

# Yarra Ex-20 Australian Equities Fund

## Gross returns as at 30 April 2021

	From 25 July 2018 <sup>A</sup>	1 month %	3 months %	1 year %	3 years % p.a.	5 years % p.a.	10 years % p.a.	Since inception % p.a.*
Yarra Ex-20 Australian Equities Fund	3.71	1.73	7.19	29.45	4.99	7.52	7.28	7.74
S&P/ASX 300 ex S&P/ASX 20 Accumulation Index <sup>#</sup>	7.27	3.75	6.53	30.71	NA	NA	NA	NA
Excess return (before fees) <sup>‡</sup>	-3.57	-2.02	0.66	-1.26	NA	NA	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 April 2021

	From 25 July 2018 <sup>A</sup>	1 month %	3 months %	1 year %	3 years % p.a.	5 years % p.a.	10 years % p.a.	Since inception % p.a.*
Yarra Ex-20 Australian Equities Fund	2.76	1.66	6.96	28.30	4.01	6.37	6.02	6.46
S&P/ASX 300 ex S&P/ASX 20 Accumulation Index <sup>#</sup>	7.27	3.75	6.53	30.71	NA	NA	NA	NA
Excess return (after fees) <sup>‡</sup>	-4.52	-2.10	0.42	-2.41	NA	NA	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 prepared on an exit to exit basis – they include all ongoing fees and expenses and assume reinvestment of all distributions.

<sup>A</sup> Effective 25 July 2018 the Fund's investment strategy, name and benchmark was changed. Performance prior to 25 July 2018 is provided here for consistency purposes only – the historical performance data shown relates to the previous strategy and should not be used to assess past or future performance of the Fund. See [here](#) for further information.

Performance data relating to the previous strategy is available upon request. 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 Yarra Ex-20 Australian Equities Fund: August 2010.

<sup>#</sup> The benchmark for the Yarra Ex-20 Australian Equities Fund has been amended since the Fund's inception. Effective 25 July 2018, the benchmark is the S&P/ASX 300 ex S&P/ASX 20 Accumulation Index, replacing the S&P/ASX 300 Accumulation Index.

<sup>‡</sup> Excess return: The difference between the Fund's return and the benchmark return.

## Market review

Australian equities continued to generate strong returns in April, rising above pre-pandemic levels for the first time.

The S&P/ASX 300 Ex-20 Accumulation Index returned +3.5% for the month, taking its 12-month return to +30.8%. The index outperformed the broader ASX300, which returned +3.7% during the period, but lagged global indices with the MSCI World Index climbing +4.1%.

Gold (+13.3%) and Information Technology (+7.3%) were the top performing sectors as the 'reflation trade' partially reversed, with the Australian 10-year bond yield falling 10 bps to 1.69%. Within the former, De Grey Mining (DEG, +48.2%) and Chalice Mining (CHN, +32.9%) released promising drilling results. Within tech, top performers included Megaport (MP1, +29.7%), Life360 (360, +20.2%), Data#3 (DTL, +19.8%) and EML Payments (EML, +16.5%).

Other strong performers were online services companies Domain Holdings (DHG, +21.0%), REA Group (REA, +11.7%) and Carsales.com (CAR, +11.7%), and waste management

company Cleanaway Waste Management (CWY, +29.5%) after it announced the acquisition of Suez's recycling and recovery business in Australia for \$2.5bn.

Conversely, Energy (-4.6%) and Consumer Staples (-2.8%) weighed on the benchmark. In the former, Origin Energy (ORG, -11.3%) announced an 8% downgrade to earnings guidance in its Energy Markets business. In the latter, China-exposed companies A2 Milk (A2M, -7.8%), Treasury Wine Estates (TWE, -3.0%) and Blackmores (BKL, -10.2%) were among the worst performers.

## Portfolio review

### Key Contributors

**Carsales.com (CAR, overweight)** – the online automotive classifieds company outperformed during the period without any material news. Our positive view remains premised on the belief CAR should benefit from attractive earnings growth, conservative accounting (with low capitalisation of research and development investment) and undervalued international

businesses. Further, we see CAR's valuation as attractive relative to peers, trading at 31.1 times forward earnings versus REA Group (REA) at 52.0 times.

**Iluka Resources (ILU, overweight)** – the mineral sands producer outperformed as its 1Q21 result highlighted a strong recovery in sales volumes. ILU reported that zircon/rutile/synthetic rutile sales volumes increased +29% q/q to 216,000 tonnes and revenue increased +23% q/q to \$345mn, significantly higher than consensus expectations. We remain overweight based on rising confidence that zircon and rutile markets are improving, with the current conditions exceeding our expectations amid the global economic recovery. We regard the industry structure as attractive (consolidated supply), with less pricing volatility compared to previous cycles. As a result, we see ILU's valuation as attractive (at 6.8 times EV/EBITDA).

**Deterra Royalties (DRR, overweight)** – the iron ore royalties company outperformed as the commodity increased in value (to US\$190 per tonne) and following better-than-expected production out of Mining Area C in 3QFY21. Further, the development of the South Flank project remains on track for first production by mid-2021. We hold a positive view of DRR's Mining Area C (MAC) royalty, which entitles the company to receive 1.232% of iron ore revenue generated from BHP Group (BHP)'s Mining Area C mine and, in addition, an annual capacity payment of \$1mn for every million tonne increase in exports from the area. In our view, the royalty is undervalued at a 12-month forward EV/EBITDA of 12.3 times and offering a 5.4% 12-month forward dividend yield.

### Key Detractors

**TPG Telecom (TPG, overweight)** – the telco underperformed as the surprise resignation of the Chair, announced late in the previous month, continued to weigh on the stock. Despite the lack of clarity around the circumstances of his resignation, we remain overweight the stock. Our positive view remains premised on the recently completed Vodafone merger, which in our view will unlock significant synergies. The combined entity is well placed to harness its infrastructure, scale and balance sheet to disrupt incumbents Telstra (TLS) and Optus through its lower-cost structure, as well as via new products such as Fixed Wireless.

**Incitec Pivot (IPL, overweight)** – the explosives and fertiliser maker underperformed after announcing a profit warning during the period. Ongoing production issues at its Waggaman ammonia plant saw its start-up delayed from mid-March to mid-April, with an announced \$36mn (estimated) impact to FY21 EBIT representing an 8% downgrade versus consensus forecasts. Further issues with the restart of the plant were announced subsequent to period end. We remain overweight the company, as we believe higher commodity prices will provide an offset to these production issues. Our positive view remains premised on key commodities (urea and DAP) reverting to mid-cycle levels. Lead indicators suggest higher demand for the commodities and the explosives business is experiencing more stable pricing as mining demand normalises in North America. At 16.6 times 12-month forward

earnings, IPL trades well below the wider Industrials sector and at a discount to key competitor Orica (ORI) at 19.8 times.

**Origin Energy (ORG, overweight)** – the company underperformed after downgrading EBITDA guidance by 8% in its Energy Markets business during the period. Management lowered its range from \$940-1,020mn (from \$1,000-1,040mn) due to an adverse ruling on a gas dispute with Beach Energy (BPT) and ongoing electricity market weakness. However, at a group level APLNG partially offset this weakness, with ORG announcing it expects a FY21 cash distribution of more than \$650mn from the plant amid higher-than-expected production and gas prices. We remain overweight the stock. Following its initiatives, ORG is now in a stronger position to withstand lower electricity wholesale prices, which we view as being at unsustainably low levels. The company has >\$4bn of liquidity – which can cover all debt maturities in the next 36 months – while APLNG has a lower distribution breakeven of US\$27-31 per barrel and \$1.2bn in cash (as at 30 June 2020).

### Key Purchases

**Latitude Group (LFS)** – we took part in the IPO during the period, with our positive view of the consumer finance business based on several factors. Firstly, we saw its valuation as attractive at 9.7 times our estimate of FY22 earnings, which we believe more than compensates for its small adjusted free float (28%) and selling overhang, and attractive versus peers which trade on an average multiple of 11 times. Secondly, we see LFS as positively leveraged to the strengthening Australian consumer, both through sales and credit expenses. Lastly, we see LFS as a beneficiary of COVID-affected categories including travel services, which we do not believe is captured in market expectations.

**Ansell (ANN)** – we increased our position in the stock during the period. In the short term, we continue to believe ANN's Health Care division (55% of EBIT) will support earnings as it provides crucial equipment to combat the COVID-19 virus, more than offsetting likely short-term disruption from its Industrial division (45% of group EBIT). More broadly, we continue to view the business favourably as it undergoes internal programs to increase operational efficiency and improve margins from new distributor agreements, and shifts towards higher-value products. We do not believe this is captured by consensus; the stock trades at 18.6 times 12-month forward earnings, a large discount to the wider Industrials ex-Financials Index which trades at 27.6 times.

**Lendlease (LLC)** – we increased our position in the construction company during the period. We expect the strong growth in its development pipeline over the last 3 years (to \$114bn) should now allow LLC to step up its annual rate of production from \$4.3bn to \$8bn by FY24. In addition, LLC plans to move 48% of developed assets onto its Investments Platform. The combined uplift in Development and Investments earnings should drive significant double-digit growth in earnings in the next few years, well ahead of consensus expectations. In our view, estimates are too cautious over the medium term (~20-30% below LLC's potential rate of deployment) which could drive earnings upgrades beyond FY21. Lastly, we expect greater earnings

consistency and quality will drive LLC's valuation (currently at 12.7 times two-year forward earnings) to higher multiples.

### Key Sales

**Nearmap (NEA)** – we exited our small position in the aerial mapping solutions company during the period. While we remain positive towards NEA (based on strong double-digit revenue growth in the coming years as NEA consolidates its expansion into North America), we believe this is largely factored into its valuation (at a forward EV/sales of 7.0 times). As a result, we see better opportunities elsewhere within Information Technology at this time, including Link Group (LNK), NEXTDC (NXT) and Tyro Payments (TYR).

**Seven West Group (SVW)** – we reduced our position following recent outperformance, but remain overweight the conglomerate. In our view the WesTrac (47% of its valuation) and Coates (25% of its valuation) businesses have strong long-term outlooks. The former, which provides equipment to the mining and construction industries, is set to benefit from customers both upgrading and purchasing new fleet following years of underinvestment. For the latter, we anticipated improved utilisation and pricing of its equipment as infrastructure activity increases and is pushed out (extending the loan period for its products). Collectively, we regard SVW as being undervalued at 13.6 times forward earnings – a significant discount to the wider Industrials ex-Financials Index at 28.2 times.

**Healius (HLS)** – we reduced our position following recent outperformance but remain overweight the company. We hold a positive view of its pathology and diagnostic imaging divisions and continue to regard its valuation as supportive. The sale of the medical centre business last year enables management to focus on and invest in the pathology, day surgery and diagnostic imaging businesses, which are return on invested capital (ROIC) accretive and have significant margin opportunities. We do not believe this is captured by consensus, with HLS trading at 21.8 times forward earnings – well below the Industrials ex-Financials Index at 28.2 times.

### Key Active Overweights

**Vocus (VOC)** – we are overweight the telco based on our view that the combination of good management, improving fundamentals and quality of the asset base will result in significant upside. The management team has made significant progress in integrating and simplifying the various acquired businesses, unifying its product offering and increasing customer product penetration – driving significant longer-term revenue and margin opportunities. In regards to the recently announced takeover bid (at \$5.50 per share), we view the offer as credible, and are more optimistic it will result in a binding offer following management's recent improvements.

**APA Group (APA)** – our overweight position is based on our view that APA's valuation – at an EV/EBITDA of 12.6 times and with a 5.3% forecast dividend yield – is attractive when considering its exposure to increasingly important gas markets and dominant market share position. We view APA's balance sheet as very strong with \$2bn of liquidity and no

refinancing requirements until FY22, particularly considering that the COVID-19 crisis has had minimal impact on earnings. In the medium term, we see dividend upside driven by lower funding costs, scope for a higher payout ratio and its conservative balance sheet position.

**Iluka Resources (ILU)** – we are overweight the mineral sands producer based on improving confidence that zircon and rutile markets are improving, with the current pace of the recovery exceeding our expectations amid the global economic recovery. We regard the industry structure as attractive (consolidated supply), with less pricing volatility compared to previous cycles. As a result, we see ILU's valuation (6.6 times EV/EBITDA) as attractive. While the outlook for rare earths appears promising in the context of a strong demand profile (as a component for electric vehicles) and potential government support, we ascribe limited value given it is a long-dated opportunity which brings significant execution risks.

### Key Active Underweights

**Sonic Healthcare (SHL)** – we are underweight the company on the grounds that positive vaccine outcomes are likely to create an earnings headwind for the company which, in 2020, brought significant earnings support through its COVID-19 testing services. While short-term earnings should remain robust, we expect EBITDA will decline in FY21 as fewer tests are issued. We no longer view its valuation as sufficiently compelling versus alternatives, with the company trading at 20.3 times forward earnings.

**Xero (XRO)** – we are underweight the accounting software provider because we believe its strong growth outlook is fully factored into its valuation, but its potential risks are not. XRO trades at 20.0 times EV/sales, reflecting lofty expectations for subscriber growth to accelerate as the company continues to expand overseas and for add-on products and services to drive higher average revenue per user (ARPU). However, international expansion carries significant risks due to greater competition in more fragmented markets, with significant ongoing product reinvestment required for XRO to maintain its advantages relative to peers.

**Sydney Airport (SYD)** – our underweight position is premised on the outlook for a more protracted recovery in international travel, underappreciated risks arising from airline and tenant agreements and the prospect of higher interest rates in the long term. Most airline agreements are scheduled for renewal in July 2021 which, if they are not extended, may result in adverse pricing outcomes for the airport operator. 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 22.7 times earnings when considering these risks.

## Market outlook

The recovery in the Australian economy continues to exceed consensus expectations. The Australian economy contracted 2.5% in calendar 2020, however strong sequential growth in 2H2020 and positive momentum in early 2021 will see economic activity in 1Q2021 exceed pre-COVID levels.

The strength of the economic recovery is particularly evident via record levels for business conditions, business confidence and the strength in employment growth. The level of employment already exceeds pre-COVID levels, and after peaking at 7.5% in July 2020 the unemployment rate has declined sharply to 5.6% in March 2021.

Although wage rates remain subdued, the recovery in labour market income has been sufficient to offset the gradual withdrawal of temporary fiscal support. Moreover, the accumulation of \$125bn in excess household saving, in concert with strong asset price gains, leaves the consumer uniquely positioned to underpin economic growth in 2021-2022. Dwelling investment is set to provide solid support for economic growth over the next 18 months following a surge in demand for new housing construction, partly in response to the Government's Homebuilder subsidy. We expect the global economy to expand 6.5% and the Australian economy to expand 6% in 2021.

We continue to expect US inflation to surprise on the upside over the remainder of 2021 and for policy makers to resist pressure to normalise interest rates. This may see bond yields continue to rise at a moderate rate in coming months, however, we are cognisant that global business surveys will likely peak around mid-2021 which may limit the adjustment in bond yields, at least until the Federal Reserve signals it is preparing to taper its asset purchases. We do not expect this to happen until late 2021 at the earliest.

The A\$/US\$ should continue to be well supported by global reflationary forces, including robust commodity price trends. We continue to expect the A\$/US\$ to appreciate to the 81-83c range by the end of calendar 2021.

We are most overweight stocks within the Telecommunication Services, Media & Entertainment and Energy sectors, and are underweight Financials, Real Estate and Industrials.

## Sector allocation

	Portfolio %	Benchmark %	Active %
Communication Services	16.51	5.16	11.35
Consumer Discretionary	10.59	9.11	1.48
Consumer Staples	3.24	3.47	-0.23
Energy	9.41	5.56	3.85
Financials	7.90	14.17	-6.27
Health Care	8.04	9.18	-1.14
Industrials	5.89	9.91	-4.02
Information Technology	6.98	7.31	-0.33
Materials	18.36	20.66	-2.31
Real Estate	6.67	12.63	-5.97
Utilities	5.35	2.85	2.50

## Top 5 holdings

	Portfolio %	Benchmark %	Active %
James Hardie Industries	5.90	2.19	3.71
APA	5.35	1.36	3.99
Vocus	4.37	0.39	3.97
Atlas Arteria	4.36	0.67	3.70
Iluka Resources	4.26	0.38	3.88

## Key active positions

Overweights	Portfolio %	Benchmark %	Active %
APA	5.35	1.36	3.99
Vocus	4.37	0.39	3.97
Iluka Resources	4.26	0.38	3.88
Underweights			
Sonic Healthcare	0.00	1.97	-1.97
Xero	0.00	1.96	-1.96
Sydney Airport	0.00	1.92	-1.92

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.

## Income and growth

	1 year %	3 years % p.a.	5 years % p.a.	Since inception % p.a.
Growth return	26.40	1.78	3.64	3.74
Distribution return	1.90	2.23	2.73	2.72

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 capital distributions.

## Features

Investment objective	To achieve medium-to-long term capital growth through exposure to Australian Securities Exchange listed securities excluding the largest 20 by market capitalisation (as defined by the S&P/ASX 20 Index). In doing so, the aim is to outperform the S&P/ASX 300 ex S&P/ASX 20 Accumulation Index over rolling 3-year periods.	
Recommended investment time frame	5 - 7 + years	
Fund inception	August 2010	
Fund size	A\$14.2 mn as at 30 April 2021	
APIR code	JBW0052AU	
Estimated management cost	0.90% p.a	
Buy/sell spread	+/- 0.15%	
Platform availability	Asgard BT Panorama BT Wrap Hub24	Macquarie Wrap Accumulator Macquarie Wrap Consolidator

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## Applications and contacts

Investment into the Yarra Ex-20 Australian Equities Fund can be made by Australian resident investors only.

**Website** [www.yarracm.com](http://www.yarracm.com)

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