Yarra Emerging Leaders Fund

Total returns as at to 30 September 2018

	1 month %	3 months %	1 year %	3 years % p.a.	5 years % p.a.	10 years % p.a.	Since inception* % p.a.
Yarra Emerging Leaders Fund	0.24	5.27	23.79	11.99	12.69	9.76	10.65
Emerging Leaders Combined Benchmark†	-0.55	2.34	19.85	17.80	11.83	6.70	7.38
Excess return‡	0.78	2.93	3.94	-5.81	0.86	3.06	3.27

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.
Due to differences in business dates at month end, Fund performance returns are provided as at 27 September 2018, and benchmark performance returns are provided as at 30 September 2018. The monthly, quarterly and annual performance returns have been impacted.
* Inception date Yarra Emerging Leaders Fund: September 1997
† Comprising 50% S&P/ASX Midcap 50 Accumulation Index and 50% S&P/ASX Small Ordinaries Accumulation Index
‡ Excess return: The difference between the Fund's return and the benchmark return.

Market review

Small and midcaps outperformed their larger peers during the August reporting season as Australia's nascent Information Technology sector delivered a 14.6% return for the quarter.

The Emerging Leaders Benchmark returned 2.3% in the three months to 30 September 2018, taking its 12-month return to 19.9%. In comparison, the S&P/ASX 200 returned 1.5% for the quarter and 14.0% for the year.

In aggregate the Australian reporting season was in line with expectations, with 29% of companies beating expectations and 28% missing[1] across the ASX 200. FY19 earnings were revised 1% lower for companies that reported[2].

The nascent Information Technology sector supported the index. Three stocks were mostly responsible for the strong return: payment solutions provider Afterpay (APT, +92.0%), online logistics company Wisetech Global (WTC, +41.2%) and electronic circuit board software provider Altium (+22.1%).

Telecommunication Services (+19.5%) and Consumer Discretionary (+4.5%) also supported the Index's return. The former re-rated following the proposed "merger of equals" between TPG Telecom (TPM, +65.2%) and Vodafone. The latter outperformed amid strong results from Tabcorp (TAH, +11.5%), JB Hi-Fi (JBH, +13.9%) and Bapcor (BAP, +18.3%).

Conversely, Metals & Mining (-9.8%) detracted the most from the Index's return as results highlighting emerging cost pressures and the gold price fell 4.9% to $US 1,192 per ounce. The largest detractors from the sector were gold miners Evolution Mining (EVN, -23.4%), Regis Resources (-25.9%) and St Barbara (SBM, -26.3%).

Portfolio review

Key contributors

TPG Telecom (TPM, overweight) – the company outperformed during the quarter after announcing a proposed merger of equals with Vodafone, with TPM to own 49.9% of the combined entity and Vodafone Holdings the remaining 50.1%. The merger, which is expected to become effective in 2019, consolidates the telco industry to three large players, with the merged entity (to be called TPG Telecom) becoming a strong challenger to incumbents Telstra (TLS) and Optus. TPG Telecom will have an enterprise value of $15bn, comprising debt of $4.1bn (2.2 times EBITDA) and equity of $10.9bn. We support the merger, which we expect will unlock significant synergies and provide the entity with the infrastructure, scale and balance sheet to maintain its disruptive nature. As a result we anticipate market share gains will accelerate across the Mobile, Fixed and Corporate divisions.

Scottish Pacific (SCO, overweight) – the debtor finance company outperformed after delivering a strong FY18 result and receiving a takeover offer from private equity group Affinity Equity Partners in the quarter. SCO increased PBIT by 14.1% to $47.6mn in the period, above its guidance for high single-digit growth. Affinity subsequently offered $4.40 cash per share for the company, an 18% premium to SCO's last traded share price prior to the announcement. In the absence of a superior proposal, the SCO board has unanimously recommended the Scheme Implementation Agreement. Outside the proposed takeover we remain positive towards SCO, which is well positioned to achieve double-digit earnings growth in the next few years as the Banks seek to retrace from the debtor finance industry.

[1] Source: JPMorgan Research.
[2] Source: UBS.

Vocus Group (VOC, overweight) – the telco outperformed after delivering a better-than-expected FY18 result. Management delivered FY18 EBITDA in line with expectations and guided to FY19 EBITDA of $350-370mn, 5% below forecasts at the midpoint, though cash conversion for the period increased from 68% to 110%. The improvement alleviated concerns that VOC would need to raise capital to avoid breaching its debt covenants. We remain positive towards the stock based on the combination of new management, improving fundamentals and quality of the asset base. The new management team is focused on integrating and simplifying its various acquired businesses, unifying its product offering and increasing customer product penetration. We remain confident in the longer-term revenue and margin opportunities and believe that the share price (at 18.2 times forward earnings) currently capitalises only limited future growth.

Atlas Arteria (ALX, overweight) – the toll road operator outperformed during the quarter despite releasing FY19 dividend guidance below market expectations at its 1H18 result. While little changed operationally, ALX provided maiden guidance of $0.30 for the full year, below forecasts for $0.35. We believe FY19 dividend guidance is conservative as ALX negotiates the internalisation of MAF, the vehicle through which ALX owns its core asset APRR. More broadly, we continue to see significant upside based on the continued strong operational performance of its attractive, long-dated assets (group revenue growing at 5.7% p.a.) and its discounted valuation of 11 times EV/EBITDA, which is in part due to its complicated ownership structure.

TradeMe (TME, overweight) – the NZ online auction and classifieds website company outperformed following a better-than-expected FY18 result. While management delivered net profit only 1% ahead of consensus at $91mn (largely due to good cost control), they surprised the market with a 22 cents per share special dividend. We continue to believe TME can generate relatively defensive and diversified high-single digit revenue growth, with stable EBITDA margins as productivity improves following a period of significant reinvestment. With a strong balance sheet – net debt to EBITDA sits at a comfortable 0.6 times – TME can also pursue accretive bolt-on acquisitions in New Zealand (international expansion is unlikely) or capital management initiatives. We regard TME's valuation of 19.5 times earnings as supportive when considering its market leadership, diversified earnings stream and significant discount to its Australian classifieds peers.

Key detractors

Eclipx Group (ECX, overweight) – the sales financing group declined in value following a disappointing FY18 trading update. Management downgraded FY18 NPATA by 11% versus earlier guidance and market expectations. The GraysOnline and Right2Drive businesses were responsible, with the core Australian and New Zealand Commercial businesses (70% of group earnings) generating earnings growth of 5%. We continue to hold a positive view towards ECX's core business: the company should continue to take market share (with high single-digit volume growth and stable pricing) and there is a large cost-out opportunity from upgrading existing systems. Additionally, ECX is well positioned to benefit from the major banks pulling back from lending in this industry. Subsequent to the downgrade the company received a takeover offer from fleet peer, SGFleet. The logic for industry consolidation is compelling, with significant synergies available to the merged entity. With the stock trading at a P/E of 10.0 times on a 12-month forward basis – a material discount to its peers – we continue to hold the position.

CSR (CSR, overweight) – the building materials company underperformed in response to concerns of a housing construction slowdown. In our view these concerns are overdone in regards to CSR, since the moderation is largely confined to the high-rise category; CSR's exposure is mostly to the single family home market which continues to enjoy strong underlying demand fundamentals. We remain overweight the stock based on three factors: a more positive outlook on the Building Products division than consensus as a result of an improved competitive landscape and market structure in bricks, management's strong operational expertise across all divisions (including Aluminium where earnings are being optimised through proactive hedging strategies and efficiency measures) and CSR's strong balance sheet – it is effectively debt free – which leave it well placed to pursue selective bolt-on acquisitions or capital management initiatives.

NEXTDC (NXT, overweight) – the data centre company underperformed in the quarter following the release of its FY18 result. FY18 results beat forecasts, with EBITDA of $64mn versus consensus at $60.8mn, and FY19 guidance was solid with EBITDA guidance of $75-80mn. However, management didn't announce any material contract wins – something the market had been anticipating from the result – which negatively impacted performance in the quarter. We continue to see upside in the business, which is structurally set to benefit from the increasing adoption of cloud technology and is accelerating its expansion to meet the demands of its clients. To this end, the company is currently building three new data centres which will support significant medium to longer term earnings growth. Overall, the outlook for NXT appears remains attractive given the company's growth profile, infrastructure-like characteristics at maturity, and supportive valuation.

Independence Group (IGO, overweight) – the nickel-gold miner underperformed early in the quarter after releasing its updated Nova Reserve statement, which showed a headline 21% reduction of contained nickel. We had already anticipated this reduction, given 11% is attributable to the previously reported reduction in the Resource report and 10% is due to mining depletion over FY18. IGO also released its FY18 results in the period, delivering a strong fourth-quarter of production and providing initial FY19 guidance that we believe is potentially conservative. We remain overweight IGO based on our positive view of the Nova and Tropicana assets – two world-class reserves – which support an increasing production profile (Jaguar was divested in May for $73mn). After a slower than expected start-up from Nova, we believe its issues have been largely resolved, with increasing production and higher commodity prices supporting material cash flow over the medium to long-term. Meanwhile, we expect higher grades and production at a lower cost from Tropicana. IGO's balance sheet is well capitalised, with net debt of $4mn.

Saracen Minerals (SAR, overweight) – the gold producer declined alongside the gold price in the quarter, with the commodity falling 4.9% to $US 1,192 per ounce. Nevertheless, SAR issued a better-than-expected production report for FY18, beat production guidance for the June quarter and upgraded FY19 production guidance by 12% to 325,000-345,000 ounces. We continue to prefer SAR amongst its peers when considering its organic production growth, increasing mine life, declining cost profile and net cash balance sheet position.

Key purchases

EBOS Group (EBO) – we established a position after EBO announced it had won the contract to distribute pharmaceuticals to Chemist Warehouse. In our view this contract will help to underwrite several years of growth for EBO, increasing FY20 EPS by 12.4% and lifting organic EPS growth to 4.5% p.a. thereafter. More broadly, we are positive towards the company based on its defensive earnings profile, its leading position in a consolidating industry (with the potential for accretive acquisitions), a strong management team and a supportive valuation (20.7 times 12-month forward earnings).

oOH! Media (OML) – we increased our position size in the outdoor media company during the quarter. We support the recent acquisition of Adshel, given its mid-single digit earnings accretion and strong strategic rationale, with clear revenue and cost synergies. More broadly we hold an optimistic view of the sector: outdoor advertising is expanding its share of the total advertising market (currently 5%) supported by increased penetration of digital boards. Given OML's high gross margins and its largely fixed cost base, we expect the positive revenue outlook will support strong medium-term earnings growth.

Alumina (AWC) – we increased our position size during the quarter. We are overweight AWC based on our positive view of the commodity and AWC's high-quality assets, with earnings, cash flow and capital management upside versus consensus expectations. The aluminium market remains very tight, with the approaching Chinese winter closures again having the potential to be even more restrictive. We believe that AWC is undervalued at a 9.1 times forward P/E when considering the strategic appeal of its assets.

Key sales

APN Outdoor (APO) – we exited the position after the ACCC approved JCDecaux's takeover bid at $6.70 per share for the company. With such a strong offer from the French suitor and implementation expected before the end of CY2018, we believe a competing bid is unlikely. However, we remain positive towards the outdoor media industry, and subsequently increased our position in peer oOH! Media (OML).

NEXTDC (NXT) – we reduced our position size following recent outperformance, prior to the company's FY18 result. While more of the company's positive outlook is captured by consensus at current levels, we continue to see upside in the business, which is structurally set to benefit from the increasing adoption of cloud technology and is accelerating its expansion to meet the demands of its clients. To this end, the company is currently building three new data centres which will support significant medium to longer term earnings growth. Overall, the outlook for NXT remains attractive given the company's growth profile, infrastructure-like characteristics at maturity, and supportive valuation.

Independence Group (IGO) – we reduced our position in the nickel-gold miner during the quarter in favour of increasing our holding in Alumina (AWC), where we have higher conviction in the commodity outlook. That being said, we remain overweight IGO based on our positive view of the Nova and Tropicana assets – two world-class reserves – which support an increasing production profile (Jaguar was divested during the June quarter for $73mn). After a slower than expected start-up from Nova, we believe its issues have been largely resolved, with increasing production and higher commodity prices supporting material cash flow over the medium to long-term. Meanwhile, we expect higher grades and production at a lower cost from Tropicana. IGO's balance sheet remains well capitalised, with net debt of $4mn.

Key active overweights

Atlas Arteria (ALX) – we maintain a favourable view towards ALX based on the continued strong operational performance of its attractive, long-dated assets and its discounted valuation of 11 times EV/EBITDA, which is in part due to the complicated ownership structures of its assets. Securityholders approved the internalisation of ALX's management in May, a change we believe is a significant step towards ultimately simplifying the ownership structures of ALX's two key assets and, in doing so, fully reflecting their intrinsic value. ALX now has a credible strategy for achieving this goal over the next 12 months which we believe will result in significant upside.

TPG Telecom (TPM) – our overweight position is based on a positive view of the proposed merger with Vodafone. We expect the combined entity to unlock significant synergies and harness its infrastructure, scale and balance sheet to disrupt incumbents Telstra (TLS) and Optus through its lower-cost structure. As a result, we anticipate market share gains will accelerate across the Mobile, Fixed and Corporate divisions. Furthermore, we expected the combined entity will now be able to acquire 5G spectrum at a lower cost in the upcoming auction.

Scottish Pacific (SCO) – we remain overweight the debtor finance company, with the stock remaining at a discount to the proposed takeover offer of $4.40 per share from Affinity Equity Partners. Our original thesis is based on attractive market fundamentals for the debtor finance company. The industry has consolidated, Australian product penetration is low compared to other developed economies, bad debt experiences are benign and competitors (i.e. the big banks) are rational, focusing on servicing existing bank clients in other products at the expense of market share.

Star Entertainment (SGR) – we are overweight the casino company because we believe the market currently underestimates SGR's ability to enhance asset performance through operational improvements and capex programs. The company's brownfield developments – the expansion in Sydney, the redevelopment in the Gold Coast and the Queen's Wharf in Brisbane – provide meaningful upside opportunities in the medium to longer term. Further, we believe SGR's valuation is attractive, with the stock trading at 16.9 times versus peer Crown Resorts (CWN) at 21.2 times.

Ooh! Media (OML) – we are overweight the outdoor media company based on our optimistic view of the sector. Outdoor advertising is expanding its share of the total advertising market (currently 5%) supported by increased penetration of digital boards. Given its high gross margins and its largely fixed cost base, we expect OML's positive revenue outlook will support strong medium term earnings growth. We also support the company's recent acquisition of Adshel, given it is mid-single digit earnings accretive and has strong strategic rationale, with clear revenue and cost synergies.

Key active underweights

Tabcorp (TAH) – we are underweight the gambling services provider because we believe earnings expectations are too optimistic and the market's valuation, at 22.9 times 12-month forward P/E, is stretched. Our key concern is the outlook for the conventional wagering business, which operates in a low growth industry and with high levels of competition, placing intense pressure on its traditional retail distribution strategy. The merger of TAH and Tatts Group in December 2017 doesn't alter our view of the structural headwinds in wagering, with the lofty acquisition price and high gearing more than offsetting targeted cost synergies in our view.

Bluescope Steel (BSL) – while our view towards the stock has recently improved, we currently maintain an underweight position. BSL's earnings remain subject to volatile commodity prices, though its recent cost-reduction programs and ongoing shift in business mix means that its earnings appear more resilient at this time compared to previous cycles.

Boral (BLD) – our underweight position is premised on the company's exposure to moderating domestic construction material markets, including new housing demand in Australia where we believe activity is likely to soften in the medium term. We also believe BLD paid a full price for the recent acquisition of US asset Headwaters and question the earnings sustainability of the US business and BLD's ability to extricate synergies to meet stated targets. While BLD's valuation of around 14.7 times forward earnings appears undemanding relative to historic valuations, we do not believe it fully factors in these risks at present.

A2 Milk (A2M) – we believe the stock's current valuation – trading at a forecast P/E of 29.1 times – fully captures the company's positive outlook. A2M's earnings growth over recent years has been underpinned by Chinese infant formula sales which have grown significantly, however we are cautious to capitalise this earnings momentum given questions regarding the sustainability of the current distribution channels (in particular via daigous), an increasing competitor presence and the fickle nature of the Chinese consumer.

Incitec Pivot (IPL) – we are underweight the stock based on a negative outlook for IPL's key commodities, urea and diammonium phosphate (DAP). IPL's other business, explosives, enjoys a strong competitive position across most markets, but moderate risks have now emerged following WA contract losses announced in FY18, with other key contracts coming up for renewal in the short term.

Market outlook

We believe fundamentals point to a strengthening earnings cycle for the Australian equity market. Consensus sees Resources and Industrials ex-Financials driving high single-digit earnings growth, moderated by more modest earnings growth in Financials.

Australian equities are priced modestly above their long-term average based on forward earnings estimates, though valuations remain attractive relative to alternatives such as fixed interest. The S&P/ASX 200 Index yields 4.6% on a 12-month forward basis (before franking) versus 2.7% from the Australian 10-year government bond yield.

At a global level, while an economic recovery outlook is driving valuations to elevated levels, we remain alert to economic and geopolitical risks, including rising interest rates and China's real rate of growth.

We see significant value in certain sectors but believe others to be overvalued based on our earnings and cash flow expectations. We are overweight the Communication Services, Consumer Discretionary and Health Care sectors, but are underweight Real Estate, Metals & Mining and Consumer Staples.

Sector allocation

	Portfolio %	Benchmark %	Active %
Communication Services	14.94	6.72	8.22
Consumer Discretionary	19.39	13.57	5.82
Consumer Staples	2.92	7.01	-4.09
Energy	2.72	5.03	-2.31
Financials	11.65	11.46	0.19
Health Care	11.36	6.64	4.71
Industrials	12.97	12.38	0.59
Information Technology	4.88	7.46	-2.58
Materials	13.32	21.58	-8.26
Real Estate	1.36	6.43	-5.07
Utilities	0.00	1.72	-1.72

Top 5 holdings

	Portfolio %	Benchmark %	Active %
Atlas Arteria	5.97	1.04	4.93
TPG Telecom	5.18	0.66	4.53
Star Entertainment	4.45	0.97	3.49
Resmed	4.42	1.82	2.60
Alumina	4.08	1.46	2.62

Key active positions

Overweights	Portfolio %	Benchmark %	Active %
Atlas Arteria	5.97	1.04	4.93
TPG Telecom	5.18	0.66	4.53
Scottish Pacific Group	3.94	0.13	3.81
Underweights			
Tabcorp Holdings	0.00	2.21	-2.21
Bluescope	0.00	2.11	-2.11
Boral	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.	10 years % p.a.
Growth return	21.55	9.93	10.47	6.91
Distribution return	2.24	2.06	2.22	2.85

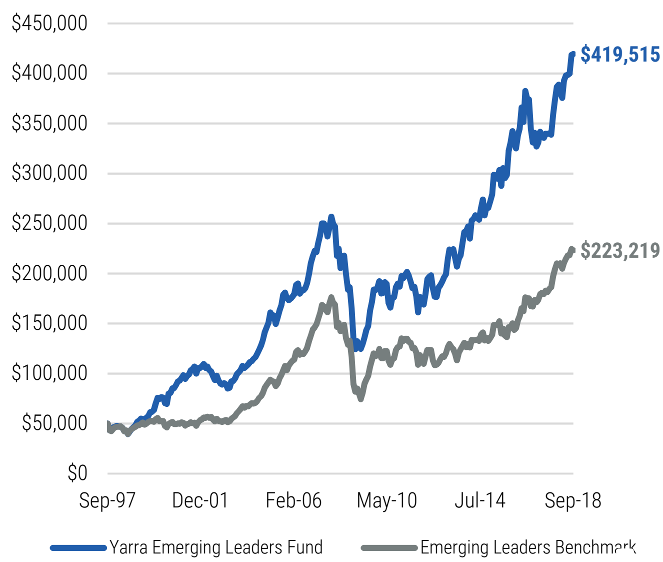
The Growth Return is measured by the movement in the Fund's unit price (inclusive of fees), ex-distribution, and can be positive or negative as the unit price can fluctuate with changes in the underlying market value of the Fund's assets. The Distribution Return is the amount that is paid to unitholders 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 small and medium sized Australian companies that are considered to possess strong capital growth potential. In doing so, the aim is to outperform the benchmark over rolling 3-year periods.
Recommended investment time frame	5 - 7 + years
Fund inception	September 1997
Fund size	Pooled Fund A$168.28 mn as at 30 September 2018
APIR codes	JBW0010AU
Estimated management cost	1.25% p.a.
Buy/sell spread	+/- 0.20%
Platform availability	Asgard BT Wrap Macquarie Wrap Consolidator Hub24

Investment performance comparison of $50,000

After fees, since inception of the Yarra Emerging Leaders Fund, September 1997 to September 2018.



For illustrative purposes only. Past performance does not guarantee future results, which may vary. The total net fund returns shown are prepared on an exit to exit basis (i.e. they include all ongoing fees and expenses and assume reinvestment of all distributions). They do not take personal taxation into account. The comparison with the benchmark (comprising 50% S&P/ASX Midcap 50 Accumulation Index and 50% S&P/ASX Small Ordinaries Accumulation Index) is for comparative purposes only. Index returns do not allow for transactional, management, operational or tax costs. An index is not managed and investors cannot invest directly in an index.

Applications and contacts

Investment into the Yarra Emerging Leaders Fund can be made by Australian resident investors only.

Website www.yarracm.com

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