position in the iron ore royalties company during the period. We continue to 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. However, we believe iron ore's recent strength – rising to almost \$US200 per tonne – is unsustainable into the medium term. In this context, we see DRR's headline valuation (at a 12-month forward EV/EBITDA of 12.5 times) as less attractive. Within Metals & Mining we prefer Iluka Resources (ILU) and IGO Limited (IGO), which offer exposure to commodities with more attractive long-term fundamentals.

### Key Active Overweights

**IGO Limited (IGO)** – our thesis is premised on the miner's recent \$US1.4bn Greenbushes acquisition and its existing portfolio of high-quality assets. 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 earlier than FY23. We also hold a positive view of IGO's Nova asset – a world-class reserve which supports an increasing production profile.

**Link Group (LNK)** – we remain overweight the company because we continue to see compelling value in its base share registry business and electronic conveyancing business PEXA. Notwithstanding the PEP/Carlyle consortium walking away from its takeover proposal, we continue to see value in LNK's stake in PEXA based on the IPO pricing. 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. Excluding PEXA, LNK trades at a forward P/E of 10-11 times, a substantial discount to peer Computershare (CPU) at 23.1 times.

**Atlas Arteria (ALX)** – we maintain a high-conviction overweight position based on ALX's strong liquidity and balance sheet position, discounted valuation and exposure to traffic recovery in Europe and the US. ALX trades on less than 11.0 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. Beyond traffic normalisation, we see a path towards value creation for ALX through concession extensions at APRR achieved as a means of funding expansion projects and settling the Dulles Greenway tolling regime.

### Key Active Underweights

**Tabcorp (TAH)** – we are underweight the gambling services provider because we believe earnings expectations are too optimistic and regard the market's valuation, at 25.3 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 (8.9 times forward EV/EBITDA), with our preferred exposures instead being Regis Resources (RRL) and Northern Star (NST). RRL trades at a relatively attractive valuation given its cash flow and earnings profile. While NST's valuation limits our exposure to a small underweight position, we believe the company will benefit from higher-than-expected production and reserves/resources after taking full ownership of the KCGM SuperPit Mine in February this year.

**OZ Minerals (OZL)** – we are underweight the copper-gold miner based on its stretched valuation metrics (at 8.6 times 12-months forward EV/EBITDA), minimal free-cash-flow generation as the company invests in projects, and downside risk to the copper price, which currently trades at decade-high levels. Notwithstanding the supportive economic environment for the commodity, we remain cautious due to higher supply coming to the market in the short term, with OZL vulnerable versus international peers given its concentrates increasingly contain uranium and thorium. Our preferred base metals exposure remains Independence Group (IGO).

### Market outlook

The recovery in the Australian economy continues to exceed consensus expectations. The Australian economy contracted 2.5% in calendar 2020, however strong sequential growth in 2H2020 and positive momentum in early 2021 will see economic activity in 1Q2021 exceed pre-COVID levels.

The strength of the economic recovery is particularly evident via record levels for business conditions, business confidence and the strength in employment growth. The level of employment already exceeds pre-COVID levels, and after peaking at 7.5% in July 2020 the unemployment rate has declined sharply to 5.6% in March 2021.

Although wage rates remain subdued, the recovery in labour market income has been sufficient to offset the gradual withdrawal of temporary fiscal support. Moreover, the accumulation of \$125bn in excess household saving, in concert with strong asset price gains, leaves the consumer uniquely positioned to underpin economic growth in 2021-2022. Dwelling investment is set to provide solid support for economic growth over the next 18 months following a surge in demand for new housing construction, partly in response to the Government's Homebuilder subsidy. We expect the global economy to expand 6.5% and the Australian economy to expand 6% in 2021.

We continue to expect US inflation to surprise on the upside over the remainder of 2021 and for policy makers to resist pressure to normalise interest rates. This may see bond yields continue to rise at a moderate rate in coming months, however, we are cognisant that global business surveys will likely peak around mid-2021 which may limit the adjustment in bond yields, at least until the Federal Reserve signals it is preparing to taper its asset purchases. We do not expect this to happen until late 2021 at the earliest.

The A\$/US\$ should continue to be well supported by global inflationary forces, including robust commodity price trends. We continue to expect the A\$/US\$ to appreciate to the 81-83c range by the end of calendar 2021.

We are most overweight stocks within the Health Care, Communication Services and Consumer Staples sectors, and are underweight Consumer Discretionary, Real Estate and Financials.

## Sector allocation

	Portfolio %	Benchmark %	Active %
Communication Services	13.88	8.42	5.46
Consumer Discretionary	9.39	15.06	-5.67
Consumer Staples	5.94	3.24	2.70
Energy	3.14	4.00	-0.86
Financials	7.27	11.46	-4.19
Health Care	13.05	6.50	6.55
Industrials	10.04	9.82	0.22
Information Technology	8.40	6.78	1.61
Materials	20.60	24.69	-4.09
Real Estate	3.98	8.76	-4.78
Utilities	0.00	1.27	-1.27

## Top 5 holdings

	Portfolio %	Benchmark %	Active %
IGO	4.56	0.92	3.63
Atlas Arteria	4.13	1.06	3.06
Link Administration	3.90	0.49	3.40
Nine Entertainment	3.46	0.79	2.68
Carsales.com	3.38	0.98	2.40

## Key active positions

Overweights	Portfolio %	Benchmark %	Active %
IGO	4.56	0.92	3.63
Link Administration	3.90	0.49	3.40
Atlas Arteria	4.13	1.06	3.06
Underweights			
Tabcorp	0.00	2.05	-2.05
Evolution Mining	0.00	1.67	-1.67
OZ Minerals	0.00	1.51	-1.51

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	25.09	6.72	4.95	7.75
Distribution return	1.41	1.70	1.80	2.46

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\$159.6 mn as at 31 May 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 May 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.

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## Applications and contacts

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

**Website** [www.yarracm.com](http://www.yarracm.com)

**Investor Services Team** 1800 034 494 (Australia) +61 3 9002 1980 (Overseas) [IST@yarracm.com](mailto:IST@yarracm.com)

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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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