

Yarra Ex-20 Australian Equities Fund

Gross returns as at 30 November 2020

	From 25 July 2018 ^A	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	2.33	9.33	7.56	-5.38	4.38	6.96	7.41	7.56
S&P/ASX 300 ex S&P/ASX 20 Accumulation Index [#]	6.30	10.13	7.94	-0.28	NA	NA	NA	NA
Excess return (before fees) [‡]	-3.97	-0.80	-0.38	-5.10	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 November 2020

	From 25 July 2018 ^A	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	1.37	9.25	7.30	-6.27	3.33	5.76	6.12	6.27
S&P/ASX 300 ex S&P/ASX 20 Accumulation Index [#]	6.30	10.13	7.94	-0.28	NA	NA	NA	NA
Excess return (after fees) [‡]	-4.94	-0.88	-0.64	-6.00	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.

^A 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 rose alongside global markets in November, driven by positive vaccine news and a decisive US election outcome.

The S&P/ASX 300 Ex-20 Accumulation Index returned 10.1% for the month, taking its 12-month return to -0.3%. The return was largely in line with the broader market, with the ASX 300 returning 10.2%. Markets surged globally after three major COVID-19 vaccine candidates were announced as highly effective in extensive trials, and after Joe Biden was declared the winner of the US Presidential Election.

Sectors which were hit hardest by COVID-19 rallied sharply. Energy (+28.5%) was the strongest performer as Brent Crude lifted 27% to \$US47.5 per barrel, led by Worley (WOR, +37.1%), Origin Energy (ORG, +29.5%), Santos (STO, +30.2%) and Beach Energy (BPT, +49.2%).

Other strong performers included Regional Banks (+30.6%), Retail REITs (+27.8%), Transportation (+19.1%) and Consumer

Services (+14.4%), with travel services companies like Webjet (WEB, +65.3%) and Flight Centre (FLT, +52.0%) rebounding.

Conversely, sectors which had proved resilient during the downturn – Gold (-11.7%), Utilities (+1.5%), Consumer Staples (+1.6%), Health Care (+2.0%) and Information Technology (+4.1%) – underperformed. At a stock level, the worst performers included Kogan (KGN, -20.4%), Saracen Minerals (SAR, -16.5%), NEXTDC (NXT, -11.7%) and Ansell (ANN, -6.9%).

Portfolio review

Key Contributors

Worley (WOR, overweight) – the engineering services company outperformed after Brent Crude increased by 27% during the period. We continue to believe WOR is in a strong position to withstand an economic slowdown and lower oil prices, with significant refinancing headroom and business diversification across different markets. We believe WOR's valuation provides significant support at current levels, with

the stock trading on 15.4 times two-year forward earnings – a cyclical low multiple despite its more resilient earnings base.

Origin Energy (ORG, overweight) – the energy company outperformed after Brent Crude increased by 27% during the period and following a well-received Investor Day, with guidance for higher production and lower costs at APLNG offsetting a more challenging outlook for the Energy Markets business. Our overweight position remains premised on our view that recent initiatives to simplify the business will unlock value (reducing debt, focusing attention on key assets Energy Markets and APLNG). Following its initiatives, ORG is now in a stronger position to withstand lower oil and 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 \$US27-31 per barrel and \$1.2bn in cash (as at 30 June 2020).

Northern Star Resources (NST, overweight) – the gold miner underperformed as the commodity declined 6% to \$US1,763 per ounce during the period. We were underweight NST based on its stretched valuation metrics (6.3 times forward EV/EBITDA), with our preferred exposures Regis Resources (RRL), Saracen Minerals (SAR) and diversified miner Independence Group (IGO). However, NST has announced a merger with SAR, with SAR shareholders receiving 0.3763 NST shares for every SAR share. We see the business combination as logical, with highly complementary operations (the Superpit joint venture) and organisational cultures, and the synergy metrics as attractive (A\$1.5-2.0bn pre-tax NPV). On valuation, we see the potential for the combined group to re-rate to peer Newcrest Mining (NCM, 6.6 times forward EV/EBITDA) given its comparable size and growing production profile in Western Australia and Alaska.

Key Detractors

NEXTDC (NXT, overweight) – the data centre operator partially retraced prior outperformance despite reaffirming its FY21 guidance during the period. Management expects underlying EBITDA in the range of \$125-130mn next financial year, up 20-24% y/y. We continue to believe NXT is structurally set to benefit from increasing adoption of cloud technology, and is accelerating its expansion to meet client demands by building new data centres which will support significant medium to longer term earnings growth.

APA Group (APA, overweight) – the gas pipeline owner underperformed during the period without any materially negative news. The company announced the construction of a \$460mn pipeline that connects gas fields in the Perth Basin to the Goldfields Region in Western Australia, which we view as positive for its growth outlook. We remain overweight APA, as we believe its valuation – at an EV/EBITDA of 12.8 times and with a 4.9% 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 given the

company's relatively high funding costs and conservative balance sheet position.

Regis Resources (RRL, overweight) – the gold miner underperformed as the commodity declined 6% to \$US1,763 per ounce during the period. We view RRL as being relatively attractive versus its peers due to its valuation (at a forward P/E of 6.7 times and EV/EBITDA of 3.2 times), well below the wider sector. Furthermore, RRL has a relatively strong cash flow and earnings profile, despite lower production growth and an optically higher AISC. Lastly, RRL's 2mn ounce McPhillamys project – which is currently moving through the NSW approval process – represents additional upside which is not recognised by the market at this time.

Key Purchases

Lend Lease (LLC) – we established a 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 plan 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 a greater consistency and earnings quality will drive LLC's valuation (currently at 10.6 times FY22 EPS) to around 13-15 times.

Seven West Group (SVW) – we established a position in the conglomerate during the period. 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 see improved utilisation and pricing of its equipment as infrastructure activity increases and is pushed out (extending the loan period for its products). Collectively, we see SVW as undervalued at 15.7 times forward earnings – a significant discount to the wider Industrials ex-Financials.

Sydney Airport (SYD) – we increased our position in the airport operator during the period. We see SYD's valuation as attractive on the grounds that the recent positive vaccine news accelerates the timeline for a recovery in international traffic, and that once the COVID-19 disruption has passed, SYD is set to benefit from a supportive demand backdrop. The airport captures approximately 40% of Australia's inbound air passengers and has strong barriers to entry as Sydney's only international airport (with its lease from the government not set to expire until 2097). In the meantime, we expect a recovery in domestic travel to provide a meaningful offset following the relaxation of state borders.

Key Sales

Coles (COL) – we exited our position after the supermarket company was promoted to the S&P/ASX 20. We remain

positive towards COL given its position in an industry structure that continues to strengthen, with potential upside versus consensus expectations for like-for-like sales and margins due to positive operating leverage, reduced shrinkage and price inflation. That being said, COL has now re-rated to 23.0 times forward earnings, and its discount to Woolworths (WOW) has closed from around ~15% to 5%.

Sonic Healthcare (SHL) – we reduced our position in the company during the period following strong outperformance and as positive vaccine news creates an earnings headwind for the company. While short-term earnings will remain robust, we expect EBITDA to decline in FY21 as fewer tests are issued for COVID-19. That being said, we continue to believe SHL's pathology division (85% of group revenues) will benefit from GP visit referrals and routine testing upon re-opening, with the potential for 5% higher volumes compared to mid-cycle levels. Secondly, as the leading player in Australia, Europe and the US (geographies which serve 85% of group revenues), SHL is well positioned to recover its lost EBITDA margin. Lastly, we regard its valuation as attractive versus health care peers, with the company trading at 22.2 times two-year forward earnings vs. the wider sector at 29.1 times.

Regis Resources (RRL) – we reduced our position size during the period due to our negative view of the sector, but continue to see the miner as attractive versus its peers. RRL trades at an attractive valuation (at a forward P/E of 6.7 times and EV/EBITDA of 3.2 times), well below the wider sector. Furthermore, RRL has a relatively strong cash flow and earnings profile, despite lower production growth and an optically higher AISC. Lastly, RRL's 2mn ounce McPhillamys project – which is currently moving through the NSW approval process – represents additional upside which is not recognised by the market at this time.

Key Active Overweights

Worley (WOR) – our positive view of the company is premised on our belief that WOR is in a strong position to withstand an economic slowdown and lower oil prices, with significant refinancing headroom and business diversification across different markets. We believe WOR's valuation provides significant support at current levels, with the stock trading on 15.4 times two-year forward earnings – a cyclical low multiple despite its more resilient earnings base.

James Hardie (JHX) – our overweight position is premised on our belief that JHX is well positioned to benefit from a recovery following the resolution of the COVID-19 crisis. JHX continues to take market share and increase margins in the key part of its business (North America comprises 70% of value), with input costs moderating from elevated levels. We are confident in the company's market share outlook due to its high-quality and reliable products, improved sales strategies (that position the product as superior versus alternatives) and the resolution of US supply and manufacturing issues.

Atlas Arteria (ALX) – we maintain a high-conviction overweight position based on ALX's strong liquidity and balance sheet position, which leaves it well placed to weather the COVID-19 related downturn in revenues for FY20, and a positive long-

term view. ALX holds attractive, long-duration assets and trades at a discounted valuation (10.0 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. We continue to believe the intrinsic value of ALX's assets will eventually be realised following the simplification of its ownership structure in the past two years, resulting in significant upside.

Key Active Underweights

Afterpay (APT) – our underweight position is premised on several factors. In the short term, we believe APT's valuation (at 22.4 times EV/sales) does not reflect the uncertainty associated with COVID-19 despite the company's strong balance sheet position. While APT's loss rates are low so far, it remains extremely early in the bad debt cycle (where APT is exposed as an unsecured consumer lending business). In addition, APT's long-term risks remain, including heightened regulation (e.g. expense verification), increased competition (such as from PayPal) and the sustainability of the company's attractive margins.

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 20.7 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.

ASX Limited (ASX) – we are underweight the securities exchange provider because we believe its valuation is unjustified in the context of modest EPS growth. ASX trades on a 12-month forward P/E of 30.9 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 2.9%, well below the Financials sector at 3.6%.

Market outlook

The recovery phase for the Australian economy is now well underway. Despite the concerning trends for new COVID-19 cases in the US and Western Europe, global economic data has continued to show solid improvement through Q3 and into Q4 2020. While it is reasonable to expect this positive data momentum will moderate as renewed lockdowns commence through Europe, the contrast with Australia could not be greater. COVID cases in Australia have reverted to their June lows and the gradual reopening in Victoria means that 100% of Australia is now in recovery mode. Economic recovery is occurring even faster than our relatively optimistic forecasts and economic growth now looks set to contract by less than 3% in 2020 before expanding by a forecast 5.5% in 2021.

The driving force of the recovery into 2021 will be consumption growth. The combination of the highest household saving ratio since the mid-1970 in concert with resilient asset prices, declining unemployment, rising hours worked and improving consumer confidence is expected to underpin a 7.0% rise in consumption growth in 2021. Although concerns have persisted over fiscal fade via lapsing fiscal stimulus measures, our analysis has long suggested that the extension of some fiscal programs, the pull forward of income tax cuts and the recovery in labour income as furloughed workers return to work is sufficient to avoid a bout of fiscal fade weighing in household income growth.

A secondary force assisting the recovery is the upswing in new housing approvals, new housing orders, and housing finance approvals. Despite a sharp drop in net migration and earlier concerns over house price declines, sentiment regarding housing has been buoyed by record low interest rates, a shift in responsible lending onus back to the borrower and large government incentives for construction.

Our expectation is that looking beyond the US election, additional expected fiscal stimulus in the US, additional expected QE in major offshore markets and a new QE program in Australia will leave a pro-growth fiscal and financial conditions environment for Australian economic growth and earnings growth.

The RBA's explicit aim of QE is to lower Australian longer term bond rates and lower the A\$. We expect the RBA to be partially successful in moderating the appreciation of the A\$, however, upward pressure on the A\$ will likely remain as the global economic recovery continues. We expect the A\$ to finish calendar 2020 at 75c and 2021 at 80c.

Smaller companies have been particularly impacted by the Government directed restrictions. The challenges of 1H20 of operational survival, liquidity and capital management have given way to which companies will be capable of capturing the operational leverage through the recovery phase and which companies have pricing power to withstand the disinflationary threats of global excess capacity. Within the small companies' sphere, the risks vs reward within such a macro backdrop is somewhat binary. Active management has perhaps never been more important in navigating the minefield.

We see significant value in certain sectors but believe others to be overvalued based on our earnings and cash flow expectations. We are most overweight stocks within the Communication Services, Energy and Industrials sectors, but are underweight Real Estate, Financials and Materials.

Sector allocation

	Portfolio %	Benchmark %	Active %
Communication Services	14.86	4.95	9.91
Consumer Discretionary	9.89	8.03	1.86
Consumer Staples	3.79	4.63	-0.84
Energy	11.39	6.04	5.35
Financials	5.72	12.72	-7.00
Health Care	9.32	9.13	0.18
Industrials	12.31	10.21	2.10
Information Technology	7.17	9.63	-2.47
Materials	13.62	18.50	-4.88
Real Estate	3.01	12.86	-9.85
Utilities	4.85	3.29	1.56

Top 5 holdings

	Portfolio %	Benchmark %	Active %
James Hardie	6.19	2.09	4.11
Worley	4.86	0.49	4.37
APA Group	4.85	1.46	3.39
Atlas Arteria	4.79	0.74	4.04
QBE Insurance	4.39	1.75	2.64

Key active positions

Overweights	Portfolio %	Benchmark %	Active %
Worley	4.86	0.49	4.37
James Hardie	6.19	2.09	4.11
Atlas Arteria	4.79	0.74	4.04
Underweights			
Afterpay	0.00	2.60	-2.60
Xero	0.00	1.84	-1.84
ASX Limited	0.00	1.78	-1.78

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	-7.82	0.65	2.85	3.54
Distribution return	1.55	2.68	2.91	2.73

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\$16.50 mn as at 30 November 2020	
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.

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