YARRA CAPITAL MANAGEMENT

Investment Commentary
Month to 31 May 2022

Yarra Australian Real Assets Securities Fund

Gross returns as at 31 May 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	8.71	-4.74	0.26	9.22	4.46	6.76	9.96	8.31
S&P/ASX 300 Custom Infrastructure, Utilities and A-REITs Index*	8.07	-5.06	1.31	13.89	4.14	5.95	NA	NA
Excess Return†	0.65	0.32	-1.05	-4.67	0.32	0.81	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 May 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	7.80	-4.81	0.04	8.30	3.58	5.87	9.04	7.39
S&P/ASX 300 Custom Infrastructure, Utilities and A-REITs Index	8.07	-5.06	1.31	13.89	4.14	5.95	NA	NA
Excess Return†	-0.27	0.25	-1.26	-5.59	-0.56	-0.09	NA	NA
Growth Return‡	NA	NA	NA	1.56	-8.25	-9.82	-1.22	-0.64
Distribution Return‡	NA	NA	NA	6.74	11.83	15.69	10.25	8.03

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 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 during May 2022, underperforming the wider market as Australia's first interest rate hike since 2010 pressured valuations.

The Custom Infrastructure, Utilities and A-REITs Accumulation Index returned -5.1% during the month, taking its 12-month return to 13.9%. In comparison, the broader ASX300 declined -2.8% for the month while global indices were flat (MSCI World Index -0.2%). The ASX300's forward P/E declined from 15.1 times to 14.3 times as the RBA lifted the official cash rate by 25 bps to 0.35%.

Infrastructure & Utilities (-0.1%) outperformed the broader ASX300 as Tollroads and Marine Ports & Services supported the benchmark, more than offsetting weakness from Airport Services. At a stock level, logistics company Qube (QUB, +3.4%) outperformed as it announced the completion of its $400mn buy-back following the $1.2bn Moorebank sale.

Conversely, Aussie Broadband (ABB, -24.8%) provided a disappointing quarterly trading update, with lower-than-expecting subs growth driving FY22 EBITDA guidance to the lower end of its previous range.

Elsewhere, REITs (-8.6%) declined sharply given their sensitivity to real interest rates. Retail and Office REITs outperformed while Industrial and Specialized REITs underperformed. At a stock level, Industrial REIT Goodman Group (GMG, -14.3%) was the largest detractor to the benchmark's return after key tenant Amazon called out excess capacity in its fulfillment and transportation network. Other large falls came from fund manager REITs Charter Hall Group (CHC, -15.3%) and Centuria Capital (CNI, -20.7%).

Portfolio review

Key Contributors

Charter Hall Group (CHC, underweight) – the fund manager REIT underperformed amid concerns around higher real yields and the prospect for lower FUM growth as the commercial real estate valuation cycle moderates. 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, our preference is with Goodman Group (GMG).

Qube Holdings (QUB, overweight) – we remain overweight the company. Following the Moorebank transaction, QUB's balance sheet has returned to investment grade (at 2.5 times net debt to EBITDA) with the company announcing a $400m buy-back. QUB's capex burden has also reduced from $1-1.2bn to $200-250mn, significantly improving the company's FCF profile. We see further upside to QUB's Operating Division as supportive trends drive higher consumer and housing activity in Australia and expect strong trading conditions in the Ports and Bulk division to persist amid high export volumes in resources and agricultural trade.

Atlas Arteria (ALX, overweight) – the toll road operator outperformed without any materially positive news during the period, although we suspect investors were favouring the stock for its transparent inflation linkage. 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.

Key Detractors

Goodman Group (GMG, overweight) – the industrial REIT underperformed after key tenant Amazon called out excess capacity in its fulfillment and transportation network. We remain overweight. The fundamentals for the business across key global markets are strong, supported by tailwinds of e-commerce growth, supply-chain optimisation and a rebound in global industrial growth following COVID disruptions. We believe GMG can deliver strong earnings growth in FY22 with growing assets under management (at $60bn by year-end) and a strong development pipeline as the company benefits from the acceleration of e-commerce. In that context we no longer see its headline valuation, at a 12-month forward EV/EBITDA of 21.0 times, as stretched.

Origin Energy (ORG, overweight) – the energy company outperformed as oil prices increased (with Brent Crude rising 2% to US$109/bbl) and the outlook for higher electricity prices domestically and in response to a strong 2QFY22 result. We remain underweight the company given its heavy reliance on Energy exposure to generate cash flow through its 27.5% stake in vertically integrated LNG export terminal APLNG. ORG has announced the closure of its Eraring coal power plant which we view positively, given it positions the company as capital light participant in the energy transition with a large retail customer base.

APA Group (APA, underweight) – the gas pipeline operator outperformed in the period after hosting an investor day. Management highlighted its inflation-linked revenues and opportunities in the energy transition, particularly given the scale of investment required into variable renewable energy (VRE) and transmission. We remain underweight the company 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 12.3 times) as sufficiently compelling when compared to large cap infrastructure alternatives.

Key Purchases

There were no key purchases during the period.

Key Sales

There were no key purchases during the period.

Key Active Overweights

Vicinity Centres (VCX) – we continue to see relative upside in the shopping mall REIT as Australia emerges from the COVID crisis. While we continue to believe that shopping mall REITs face accelerated structural issues, we now believe this is well recognised with VCX trading at 0.83 times trailing NTA and increasing direct transactional evidence at prices at or close-to prevailing NTA's. Due to its large exposure to Victoria (53% NTA), we expect short-term support as COVID cases across the state continue to fall.

BWP Trust (BWP) – we believe BWP trades at a compelling valuation versus peers – 1.1 times NTA (based on conservative cap rates) with a 4.5% forecast 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 (at less than 17%) and is set to benefit from higher inflation given CPI leases account for around 53% of its lease structures.

GPT Group (GPT) – we believe GPT offers investors exposure to a high-quality, diversified commercial real estate portfolio. Its conservative balance sheet (gearing is below 30%) and high level of liquidity ($1.2bn) provide us with confidence that the company is appropriately positioned for the forthcoming de-valuation cycle. Lastly, GPT's valuation has become more attractive at 0.79 times trailing NTA, which implies an approximate decline of 20% in gross asset values (when ascribing value to GPT's Funds Management business) – a more significant fall than our base expectations.

Key Active Underweights

Origin Energy (ORG) – we remain underweight the company given its heavy reliance on Energy exposure to generate cash flow through its 27.5% stake in vertically integrated LNG export terminal APLNG. ORG has announced the closure of its Eraring coal power plant which we view positively, given it positions the company as capital light participant in the energy transition with a large retail customer base.

Stockland (SGP) – our underweight position is premised on long-term concerns about the sustainability of what is now becoming the tail-end of booming domestic residential conditions driven by pandemic-related stimulus programs which have heavily supported the first home buyer segment. Over time, SGP's valuation faces downside risk given its exposure is to second-tier shopping centres (43% of NTA), where structural change is likely to accelerate, and to residential profitability (35% earnings, and 22% 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.

APA Group (APA) – we remain underweight the company 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 12.3 times) as sufficiently compelling when compared to large cap infrastructure alternatives.

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 4.3%, a compelling 1.0% premium above the 10-year Australian bond rate with the index dividend yield 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. Tollroads 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 name. Chorus is a quality regulated utility trading on a 5.85% 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 see a mixed outlook across REIT sub-sector exposures moving into CY2022. 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 to 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 into CY22 the prospect of higher interest rates to begin to slow and even decrease capital values (i.e. REIT NTA's) as investor acquisition 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	19.90	18.28	1.62
Goodman	17.35	14.48	2.88
GPT	7.43	3.82	3.61
Vicinity Centres	6.87	3.03	3.84
Atlas Arteria	5.98	2.86	3.12

Key active positions

Overweights	Portfolio %	Benchmark %	Active %
Vicinity Centres	6.87	3.03	3.84
BWP Trust	4.48	0.82	3.66
GPT	7.43	3.82	3.61
Underweights			
Origin Energy	0.00	5.00	-5.00
Stockland	0.00	3.96	-3.96
APA	1.63	5.56	-3.93

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	**41.05**	**30.24**	**10.81**
Airport Services	0.00	0.64	-0.64
Highways & Railtracks	25.87	21.13	4.74
Communication Services	5.68	2.94	2.74
Railroads	0.00	3.07	-3.07
Marine Ports & Services	7.06	2.45	4.61
Information Technology	2.43	0.00	2.43
Utilities	**1.63**	**12.95**	**-11.32**
Electric Utilities	0.00	5.00	-5.00
Gas Utilities	1.63	5.56	-3.93
Multi-Utilities	0.00	2.39	-2.39
Real Estate Investment Trusts (REITs)	**56.26**	**56.81**	**-0.55**
Specialized REITs	5.51	3.71	1.79
Diversified REITs	12.39	17.27	-4.88
Industrial REITs	17.35	15.54	1.81
Office REITs	2.01	5.73	-3.72
Retail REITs	17.31	13.95	3.36
Other	1.70	0.62	1.08
Cash and receivables	**1.06**	**0.00**	**1.06**

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$19.6 mn as at 31 May 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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