# Yarra Australian Real Assets Securities Fund

## Gross returns as at 31 March 2021

| | 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 | 8.44 | 5.59 | -1.86 | 27.91 | 8.92 | 7.06 | 9.03 | 8.18 |
| S&P/ASX Custom Infrastructure, Utilities and A-REITs Index* | 6.83 | 5.47 | -1.22 | 25.13 | 6.38 | 5.70 | NA | NA |
| Excess Return† | 1.60 | 0.12 | -0.64 | 2.78 | 2.55 | 1.36 | 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 March 2021

| | 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 | 7.52 | 5.52 | -2.06 | 26.84 | 8.01 | 6.16 | 8.11 | 7.27 |
| S&P/ASX Custom Infrastructure, Utilities and A-REITs Index* | 6.83 | 5.47 | -1.22 | 25.13 | 6.38 | 5.70 | NA | NA |
| Excess Return† | 0.69 | 0.05 | -0.84 | 1.71 | 1.63 | 0.46 | NA | NA |
| Growth Return‡ | NA | NA | NA | 13.26 | -11.18 | -9.02 | -1.73 | -0.93 |
| Distribution Return‡ | NA | NA | NA | 13.57 | 19.18 | 15.18 | 9.84 | 8.20 |

**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

Australian Real Assets declined in the March quarter as rising bond yields globally offset a solid interim reporting season.

The S&P/ASX 300 Custom Infrastructure, Utilities and A-REITs Accumulation Index returned -1.2% for the quarter, taking its 12-month return to +25.1%. In comparison, the broader ASX 300 returned +4.2% for the quarter and 38.3% for the year. Returns had been stronger as companies delivered one of the best reporting seasons on record, with 3.2 times more beats than misses[1]. However, equities de-rated in the second half of the period as the Australian 10-year bond yield rose 82 bps to 1.79%.

Infrastructure & Utilities weighed on the benchmark, declining -2.0%. At a sub-industry level, gains from Railroads and Airport Services were dwarfed by falls in Utilities and Tollroads. Within Utilities, AGL Energy (AGL, -15.8%) underperformed following a disappointing 1H21 result; management stated wholesale electricity prices would weigh on profitability into FY22 and, subsequently, announced plans to demerge its retail-facing and coal generation businesses. Gas pipeline operator APA Group (APA, +3.8%) provided an offset as it upgraded dividend guidance for FY21, with the company also announcing a shift in strategy towards renewables, hydrogen and batteries. Within Tollroads, Atlas Arteria (ALX, -6.3%) and Transurban (TCL, -2.5%) underperformed as COVID-19 related restrictions continued to impact traffic volumes.

Meanwhile, performance among REITs (-0.6%) was more mixed. At a sub-industry level, 're-opening' beneficiaries (Retail and Office REITs) outperformed, while 'COVID' beneficiaries (Industrial REITs) underperformed. At a stock level, shopping mall operators Scentre Group (SCG, +4.1%) and Vicinity

[1] Source: Morgan Stanley.

Centres (VCX, +3.1%) rallied after delivering results largely ahead of expectations on the back of lower leasing spreads (-13% and -12% respectively), higher rent collection and higher occupancy than anticipated. Conversely, Industrial REIT Goodman Group (GMG, -4.2%) retraced prior outperformance despite upgrading FY21 EPS growth guidance at its 1H21 result.

## Portfolio review

### Key Contributors

AGL Energy (AGL, underweight) – the energy company underperformed following a disappointing 1H21 result. Though earnings for the period were broadly in line with downgraded consensus (with underlying NPAT falling 27% y/y to $317mn), management stated wholesale electricity prices would weigh on profitability into FY22 and that the company's business model was under review as Australia's transition to renewable energy accelerates. AGL subsequently announced a de-merger of its coal generation and retail assets. The result supported our negative thesis on the stock. In the short term, we expect declining electricity wholesale prices to weigh on earnings, with prices likely to remain depressed before recovering to a level that can incentivise new energy generation. In the longer term, we believe AGL's transition away from being a fully integrated electricity generator is likely to create material earnings pressure over time, including via the Liddell power station closure in 2023 which currently represents 15-20% of earnings.

Charter Hall Group (CHC, underweight) – the fund manager REIT underperformed as its 1H21 result failed to live up to high expectations and due to higher bond yields, with CHC more operationally leveraged to real estate values versus peers. CHC delivered 1H21 earnings of 28.7 cents per share, 2% ahead of consensus, and upgraded FY21 EPS guidance from 53-55 cents per share – 1% below analyst forecasts. We remain underweight the stock based on our view that AUM growth and transaction volumes – which are running at elevated levels – will normalise in the medium term as the cap rate compression cycle slows. As the growth rate of the business slows from impressive double-digit levels, we expect the multiple to contract, putting pressure on the share price outlook. Within the real estate fund manager space, we maintain a preference for Centuria Capital (CNI).

GPT Group (GPT, overweight) – the diversified REIT outperformed following its FY20 result. GPT reported FY20 FFO of $554.7mn, down 10% y/y but around 10% ahead of consensus expectations due to higher rent collections (at 94% of net billings for the year). We continue to believe GPT offers investors exposure to a high-quality, diversified commercial real estate portfolio. Its conservative balance sheet (gearing at 25%) and high level of liquidity ($1.2bn) provide us with confidence that the company is well positioned for the forthcoming de-valuation cycle. Lastly, GPT's valuation has become more attractive at 0.83 times trailing NTA, which implies a 15% fall in gross asset values, a more significant fall than our base expectations of 5-10% as a result of the COVID-19 crisis.

### Key Detractors

Scentre Group (SCG, underweight) – the shopping mall owner outperformed during the period after delivering a solid 1H21 result, with higher rent collection (at 93%) and higher occupancy (99%) than anticipated. We remain underweight based on our view of ongoing challenging leasing dynamics and, in the longer-term, a belief that SCG's balance sheet is too heavily geared as asset values continue to grind lower. While headline gearing fell from 38% to 28% during the period as a result of the company issuing hybrid securities, we expect further de-valuations of 10% in the next 6-18 months. Further, SCG is taking a tougher stance on negotiations with non-SME tenants, which we expect may lead to increased vacancy risks across the portfolio. Lastly, we do not regard SCG's forecast dividend yield of 5.1% as attractive versus peers when factoring in these risks. Our preferred Retail REIT exposure remains Vicinity (VCX), which offers a more compelling valuation and exposure to recovering Victorian-skewed portfolio.

Stockland Group (SGP, underweight) – the diversified REIT outperformed during the period amid Australia's strengthening residential market and after delivering a strong 1H21 result, with FFO 6% ahead of consensus estimates and full-year guidance reinstated in line with expectations. Our underweight position remains premised on long-term concerns about SGP's asset values beyond COVID-19 and the sustainability of current booming residential conditions driven by pandemic-related stimulus programs which are heavily supporting the first home buyer segment. SGP's valuation faces downside risk. It is exposed to 2nd tier shopping centres (43% of NTA), where structural change is likely to accelerate, and to residential (22% of NTA), where beyond current peak-like conditions we see softer demand in the medium-term as housing stimulus (HomeBuilder) rolls over and the impact of lower migration levels takes hold.

NEXTDC (NXT, overweight) – the data centre operator partially retraced outperformance from prior periods without any materially negative news. Its 1H21 result was ahead of consensus estimates and full-year guidance was upgraded from $125-130mn to $130-133mn (versus consensus at $129mn). We believe NXT is set to benefit from increasing adoption of cloud technology, and is accelerating its expansion to meet client demands by building new data centres which will support significant medium to longer term earnings growth. While the stock appears expensive at a headline 33.4 times 12-months forward EV/EBITDA multiple, the company is supported by a strong balance sheet (net cash) and annuity-style revenue growth (+20% p.a.).

### Key Purchases

Qube Logistics (QUB) – we established a holding in the logistics company following the $1.65bn announced sale of its Moorebank property and solid 1H21 result, reducing our underweight position. Assuming the Moorebank transaction occurs at end of 2021 as expected (the deal is non-binding at this stage), QUB's balance sheet will be returned to investment grade (at 2.5 times net debt to EBITDA) and with the potential for a special dividend or buy-back. In our view the announcement of the Moorebank transaction will eventually refocus the market's attention on QUB's Operating Division which is likely to see supportive trading conditions as the domestic economic backdrop strengthens.

Scentre Group (SCG) – we reduced our underweight as the shopping centre REIT rallies in concert with the re-opening theme in the short term. However, SCG remains a high-conviction underweight, predicated on our view of ongoing challenging leasing dynamics and, in the longer-term, a belief that SCG's balance sheet is too heavily geared as asset values continue to grind lower. Gearing to common equity increased to 38% as at 31 December, up from 31% in the prior year, with 10% further de-valuations likely to come in the next 6-18 months. Further, SCG is taking a tougher stance on negotiations with non-SME tenants, which we expect may lead to increased vacancy risks across the portfolio. Within the pure mall owner space, we prefer peer Vicinity Centres (VCX), which has a more conservative balance sheet position (25% gearing) following its $1.4bn equity raising in June.

Goodman Group (GMG) – we increased our holdings in the industrial REIT during the period, and now hold a small underweight position. We believe GMG can deliver strong FY21 earnings growth (double-digit EPS growth), adding further to its assets under management (at $60bn by year-end) and with a strong development pipeline as the company benefits from e-commerce acceleration. That being said, our underweight is underpinned by earnings normalising on a 2-3 year view and a stretched valuation (at 23.5 times forward EV/EBITDA).

**Key Sales**

SCA Property Group (SCP) – we exited our position in the shopping mall REIT during the period following recent outperformance, reallocating our holdings to peer Charter Hall Retail REIT (CQR). In our view, CQR trades at a more attractive valuation (at 1.0 times NTA versus SCP at 1.1 times) and will continue to benefit from the 'shop local' theme as consumers avoid large shopping mall hubs.

Sydney Airport (SYD) – we reduced our position in the airport operator due to the outlook for a more protracted recovery in international travel and underappreciated risks arising from the renewal of airline and tenant agreements. Most airline agreements are scheduled for renewal in July 2021 which may be extended by a further 12 months, however ultimately we see these renewals as presenting adverse pricing pressure for the airport operator given the global state of the aviation industry. While we continue to view SYD's assets as high-quality and with strong barriers to entry, we regard the stock as fully valued at a CY22 EV/EBITDA of 20.7 times earnings when considering these risks. We have moved to a modest underweight position.

Waypoint REIT (WPR) – we reduced our position in the petrol station REIT after it rallied to pre-COVID levels, but remain overweight. We see the REIT as well positioned in the current environment, particularly compared to its Retail and Office peers which face vacancy and rental pressure amid the COVID-19 crisis. WPR owns a portfolio of 469 service stations with 100% occupancy from sole tenant Viva Energy Group (VEA). The rental terms are attractive, with 3% per annum fixed rental increases and a weighted average lease expiry of 11.7 years. We view WPR's capital position as adequate, with 30% gearing and undrawn debt of $250mn.

**Key Active Overweights**

APA Group (APA) – our overweight position is based on our view that APA's valuation – at an EV/EBITDA of 12.7 times and with a 5.3% forecast dividend yield – is attractive when considering its exposure to increasingly important gas markets and dominant market position. We view APA's balance sheet as very strong, with $2bn of liquidity and no refinancing requirements until FY22. We also see material dividend upside driven by lower funding costs, scope for higher payout ratio and are attracted to the company's conservative balance sheet position.

GPT Group (GPT) – we believe GPT offers investors exposure to a high-quality, diversified commercial real estate portfolio. Its conservative balance sheet (gearing at 25%) and high level of liquidity ($1.2bn) provide us with confidence that the company is well positioned for the forthcoming de-valuation cycle. Lastly, GPT's valuation has become more attractive at 0.83 times trailing NTA, which implies a 15% fall in gross asset values. This is a more significant fall than our base expectations of 5-10% as a result of the COVID-19 crisis.

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 short term traffic volumes. Beyond traffic normalisation, we see a path towards value creation for ALX through extension of concessions at APRR as a means to fund expansion projects and settling the Dulles Greenway tolling regime.

**Key Active Underweights**

Stockland (SGP) – our underweight position is premised on long-term concerns about SGP's asset values beyond COVID-19 and the sustainability of current booming residential conditions driven by COVID-19 stimulus programs which are heavily supporting the first home buyer segment. SGP's valuation faces downside risk. It is exposed to 2nd tier shopping centres (43% of NTA), where structural change is likely to accelerate, and to residential (22% of NTA), where beyond current peak-like conditions 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 is predicated on SCG's unsustainable balance sheet on a longer-term view, as asset values continue to shift lower. While headline gearing fell from 38% to 28% during the period as a result of the company issuing hybrid securities, we expect 10% further de-valuations in the next 6-18 months. Further, SCG is taking a tougher stance on negotiations with non-SME tenants, which we expect may lead to increased vacancy risks across the portfolio. Lastly, we do not see SCG's forecast dividend yield of 5.1% as attractive versus peers given these risks.

Our preferred Retail REIT exposure remains Vicinity (VCX), which offers a more compelling valuation and exposure to a recovering Victorian-skewed portfolio.

Aurizon Holdings (AZJ) – we are underweight AZJ because we find the headline valuation unsupportive (at an EV/EBITDA of 7.4 times and on a 12-month forward dividend yield of 7.3%) when considering long-term revenue headwinds. We believe the outlook for customer-end markets in coal will weaken further, with the commodity facing structural challenges as the world's energy mix shifts away from emissions-intensive fossil fuels.

## Market outlook

We maintain our 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 4.2%, a compelling 2.4% premium above the 10-year Australian bond rate.

Within Infrastructure, we believe that in the long run strong fundamentals and attractive growth opportunities should continue to support the likes of Transurban (TCL) and Atlas Arteria (ALX). In the nearer term, we expect toll roads to be at the forefront of the post COVID-19 recovery in activity levels amongst patronage-based infrastructure assets. We remain cautious towards infrastructure providers with exposure to cyclical end markets such as AGL Energy (AGL), with a strong preference within Utilities for APA Group where we see substantial scope for operating cash flow growth and higher dividends over the medium term.

Within A-REITs, we maintain a strong preference to being exposed to high quality asset owners with strong balance sheets at more attractive valuations such as GPT Group (GPT). We believe the structural headwinds facing shopping mall owners are likely to persist, with changing consumer preferences increasingly directing retail sales away from malls to online. We continue to maintain a highly selective approach across the sector, steering away from owners of malls lacking strong competition barriers and steering towards resilient sectors with attractive long-term leases (10-years+) and high quality tenants.

We expect COVID-19 will create patches of short-term uncertainty for earnings and distributions, as tenants exposed to the Australian consumer and SME customer are faced with escalating operating constraints in the current period. Robust balance sheets (average gearing levels around 25% net debt / total assets), solid levels of liquidity and strong in-place occupancy levels suggest REITs are well positioned overall to see through the current dislocation.

## Sector allocation

| | Portfolio % | Benchmark % | Active % |
|---|---|---|---|
| **Infrastructure** | 34.81 | 33.95 | 0.86 |
| Airport Services | 6.15 | 7.88 | -1.72 |
| Highways & Railtracks | 24.02 | 18.31 | 5.71 |
| Communication Services | 0.00 | 1.91 | -1.91 |
| Railroads | 0.00 | 3.14 | -3.14 |
| Marine Ports & Services | 3.17 | 2.71 | 0.46 |
| Information Technology | 1.46 | 0.00 | 1.46 |
| **Utilities** | 9.83 | 10.86 | -1.03 |
| Electric Utilities | 0.00 | 3.12 | -3.12 |
| Gas Utilities | 9.83 | 5.13 | 4.70 |
| Multi-Utilities | 0.00 | 2.61 | -2.61 |
| **Real Estate Investment Trusts (REITs)** | 53.51 | 55.19 | -1.68 |
| Specialized REITs | 6.10 | 2.68 | 3.42 |
| Diversified REITs | 18.87 | 18.15 | 0.72 |
| Industrial REITs | 12.72 | 14.08 | -1.36 |
| Office REITs | 1.77 | 5.84 | -4.07 |
| Retail REITs | 12.11 | 13.31 | -1.20 |
| Other | 1.93 | 1.11 | 0.82 |
| **Cash and receivables** | 1.85 | 0.00 | 1.85 |

## Top 5 holdings

| | Portfolio % | Benchmark % | Active % |
|---|---|---|---|
| Transurban | 17.75 | 15.83 | 1.92 |
| Goodman | 12.72 | 13.23 | -0.50 |
| APA | 9.83 | 5.13 | 4.70 |
| GPT | 8.39 | 3.89 | 4.50 |
| Mirvac | 7.89 | 4.27 | 3.62 |

## Key active positions

| Overweights | Portfolio % | Benchmark % | Active % |
|---|---|---|---|
| APA | 9.83 | 5.13 | 4.70 |
| GPT | 8.39 | 3.89 | 4.50 |
| Atlas Arteria | 6.26 | 2.48 | 3.79 |
| **Underweights** | | | |
| Stockland | 0.00 | 4.56 | -4.56 |
| Scentre | 2.98 | 6.35 | -3.38 |
| Aurizon | 0.00 | 3.14 | -3.14 |

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.

## 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$23.8 mn as at 31 March 2021 |
| APIR code | JBW0030AU |
| Estimated management cost | 0.85% p.a. |
| Buy/sell spread | +/- 0.15% |
| Platform availability | Asgard<br>BT Panorama<br>BT Wrap<br>Hub24<br>IOOF Pursuit Select<br>Macquarie Wrap<br>Consolidator<br>OneVue<br>PowerWrap<br>SmartWrap |

## Applications and contacts

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

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