

# Yarra Ex-20 Australian Equities Fund

## Gross returns as at 31 May 2022

	From 25 June 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	4.37	-4.50	0.00	6.71	7.31	6.82	9.37	7.59
S&P/ASX 300 ex S&P/ASX 20 Accumulation Index <sup>#</sup>	6.52	-4.30	0.31	4.51	7.28	NA	NA	NA
Excess return (before fees) <sup>‡</sup>	-2.14	-0.20	-0.31	2.20	0.02	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 31 May 2022

	From 25 June 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	3.43	-4.57	-0.23	5.76	6.34	5.76	8.13	6.35
S&P/ASX 300 ex S&P/ASX 20 Accumulation Index <sup>#</sup>	6.52	-4.30	0.31	4.51	7.28	NA	NA	NA
Excess return (after fees) <sup>‡</sup>	-3.09	-0.28	-0.54	1.25	-0.94	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 June 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 declined during May as Australia's first interest rate hike since 2010 pressured valuations, with only the Energy sector recording a positive return.

The S&P/ASX 300 Ex-20 Accumulation Index returned -4.3% for the month, taking its 12-month return to +4.5%. In comparison, the broader ASX300 declined -2.8% for the month while global indices were flat (MSCI World Index -0.2%). The benchmark's forward P/E declined from 15.7 times to 14.8 times as the RBA lifted the official cash rate by 25 bps to 0.35%.

Within Energy (+2.7%), coal producers continued to rise in value amid the global energy crisis. While hard coking coal retreated 15% during the month to US\$442/t, thermal coal rose another 31% to US\$427/t. Whitehaven Coal (WHC) – now the largest constituent in the index – climbed +7.3% and New Hope Corporation (NHC) lifted +5.7%. Elsewhere, Worley (WOR, +6.0%) continued to rally amid growing demand for its

engineering services in both oil & gas and sustainability projects.

Conversely, the worst performing sectors included Consumer Discretionary (-8.3%), Information Technology (-8.0%) and Media (-16.3%). In particular, travel services companies Corporate Travel Management (CTD, -15.5%) and Flight Centre (FLT, -9.3%) underperformed as updates suggested ongoing lower margins for international travel, while in Information Technology Xero (XRO, -7.3%) delivered a disappointing FY22 result.

Elsewhere, Real Estate (-6.8%) also experienced widespread declines given its negative correlation to higher rates, led by Charter Hall Group (CHC, -15.3%), Mirvac Group (MGR, -6.6%), Home Consortium (HMC, -17.2%) and Dexus Group (DXS, -6.2%).

## Portfolio review

### Key Contributors

**Worley (WOR, overweight)** – the engineering services firm outperformed due to expectations the global energy crisis will stimulate capex for both oil & gas and energy transition projects. We remain overweight the company. Following the Jacobs ECR acquisition, it is our view the business is diversified across different markets and is well positioned to capture higher structural demand from energy transition work to low carbon solutions in addition to its traditional work for the oil & gas industry. We believe WOR's valuation provides significant support at current levels, with the stock trading on 18.9 times forward earnings, a sharp discount to the Industrials ex-Financials at 25.5 times.

**Atlas Arteria (ALX, overweight)** – the toll road operator outperformed without any materially positive news during the period. 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, in our view, 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.

**Amtcor (AMC, overweight)** – the plastic packaging company outperformed after announcing a stronger-than-expected trading update. Earnings per share in the third quarter came in at US20.4 cents per share, 4% above consensus and 13% above the prior year. Further, management upgraded full-year guidance for 9.5-11% EPS growth, above its prior guidance for 7-11%. The update supported our thesis for owning the stock. We view AMC as a defensive stock with a strong dividend yield (+4.0%) that should generate strong EPS growth in FY22 (+13%), before returning to more normal levels from FY23 onwards (mid-single digit). While AMC's Flexibles division faces volume headwinds as customers turn away from non-recyclable plastics, we believe the company is moving in the right direction from the point of view of producing more recycled product and using more post-consume resin. Further, shifts to higher margin customers (pharmaceutical and medical) and cost-out initiatives will provide an offset.

### Key Detractors

**Link Administration (LNK, overweight)** – the company underperformed over speculation the recent acquisition offer by Dye and Durham may not complete and after the ACCC temporarily suspended its approval timeline until it received further information. Notwithstanding the uncertainty, we remain overweight the stock. We see compelling value in its base share registry business and electronic conveyancing business PEXA, which has been supported by recent corporate interest. We hold a positive view of PEXA premised on its infrastructure-like characteristics of the property settlement exchange upon maturity, supplemented by numerous growth opportunities in immediate adjacencies. Further, LNK is

positively leveraged to higher US interest rates, which we see as a meaningful tailwind over the medium term. Lastly, LNK trades at 17.4 times forward earnings, a discount to the ASX200 Industrials ex-Financials at 23.3 times.

**Nine Entertainment (NEC, overweight)** – the media company underperformed despite delivering a solid trading update during the period. Management expects FY22 EBITDA to be up 22% y/y, unchanged versus its previous guidance, supported by slightly stronger underlying metrics. Our positive view remains premised on a supportive valuation, its high-quality digital assets (Stan, 9Now and Domain), and a number of cost saving initiatives in the short term. We believe the ad market's recovery is only partially factored into NEC's valuation, with the stock trading at 10.8 times forward earnings. At these levels, we also do not believe sufficient value is attributed to its subsidiaries when considering their long-term growth profile, with double-digit earnings growth expected in the next 12 months.

**Eclix (ECX, overweight)** – the fleet management company underperformed despite beating expectations in its 1H22 result. NPATA for the period came in at \$60.4mn, well ahead of consensus of \$46.2mn, primarily driven by end-of-lease income. We remain overweight. We believe its core business (largely fleet management) will be a strong beneficiary of Australia's post-COVID recovery, and that the valuation provides ample support (at around 10 times forward earnings excluding end-of-lease income). We believe ECX can take market share in the longer term (with high single-digit volume growth and stable pricing).

### Key Purchases

**Xero (XRO)** – we initiated a position in the accounting software company during the period, taking advantage of recent underperformance. While consensus continues to view XRO as a subscriber growth story, we see significant upside from higher average revenue per user (ARPU) and expansion into financial services. Regarding financial services (i.e. invoicing, payments), early-stage growth is positive and, we believe, could grow to around 50% of revenues in the next 5 years. For ARPU, we expect growth to materialise as a result of XRO's strategy to have an open platform, use M&A to purchase the most successful adjacent apps to bring into its platform, and justify price rises by including them into the core platform. Lastly, on valuation grounds subscriber total lifetime value (LTV) has fallen to below 1.2 times and will be less than 1 times by FY23, thus no longer requires an extended period of time to grow into the valuation.

**Reliance (RWC)** – we increased our position in the plumbing fittings group during the period. In our view RWC is a quality industrial company which has been over-sold based on short term earnings headwinds (the roll-off of the COVID benefit, higher raw material costs), which we expect to ease over our longer-term investment horizon. Further, we are more positive on the US Repair & Remodel (R&R) market than consensus, which comprises 38% of RWC's EBITDA and is more resilient to macro factors than new housing. In terms of quality attributes, we note RWC's brand power through products such as SharkBite, loyal customers in both Lowes, and Home Depot

and end customers, excellent supply chain management in normal times (98% OTIF in the Americas retail channel), and strong pricing power (in-house R&D). As a result, we see its valuation (at a 12.9 times forward P/E) as attractive.

**OZ Minerals (OZL)** – we increased our position in the copper producer during the period. Our positive view remains premised on OZL's two high quality, long life, 100% owned copper mines in South Australia - Prominent Hill and Carrapateena. We expect the company's copper production to double to >200ktpa by 2030, as Carrapateena moves to a block caving operation, and as the company develops the greenfield West Musgrave copper/nickel deposit in Western Australia. OZL is well positioned to fund its growth ambitions through the net cash balance sheet, strong cash flow generation, and flexibility to divest assets such as the Centro Gold deposit in Brazil. We also support OZL's plan to achieve net zero scope 1 and 2 emissions by 2030, which we view as ambitious and considered.

### Key Sales

**QBE Insurance (QBE)** – we reduced our position following recent outperformance but remain overweight. Our positive view towards the general insurer is premised on the company benefiting from an ongoing global hardening cycle in commercial insurance along with a return to unit growth after several years of volume declines as the company exited sub economic exposures. QBE's recent result, in our view, demonstrated that the company has sufficiently strengthened reserves against problematic North American long tail insurance lines, which was previously viewed as a key risk. We continue to see upside to its relative valuation, with the stock trading on 12.3 times forward earnings and offering a 4.0% dividend yield.

**Metcash (MTS)** – we reduced our position in the wholesale distributor during the period but remain overweight. MTS trades at 15.2 times, a discount to peers WOW and COL, with the market treating MTS as if it is a majority Food business in structural decline. This is no longer the case, with MTS' largest division now Hardware (41% of Group EBIT). Hardware is set to benefit from a strong store rollout and refurbishment strategy as well as more corporate stores (from current 30% to ~50%), which will support margins. In relation to Food (41% of Group EBIT), significant work has been done over recent time to gain supplier support to reduce prices, which has finally come to fruition as C-19 provided a surge in foot traffic. Continued strength despite relaxing C-19 restrictions highlights the improvement in the IGA offer and builds confidence for the outlook in the short to medium term. Finally, inflation is anticipated in the coming 12 months which will benefit MTS by assisting them to cycle strong comps whilst also being margin accretive.

**PEXA (PXA)** – we reduced our overweight position in the company to reflect short-term earnings risk. In particular, we see risk from a reversion of peak market transaction volumes, which we do not believe is adequately captured in consensus forecasts. That being said, we continue to view PXA as a high-quality business with upside potential over the long term. Our investment thesis is premised on the infrastructure like

characteristics of the property settlement exchange upon maturity, supplemented by numerous growth opportunities in immediate adjacencies (data and new markets). We see significant earnings upside as cost reductions are realised in the transition from the business's growth phase towards more of a utility phase, supporting higher sustainable EBITDA margins going forward.

### Key Active Overweights

**Worley (WOR)** – we believe the company is in a strong position to benefit from the recovery in its traditional work and, increasingly, new sustainability projects. Following the Jacobs ECR acquisition, the business is diversified across different markets and is, in our view, well positioned to capture higher structural demand from energy transition work to low carbon solutions. We believe WOR's valuation provides significant support at current levels, with the stock trading on 19.8 times forward earnings, a sharp discount to the Industrials ex-Financials at 24.7 times.

**Link Group (LNK)** – we are positive on the company because we see compelling value in its base share registry business and electronic conveyancing business PEXA, which has been supported by recent corporate interest. We hold a positive view of PEXA premised on its infrastructure-like characteristics of the property settlement exchange upon maturity, supplemented by numerous growth opportunities in immediate adjacencies. Further, LNK is positively leveraged to higher US interest rates, which we see as a meaningful tailwind over the medium term. Lastly, LNK trades at 20.3 times forward earnings, a discount to the Industrials ex-Financials at 24.7 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 on less than 11.0 times normalised EV/EBITDA, which, in our view, 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

**South32 (S32)** – we maintain a negative medium to longer-term view towards the company: in our view S32's key commodity prices are unsustainable, with the prices of manganese and coking coal – around 50% of S32's earnings – skewed to the downside, based on supply and demand fundamentals. S32 appears devoid of growth opportunities, with short mine lives, no active exploration, increased capital intensity and material geopolitical risk from its South African operations.

**Sonic Healthcare (SHL)** – we are underweight the company on the grounds that normalisation of COVID-19 testing volumes are likely to create an earnings headwind for the company which has seen significant earnings support from these services. While short-term earnings will remain robust, we

expect EBITDA to decline in FY23 as fewer tests are issued. We do not view its valuation as sufficiently compelling versus alternatives, with the company trading 19.5 times elevated forward earnings.

**ASX Limited (ASX)** – we remain underweight because we believe ASX's valuation is unjustified in the context of modest EPS growth. ASX trades on a 12-month forward P/E of 29.5 times, well above its long-run average and higher than global peers with a similar revenue mix. While the defensive nature of its earnings is attractive in the current environment, at present levels the stock offers a forecast dividend yield of only 3.0%, below the broader market at 3.6%.

## Market outlook

Geopolitical events and surging commodity prices have taken centre stage in 2022, shaking risk sentiment and challenging consensus' optimistic forecast for global growth. From our perspective, although for the past six months our forecasts for global growth in 2022 have been below consensus, we believe a series of downgrades will soon be evident for global earnings growth in most major markets. Surging commodity prices and ongoing supply shortages have resulted in further upside to the inflation outlook and risks forcing the hand of central banks in coming months to try to contain rising inflation expectations. The reality for 2022 is likely a world of higher inflation, slower growth and higher financing costs awaits.

Australia does have some key natural advantages in such a climate. One of the most notable is that Australia's export dominance of iron ore, coal, LNG, gold, wheat and base metals contribute close to 80% of Australia's exports and each of these commodities have seen strong price rises in 1H 2022 which will likely translate into a large positive national income boost even if spot prices retreat in coming weeks. Indeed, Australia presents as a safe haven market which is far from the conflict in Europe, an exporter of in demand raw materials and given its own undershooting of its inflation target since 2015 it has ample room to adjust policy settings at a gradual pace.

Australia also has the benefit of recovering underlying household income growth, \$230bn in 'excess saving', strong corporate profit growth, robust capex expectations in concert and improving government finances which suggests Australian economic growth in 2022 will remain more robust than its developed economy peer group. In CY2022 we expect the Australian economy to expand at an above 'potential' rate of 3%. While this is slower than the 4% pace recorded in 2021 it is still sufficient to see further employment growth gains and we expect the unemployment rate will soon fall below 4% and below the RBA's estimate of non-accelerating inflation rate of unemployment (NAIRU) and further wage pressure will become evident into mid-2022.

While the RBA has been later than most other developed nations in tightening policy, tighter financial conditions in 2022 are likely to come via both significantly higher cash rates and a stronger currency. The A\$/US\$ has in recent months been buffeted by concerns of a peak in global industrial growth

indicators and slowing China economic momentum. Nevertheless, Australia's external accounts are in their best position since the early 1970s and surging commodity prices in early 2022 is providing an incentive for the A\$/US\$ to commence an appreciation cycle, together with the attractive carry on offer. We expect the A\$ will finish 2022 at around 76 cents, albeit the risk to this forecast is on the upside.

We are most overweight stocks within the Communication Services, Information Technology and Materials sectors, and are underweight Real Estate, Health Care and Consumer Staples.

## Sector allocation

	Portfolio %	Benchmark %	Active %
Communication Services	12.36	4.34	8.02
Consumer Discretionary	8.04	7.95	0.10
Consumer Staples	2.20	4.34	-2.14
Energy	5.47	4.06	1.41
Financials	12.41	13.74	-1.33
Health Care	6.07	8.68	-2.61
Industrials	10.71	9.81	0.90
Information Technology	10.96	8.22	2.74
Materials	25.26	22.80	2.46
Real Estate	0.00	12.52	-12.52
Utilities	4.52	3.53	0.99

## Top 5 holdings

	Portfolio %	Benchmark %	Active %
Worley	5.47	0.62	4.85
QBE Insurance	5.41	2.01	3.40
Atlas Arteria	5.13	0.78	4.35
Link Administration	4.66	0.25	4.41
Origin Energy	4.52	1.36	3.16

## Key active positions

Overweights	Portfolio %	Benchmark %	Active %
Worley	5.47	0.62	4.85
Link Administration	4.66	0.25	4.41
Atlas Arteria	5.13	0.78	4.35
Underweights			
South32	0.00	2.63	-2.63
Sonic Healthcare	0.00	1.99	-1.99
ASX	0.00	1.77	-1.77

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.	10 years % p.a.
Growth return	3.82	4.23	3.27	5.31
Distribution return	1.93	2.11	2.49	2.82

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\$11.9 mn as at 31 May 2022	
APIR code	JBW0052AU	
Estimated management cost	0.90% p.a	
Buy/sell spread	+/- 0.15%	
Platform availability	BT Panorama Hub24	Praemium

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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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