

Yarra Ex-20 Australian Equities Fund

Gross returns as at 30 September 2021

	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	5.77	-0.45	4.07	25.80	4.35	7.53	10.11	8.21
S&P/ASX 300 ex S&P/ASX 20 Accumulation Index [#]	9.00	-1.15	4.80	27.92	9.56	NA	NA	NA
Excess return (before fees) [‡]	-3.23	0.70	-0.73	-2.13	-5.21	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 September 2021

	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	4.81	-0.52	3.84	24.68	3.40	6.41	8.83	6.94
S&P/ASX 300 ex S&P/ASX 20 Accumulation Index [#]	9.00	-1.15	4.80	27.92	9.56	NA	NA	NA
Excess return (after fees) [‡]	-4.20	0.63	-0.97	-3.25	-6.16	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 delivered a solid return in the September 2021 quarter, overcoming uncertainty relating to protracted lockdowns in NSW and VIC, negative earnings revisions across the market and rising inflation.

The S&P/ASX 300 Ex-20 Accumulation Index lifted by 4.8% in the quarter, taking its 12-month return to +30.9%. In comparison, the broader ASX 300 returned 1.8% and the MSCI Global Index returned 0.7% in local currency terms. However, FY21 reporting season saw more misses than beats despite recording +28% growth y/y, and FY22 forecasts were revised down at -1.2% for the ASX200 and -1.5% for the Small Ords.

Equity valuations had risen substantially as the delta outbreak and dovish commentary from the US Fed depressed bond yields, with the Australian 10-year bond yield falling to 1.08% midway through the quarter. However, this reversed in September as the inflation theme re-emerged and concerns mounted about faster tapering of QE.

Energy (11.7%) was the top performer during the period, as the emerging gas crisis in the EU/UK and China saw widespread gains across broader commodity complex, with Brent Crude rising 7% to US\$80 per barrel, thermal coal up 62% to US\$218/t and JKM LNG futures surging 137% to US\$31.10MMBtu. At a stock level, the top performers included Oil Search (OSH, +16.6%), Whitehaven Coal (WHC, +66.5%) and Beach Energy (BPT, +21.7%).

Elsewhere, travel services stocks rebounded during the period as Australia draws closer to re-opening the economy. Within Industrials (+6.3%), Qantas (QAN, +21.7%) and Sydney Airport (SYD, +42.3%) were the top performers, with the latter also receiving an improved bid of \$8.75 per share from an IFM-backed consortium during the period. Other strong performers were Flight Centre (FLT, +44.5%) and IDP Education (IEL, +39.0%).

Conversely, Gold (-14.8%) was among the worst performers during the period, weighed down by ongoing USD strength. The worst performers included Evolution Mining (EVN -21.5%),

Silver Lake Resources (SLR, -19.3%) and De Grey Mining (DEG, -21.9%).

Portfolio review

Key Contributors

Carsales.com (CAR, overweight) – the online automotive company outperformed as its FY21 result came in at the top end of guidance issued in May, with revenue and NPAT growing 4% and 11% respectively y/y. While prolonged lockdowns in NSW and VIC clouds the outlook for FY22, CAR still expects 'solid growth' in underlying NAPT. A new product launch called "carsales SELECT" – a digital offering allowing consumers to purchase used cars directly from dealers – also impressed investors. We remain overweight the automotive online classifieds company. Our positive view is premised on the belief CAR should benefit from attractive earnings growth, conservative accounting (with low capitalisation of research and development investment), and product initiatives to drive long-term growth (such as transitioning from a leads-based model to a transaction-based model) and undervalued international businesses.

Incitec Pivot (IPL, overweight) – the explosives and fertiliser maker outperformed after delivering a positive market update during the period and, moreover, ammonia-gas spreads surged in the US in response to the emerging EU/UK gas crisis. Management announced its WALA ammonia plant returned to full production from 1 June and the turnaround at its Moranbah AN plant was successfully completed. We remain overweight as we continue to believe the risk is skewed to the upside at current levels (at 13.7 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.

Alumina (AWC, overweight) – the alumina producer outperformed after the commodity increased in value by 60% to US\$457/t during the period. The rise was in response to stronger demand and supply disruptions following a flood in China's Henan province (a key centre for Chinese alumina production, responsible for 7% of global alumina production) and a coup in Guinea, a major producer of bauxite. We remain overweight the company. We expect global aluminium demand to continue to improve as China's consumption continues to outpace expectations and the Transportation sector recovers. More broadly we continue to hold a positive view of AWC's high-quality assets and strong earnings, cash flow and capital management potential. As a result, we see its valuation (at a forward P/E of 18.6 times with a 5.5% forecast dividend yield) as attractive.

Key Detractors

Ansell (ANN, overweight) – the protective equipment manufacturer underperformed as its FY21 result missed market expectations. FY21 EPS came in at \$1.29 – below consensus by 3% – as performance from its Industrial division was underwhelming despite the manufacturing rebound in the

US. Further, FY22 EPS of \$1.75-1.95% was 4% below consensus as management cautioned that COVID-related sales would fade and COVID outbreaks were disrupting its manufacturing plants in 1H22. Nevertheless, we remain overweight the company. Though we expect an air pocket in exam and single-use earnings as higher capacity in the market suppresses pricing, we expect ANN underlying earnings to reclaim its FY21 COVID peak by FY23 as underlying earnings grow. More broadly, we expect both divisions to benefit from internal programs to increase operational efficiency, higher margins from new distributor agreements and shifts towards higher-value products. Lastly, ANN has a strong balance sheet; we estimate \$220mn of buy-back capacity. We do not believe this is captured by consensus; the stock trades at 13.8 times, a large discount to the wider Industrials ex-Financials at 29.3 times.

Worley (WOR, overweight) – the engineering firm underperformed during the period despite delivering a solid FY21 result. While revenue declined 5% half-on-half, EBITDA grew +26% as management delivered on its cost initiatives – contributing to a +4% NPATA beat versus consensus forecasts. Moreover, management expects revenue to pick-up in FY22 as key end markets recover; its backlog has grown 8% and its total sales pipeline has lifted 16%, driven largely by sustainability projects (+17%). However, Brent crude declined 6% during the month to US\$73/bbl and the market remains concerned about structurally challenged global energy markets. We believe WOR is in a strong position to withstand a lower-than-expected recovery in its traditional work. Following the Jacobs ECR acquisition, the business is diversified across different markets and is 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 14.4 times forward earnings, a sharp discount to the Industrials ex-Financials at 29.3 times.

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 remain underweight on the grounds that the offer price is full and, if it is unsuccessful, there are 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 2022 which, if they are not extended, may result in adverse pricing outcomes for the airport operator.

Key Purchases

Northern Star (NST) – we established a position in the gold miner. We believe the company will benefit from higher-than-expected production and reserves/resources after taking full ownership of the KCGM SuperPit Mine in February this year. We see the company's valuation as attractive at 5.7 times forward EV/EBITDA, which is only marginally above the wider

Gold sector's 5.6 times despite a superior growth outlook. More broadly, we have a neutral exposure to the commodity, balancing the prospect of higher inflation with an uncertain rate hike path in the US (which is generally a headwind to the gold price).

Qantas (QAN) – we established a small position in the airline during the period. Notwithstanding short-term disruption from border restrictions, our positive view is predicated on QAN emerging from COVID with a significantly improved industry structure and more competitive cost base in both its domestic and international businesses. We are particularly optimistic on the domestic side of the business, where we expect the improved industry structure, operating leverage and cost out initiatives (up to \$300mn) to drive significant earnings upside versus consensus forecasts. We expect relative multiples to retrace to historic averages as confidence in the recovery builds (trading at or above pre-COVID multiples on normalised earnings).

Pexa (PXA) – we took part in the IPO of the electronic conveyancing business during the period. Our investment thesis is premised on 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 Sales

APA Group (APA) – we exited our position in the gas pipeline operator during the period. 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. We used the funds to increase our position size in Transurban (TCL), which has a strong growth outlook (with a number of new project and expansion plans) and a high degree of inflation-linked revenues.

Healius (HLS) – we exited our position in the company during the period. We hold a positive view of its pathology and diagnostic imaging divisions, while 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. That being said, we believe this is more fully reflected in its valuation.

Santos (STO) – we exited our small position in the oil & gas company during the period as its valuation appeal has subsided. We remain positive towards the company on a fundamental basis, premised on its resilient low-cost base business (break-even <US\$25/bbl); a diversified asset base

across multiple basins, customers and products (with 60% oil exposure); latent value in its midstream infrastructure and a defined pathway to net zero emissions. However, we note emissions cuts rely heavily on scaling carbon capture and storage (CCS) and hydrogen – two unproven technologies at scale – without committing significant capital to shifting the business to a low carbon world. We view the proposed merger with Oil Search (OSH) as logical from a financial perspective, however at this stage it is unclear how the merger affects the group's climate change strategy.

Key Active Overweights

TPG Telecom (TPG) – our positive view is premised on the improving outlook for the mobiles market, recovery in volumes post COVID and 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 new products such as Fixed Wireless.

James Hardie (JHX) – we continue to believe JHX is well positioned to benefit from the stronger US housing environment 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 (positioning the product as superior versus alternatives) and the resolution of US supply and manufacturing issues.

Incitec Pivot (IPL) – we are overweight the company as we believe the risk is skewed to the upside at current levels (at 13.7 times forward earnings), particularly as operational issues are resolved. The company's key markets – fertilisers and coal volumes – are benefiting from an emerging energy crisis globally, which we believe will result in upgrades to consensus forecasts. As an ammonia producer in the US, IPL is benefiting from a widening spread between Ammonia prices (where the marginal producer is in Europe) and the US natural gas price.

Key Active Underweights

Sydney Airport (SYD) – we are underweight on the grounds that the latest takeover offer for the company fully reflects its recovery at \$8.75 per share and, at 22 times FY24 earnings, is above other major airport transactions globally. Further, if it is unsuccessful, there are 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 2022 which, if they are not extended, may result in adverse pricing outcomes for the airport operator.

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 FY22 as fewer tests are issued. We no longer view its valuation as sufficiently compelling

versus alternatives, with the company trading at 21.4 times elevated 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 19.0 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.

Market outlook

After completing 1H2021 with strong momentum, renewed Covid-related lockdowns in Melbourne and Sydney will see the Australian economy contract in 3Q21, albeit it has been notable how well both business surveys and employment indicators have held up in Q3, suggesting a modest contraction than might have been expected several months ago.

We continue to believe the interruption to economic growth from renewed lockdowns will be an aberration within an improving trend. Indeed, the fundamentals that will drive the economic recovery remain in place. The recovery in labour market income has been sufficient to offset the gradual withdrawal of temporary fiscal support. Moreover, the accumulation of an estimated \$185bn 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 6 months as previously approved housing moves through the construction phase, and a broader-based lift in business investment expectations is an important step in ensuring a sustained economic recovery. We expect the global economy to expand 6% and the Australian economy to expand 4.5% in 2021, a downward revision from our pre-lockdown forecast of 6%. We expect another strong year of economic growth in 2022 of 4.0%.

Nevertheless, there are some areas that are cause for concern. For over 12 months we have warned about rising US inflation pressures and rising inflation expectations. However, supply chain constraints and energy shortages in the Northern Hemisphere risk inflation pressures becoming more widespread and more entrenched. With the peak in global business surveys having passed, cost inflation continuing to escalate and the Federal Reserve signalling increased willingness to taper its purchases, we expect bond yields will move higher through the remainder of 2021. We expect US 10-year yields to approach 1.80% by the end of 2021, providing some ongoing challenges for risk assets in Q4.

The A\$/US\$ has recently been buffeted by concerns of a peak in global industrial growth indicators, slowing China economic momentum and recent declines in iron ore prices. Nevertheless, Australia's external accounts are in their best

position since the early 1970s and despite some moderation in commodity prices the A\$/US\$ should remain supported by global reflationary forces through 2021-22. We expect the A\$/US\$ to finish the year in the 76-78c range, and remain around that level through 1H22.

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

Sector allocation

	Portfolio %	Benchmark %	Active %
Communication Services	14.04	4.73	9.30
Consumer Discretionary	11.03	9.21	1.82
Consumer Staples	2.83	4.16	-1.32
Energy	3.17	5.19	-2.03
Financials	8.93	14.14	-5.21
Health Care	6.83	9.33	-2.50
Industrials	6.95	10.48	-3.52
Information Technology	8.34	7.79	0.55
Materials	25.74	19.15	6.60
Real Estate	5.37	12.48	-7.11
Utilities	3.34	3.34	0.00

Top 5 holdings

	Portfolio %	Benchmark %	Active %
James Hardie Industries	5.98	2.33	3.65
QBE Insurance	5.18	1.80	3.39
TPG Telecom	4.31	0.27	4.03
Atlas Arteria	4.14	0.65	3.49
Incitec Pivot	4.09	0.60	3.50

Key active positions

Overweights	Portfolio %	Benchmark %	Active %
TPG Telecom	4.31	0.27	4.03
James Hardie Industries	5.98	2.33	3.65
Incitec Pivot	4.09	0.60	3.50
Underweights			
Sydney Airport	0.00	2.32	-2.32
Sonic Healthcare	0.00	2.03	-2.03
Xero	0.00	1.87	-1.87

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	22.27	1.04	3.65	4.21
Distribution return	2.41	2.35	2.75	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\$13.8 mn as at 30 September 2021	
APIR code	JBW0052AU	
Estimated management cost	0.90% p.a	
Buy/sell spread	+/- 0.15%	
Platform availability	BT Panorama Hub24	Praemium

Applications and contacts

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

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