YARRA
CAPITAL MANAGEMENT

Investment Commentary
Quarter to 30 September 2022

Yarra Emerging Leaders Fund

Gross returns as at 30 September 2022

	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	-9.40	0.52	-14.05	3.02	8.15	10.97	10.68
Emerging Leaders Combined Benchmark†	-9.35	2.37	-15.28	3.58	6.68	8.45	6.77
Excess return (before fees)‡	-0.06	-1.85	1.23	-0.57	1.47	2.52	3.91

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 2022

	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	-9.50	0.20	-15.11	1.74	6.82	9.60	9.38
Emerging Leaders Combined Benchmark†	-9.35	2.37	-15.28	3.58	6.68	8.45	6.77
Excess return (after fees)‡	-0.15	-2.16	0.17	-1.84	0.14	1.15	2.61

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* 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

The Emerging Leaders Benchmark returned 2.37% for the quarter, taking its 12-month return to -15.28%. In comparison, the broader ASX300 gained 0.45% for the quarter and, globally, the MSCI World Index fell 15.70%.

The Energy and Materials sectors recorded positive returns. Within Energy (+12.4%), coal producers continued to rise in value amid the global energy crisis, with thermal coal reaching an all-time high of $457/t during the quarter. New Hope Corporation (NHC) lifted +81.8% and Paladin Energy (PDN) gained 30.1%.

Within Materials (+8.2%), with continued lithium price strength ahead of consensus forecasts the sector is moving towards the positive side led by Pilbara Minerals (PLS, +99.1%) and OZ Minerals (OZL, +45.6%).

Conversely, the worst performing sectors were Utilities (-16%) and Real Estate (-4.7%). Due to ongoing hikes in Interest rates and increasing Inflation both sectors experienced widespread decline. The largest fall came from AGL Energy (AGL, -16%), Centuria Capital Group (CNI, -15.2%) and Arena REIT (ARF, -21%).

Key Contributors

OZ Minerals (OZL, overweight) – the copper miner was a positive contributor to the portfolio during the month following BHP's $25/share takeover offer for the company. The offer represented a 32% premium to prior close. With the OZL board rejecting the initial offer, we recognize the potential for BHP to return with a higher bid. The potential for a counterbidder to emerge is limited, in our view, given BHP's significant regional synergies with Oz Minerals. We retain our fundamental positive view on OZL due to its two high quality, long life, 100% owned copper mines in South Australia - Prominent Hill and Carrapateena. We expect the company's copper production to double to >200ktpa by 2030, as Carrapateena moves to a block caving operation, and the company develops the greenfield West Musgrave copper/nickel deposit in Western Australia.

Pilbara Minerals (PLS, overweight) – the lithium miner was an outperformer during the period, with continued lithium price strength ahead of consensus forecasts. We see PLS as the most attractive exposure to lithium as a future facing commodity with their flagship project, the Pilgangoora spodumene project, well positioned to benefit from continued high lithium prices. The project is in the process of undertaking a 100ktpa capacity expansion to 680ktpa, with a clear path to 1,000ktpa through additional capital

efficient brownfield expansions. The company is progressing a downstream lithium hydroxide strategy with partner POSCO and assessing the potential to produce a value-added lithium/salts product.

AVZ Minerals (AVZ, underweight) – the underweight position in the exploration and development company contributed during the period following several months of suspension due to ongoing litigation surrounding the ownership of the company's key asset, a pre-production lithium site in the DRC (Congo).

IGO (IGO, overweight) – the battery commodity producer was a key contributor during the period on continued lithium price strength ahead of consensus forecasts. Our positive thesis is premised on the miner's US$1.4bn Greenbushes and $A1.25bn Western Areas (WSA) acquisitions, and its existing portfolio of high-quality assets. Greenbushes gives IGO exposure to a high-quality, long-dated asset (>20 years mine life) and completes IGO's suite of battery commodities with the company already producing nickel, copper and cobalt. WSA diversifies production (rebalancing commodity exposure to 70% Li, 30% Ni) and extends the mine life for nickel production (which is currently through its world-class Nova asset).

Megaport (MP1, overweight) – the network as a service solutions company outperformed during the period after reporting a stronger than expected June quarter result across revenue growth (+10% quarter on quarter) and the first EBITDA positive quarter. We see strong growth from the core business connecting data centres to the cloud, with a strong global pipeline as businesses invest in IT projects. With its expansion into broader telecommunication services – which leverages the same infrastructure – the total addressable market more than doubles. The company is currently at an inflection point for earnings and cashflow; we believe it will turn positive in the next year with significant long-term earnings and cashflow potential.

Key Detractors

Whitehaven Coal (WHC, not held) – the coal mining operator was a key detractor for the portfolio during the period as coal prices continued to trade at significantly inflated levels. We view current prices of both thermal and metallurgical coal as unsustainable, and well in excess of cost curve support. Additionally, we are cognizant of coal's diminishing role in the global energy mix as stationary energy systems shift to lower carbon intensity.

Link Group (LNK, overweight) – the superannuation admin and property technology company fell materially in the quarter following its takeover by Dye & Durham being scuppered at the eleventh hour by the UK's Financial Conduct Authority (FCA). The FCA has imposed an £50m fine on LNK's UK Fund Solutions business and a potential restitution payment of up to £306m for the Woodford issue which has been under investigation since 2019. Despite the uncertainty this creates, we still see considerable value in LNK and a pathway to crystalising this value with the announced demerger of its stake in PEXA an appropriate first step.

NEXTDC (NXT, overweight) – the data centre operator underperformed the market during the quarter, despite reporting a solid result and upbeat outlook at the end of the period. We believe the high recurring nature of NXT's revenues, its infrastructure like characteristics and tangible asset base are attractive. NXT has been excessively discounted and we see no diminution to its growth trajectory. NXT trades on 20.8 times Financial Year 2024 EV/EBITDA, which compares favourably to more mature global peers.

TPG Telcom (TPG, overweight) – the telecommunications provider underperformed during the period following a slightly disappointing (4% miss at the EBITDA level) FY22 result. We retain a positive view on the company given the mobile market is becoming more rational supporting repricing. As the value brand TPG can gain market share. Ongoing technology shifts towards fixed wireless and fiber to the basement will favor TPG. We expect the momentum in the business to continue improving through F23 and the valuation remains attractive at 7.5 times EV/EBITDA.

Atlas Arteria (ALX, overweight) – the toll road operator underperformed following the announcement of the acquisition of the Chicago Skyway toll road and a $3b associated capital raising at $6.30, a 19% discount to the pre-deal share price. This was unquestionably a negative development given ALX was being actively pursued by suitor IFM who had built a stake at $8.10. ALX have paid a very full price for the asset and the transaction has lowered our valuation for the stock, although the transaction itself does not rule out IFM returning with another bid.

Key Purchases

Sims Metals (SGM) – we initiated a new overweight position in the scrap and metals recycling company during the period. The company's US business SA Recycling is performing strongly and we see further upside from bolt-on acquisitions in this highly fragmented market. While we expect scrap margins to moderate from historical highs, capital expenditure spend is increasing, a skew towards improving environmental performance should position the business strongly relative to peers as environmental regulations tighten.

Nine Entertainment (NEC) – we added to our position in the media company reflecting our constructive outlook for advertising spend, and NEC's ability to grow higher-margin digital revenues in a potentially softer environment. The company's sell off CYTD in part reflects the sell-off in Domain (DHG), which is 59% owned by NEC. The sell-off in both companies placed NEC, excluding DHG, on a 3.9 times FY23 EV/EBITDA multiple which we regard as attractive for a leading media company which is diversifying its revenue streams to be less cyclical, driven by higher margin digital revenues.

Reliance Worldwide (RWC) – we added to our position in the plumbing supplies company over the period. RWC has sold off significantly on fears of a weaker demand environment ahead. We think RWC is a compelling opportunity with the market pricing for a significant decline in earnings (PE of only 13 times vs 17 times mid cycle) while we remain constructive on the demand environment given the defensive nature of the majority of RWC's repair and re-modelling sales.

Key Sales

OZ Minerals (OZL) – we trimmed our position in Oz Minerals during the period. We retain our positive view on the company, underpinned by both our constructive view on copper, and the potential for an increase to BHP's recent takeover offer. Quality copper assets are scarce globally, and we remain positive on OZL due to its two high quality, long life, 100% owned copper mines in South Australia - Prominent Hill and Carrapateena. We expect the company's copper production to double to >200ktpa by 2030, as Carrapateena moves to a block caving operation, and the company develops the greenfield West Musgrave copper/nickel deposit in Western Australia.

Worley (WOR) – we reduced our position in WOR following a period of strong outperformance. Whilst we remain constructive on the name longer term, the upside opportunity is more modest, at 26 times P/E after a strong period of performance. We also had the view that oil and gas prices were likely to soften, and whilst not a direct fundamental driver for the stock, WOR can trade in line with oil price movements given its inclusion in the energy index.

Eclipx Group (ECX) – the ECX position was reduced after recent outperformance and to reflect the abnormally strong earnings contribution from end of lease income. We continue to hold an ECX position given continued asset growth supported by market share gains, cost reduction opportunities to offset inflation and balance sheet strength to support continued share buybacks.

Key Active Overweights

OZ Minerals (OZL) – OZ Minerals remains a key active overweight in the portfolio. BHP's recent takeover offer represented a 32% premium to prior close and underlined the appetite for scarce quality copper assets globally. With the OZL board rejecting the initial offer, we recognize the potential for BHP to return with a higher bid. The potential for a counterbidder to emerge is limited, in our view, given BHP's significant available regional synergies. We retain our fundamental positive view on OZL due to its two high quality, long life, 100% owned copper mines in South Australia - Prominent Hill and Carrapateena. We expect the company's copper production to double to >200ktpa by 2030, as Carrapateena moves to a block caving operation, and the company develops the greenfield West Musgrave copper/nickel deposit in Western Australia.

Worley (WOR) – we remain overweight the professional project and asset services company. Following years of underinvestment in oil & gas projects, and with the more recent supply disruptions stemming from the war in Ukraine, expectations for project spend across WOR's traditional customer base has increased to 27% YoY growth. There is also a strong pipeline of margin accretive capital spend required to decarbonise energy production and provide more sustainable solutions across chemical and resources customers.

Reliance Worldwide (RWC) – we regard the plumbing supplies company as a compelling opportunity, with the market pricing for a significant decline in earnings (P/E of only 11.4 times) while we remain constructive on the demand environment (both in the trough and longer term) given the defensive nature of the majority of the company's repair and remodelling sales; these sales represent. 80% of group revenues and are not tightly correlated with the housing sector.

Key Active Underweights

WiseTech (WTC) – we remain underweight WTC with a preference for other names in the technology sector given WTC's 38 acquisitions since 2016 which has created issues for earnings quality, as well as questions around the strategy for the business. WTC is also relatively over-valued compared to other technology sector names which we prefer.

Whitehaven Coal (WHC) – we remain underweight Whitehaven Coal. While this position was a key detractor for the portfolio during the period as coal prices continued to trade at significantly inflated levels, we view current prices for both thermal and metallurgical coal as unsustainable, and well in excess of cost curve support. Additionally, we are cognizant of coal's diminishing role in the global energy mix as stationary energy systems shift to lower carbon intensity.

Allkem (AKE) – we are underweight the lithium producer, with our preferred exposures via Pilbara Minerals and IGO. While Allkem provides diversity of supply type as a producer of both lithium brines and hard-rock spodumene, we remain concerned with the company's sovereign risk exposure in Argentina. The Oloroz brine project is in Argentina, where inflation has reached close to triple digit levels in recent months, underlying significant cost and supply chain challenges in our view.

Market outlook

Financial markets have now embraced the risk of recession in the US and Europe over the past quarter, and the gap between our more pessimistic forecasts for the global economy and the consensus has narrowed. Indeed, with the Fed signalling that financial conditions are close to neutral, we are edging closer to the point where the pace of monetary tightening will slow, providing some scope for risk markets to recover some lost ground.

The period of excess inflation is starting to recede, with prior surges in commodity prices retreating, an easing in

supply constraints, and signs of slowing demand likely to compress elevated sales margins. As central banks continue to await firmer signs that inflation expectations have stabilised and for labour demand to ease, financial markets are faced with the positive news of less restrictive monetary policy and the negative news of likely weaker company earnings.

In a world of heighted concerns of recession in major developed economies, subdued economic activity in China and ongoing conflict between Russia and the Ukraine which has contributed to commodity shortages, high inflation and rising interest rates, the Australian economy presents as a relative safe haven.

Australia's economic data has remained robust in 1H2022, although we do expect economic activity to slow significantly in 2023 to average just 1.5%. While a local recession is possible in 2023, we believe Australia should be able to avoid a technical recession due to three key reasons:

1. Australia has been a net beneficiary of global commodity shortages. This surge in commodity prices saw Australia's export prices in A$ terms move to their highest levels since the 1880s in 1H2022. The consequence has been strong national income growth, profits growth and an improving underlying fiscal position.
2. The household sector continues to hold a significant buffer of over $160bn of excess savings relative to pre-COVID levels. Although we expect the impact of higher interest rates and higher living expenses will curtail consumer spending, we do expect the combination of rising wage growth and a run down in the level of savings to continue to support consumption spending.
3. Low levels of spare productive capacity, strong profit and low corporate debt have contributed to robust capital investment intentions.

Over the medium term we believe a recovery in net immigration levels into Australia and Australia's exposure to key commodities crucial to the global energy transition will provide a solid underpin for future economic growth.

While the RBA has been later than most other developed nations in tightening policy, tighter financial conditions in 2022 have come via both significantly higher cash rates, higher government bond yields and wider corporate bond spreads. We expect that the RBA cash rate will finish the year at 3.10%, which we expect will mark the peak for the RBA, well below market expectations of a 4.0% peak in 2H23. The A$/US$ has been particularly weak in recent weeks, albeit on a TWI basis the A$ has been broadly stable. With Australia's external accounts are in their best position since the early 1970s and the prospect the US$ uptrend will peak as the Fed pivots from its aggressive hiking strategy we expect the A$/US$ will appreciate to the mid-70s by end-2023.

We are most overweight stocks within the Communication Services, Health Care and Information Technology sectors, and are underweight Real Estate, Energy and Materials.

Sector allocation

	Portfolio %	Benchmark %	Active %
Communication Services	12.46	5.72	6.74
Consumer Discretionary	9.24	10.87	-1.63
Consumer Staples	1.78	4.06	-2.28
Energy	4.11	8.51	-4.40
Financials	8.99	10.35	-1.36
Health Care	6.96	4.25	2.70
Industrials	11.63	11.72	-0.08
Information Technology	9.12	8.35	0.77
Materials	23.76	26.06	-2.30
Real Estate	3.69	9.28	-5.59
Utilities	0.00	0.83	-0.83

Top 5 holdings

	Portfolio %	Benchmark %	Active %
OZ Minerals	5.15	1.76	3.40
Pilbara Minerals	4.46	2.40	2.06
Worley	4.11	0.96	3.15
IGO	3.88	1.88	2.00
Carsales.com	3.80	1.34	2.46

Key active positions

Overweights	Portfolio %	Benchmark %	Active %
OZ Minerals	5.15	1.76	3.40
Worley	4.11	0.96	3.15
Reliance Worldwide	3.63	0.55	3.08
Underweights			
Wisetech Global	0.00	1.83	-1.83
Whitehaven Coal	0.00	1.75	-1.75
Allkem	0.00	1.69	-1.69

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	-25.84	-3.52	2.69	6.32
Distribution return	10.73	5.27	4.13	3.28

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$71.4 mn as at 30 September 2022	
APIR codes	JBW0010AU	
Estimated management cost	1.25% p.a.	
Buy/sell spread	+/- 0.20%	
Platform availability	Asgard Ausmaq BT Panorama BT SuperWrap Financial Index	Hub24 Macquarie Wrap Mason Stevens MLC Wrap OneVue

Investment performance comparison of $50,000

After fees, since inception of the Yarra Emerging Leaders Fund, September 1997 to September 2022.

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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