YARRA CAPITAL MANAGEMENT

Investment Commentary
Quarter to 30 September 2022

Yarra Ex-20 Australian Equities Fund

Gross returns as at 30 September 2022

	From 25 June 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	1.67	-9.23	-0.47	-10.66	0.56	4.57	7.45	6.52
S&P/ASX 300 ex S&P/ASX 20 Accumulation Index#	3.50	-8.38	0.64	-12.63	1.17	NA	NA	NA
Excess return (before fees)‡	-1.83	-0.86	-1.11	1.97	-0.61	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 2022

	From 25 June 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	0.75	-9.30	-0.70	-11.45	-0.34	3.57	6.24	5.29
S&P/ASX 300 ex S&P/ASX 20 Accumulation Index#	3.50	-8.38	0.64	-12.63	1.17	NA	NA	NA
Excess return (after fees)‡	-2.75	-0.92	-1.33	1.18	-1.51	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 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.

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 gained 0.40% during the September quarter, with the Energy, Materials and Information Technology sectors recording positive returns.

The S&P/ASX 300 Ex-20 Accumulation Index returned 0.64% for the quarter, taking its 12-month return to -12.63%. In comparison, the broader ASX300 gained 0.45% for the period and, globally, the MSCI World Index fell by 15.70%.

Within Energy (+14.3%), coal producers continued to rise in value amid the global energy crisis, with thermal coal reaching an all-time high of US$457/t during the quarter. Whitehaven Coal (WHC) climbed +95.6%, New Hope Corporation (NHC) lifted +81.8% and Paladin Energy (PDN) gained 30.1%.

Within Information Technology (+2.8%), Tyro Payment (TYR, +116.7%) outperformed during the quarter after receiving a bid from a private equity firm Potentia at $1.24, a 31% premium to the prevailing share price pre bid. Megaport (MP1, +42.9%) outperformed during the period after reporting a stronger than expected June quarter result across revenue growth (+10% q/q) and its first EBITDA positive quarter.

Conversely, the worst performing sectors included Utilities (-12.5%) and Real Estate (-4.8%). In particular, AGL Energy (AGL, -16.0%) and APA Group (APA, -14.9%) and Real Estate companies Dexus (DXS, -13.1%) and Centuria Office REIT (CIP, -12.3%) declined in response to constant hikes in interest rates.

Elsewhere, Financials (-2.3%) also experienced widespread declines given the negative correlation to higher rates for several stocks (in particular fund managers) such as Challenger (CGF, -12.9%) and ASX (ASX, -10.8%).

Key Contributors

OZ Minerals (OZL, overweight) – the copper miner was a positive contributor to the portfolio during the month following BHP's $25/share takeover offer for the company. The offer represented a 32% premium to prior close. With the OZL board rejecting the initial offer, we recognize the potential for BHP to return with a higher bid. The potential for a counterbidder to

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emerge is limited, in our view, given BHP's significant regional synergies with Oz Minerals. We retain our fundamental positive view on OZL due to its 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 the company develops the greenfield West Musgrave copper/nickel deposit in Western Australia.

IGO (IGO, overweight)– the battery commodity producer was a key contributor during the period on continued lithium price strength ahead of consensus forecasts. Our positive thesis is premised on the miner's US$1.4bn Greenbushes and $A1.25bn Western Areas (WSA) acquisitions, and its existing portfolio of high-quality assets. We support the acquisitions for several reasons. Greenbushes gives IGO exposure to a high-quality, long-dated asset (>20 years mine life) and completes IGO's suite of battery commodities with the company already producing nickel, copper and cobalt. We support the WSA acquisition on the grounds it diversifies production (rebalancing commodity exposure to 70% Li, 30% Ni) and extends the mine life for nickel production (which is currently through its world-class Nova asset).

Tyro (TYR, overweight) – the payments technology company outperformed during the quarter after receiving a bid from a private equity firm Potentia at $1.24, a 31% premium to the prevailing share price pre bid. We view the timing of the bid as highly opportunistic and the price as dramatically undervaluing the business. TYR's result and guidance during the quarter demonstrated that cost discipline is being instilled in the organisation and that the revenue line continues to grow strongly.

Key Detractors

Link Group (LNK, overweight) – the superannuation admin and property technology company fell materially in the quarter following its takeover by Dye & Durham being scuppered at the eleventh hour by the UK's Financial Conduct Authority (FCA). The FCA has imposed an $87m fine on LNK's Fund Solutions business and a potential restitution payment of up to $536m for the Woodford issue which they have been investigating since 2019. Despite the uncertainty created by this, we still see considerable value in LNK and a pathway to crystalising this value with the announced demerger of its stake in PEXA an appropriate first step.

Pilbara Minerals (PLS, underweight) – the lithium producer was an outperformer during the period, with continued lithium price strength ahead of consensus forecasts. Our underweight position in PLS was a detractor for the portfolio as a result. We are positive on lithium as a future facing commodity (with a preference for IGO as an exposure) but recognise that current spot prices >US$7,000/t for the company's spodumene product are well in advance of consensus long term estimates, and industry cost curves.

Atlas Arteria (ALX, overweight) – the toll road operator underperformed following the announcement of the acquisition of the Chicago Skyway toll road and a $3b associated capital raising at $6.30, a 19% discount to the pre deal share price. This was unquestionably a negative development given ALX was being actively pursued by suitor IFM who had built a stake at $8.10. ALX have paid a very full price for the asset and the transaction has lowered our valuation for the stock, although the transaction itself does not rule out IFM returning with another bid.

Key Purchases

Carsales.com (CAR) – we participated in CAR's equity raising and on market to acquire the remaining 51% of Trader interactive, CAR's US based classifieds business. Trader Interactive is approximately 30% of the company's earnings post the transaction. There is strong potential for growth from various drivers across the Trader Interactive business including: an uplift in dealer penetration, moving from a subscription based to a leads-based and higher yielding model, and an improvement in inventories on the site. We are constructive on CAR's Australian business, which now represents 50% of the group. As inventory levels rise (as supply improves), CAR will have a better environment for which it can improve yields across both dealer and private sales.

United Malt (UMG) – we initiated a position in the fourth largest commercial maltster and international distributor to brewers and distillers following its downgrade and Investor Day in early August. The company detailed its plans for a strong recovery in earnings (+44% in FY23, +29% in FY24) off a cyclical low in FY22. The company also detailed its pathway to reduce financial leverage, largely through earnings recovery, which has been weighing on UMG's share price. We estimate the company was trading close to the replacement cost for the processing assets and trade working capital. Following a rebound in earnings, UMG should attract a much higher multiple reflecting the value of the operating business.

Reliance Worldwide (RWC) – we added to our position in the plumbing supplies company over the period. RWC has sold off significantly on fears of a weaker demand environment ahead. We think RWC is a compelling opportunity with the market pricing for a significant decline in earnings (PE of only 13 times vs 17 times mid cycle) while we remain constructive on the demand environment given the defensive nature of the majority of RWC's repair and remodelling sales.

Key Sales

Atlas Arteria (ALX) – we took the opportunity to trim our position in the toll road company following the outperformance that resulted from IFM's approach given a material portion of the likely upside had been realised, prior to the acquisition and capital raising.

Latitude Financial (LFS) – the portfolio's position in the payments solutions company was exited during the period. LFS has consistently missed operating and earnings targets since the IPO and faces an urgent need to innovate around its core consumer facing businesses. The exit of the CEO further lowered confidence in the outlook for the company.

IGO (IGO) – we modestly reduced our position during the period following strong recent performance on continued lithium price strength ahead of consensus forecasts. We retain our positive thesis on IGO, premised on the miner's US$1.4bn Greenbushes and A$1.25bn Western Areas (WSA) acquisitions, and its existing portfolio of high-quality assets. We support the acquisitions for several reasons. Greenbushes gives IGO exposure to a high-quality, long-dated asset (>20 years mine life) and completes IGO's suite of battery commodities with the company already producing nickel, copper and cobalt.

Key Active Overweights

Carsales.com (CAR) – we remain overweight the online car classifieds company and participated in CAR's recent equity raising to acquire the remaining 51% in Trader Interactive, a US online classifieds business with strong potential for growth from various drivers (an uplift in dealer penetration, moving from a subscription based to a leads-based and higher yielding model, and an improvement in inventories on the site). Longer term, we remain overweight CAR based on improving yield from products such as Instant Offer and Select, as well as the improving profitability of Encar, CAR's South Korean business.

Worley (WOR) – we remain overweight the professional project and asset services company. Following years of underinvestment in oil & gas projects, and with the more recent supply disruptions stemming from the war in Ukraine, expectations for project spend across WOR's traditional customer base has increased to 27% growth (y/y). There is also a strong pipeline of margin accretive capital spend required to decarbonise energy production and provide more sustainable solutions across chemical and resources customers.

Nine Entertainment (NEC) – we remain overweight the entertainment and media company given we are constructive on NEC's ability to grow higher-margin digital revenues in a potentially softer environment. NEC's recent sell off in part reflects the sell-off in Domain (DHG), which is 59% owned by NEC. The sell-off in both companies placed NEC, excluding DHG, on a 3.9 times FY23 EV/EBITDA multiple which we think is an attractive valuation for a leading media company which is diversifying its revenue streams to be less cyclical (driven by higher margin digital revenues).

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.

Brambles (BXB) – we are underweight the global provider of pallet pooling solutions to various FMCG producers. We remain cautious on the normalisation of pallet volumes and the company's ability to drive medium term growth in key markets such as the US. The normalisation of lumber prices is providing near term relief to margins, but we believe the longer-term margin profile is mature.

Sonic Healthcare (SHL) – we are underweight the global pathology and radiology provider 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 COVID-19 tests are issued. We do not view its valuation as sufficiently compelling versus alternatives, with the company trading 19.1 times elevated forward earnings.

Market outlook

Financial markets have now embraced the risk of recession in the US and Europe over the past quarter, and the gap between our more pessimistic forecasts for the global economy and the consensus has narrowed. Indeed, with the Fed signalling that financial conditions are close to neutral, we are edging closer to the point where the pace of monetary tightening will slow, providing some scope for risk markets to recover some lost ground.

The period of excess inflation is starting to recede, with prior surges in commodity prices retreating, an easing in supply constraints, and signs of slowing demand likely to compress elevated sales margins. As central banks continue to await firmer signs that inflation expectations have stabilised and for labour demand to ease, financial markets are faced with the positive news of less restrictive monetary policy and the negative news of likely weaker company earnings.

In a world of heighted concerns of recession in major developed economies, subdued economic activity in China and ongoing conflict between Russia and the Ukraine which has contributed to commodity shortages, high inflation and rising interest rates, the Australian economy presents as a relative safe haven.

Australia's economic data has remained robust in 1H2022, although we do expect economic activity to slow significantly in 2023 to average just 1.5%. While a local recession is possible in 2023, we believe Australia should be able to avoid a technical recession due to three key reasons:

1. Australia has been a net beneficiary of global commodity shortages. This surge in commodity prices saw Australia's export prices in A$ terms move to their highest levels since the 1880s in 1H2022. The consequence has been strong national income growth, profits growth and an improving underlying fiscal position.
2. The household sector continues to hold a significant buffer of over $160bn of excess savings relative to pre-COVID levels. Although we expect the impact of higher interest rates and higher living expenses will curtail consumer spending, we do expect the combination of rising wage growth and a run down in the level of savings to continue to support consumption spending.

3. Low levels of spare productive capacity, strong profit and low corporate debt have contributed to robust capital investment intentions.

Over the medium term we believe a recovery in net immigration levels into Australia and Australia's exposure to key commodities crucial to the global energy transition will provide a solid underpin for future economic growth.

While the RBA has been later than most other developed nations in tightening policy, tighter financial conditions in 2022 have come via both significantly higher cash rates, higher government bond yields and wider corporate bond spreads. We expect that the RBA cash rate will finish the year at 3.10%, which we expect will mark the peak for the RBA, well below market expectations of a 4.0% peak in 2H23. The A$/US$ has been particularly weak in recent weeks, albeit on a TWI basis the A$ has been broadly stable. With Australia's external accounts are in their best position since the early 1970s and the prospect the US$ uptrend will peak as the Fed pivots from its aggressive hiking strategy we expect the A$/US$ will appreciate to the mid-70s by end-2023.

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

Sector allocation

	Portfolio %	Benchmark %	Active %
Communication Services	13.90	4.24	9.66
Consumer Discretionary	8.83	7.44	1.39
Consumer Staples	1.97	4.61	-2.64
Energy	4.27	5.08	-0.81
Financials	11.62	14.25	-2.62
Health Care	5.00	8.95	-3.94
Industrials	12.12	10.24	1.88
Information Technology	13.17	8.00	5.16
Materials	23.26	22.37	0.88
Real Estate	0.00	11.73	-11.73
Utilities	3.90	3.10	0.80

Top 5 holdings

	Portfolio %	Benchmark %	Active %
QBE Insurance Group	5.32	2.18	3.14
ResMed	5.00	1.69	3.32
IGO	4.92	1.18	3.74
Insurance Australia Group	4.80	1.45	3.36
Carsales.com	4.67	0.84	3.83

Key active positions

Overweights	Portfolio %	Benchmark %	Active %
Carsales.com	4.67	0.84	3.83
IGO	4.92	1.18	3.74
Worley	4.27	0.60	3.67
Underweights			
South32	0.00	2.14	-2.14
Brambles	0.00	2.02	-2.02
Sonic Healthcare	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.	10 years % p.a.
Growth return	-13.69	-2.36	1.03	3.48
Distribution return	2.24	2.03	2.54	2.76

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$10.2 mn as at 30 September 2022	
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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