Yarra Australian Real Assets Securities Fund

Gross returns as at 30 September 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	9.98	-0.81	5.52	18.64	10.30	8.27	11.01	8.75
S&P/ASX 300 Custom Infrastructure, Utilities and A-REITs Index*	8.63	-0.46	6.76	20.01	7.94	7.14	NA	NA
Excess Return†	1.35	-0.35	-1.23	-1.36	2.36	1.12	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 30 September 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	9.05	-0.88	5.30	17.64	9.37	7.35	10.08	7.84
S&P/ASX 300 Custom Infrastructure, Utilities and A-REITs Index	8.63	-0.46	6.76	20.01	7.94	7.14	NA	NA
Excess Return†	0.42	-0.42	-1.46	-2.36	1.43	0.21	NA	NA
Growth Return‡	NA	NA	NA	10.00	-3.40	-8.72	-0.35	-0.50
Distribution Return‡	NA	NA	NA	7.65	12.78	16.08	10.42	8.34

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 delivered solid returns during the September 2021 quarter, overcoming uncertainty relating to protracted lockdowns in NSW and VIC and negative earnings revisions across the market.

The S&P/ASX 300 Custom Infrastructure, Utilities and A-REITs Accumulation Index increased by 6.8% during the quarter, taking its 12-month return to 20.0%. In comparison, the broader ASX300 returned 1.8% for the quarter and +30.9% for the year. FY21 reporting season saw more misses than beats across the ASX despite recording +28% growth y/y, and FY22 forecasts were revised down by -1.2%.

Infrastructure and Utilities stocks increased by 9.0% in the quarter, supported by takeover targets Sydney Airport (SYD, +42.3%), Ausnet Services (AST, +44.0%) and Spark Infrastructure (SKI, +28.8%). Conversely, AGL Energy (AGL, -26.1%) delivered a FY21 dividend below expectations and issued disappointing FY22 guidance due to lower electricity wholesale prices (as hedged positions roll off) and higher gas costs.

REITs rallied by 4.8% during the quarter, driven mostly by the Retail (+9.0%) and Specialised (+11.0%) sub-industries. Investors looked through the protracted lockdowns in NSW and Victoria and rewarded shopping mall owners Scentre Group (SCG, +12.1%) and Vicinity Centres (VCX, +8.1%) for results which were ahead of consensus expectations. Within Specialised, National Storage REIT (NSR, +17.2%) benefited from strong occupancy rates in self-storage as well as elevated acquisition and development activity.

Portfolio review

Key Contributors

AGL Energy (AGL, underweight) – the energy company underperformed after delivering a FY21 dividend below expectations and issued disappointing FY22 guidance due to lower electricity wholesale prices (as hedged positions roll off) and higher gas costs. While FY21 NPAT met analyst forecasts, declining 34% to $537mn, for FY22 management guided to NPAT of $220-340mn, 15% below expectations. We remain underweight AGL. While we support the strategic logic of demerging its coal generation business from its energy retailing business, the reality is that the dis-synergies of doing so will mean that neither of the two resulting businesses have material debt capacity, suggesting additional equity may be required to support the demerger.

Stockland (SGP, underweight) – the diversified REIT underperformed during the period following its FY21 result and as it announced the acquisition of Halcyon, a Queensland-based land lease operator, for $620mn. Management guided to FY22 funds from operations (FFO) of 34.6-35.6 cents, slightly below consensus for 35.9 cents amid a lower-than-expected residential development outcomes, and provisions for COVID-impacted rent deferment. The acquisition of Halcyon appears to have been made at a premium: on a per lot basis, the acquisition equates to $160k compared to other similar projects which are priced at around $100k. We remain underweight SGP due to longer-term concerns around the sustainability of current booming residential conditions driven by pandemic-related stimulus programs. Over time, SGP's valuation also 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 (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.

Centuria Capital (CNI, overweight) – the fund manager REIT outperformed in response to its FY21 result. While earnings of $71.2mn matched consensus expectations, the market was focused on very strong AUM growth (+71%) and the outlook for a more meaningful contribution from its Development income as its pipeline grew to $1.9bn. We see CNI's growth platform as attractive in a post-COVID-19 world. The company manages close to $17bn in funds across a diversified portfolio, underpinned by $4.5bn in listed investment vehicles (CIP and COF). We hold a positive view of its recent merger with Primewest Group (PWG) which increases CNI's FUM to $17bn, is accretive and diversifies the business across new markets (Retail, Agriculture). The company trades on a 12-month forward P/E of 19.7 times, which is only marginally above peer Charter Hall Group (CHC, at 17.0 times) despite superior growth potential.

Key Detractors

Sydney Airport (SYD, underweight) – the airport operator outperformed after receiving a strengthened takeover proposal from an IFM-backed consortium. The bid, which was priced at $8.75 per share, implies a valuation of 22 times FY24 EV/EBITDA, is above other major historic airport transaction multiples such as Gatwick and Copenhagen (which were priced 20-21 times EV/EBITDA). The SYD board granted due diligence on the improved bid. We increased our position during the period, now holding a portfolio weight in line with the benchmark. While we remain negative towards SYD's near term outlook based on a more protracted travel recovery and uncertainty around aeronautical agreements, we believe that even if the bid is not ultimately successful, valuation expectations for the asset have been adjusted upwards, including greater focus on the company's property assets.

Ausnet (AST, underweight) – the electric utilities company outperformed after receiving competing takeover offers from APA Group (APA) and Brookfield Asset Management. We remain underweight the stock as we see limited opportunity for further upside. However, we see a significant risk that Brookfield's offer will be rejected by the Foreign Investment Review Board (FIRB) on the grounds AST's assets are critical infrastructure, particularly amid Australia's accelerating energy transition.

Spark Infrastructure (SKI, underweight) – the electric utility company outperformed after receiving an upped takeover bid from a consortium comprising KKR and OTTP. The third takeover bid – increased from $2.80 to $2.95 per share – was sufficiently attractive for SKI to grant the consortium due diligence. We remain underweight the company as we see limited upside potential following the sweetened takeover proposal, with the indicative offer equating to an enterprise value to regulated asset base (EV/RAB) of 1.45 times. Conversely, significant downside potential exists if the consortium walks away from the offer or, moreover, if FIRB rejects the offer on the grounds it is critical infrastructure amid the energy transition.

Key Purchases

Chorus (CNU) – we established a position in the NZ-based telecommunications infrastructure provider during the period whose regulatory regime has now been largely settled and will commence from January 1 2022. The stock offers attractive attributes of regulated returns and modest growth on the appealing valuation metrics of a 6% dividend yield and 8.7 times EV/EBITDA. With peer companies trading on much higher multiples in New Zealand and medium term regulatory return upside, we expect the stock to re-rate as the market becomes comfortable with CNU's regulatory model.

BWP Trust (BWP) – we increased our position in the REIT during the period. We believe BWP trades at a compelling valuation versus peers – 1.2 times NTA (based on conservative cap rates) with a 4.6% 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 is set to benefit from higher inflation given CPI leases account for around 53% of its lease structures.

Sydney Airport (SYD) – we increased our position in the airport operator during the period following its takeover approach when the stock was trading at a material discount to terms, now holding a portfolio weight in line with the benchmark. At the time we believed there was a good chance of a revised bid – which has subsequently borne out – and even in the scenario where a bid was not ultimately successful, this has resulted in valuation expectations for the asset being adjusted upwards.

Key Sales

APA Group (APA) – we reduced our position during the period, and are now underweight the gas pipeline operator. We believe management is appropriately shifting its business model towards renewables and transmission as Australia's energy mix decarbonises. However, potential upside from the shift is 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 11.9 times) as sufficiently compelling when compared to large cap infrastructure alternatives.

Mirvac Group (MGR) – we reduced our position in the diversified REIT following recent outperformance. Our investment thesis is premised on several factors. Firstly, we expect active residential development earnings (~17% of expected earnings in FY21) to rebound strongly in FY22 and FY23, driven by improved lot volumes. Secondly, we view MGR's office portfolio (61% of its passive portfolio) as best-in-class in the A-REIT sector. Weighted average lease expiries (WALEs) are at 6.5 years, significantly longer than peers such as GPT Group (GPT) (5.5 years) and Dexus Property (DXS) (4.5 years). Lastly, we do not believe its strong overall growth profile (~10% EPS growth in FY22 and FY23) is captured in its current valuation, trading at 1.10 times trailing NTA.

GPT Group (GPT) – we trimmed our position to fund a larger position in Sydney Airport (SYD), but the diversified REIT remains a high-conviction overweight within the portfolio. 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 0.92 times trailing NTA, which implies more than a 15% fall in gross asset values – a more significant fall than our base expectations as a result of the COVID-19 crisis.

Key Active Overweights

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 0.88 times trailing NTA, which implies more than a 15% fall in gross asset values – a more significant fall than our base expectations as a result of the COVID-19 crisis.

Transurban (TCL) – we are overweight the toll road operator based on our positive view of its 100% acquisition of WestConnex, which was done at a fair price and consolidates a strong position across Australia's toll roads. More broadly, we believe that once the COVID disruption is passed, TCL has a strong growth outlook (with a number of new project and expansion plans) and attractive risk-adjusted total return. TCL has the ability to maintain strong (5%-plus) dividend growth by releasing equity over time from its large projects, which we believe is underappreciated by the market.

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 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 Active Underweights

Stockland (SGP) – our underweight position is premised on long-term concerns about SGP's asset values beyond COVID19 and the sustainability of current booming residential conditions driven by pandemic-related stimulus programs, heavily supporting the first home buyer segment currently. 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 (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.

Scentre Group (SCG) – our underweight position is predicated on SCG's challenged balance sheet on a longer-term view, as asset values continue to shift lower. 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 5.2% as attractive compared to peers given these risks. Our preferred Retail REIT exposures remain Vicinity (VCX) and Charter Hall Retail (CQR), which offer more compelling risk adjusted valuations.

Origin Energy (ORG) – the energy company became a key underweight following its inclusion into the Real Assets benchmark late in the prior quarter. We do not believe ORG should be classified as a Utilities company, particularly at a time when the enterprise value of its Energy Markets division has never been lower (amid lower wholesale electricity prices) while its APLNG division has benefited from stronger oil prices. We are in discussions with GICs about reversing the change to the classification.

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 3.8%, a compelling 2.3% 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.

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 as activity amongst patronage-based infrastructure assets rebounds. We remain cautious towards infrastructure providers with exposure to cyclical end markets such as AGL Energy (AGL).

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 – changing consumer preferences are directing an increasing proportion of retail sales away from malls to online – and we continue to maintain a highly selective approach across the sector. This includes steering towards resilient sectors with attractive long-term leases (10-years+) and high-quality tenants. Notwithstanding the recent and ongoing lockdowns in Victoria and NSW, we expect the temporary disruption in earnings and dividends for the REIT sector will recover once re-opening returns, albeit nonuniformly across landlords. From a stability perspective, REITs in our view are well supported by robust balance sheets (average gearing levels around 25% net debt / total assets), solid levels of liquidity and strong in-place occupancy levels.

Sector allocation

	Portfolio %	Benchmark %	Active %
Infrastructure	**44.81**	**34.20**	**10.61**
Airport Services	8.46	8.82	-0.36
Highways & Railtracks	23.89	18.22	5.67
Communication Services	4.12	2.04	2.08
Railroads	0.00	2.58	-2.58
Marine Ports & Services	6.15	2.54	3.61
Information Technology	2.19	0.00	2.19
Utilities	**1.07**	**11.82**	**-10.76**
Electric Utilities	0.00	6.69	-6.69
Gas Utilities	1.07	3.80	-2.74
Multi-Utilities	0.00	1.33	-1.33
Real Estate Investment Trusts (REITs)	**52.93**	**53.98**	**-1.04**
Specialized REITs	5.23	3.29	1.94
Diversified REITs	15.68	17.92	-2.23
Industrial REITs	15.75	14.36	1.38
Office REITs	1.76	5.34	-3.57
Retail REITs	12.64	12.35	0.29
Other	1.87	0.72	1.15
Cash and receivables	**1.19**	**0.00**	**1.19**

Top 5 holdings

	Portfolio %	Benchmark %	Active %
Transurban	16.96	15.92	1.04
Goodman	15.75	13.47	2.27
Sydney Airport	8.46	8.22	0.24
GPT	6.82	3.59	3.23
Mirvac	5.81	4.36	1.45

Key active positions

Overweights	Portfolio %	Benchmark %	Active %
GPT	6.82	3.59	3.23
Transurban	18.88	15.92	2.96
Atlas Arteria	5.01	2.30	2.71
Underweights			
Stockland	0.00	3.95	-3.95
Scentre	2.12	5.74	-3.62
Origin Energy	0.00	3.08	-3.08

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$21.0 mn as at 30 September 2021
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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