Yarra Emerging Leaders Fund

Gross returns as at 30 September 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	-0.56	6.07	31.00	11.16	9.57	14.57	11.85
Emerging Leaders Combined Benchmark†	-1.39	3.70	32.28	10.95	11.72	10.84	7.82
Excess return (before fees)‡	0.83	2.37	-1.28	0.21	-2.16	3.73	4.03

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 30 September 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	-0.66	5.73	29.39	9.79	8.21	13.16	10.54
Emerging Leaders Combined Benchmark†	-1.39	3.70	32.28	10.95	11.72	10.84	7.82
Excess return (after fees)‡	0.73	2.04	-2.90	-1.16	-3.51	2.32	2.72

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 delivered a solid return in the September 2021 quarter, overcoming uncertainty relating to protracted lockdowns in NSW and VIC, negative earnings revisions across the market and rising inflation.

The S&P/ASX Emerging Leaders Benchmark lifted by 3.7% in the quarter, taking its 12-month return to +32.3%. In comparison, the broader ASX 300 returned 1.8% and the MSCI Global Index returned 0.7% in local currency terms. However, FY21 reporting season saw more misses than beats despite recording +28% growth y/y, and FY22 forecasts were revised down at -1.2% for the ASX200 and -1.5% for the Small Ords.

Equity valuations had risen substantially as the delta outbreak and dovish commentary from the US Fed depressed bond yields, with the Australian 10-year bond yield falling to 1.08% midway through the quarter. However, this reversed in September as the inflation theme re-emerged and concerns mounted about faster tapering of QE.

Energy (+11.5%) was a strong performer during the period, as the emerging gas crisis in the EU/UK and China saw widespread gains across broader commodity complex, with Brent Crude rising 7% to $US80 per barrel, thermal coal up 62% to $US218/t and JKM LNG futures surging 137% to $US31.10MMBtu. At a stock level, the top performers included Oil Search (OSH, +16.6%), Whitehaven Coal (WHC, +66.5%) and Beach Energy (BPT, +21.7%).

Elsewhere, travel services stocks rebounded during the period as Australia draws closer to re-opening the economy. Top performers included Flight Centre (FLT, +44.5%), Webjet (WEB, +29.1%) and Corporate Travel Management (CTD, +13.8%).

Conversely, Gold (-15.8%) was among the worst performers during the period, weighed down by ongoing USD strength. The worst performers included Evolution Mining (EVN -21.5%), Silver Lake Resources (SLR, -19.3%) and De Grey Mining (DEG, -21.9%).

Portfolio review

Key Contributors

Carsales.com (CAR, overweight) – the online automotive company outperformed as its FY21 result came in at the top end of guidance issued in May, with revenue and NPAT growing 4% and 11% respectively y/y. While prolonged lockdowns in NSW and VIC clouds the outlook for FY22, CAR still expects 'solid growth' in underlying NAPT. A new product launch called "carsales SELECT" – a digital offering allowing consumers to purchase used cars directly from dealers – also impressed investors. We remain overweight the automotive online classifieds company. 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 product initiatives to drive long-term growth (such as transitioning from a leads-based model to a transaction-based model) and undervalued international businesses.

IGO Limited (IGO, overweight) – the battery minerals miner outperformed after announcing the completion of its Greenbushes lithium acquisition late in the prior period, a strong June quarter production report and as lithium prices surged globally, with spodumene rising 213% to $US2,250. Our positive view is premised on the acquisition, which gives IGO exposure to a high-quality, long-dated asset (>20 years mine life) and completes its 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.

Magellan Financial Group (MFG, underweight) – the fund manager underperformed following a disappointing FY21 result. The business is expanding into lower-multiple investment banking and principal investments, which contributed a loss of $42mn during the period. Moreover, MFG is experiencing outflows in its higher ROE base business, with net outflows of $1.53bn in the September 2021 quarter amid deteriorating performance. We remain underweight MFG because we believe its valuation continues to overstate 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 13.9 times forward earnings, which remains full for a business that is now increasingly reliant on underlying market investment performance (i.e. Beta) for future growth, particularly in the current environment.

Select Harvests (SHV, overweight) – the almond producer rebounded as management gave a positive update, announcing that current market prices for almonds have increased to $7.25-7.75/kg, up 20% on its lows earlier in the year. We remain overweight SHV, with our positive view based on several factors. Firstly, we see considerable upside to sales from both pricing (pre-COVID-19 was at A$8.50/kg) and volume (which should grow by +5% per annum over the next three years as orchards mature). Secondly, we expect costs to decline from abnormally high levels, with water prices likely to fall as drought conditions recede. Thirdly, limited value is currently implied in SHV's food processing business, which is realising value through capital releases. Lastly, SHV has a strong balance sheet and supportive valuation (its P/E multiple falls sharply to 15 times in FY23), with hard assets comprising more than 70% of the company's enterprise value.

Flight Centre (FLT) – the travel services company outperformed as Australian vaccination rates accelerated, pulling forward the timeline for the resumption of domestic and international travel. We see significant upside at current levels based our positive view of the Leisure division (38% of pre-COVID EBIT), which is set to benefit from pent-up travel demand in FY23 and FY24, with a skew towards bricks & mortar. In comparison, consensus is factoring Total Travel Value (TTV) remaining 30% below FY19 levels by FY24. And while Corporate (60% of pre-COVID EBIT) faces challenges from cost savings and a preference for Zoom meetings, FLT is taking market share in the segment. As a result, we see FLT as highly attractive at an EV/EBITDA of 11.5 times in FY23.

Key Detractors

Wisetech Global (WTC, underweight) – the logistics software company outperformed after delivering a stronger-than-expected FY21 result. EBITDA grew 63% to $207mn, 13% ahead of consensus expectations, as demand accelerated for WTC's software platform and margins expanded on cost initiatives. We remain underweight WTC based on the company's unappealing valuation and high risk profile following a string of acquisitions. WTC now trades at a forecast EV/Sales of 24.2 times, which we believe continues to capitalise unrealistic growth expectations and ignores downside risks.

Worley (WOR, overweight) – the engineering firm underperformed during the period despite delivering a solid FY21 result. While revenue declined 5% half-on-half, EBITDA grew +26% as management delivered on its cost initiatives – contributing to a +4% NPATA beat versus consensus forecasts. Moreover, management expects revenue to pick-up in FY22 as key end markets recover; its backlog has grown 8% and its total sales pipeline has lifted 16%, driven largely by sustainability projects (+17%). However, brent crude declined 6% during the month to US$73/bbl and the market remains concerned about structurally challenged global energy markets. We believe WOR is in a strong position to withstand a lower-than-expected recovery in its traditional work. Following the Jacobs ECR acquisition, the business is diversified across different markets and is well positioned to capture higher structural demand from energy transition work to low carbon solutions. We believe WOR's valuation provides significant support at current levels, with the stock trading on 14.4 times forward earnings, a sharp discount to the Industrials ex-Financials at 29.3 times.

Link Group (LNK, overweight) – the share registry company underperformed in response to a disappointing FY21 result. While operating NPATA of $113.2mn was only 2% below consensus, management guided to broadly flat operating EBIT in FY22 – well below consensus for 15% growth. The market was anticipating an earnings recovery in FY22, but this appears to have been pushed out to FY23 due to further investment in operations and higher costs. 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 PEXA (with the company retaining its 45% stake in the IPO subsequent to month-end). 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 less than 10-11 times, a substantial discount to peer Computershare (CPU) at 23.8 times.

Ansell (ANN, overweight) – the protective equipment manufacturer underperformed as its FY21 result missed market expectations. FY21 EPS came in at $1.29 – below consensus by 3% – as performance from its Industrial division was underwhelming despite the manufacturing rebound in the US. Further, FY22 EPS of $1.75-1.95% was 4% below consensus as management cautioned that COVID-related sales would fade and COVID outbreaks were disrupting its manufacturing plants in 1H22. Nevertheless, we remain overweight the company. Though we expect an air pocket in exam and single-use earnings as higher capacity in the market suppresses pricing, we expect ANN underlying earnings to reclaim its FY21 COVID peak by FY23 as underlying earnings grow. More broadly, we expect both divisions to benefit from internal programs to increase operational efficiency, higher margins from new distributor agreements and shifts towards higher-value products. Lastly, ANN has a strong balance sheet; we estimate $220mn of buy-back capacity. We do not believe this is captured by consensus; the stock trades at 13.8 times, a large discount to the wider Industrials ex-Financials at 29.3 times.

Domino's Pizza Enterprises (DMP, underweight) – the pizza franchisor outperformed during the period following its FY21 result. While adjusted NPAT of $188.2mn (+29.2% y/y) was in line with consensus expectations, store additions of +10.7% and the final dividend of 173.5cps were ahead of forecasts. We remain underweight the company because we believe its valuation – at a 12-month forward P/E of 59.5 times forward earnings – does not reflect the potential for growth to slow post-COVID as economies re-open. And while management has increased investment to encourage franchisees to expand, we see limited opportunities in Australia where store density is already high.

Key Purchases

Tabcorp (TAH) – we established a position in the wagering & lotteries company during the period. Our positive investment thesis is premised on its Lotteries business (70% of FY21 EBITDA), which we see as having a defensive revenue stream, significant pricing power and growth opportunities driven by online penetration (which currently sits at 32%, below the global average of 50%). We expect the planned spin-off, announced in July, will crystallise value for the division. While we are more negative towards TAH's wagering & media business (30% of FY21 EBITDA), recent takeover bids have placed a floor under the division's valuation. Assuming the division is valued at $3.5bn – the highest bid that TAH rebuffed – the lotteries business trades at 15 times EBITDA, well below peers including reseller Jumbo Interactive (JIN) at 30 times.

OZ Minerals (OZL) – we established a position in the copper miner during the period. OZL operates two high quality, long life, 100% owned copper mines in South Australia - Prominent Hill and Carrapateena - and also holds a portfolio of Brazilian assets of modest quality. We expect OZL copper production to double to >200ktpa by 2030, as Carrapateena moves to a block caving operation, and the company develops the greenfields West Musgrave copper/nickel deposit in Western Australia. OZL is well positioned to fund its growth ambitions through the net cash balance sheet, strong cash flow generation, and flexibility to divest assets such as the Centro Gold deposit in Brazil.

SeaLink Travel (SLK) – we established a small position in the travel services company based on our positive view of SLK's Transit Systems (80% of expected EBITDA) business, which has long-term contracts with governments or agencies to operate bus services and limited impact from reduced service frequency. The business has opportunities for a large pipeline of government contracts. We also see upside from demand recovering from domestic tourism, which in our view will generate volume and yield growth, translating into high organic earnings growth.

Key Sales

Bluescope Steel (BSL) – we exited 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. As a result, its headline forward P/E of 5.6 times is misleading. That being said, we continue to view BSL as a high-quality cyclical company with attractive assets (both domestically and internationally) and a strong balance sheet.

Bingo Industries (BIN) – we exited our position shortly before the waste management company was de-listed during the period following the successful takeover from a consortium comprising CPE Capital and Macquarie Infrastructure and Real Assets (MIRA).

Genworth Mortgage Insurance (GMA) – we exited our position in the mortgage insurance company during the period. Protracted lockdowns across NSW and Victoria, combined with lower government support, has increased the risk associated with defaults. Further, excess housing supply is looming following historic fiscal support and lower demand. Lastly, we expect uncertainty relating to its contract with CBA – which comprises 57% of its in force book – to continue to be a headwind in the short term.

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.

TPG Telecom (TPG) – our positive view is premised on the improving outlook for the mobiles market, recovery in volumes post COVID and the recently completed Vodafone merger, which in our view will unlock significant synergies. The combined entity is well placed to harness its infrastructure, scale and balance sheet to disrupt incumbents Telstra (TLS) and Optus through its lower-cost structure, as well as new products such as Fixed Wireless.

Atlas Arteria (ALX) – we maintain an 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 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.

Link Group (LNK) – we are 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 PEXA (with the company retaining its 45% stake in the IPO subsequent to month-end). 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 less than 10-11 times, a substantial discount to peer Computershare (CPU) at 23.8 times.

Carsales.com (CAR) –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 product initiatives to drive long-term growth (such as transitioning from a leads-based model to a transaction-based model) and undervalued international businesses.

Key Active Underweights

Bluescope Steel (BSL) – the steel producer became a key underweight during the period after we reduced our position. 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. As a result, its headline forward P/E of 4.7 times is misleading. That being said, we continue to view BSL as a high-quality cyclical company with attractive assets (both domestically and internationally) and a strong balance sheet.

Domino's Pizza Enterprises (DMP) – we remain underweight the company because we believe its valuation – at a 12-month forward P/E of 59.5 times forward earnings – does not reflect the potential for growth to slow post-COVID as economies re-open. And while management has increased investment to encourage franchisees to expand, we see limited opportunities in Australia where store density is already high.

Wisetech (WTC) – remain underweight WTC based on the company's unappealing valuation and high risk profile following a string of acquisitions. WTC now trades at a forecast EV/Sales of 24.2 times, which we believe continues to capitalise unrealistic growth expectations (based on the recent acceleration in demand for its software platform and expanding margins), and ignores downside risks.

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 51.1 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.

Oil Search (OSH) – we remain underweight OSH because we believe the sheer size of its growth projects (the Pikka project in Alaska alone is worth more than $US1.5bn to OSH just for phase 1) and its levered balance sheet (at 40% gearing) will be an ongoing constraint on its growth aspirations. While we are supportive of its proposed merger with Santos (STO) on fundamentals – given its low cost and greater project alignment with PNGLNG – we believe it is dilutive from a climate risk perspective, with no clear strategy for the combined group to transition to a low carbon economy.

Market outlook

After completing 1H2021 with strong momentum, renewed Covid-related lockdowns in Melbourne and Sydney will see the Australian economy contract in 3Q21, albeit it has been notable how well both business surveys and employment indicators have held up in Q3, suggesting a modest contraction than might have been expected several months ago.

We continue to believe the interruption to economic growth from renewed lockdowns will be an aberration within an improving trend. Indeed, the fundamentals that will drive the economic recovery remain in place. The recovery in labour market income has been sufficient to offset the gradual withdrawal of temporary fiscal support. Moreover, the accumulation of an estimated $185bn 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 6 months as previously approved housing moves through the construction phase, and a broader-based lift in business investment expectations is an important step in ensuring a sustained economic recovery. We expect the global economy to expand 6% and the Australian economy to expand 4.5% in 2021, a downward revision from our pre-lockdown forecast of 6%. We expect another strong year of economic growth in 2022 of 4.0%.

Nevertheless, there are some areas that are cause for concern. For over 12 months we have warned about rising US inflation pressures and rising inflation expectations. However, supply chain constraints and energy shortages in the Northern Hemisphere risk inflation pressures becoming more widespread and more entrenched. With the peak in global business surveys having passed, cost inflation continuing to escalate and the Federal Reserve signalling increased willingness to taper its purchases, we expect bond yields will move higher through the remainder of 2021. We expect US 10-year yields to approach 1.80% by the end of 2021, providing some ongoing challenges for risk assets in Q4.

The A$/US$ has recently been buffeted by concerns of a peak in global industrial growth indicators, slowing China economic momentum and recent declines in iron ore prices. Nevertheless, Australia's external accounts are in their best position since the early 1970s and despite some moderation in commodity prices the A$/US$ should remain supported by global reflationary forces through 2021-22. We expect the A$/US$ to finish the year in the 76-78c range, and remain around that level through 1H22.

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

Sector allocation

	Portfolio %	Benchmark %	Active %
Communication Services	13.50	8.02	5.49
Consumer Discretionary	13.02	13.61	-0.59
Consumer Staples	5.95	3.87	2.08
Energy	2.84	6.42	-3.58
Financials	6.47	11.35	-4.88
Health Care	10.97	4.90	6.07
Industrials	7.90	10.68	-2.78
Information Technology	8.79	8.14	0.65
Materials	22.21	21.37	0.84
Real Estate	4.02	9.26	-5.25
Utilities	0.00	2.38	-2.38

Top 5 holdings

	Portfolio %	Benchmark %	Active %
IGO	4.97	1.06	3.91
Atlas Arteria	4.06	1.11	2.96
Carsales.com	3.94	1.27	2.67
TPG Telecom	3.46	0.46	3.00
Incitec Pivot	3.32	1.02	2.30

Key active positions

Overweights	Portfolio %	Benchmark %	Active %
IGO	4.97	1.06	3.91
TPG Telecom	3.46	0.46	3.00
Atlas Arteria	4.06	1.11	2.96
Underweights			
Bluescope Steel	0.00	1.84	-1.84
Domino's Pizza Enterprises	0.00	1.80	-1.80
Wisetech Global	0.00	1.55	-1.55

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	27.74	8.20	6.45	10.82
Distribution return	1.65	1.59	1.77	2.34

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	A$59.5 mn as at 30 September 2021	
APIR codes	JBW0010AU	
Estimated management cost	1.25% p.a.	
Buy/sell spread	+/- 0.20%	
Platform availability	Asgard BT Panorama Hub24 Macquarie Wrap	Mason Stevens MLC Navigator MLC Wrap Praemium

Investment performance comparison of $50,000

After fees, since inception of the Yarra Emerging Leaders Fund, September 1997 to September 2021.

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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

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