YARRA CAPITAL MANAGEMENT

Investment Commentary
Month to 31 August 2022

Yarra Australian Real Assets Securities Fund

Gross returns as at 31 August 2022

	From 17 December 2015	1 month %	3 months %	1 year %	3 years % p.a.	5 years % p.a.	10 years % p.a.	Since inception^ % p.a.
Yarra Australian Real Assets Securities Fund	8.27	-2.81	-0.61	-2.55	0.87	7.13	9.49	8.14
S&P/ASX 300 Custom Infrastructure, Utilities and A-REITs Index*	7.30	-3.00	-2.76	-1.10	0.42	6.00	NA	NA
Excess Return†	0.97	0.19	2.16	-1.45	0.44	1.13	NA	NA

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 fees, meaning they do not reflect the deduction of any investment management fees 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 August 2022

	From 17 December 2015	1 month %	3 months %	1 year %	3 years % p.a.	5 years % p.a.	10 years % p.a.	Since inception^ % p.a.
Yarra Australian Real Assets Securities Fund	7.36	-2.88	-0.82	-3.37	0.02	6.23	8.57	7.23
S&P/ASX 300 Custom Infrastructure, Utilities and A-REITs Index	7.30	-3.00	-2.76	-1.10	0.42	6.00	NA	NA
Excess Return†	0.06	0.12	1.94	-2.27	-0.41	0.22	NA	NA
Growth Return‡	NA	NA	NA	-25.98	-13.92	-11.73	-3.99	-2.20
Distribution Return‡	NA	NA	NA	22.60	13.94	17.96	12.55	9.43

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 of Yarra Australian Real Assets Securities Fund: December 2005.
* Effective 17 December 2015, the benchmark for the Yarra Australian Real Assets Securities Fund is the S&P/ASX 300 Custom Infrastructure, Utilities and A-REITs Index: a market cap weighted index of infrastructure, utilities and REIT securities included in the S&P/ASX300.
† Excess return: The excess return figures shown represent the difference between the portfolio's return and the benchmark return.
‡The Growth Return is measured by the movement in the Fund's unit price, 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 distribution amounts deemed as capital distributions.

Market review

The Custom Infrastructure, Utilities and A-REITs Accumulation Index returned -3.0% for the month, taking its 12-month return to -1.1%. In comparison, the broader S&P/ASX 300 Accumulation Index gained 1.2% for the month and global indices were negative (MSCI World Index -3.4%).

Key Contributors

AGL Energy (AGL, underweight) – the utilities company underperformed during the period given as it reported a soft result given plant reliability issues in the half and uncertain outlook given the wholesale changes in management underway. We remain underweight AGL. Whilst acknowledging the potential for corporate activity, we feel any upside from this is likely to be modest in the context of the substantial risks AGL faces in transitioning away from its highly profitable but carbon intensive coal generation fleet. With the demerger plans now forgone and much of the executive team and Board exiting the business, we await a meaningful strategy update to assess AGL's path forward.

Stockland (SGP, underweight) – the diversified REIT's FY22 result released in August highlighted a challenging backdrop for its residential development business, as inquiry rates drop, land lot prices begin to fall, and costs remain elevated. Notwithstanding the stock offering an attractive dividend yield of 7.0% and trading at a 16% discount to last stated asset backing (NTA), we continue to see superior risk adjusted returns in a combination of passive Trusts (GPT, VCX) and MGR for residential exposure.

Event Hospitality (EVT, overweight) – the hospitality provider outperformed following the release of the company's results during the period, with its diversified asset base (cinemas, hotels and ski field) continuing to experience a recovery in its visitation and improving pricing power. With the prosect for well in excess of 100% growth in earnings from FY22 levels as operating conditions normalise, we continue to maintain an overweight position.

Key Detractors

Scentre Group (SCG, underweight) – the shopping mall REIT outperformed following the release of its first half accounts. The strong rebound reflects ongoing improvement in operating metrics (visitations, occupancy), high levels of CPI linkages in specialty leases and robust underlying asset valuations. While the stock trades at 0.80 times NTA and offers a 5.6% dividend yield, we continue to see superior risk-adjusted returns in peer retail owners such as Vicinity Centres (VCX) and Bunnings Trust (BWP).

Charter Hall Group (CHC, underweight) – the fund manager REIT outperformed over the month, partially reversing recent underperformance reflecting broader concerns around higher real yields and the prospect for lower FUM growth as the commercial real estate valuation cycle moderates. The company's FY22 revealed a strong start to FY23 from a transaction perspective. However, we remain underweight based on our view that AUM growth and transaction volumes – which are running at elevated levels – will normalise in the longer term as the cap rate compression cycle reverses. As CHC's growth rate slows from impressive double-digit levels, we expect pressure on the earnings multiple will constrain share price performance, and maintain a preference for Goodman Group (GMG) at this time.

Origin Energy (ORG, underweight) – the energy company outperformed during the month as the certainty for the near-term outlook in its Energy Markets business improved and the company benefited from higher domestic gas and international oil prices. ORG has only a low level of Real Asset characteristics, so we would require compelling valuation to be overweight the name.

Key Purchases

GPT (GPT) – we added to our GPT position during the period at prices we believe significantly undervalue its high-quality asset base and cash flow profile. While significant concern has been levelled at GPT's financing position, which had exposed the Trust to elevated re-pricing risk on its debt finance, its conservative balance sheet (gearing at <30%) and high level of liquidity provide us with confidence that the company is appropriately positioned for the forthcoming de-valuation cycle, With the stock marked down to 0.7 times trailing NTA – embedding an assumption of 25%+ falls in asset values – and offering an attractive 5.8% dividend yield, we believe there is compelling value available on a long-term view. Lastly, GPT successfully accumulating capital in its funds management business, evidenced by the recent win of $2.7bn of retail asset management on behalf of Cbus Property and UniSuper. We believe the current share price significantly undervalues this growing, diversified third-party funds management business (now $20bn FUM).

Key Sales

Vicinity Centres (VCX, overweight) – we reduced our position in the shopping mall REIT following a period of strong outperformance, which provided an opportunity to rebalance into discounted opportunities such as GPT. We continue to see relative upside in VCX as Australia emerges from the COVID crisis, with the company better positioned to navigate higher interest rates, with lower leverage and higher hedging than peers. While we continue to believe that shopping mall REITs face longer term structural rental challenges, we believe this is already factored into VCX's valuation of 0.82 times trailing NTA and with increasing direct transactional evidence at prices at or close-to prevailing NTAs.

BWP (BWP, overweight) – we reduced our position over the month to reflect strong recent performance, redeploying funds into GPT. We remain attracted to BWP's high quality hardware tenanted portfolio, with assets typically in high value locations which provide excellent alternate uses should Bunnings chose to vacate assets over time. Additionally, with over 50% of BWP's leases linked to CPI, the outlook is well supported amidst a higher inflationary period.

Goodman Group (GMG, overweight) – we reduced our position following strong recent performance, coupled with the implications of the cap rate cycle turning for industrial assets. We believe GMG is well-placed to continue to grow earnings well above sector peers (FY23 EPS guidance is for 11% y/y) but have recalibrated our holding given an elevated valuation (12 times 12-month forward earnings) and the 1.5% dividend yield on offer.

Key Active Overweights

GPT Group (GPT) – we believe GPT offers investors exposure to a high-quality, diversified commercial real estate portfolio. The company's conservative balance sheet (gearing at <30%) and its high-level of liquidity provide us with confidence that the company is appropriately positioned for the forthcoming de-valuation cycle. Lastly, GPT's valuation has become more attractive, trading at 0.70 times trailing NTA and with a 5.8% dividend yield.

BWP Trust (BWP) – we believe BWP trades at a compelling valuation versus peers – 1.0 times NTA (based on conservative cap rates) with a 4.5%-plus dividend yield – when considering its strong operating outlook, driven by well-located properties that encourage high rates of lease renewals from tenant Bunnings. Further, the REIT has the lowest gearing levels in the sector and is set to benefit from higher inflation given CPI leases account for around 53% of its lease structures.

Chorus (CNU) – CNU is a quality regulated utility, trading on a 6.0% FY24 dividend yield and with medium term upside via regulatory returns. As the build out of the company's fibre network comes to an end, we expect CNU will move to strong free cash flow generation against the backdrop of having a balance sheet that is under levered vs. target gearing and with a strong line of sight on regulatory revenues. Based on current market metrics, CNU should earn a 100bp higher regulatory return in the next regulatory period from July 2024, providing further upside to the medium-term dividend yield.

Key Active Underweights

APA Group (APA) – we remain underweight the gas pipeline operator on the grounds that APA's initiatives to shift its business model towards electrification won't be sufficient. We expect it to be dwarfed by the discount increasingly applied to its gas pipeline business, particularly as planned government policies accelerate the shift to zero emissions sources. As a result, we no longer see its valuation (at a 12-month EV/EBITDA of 13.3 times) as sufficiently compelling when compared to large cap infrastructure alternatives.

Stockland (SGP) – our underweight position in the diversified REIT is premised on long-term concerns on the sustainability of what is now becoming the tail-end of booming domestic residential conditions driven by pandemic-related stimulus which has heavily supported the first home buyer segment. Over time, SGP's valuation faces downside risk given its exposure to second-tier shopping centres (40% of NTA), where structural change is likely to accelerate, and to residential profitability (~35% earnings and 20% of NTA), where we see softer demand in the medium-term as the housing stimulus (Homebuilder) rolls over and the impact of lower migration levels takes hold.

Scentre Group (SCG) – our underweight position in the shopping mall REIT reflects longer-term concerns around the sustainability of leasing growth, leading to concerns around dividend and valuation growth sustainability. While industry evidence of retail valuations largely held into June-22 (VCX and SCP declared cap rate tightening into June-22) we view this as temporary and expect valuation declines in future periods. Additionally, SCG's relatively high level of debt and its lower hedged position leaves it vulnerable compared to large cap retail peers such as Vicinity Group. While the stock trades at 0.79 times NTA and offers a 5.6% dividend yield, we continue to see superior risk adjusted returns in peer retail owners such as Vicinity Centres (VCX) and Bunnings Trust (BWP).

Market outlook

We maintain our longer-term conviction in the Real Assets sector, underpinned by solid fundamentals and attractive underlying valuation support. The S&P/ASX 300 Custom Infrastructure, Utilities and A-REITs Accumulation Index offers a 12-month forward forecast dividend yield of 4.6%, an attractive 0.9% premium above the 10-year Australian bond rate and with the index dividend yield set to increase in future years as traffic levels normalise on patronage-based infrastructure assets.

We see opportunities in high quality infrastructure companies with strong inflation protection and exposure to recovering economies, qualities both present within the transportation infrastructure sector. Toll roads are at the forefront of the post COVID-19 recovery and at Atlas Arteria (ALX) we see several catalysts on the horizon and are not surprised to see recent corporate interest in the company. Chorus (CNU) is a quality regulated utility trading on a 5.9% FY23 dividend yield with medium term upside in regulatory returns. We remain cautious towards utilities names with a high reliance on fossil fuels and difficulty in transitioning to a lower carbon environment, namely AGL Energy (AGL) and APA Group (APA).

We view the outlook as mixed across the REIT sub-sector exposures moving into CY23. Positively, we see recovering occupier demand – particularly as office workers return to the offices, and shoppers return back to shopping malls – following an elongated period of COVID-disruptions and restrictions concentrated in the major cities of Melbourne and Sydney (combined >50% A-REIT asset exposure). We expect this will drive improved leasing outcomes and support the rent collection trajectory. Additionally, a number of the REITs also have rents linked to CPI increases, providing an effective hedge to increasing inflation.

However, accompanying this recovery, we expect the prospect of higher interest rates to begin to slow and even decrease capital values (i.e. REIT NTAs) as return requirements begin to increase, and REITs see an end of the multi-year trend of falling borrowing costs (an important driver of earnings and dividend growth over the past three years).

Top 5 holdings

	Portfolio	Benchmark	Active
Transurban	19.23	18.95	0.28
Goodman	15.92	14.78	1.14
GPT	7.73	3.57	4.16
Dexus	5.89	4.15	1.74
Vicinity Centres	5.52	3.31	2.21

Key active positions

Overweights	Portfolio	Benchmark	Active
GPT	7.73	3.57	4.16
BWP Trust	3.76	0.85	2.92
Chorus	4.25	1.41	2.84
Underweights			
APA	0.00	5.78	-5.78
Stockland	0.00	3.82	-3.82
Scentre	3.18	6.75	-3.56

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.

Sector allocation

	Portfolio	Benchmark	Active
Infrastructure	**37.76**	**30.14**	**7.63**
Airport Services	0.00	0.62	-0.62
Highways & Railtracks	24.48	22.34	2.13
Communication Services	5.43	1.64	3.79
Railroads	0.00	3.04	-3.04
Marine Ports & Services	5.48	2.50	2.97
Information Technology	2.38	0.00	2.38
Utilities	**2.44**	**12.98**	**-10.55**
Electric Utilities	2.44	4.91	-2.48
Gas Utilities	0.00	5.78	-5.78
Multi-Utilities	0.00	2.28	-2.28
Real Estate Investment Trusts (REITs)	**56.58**	**56.88**	**-0.30**
Specialized REITs	5.92	3.91	2.01
Diversified REITs	12.32	16.55	-4.23
Industrial REITs	15.92	15.80	0.13
Office REITs	5.89	5.17	0.71
Retail REITs	14.75	14.76	-0.00
Other	1.77	0.69	1.08
Cash and receivables	**3.22**	**0.00**	**3.22**

Features

Investment objective	To achieve a balance of income and medium-to-long term capital growth by investing primarily in Australian listed infrastructure, utilities and REIT securities. In doing so, we aim to outperform the S&P/ASX 300 Custom Infrastructure, Utilities and A-REITs Index over rolling three year periods.	
Recommended investment time frame	5 - 7 + years	
Fund inception	December 2005	
Fund size	A$17.0 mn as at 31 August 2022	
APIR code	JBW0030AU	
Estimated management cost	0.85 p.a.	
Buy/sell spread	+/- 0.15	
Platform availability	Asgard BT Panorama	Hub24

Applications and contacts

Investment into the Yarra Australian Real Assets Securities Fund can be made by Australian resident investors only.

Website www.yarracm.com

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