

# BLACKROCK HIGH CONVICTION AUSTRALIAN EQUITY FUND

**BLACKROCK®**

FUND UPDATE

30 June 2022

## Investment Performance (%)

	1 Mth	3 Mths	YTD	1 Yr	2 Yrs pa	3 Yrs pa	5 Yrs pa	Since Incep <sup>1</sup> pa
The Fund (Net of Fees)	-12.93	-21.04	-31.09	-31.73	-2.58	-3.81	0.64	4.07
Benchmark <sup>2</sup>	-6.68	-11.21	-16.62	-10.74	5.38	1.80	5.21	6.99
Outperformance (Net of Fees)	-6.25	-9.83	-14.46	-20.99	-7.96	-5.60	-4.57	-2.92
S&P/ASX 300 (for comparative purposes)	-8.97	-12.22	-10.39	-6.78	9.45	3.44	6.90	8.23

<sup>1</sup> Performance of the fund is an adjusted combination of the past performance of class X and class D to illustrate performance of the strategy since inception of the fund. It is for illustrative purposes only to show the performance of class D as if its inception date of that class was 9 December 2015. The unadjusted past performance of class D is set out [below]. Please see \* in the footnotes for further information.

<sup>2</sup> S&P/ASX300 Industrials Accumulation Ex Top 5 Stocks by Mkt Cap Gross Index

	1 Mth	3 Mths	YTD	1 Yr	2 Yrs pa	3 Yrs pa	5 Yrs pa	Since Incep pa
Class D (net of fees)	-12.93	-21.04	-31.09	-31.73	-2.58	-3.81	0.64	3.35

Please see \*\* in the footnotes of further information.

## Performance Summary – June 2022

### Fund Review

The recent June quarter has been one of the toughest quarters for the fund since its inception. We live and breathe every stock that we own in the portfolio and it has been difficult to watch the share prices fall the way they did. As we mentioned in our last monthly update, the bear market in small cap industrial stocks is well and truly entrenched. This often happens in protracted sell offs where liquidity is sucked out of this part of the market first. We are not exclusively positioned in small caps, but we have natural tendency to scour this part of the market as we think that in the long term this is where the most mispriced opportunities can be found. With hindsight, given that this is a relatively small and nimble fund, we should have used this advantage to pivot out of some of smaller names into the more liquid large cap end of the market much earlier into the drawdown but we were surprised by how harshly the market uniformly punished all small cap companies, regardless of their future prospects. Within the portfolio we were also surprised that the performance of our more Value oriented smaller companies was dominated by just a few of the smaller Growth names that they were supposed to balance. The month of June, being the end of financial year, also saw underperformance of some of our small cap holdings further exacerbated by high levels of tax-loss selling, which tends to hit this part of the market the hardest. Pleasingly though, we have seen some strong rebounds in many of our holdings in the first few days of July.

We are long term investors, not short term market traders, and we remain committed to all of the current holdings in the portfolio. We take a longer term view where business models matter, cash flows matter and balance sheets matter. At the moment, the market is focused on the short term, being driven by the macro, but this won't last forever. Even in an inflationary environment, where rates are rising, there will still be companies that will outperform their peers and be tomorrow's winners. We believe that we are invested alongside quality management teams that are making smart decisions about how to invest their capital. Interestingly we are seeing increased levels of insider buying (as we highlighted in last month's commentary, over the last 6 months, insiders in 9 of our top 10 holdings were buying their own stock), including corporate buy backs that have been recently announced by three of the companies we hold; Aristocrat, Virgin Money and Superloop. Broadly speaking corporate balance sheets are generally in good shape, and we expect continuing relatively high levels of mergers and acquisitions given some of the price dislocation in markets.

## Portfolio Management Team



**Charles Lanchester,**  
Portfolio Manager



**Madeleine Beaumont,**  
Portfolio Manager



**Sam Theodore,**  
Portfolio Manager



**Nick Corkill,**  
Portfolio Manager

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We believe that we are currently invested in some exciting businesses with bright futures. Many of these companies are relatively defensive in nature and are not particularly exposed to the economic cycle. Noting we sold out of our consumer facing e-commerce names some time ago. If we look across the fund we have a diverse range of exposures to healthcare, mining services, naval shipbuilding, premium wine and premium olive oil, storage facilities, technology, telecommunications, gaming and A-grade industrial real estate. We firmly believe that this is an interesting and balanced portfolio that is currently undervalued by the stock market pricing machine. We will continue to work hard to make sure that we are testing the edge and the insights that sit behind each and every one of our investments. And we look forward to the market once again taking a longer term view on companies to help us deliver for our clients.

## Fund Performance and Stock Selection

The fund returned -21.06% during the quarter, net of fees, underperforming its benchmark (ASX300 Industrials ex Top 5 Market Cap Index) return of -11.21% by -9.85%.

On a market adjusted basis, amongst the top contributors for the quarter were positions in Treasury Wine Estate (TWE), Orica (ORI) and IAG (IAG) while Nine Entertainment (NEC), Dubber (DUB) and Imricor (IMR) were amongst the top detractors.

## Contributors

**TWE** – Treasury Wine Estates outperformed the market over the quarter, after a strong half year result highlighting that the new management team are proving to be adept in navigating changes to Chinese tariffs as well as softer demand from on premise and travel retail due to Covid. We expect the latter two to improve over time. In July, Wine Australia announced that grape prices had fallen 10 percent in Australia for the FY22 vintage, representing the first decline since 2014. Grapes are a key input to CoGS for TWE which should prove helpful for margins in the current global inflationary environment. We met with the Board in June to discuss remuneration and governance issues.

**ORI** – Orica was a positive contributor for the quarter. We have been of the view that the long earnings downgrade cycle for Orica was ending and we are at the early stages of an upgrade cycle. The first half result was the first piece of evidence that this thesis remains on track with earnings coming in well ahead of consensus despite some weather impacts in the half. The business has good momentum and the market structure is favourable.

**IAG** – A relatively new position for the fund – this is one of our relative value names in the portfolio, and it has positively contributed to performance this quarter. With inflation fears gripping markets, IAG's business will likely not be immune (i.e. the cost of repairing a car after an accident in their motor business, or damage to a house from a storm in their home insurance business will likely be going up), however the IAG insurance business is a 'short tail' book – i.e. the insurance is written for a relatively short period (usually 12 months). Hence often these businesses can manage this inflation risk through higher insurance premiums – which we had already been seeing. Further, with bond yields rising – the investment book has a direct benefit unlike other businesses in the market that do not have this offset. We also believe the share price has benefited from a relative perspective from the view that the earnings base of the business should prove to be somewhat defensive given fears around a softening in economic conditions.

## Detractors

**NEC** – Nine Entertainment shares fell sharply during the quarter as the market sold off cyclically exposed companies. The two key drivers of NEC revenues are advertising sales as well as property listings. While advertising sales would be impacted if the economy fell sharply,

the relationship between property listings and property prices is more complex. The recently announced changes to NSW stamp duty is an additional consideration that could increase housing turnover. We note that the Chairman of Domain purchased shares in May. During the quarter we also met with the Chairman of Nine Entertainment to discuss succession, remuneration and governance issues.

**DUB** – Dubber has been a poor performer from a share price perspective this year. Whilst we are clearly disappointed with the share price we are not disappointed with the business performance nor the investment case. Small cap growth has been hit hard over the last 12 months globally as financial conditions tighten in response to hotter than expected inflation and more hawkish central banks. The de-rating of these stocks has been quite uniform which suggests the market is not differentiating between the business models and essentially the baby has been thrown out with the bath water. Dubber is in the unique position of being very well funded with over \$90m net cash on the balance sheet and can therefore continue to invest and grow the business. When markets settle as they always do and sensible valuations return, the multiple will be applied to a larger business and therefore patient investors will get rewarded.

**IMR** – Imricor was clearly swept up in the tax loss selling phenomenon we often see towards financial year end. At one point during the month of June it was trading at cash backing meaning the technology had no value. This clearly makes no sense to us and is a clear example of the dislocation in small cap growth. The company has spent over 15 years and US\$100m to develop the world's first MRI compatible ablation catheter. This product has regulatory approval and 15 hospitals using/ planning to use it as well as 50 more in the near-term pipeline. The last 12 months have clearly been tough for the company with the lingering effects of Covid but the next 12 months should see great progress made towards gaining approval for the VT ablation catheter as well as expanding the installed base of hospitals.

### Top 10 Holdings Alphabetically

Stock
ALS LTD
ARISTOCRAT LEISURE LTD
GOODMAN GROUP UNITS
INSURANCE AUSTRALIA GROUP LTD
MAAS GROUP HOLDINGS LTD
MONASH IVF GROUP LTD
ORICA LTD
PETER WARREN AUTOMOTIVE LTD
SUPERLOOP LTD
TREASURY WINE ESTATES LTD

Source: BlackRock

### Sector Exposure

Sector	Weight %
Consumer Discretionary	17.02%
Industrials	16.61%
Financials	11.64%
Real Estate	10.33%
Information Technology	10.22%
Health Care	9.79%
Communication Services	8.98%
Consumer Staples	8.76%
Materials	7.67%
Utilities	-

Source: BlackRock

## About the Fund

### Investment Objective

The Fund aims to deliver returns that are 4-6% (before fees) p.a. above those of the S&P/ASX 300 Industrials Accumulation Index ex top 5 stocks by market capitalisation (Benchmark) over rolling 3-year periods.

### Fund Strategy

Our investment style is based on the belief that a small team of experienced investment professionals focusing on the quality stocks in the market, will outperform over the long-term.

The Fund applies a fundamental approach that is focused on bottom up analysis, where detailed research is conducted prior to any investment decision. There is a strict focus on quality first and only those companies that meet the following quality filters will be considered for inclusion in the Fund:

- ▶ **Management:** engagement with key executives and board members to identify talented management teams.
- ▶ **Profitability:** rigorous evaluation of companies' ability to generate profits
- ▶ **Debt:** strict assessment of debt levels and the ability to service and repay debt.
- ▶ **Businesses:** superior businesses that are easy to understand.
- ▶ **Sustainability:** analysis of ESG risks and factors to identify companies well positioned to grow sustainability.

We believe that the focus on quality first adds significant outperformance, particularly in times of market dislocation, where successful investing is as much about avoiding the losses as picking the winners.

### Fund Details

BlackRock High Conviction Australian Equity Fund	
APIR Code (D Class)	BLK0012AU
Fund Size/strategy Size	\$107m/\$261m
Buy/Sell Spread	0.275%/0.275%
Management Fee	0.70%
Performance Fee	15%
Liquidity	Daily

^ The BlackRock High Conviction Australian Equity Fund ("Fund") is structured to allow for different classes of units with different fee structures. The same investment strategy is applied holistically across all unit classes in the Fund. The first class of units for the Fund ("class X") was launched on 9 December 2015 with more than \$220m of assets. A second unit class ("class D") was launched for retail investors on 4 January 2016. This report is designed for class D unit holders. In order to illustrate the performance of the Fund's strategy across both classes since the official launch date of the Fund on the 9 December 2015, performance since inception quoted here is based on the period from 9 December 2015. Performance figures quoted here apply the fees charged to the class D units in order to provide class D unitholders with an estimated performance estimate over the period. This adjustment is estimated and unaudited and is for illustrative purposes only. Past performance is not a reliable indicator of future performance. Net of fees performance is calculated on exit-to-exit price basis, e.g. net of ongoing fees, performance fees and expenses.

^^ Performance figures represent past performance and are not indicative of future performance. Current performance may be higher or lower than that shown. Net performance figures are calculated after fund management fees and expenses, and assume reinvestment of distributions. Unless otherwise stated, performance for periods greater than one year is annualised and performance calculated to the last business day of the month.

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