

Yarra Ex-20 Australian Equities Fund

Gross returns as at 30 June 2021

	From 25 July 2018 [^]	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	4.87	4.08	5.86	24.55	5.24	7.82	8.26	8.01
S&P/ASX 300 ex S&P/ASX 20 Accumulation Index [#]	8.10	3.11	7.43	24.89	8.38	NA	NA	NA
Excess return (before fees) [‡]	-3.22	0.97	-1.56	-0.34	-3.14	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 June 2021

	From 25 July 2018 [^]	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	3.91	4.01	5.63	23.44	4.28	6.67	6.99	6.73
S&P/ASX 300 ex S&P/ASX 20 Accumulation Index [#]	8.10	3.11	7.43	24.89	8.38	NA	NA	NA
Excess return (after fees) [‡]	-4.18	0.90	-1.80	-1.45	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.

[^] 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.

[#] 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.

[‡] Excess return: The difference between the Fund's return and the benchmark return.

Market review

Australian equities shrugged off new COVID-19 outbreaks across the country to deliver strong returns in the June quarter.

The S&P/ASX 300 Ex-20 Accumulation Index increased by 7.4% in the three months to 30 June 2021, taking its 12-month return to 24.9%. The ASX outperformed global indices, with the MSCI World Index returning 7.7%, despite all major cities going into lockdown at one point during the quarter in response to COVID-19 cases.

Information Technology (+10.4%) rebounded in the period as the Australian 10-year bond yield retraced -26 bps to 1.5%, supporting the sector's valuation (given long-dated cash flows). Top contributors to the benchmark included Afterpay (APT, +16.4%), Altium (ALU, +38.6%) and Megaport (MP1, +66.2%).

Elsewhere, the Financials sector (+10.3%) was supported by insurers QBE insurance (QBE, +12.2%) and Suncorp (SUN, +12.2%) and Insurance Australia Group (+10.3%) as strong

underlying fundamentals remain intact (global commercial hardening cycle).

Other strong performers included Metals & Mining (+11.2%) amid higher commodity prices, Construction Materials (+16.0%) as housing activity continued to increase and Media & Entertainment (+13.5%) as advertising markets responded to stronger consumer demand.

Conversely, the only sectors to decline during the period were Energy (+0.3%) and Utilities (-4.5%). In the former, Beach Energy (BPT, -27.7%) downgraded production and reserves guidance while Oil Search (OSH, -7.1%) declined despite Brent Crude rising 18% to \$US75 per barrel. In Utilities, AGL Energy (AGL, -15.0%) lowered earnings guidance to the bottom half of its FY21 range and cut its dividend guidance to 75% of NPAT, down from 100%.

Portfolio review

Key Contributors

Iluka Resources (ILU, overweight) – the mineral sands producer outperformed as its 1Q21 result highlighted a strong recovery in sales volumes. ILU reported 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 improving 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 8.0 times EV/EBITDA).

Aristocrat Leisure (ALL, overweight) – the gaming company outperformed as its 1H21 results highlighted its leverage to the re-opening US economy and strong competitive position. Normalised profit after tax and before amortisation of acquired intangibles (NPATA) grew 12% y/y to \$411.6mn, beating consensus by 42% and rising to just 2.5% below pre-COVID-19 levels. While earnings were strong across the board, Digital (45% of group EBIT) was the standout as social casino and social casual growth experienced a step change in growth from COVID. Our thesis remains premised on ALL's strong growth profile following the resolution of the COVID-19 crisis. ALL has a dominant position in land based games and is set to benefit from significant opportunities from Digital (55% of EBIT post-COVID), which offers a wide range of outcomes. Lastly, the stock screens as undervalued at 26.9 times forward earnings when considering the Industrials Ex-Financials trades at 27.9 times and ALL's superior long-term growth potential.

ResMed (RMD, overweight) – the sleep apnea device maker outperformed during the period despite delivering a weaker-than-expected 3Q21 result early in the period, with sales 3% below consensus forecasts. That being said, management commentary was positive ahead of the AirSense 11 product launching in 2H21 and pent-up demand returns amid the re-opening US economy. We continue to believe RMD's core sleep apnea division will rebound strongly on the grounds that demand for its products has been deferred, not lost. Our long-term investment thesis remains intact, with benefits accruing from a positive product cycle in the flow generator and mask segments. New software and integration with the customer is supporting device sales versus competitors.

Key Detractors

Incitec Pivot (IPL, overweight) – the explosives and fertiliser maker underperformed during the period as ongoing operational issues and a soft 1H21 result overshadowed stronger fertiliser prices. Management reported EBIT of \$110mn for the period – 35% below consensus forecasts – as unplanned manufacturing outages, import constraints and flooding caused lower volumes, outweighing the benefit from higher commodity prices. Notwithstanding the disappointing operational issues, we remain overweight the company as we believe the risk is skewed to the upside at current levels (at 14.0 times forward earnings). Lead indicators suggest higher

demand for key commodities (urea and DAP) will sustain current spot prices, resulting in consensus upgrades. Meanwhile, the explosives business is experiencing more stable pricing as mining demand normalises in North America.

APA Group (APA, overweight) – the gas pipeline operator underperformed during the period without any negative company-specific news. At its Investor Day during the period, management reiterated FY21 EBITDA guidance (to be replaced by dividend guidance from FY22) and its strategy to shift the business towards renewables and transmission as Australia's energy mix transitions. Our positive view remains premised on our belief that APA's valuation – at an EV/EBITDA of 11.5 times and with a 6.0% 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 the COVID-19 crisis has had minimal impact on earnings. In the medium term, we see dividend upside given the company's relatively high funding costs and conservative balance sheet position.

Lendlease Group (LLC, overweight) – the global development and investment group underperformed during the period after issuing a profit warning. The company now expects FY21 NPAT of \$375mn to \$410mn – an 18% downgrade versus consensus forecasts at the midpoint – driven by weakness in London's build-to-rent market and project slippage. Further, management announced new provisioning of \$90-175mn as part of the Engineering sale to Acciona. We remain overweight despite the downgrade, as we see the headwinds as largely short-term in nature. We continue to expect the strong growth in its development pipeline will allow it 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 – driving 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 a greater consistency and earnings quality will drive LLC's valuation (currently at 14.1 times forward earnings) to higher multiples.

Key Purchases

IGO Limited (IGO) – we established a position in the lithium-nickel miner during the period. Our thesis is premised on the miner's recent US\$1.4bn Greenbushes acquisition and its existing portfolio of high-quality assets. We support the acquisition for several reasons. Not only does it give IGO exposure to a high-quality, long-dated asset (>20 years mine life), but it also completes IGO's suite of battery commodities with the company already producing nickel, copper and cobalt. We also think the purchase price was reasonable, with Greenbushes likely to be NPV and EPS accretive earlier than FY23. We also hold a positive view of IGO's Nova asset – a world-class reserve which supports an increasing production profile.

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 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 don't believe is captured in market expectations.

ResMed (RMD) – we increased our position in the company during the period. We continue to believe RMD's core sleep apnea division will rebound strongly on the grounds that demand for its products has been deferred, not lost. Our long-term investment thesis remains intact, with benefits accruing from a positive product cycle in the flow generator and mask segments. New software and integration with the customer is supporting device sales versus competitors.

Key Sales

Vocus Group (VOC) – the telecommunications company was taken over during the period following shareholder approval, de-listing from the ASX. The takeover bid supported our investment thesis on the stock; namely that the combination of good management, improving fundamentals and quality of the asset base will result in significant upside.

Deterra Royalties (DRR) – we exited our position in the iron ore royalties company during the period, following recent outperformance. We continue to 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. However, we believe iron ore's recent strength – rising to almost US\$200 per tonne – is unsustainable into the medium term. In this context, we do not see DRR's headline valuation (at a 12-month forward EV/EBITDA of 11.6 times) as attractive. Within Metals & Mining we prefer Iluka Resources (ILU) and IGO Limited (IGO), which offer exposure to commodities with more attractive long-term fundamentals.

APA Group (APA) – we trimmed our position to fund other opportunities but remain overweight the gas pipeline operator. Our positive view is based on our belief that APA's valuation – at an EV/EBITDA of 11.5 times and with a 6.0% 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. The company will actually generate additional cash flows as weakness in oil end-markets reduces capex requirements, further protecting the dividend trajectory. In the medium term, we see dividend upside given the company's relatively high funding costs and conservative balance sheet position.

Key Active Overweights

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 as attractive (at 6.8 times EV/EBITDA). 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 long-dated opportunity with significant execution risks. We ascribe zero to ILU's valuation from Sierra Rutile after the company suspended operations due to ongoing poor financial performance.

Worley (WOR) – we believe WOR is in a strong position to withstand an economic slowdown and disruption to activity caused by the lower oil prices, with significant refinancing headroom and business diversification across different markets. Further, we see WOR as well placed for the energy transition, with a leading role in developing emerging technologies, commercialising and scaling up new projects, for both its existing customer base and new customers seeking to lower their carbon footprint. We believe WOR's valuation provides significant support at current levels, with the stock trading on 16.9 times forward earnings, a sharp discount to the Industrials ex-Financials at 29.2 times.

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 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

Sonic Healthcare (SHL) – we are underweight the company on the grounds positive vaccine outcomes are likely to create an earnings headwind for the company which, in 2020, saw significant earnings support from its COVID-19 testing services. While short-term earnings will remain robust, we expect EBITDA to decline in FY21 as fewer tests are issued. We no longer view its valuation as sufficiently compelling versus alternatives, with the company trading at 23.4 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 18.9 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. Subsequent to period-end SYD received a takeover proposal from an IFM-back consortium. The bid of \$8.25 implies 21x F24 EV/EBITDA (VA consensus), in-line with other major airport transaction multiples such as Gatwick and Copenhagen 20-21x in 2017.

Market outlook

The recovery in the Australian economy continues to exceed consensus expectations. Real GDP contracted 2.5% in calendar 2020, however strong sequential growth in 2H2020 and 1Q21 has seen our economy already exceed pre-pandemic 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 5.1% in May 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 Utilities sectors, and are underweight Financials, Real Estate and Industrials.

Sector allocation

	Portfolio %	Benchmark %	Active %
Communication Services	13.17	4.85	8.33
Consumer Discretionary	10.70	9.16	1.55
Consumer Staples	3.36	4.25	-0.89
Energy	5.86	4.81	1.06
Financials	7.75	14.47	-6.72
Health Care	8.79	9.46	-0.67
Industrials	5.09	9.58	-4.48
Information Technology	7.73	7.26	0.47
Materials	18.21	20.21	-2.00
Real Estate	6.16	12.57	-6.41
Utilities	6.77	3.40	3.36

Top 5 holdings

	Portfolio %	Benchmark %	Active %
James Hardie Industries	5.71	2.23	3.48
Iluka Resources	4.45	0.43	4.02
QBE Insurance	4.19	1.76	2.43
Atlas Arteria	4.18	0.68	3.51
Worley	3.93	0.42	3.51

Key active positions

Overweights	Portfolio %	Benchmark %	Active %
Iluka Resources	4.45	0.43	4.02
Worley	3.93	0.42	3.51
Atlas Arteria	4.18	0.68	3.51
Underweights			
Sonic Healthcare	0.00	2.03	-2.03
Xero	0.00	1.84	-1.84
Cochlear	0.00	1.83	-1.83

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	21.06	1.90	3.91	3.95
Distribution return	2.38	2.37	2.76	2.79

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 June 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

Applications and contacts

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

Website www.yarracm.com

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