Yarra Emerging Leaders Fund (Direct)

Gross returns as at 30 June 2022

	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 (Direct)	-10.10	-16.69	-9.33	5.55	8.01	11.64	12.76
Emerging Leaders Combined Benchmark†	-11.71	-17.57	-14.49	3.87	6.57	8.77	7.88
Excess return (before fees)‡	1.61	0.88	5.16	1.68	1.44	2.88	4.88

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 June 2022

	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 (Direct)	-10.24	-17.08	-11.02	3.41	5.75	9.24	10.45
Emerging Leaders Combined Benchmark†	-11.71	-17.57	-14.49	3.87	6.57	8.77	7.88
Excess return (after fees)‡	1.47	0.49	3.47	-0.46	-0.82	0.47	2.57

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 Emerging Leaders Fund (Direct): November 1994

† 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

Australian small caps declined sharply during the June quarter as Australia's first interest rate hike since 2010 pressured valuations, with only the Energy and Utilities sectors recording positive returns.

The Emerging Leaders Benchmark returned -17.6% for the quarter, taking its 12-month return to -14.2%. In comparison, the broader ASX300 declined 12.2% for the quarter and, globally, the MSCI World Index fell 14.2%. The benchmark's forward P/E declined from 15.6 times to 12.2 times as the RBA lifted the official cash rate by 75 bps to 0.85%.

Within Energy (+1.6%), coal producers continued to rise in value amid the global energy crisis, with thermal coal rising another 49% to $US386/t during the quarter. Whitehaven Coal (WHC) – which was promoted to the ASX100 late in the period – climbed +16.6% and New Hope Corporation (NHC) lifted +10.5%. AGL Energy (+6.9%) was the sole constituent in the Utilities Index, rising in response to higher wholesale electricity prices even as shareholders voted down its proposal to demerge into its coal generation and retail energy businesses.

Conversely, the worst performing sectors were Metals & Mining (-28.9%) and Information Technology (-24.1%). In the former, pre-production miners leveraged to the EV thematic plummeted, led by Lake Resources (LKE, -60.7%), Australian Strategic Materials (ASM, -54.5%) and Aurelia Metals (AMI, -48.0%). In the latter, unprofitable tech were noticeable underperformers, in particular Tyro Payments (-65.9%) and Novonix (NVX, -63.2%).

Elsewhere, Consumer Discretionary (-21.4%) also experienced widespread declines as the macro outlook deteriorated. The largest falls came from Kogan (KGN, -51.1%), Temple & Webster (TPW, -50.4%) and Betmakers Technology (BET, -46.5%).

Portfolio review

Key Contributors

Atlas Arteria (ALX, overweight) – the toll road operator outperformed due to its transparent inflation hedge and, moreover, as IFM's global infrastructure fund took a 14.96% stake in the company, causing speculation of a possible takeover bid. We maintain an overweight position based on ALX's strong liquidity and balance sheet position, discounted valuation and exposure to traffic recovery in Europe and the US. ALX trades on less than 11.0 times normalised EV/EBITDA, which sufficiently captures the disruption from COVID-19 as travel restrictions and lockdowns reduce traffic volumes in the short term. Beyond traffic normalisation, we see a path towards value creation for ALX through concession extensions at APRR achieved as a means of funding expansion projects and settling the Dulles Greenway tolling regime.

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

TPG Telecom (TPG) – the telco outperformed as its investor day highlighted the company's defensive earnings stream and leverage to re-opening international borders, with a relatively high mix of migrants and students in its mobile phone customer base. Our thesis 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.

Tabcorp (TAH, overweight) – the company contributed to excess returns as it demerged its lottery and wagering divisions during the month. The outcome supported our investment thesis that the spin-off will likely crystalise value for the lotteries division. We see Lotteries (70% of FY21 EBITDA) as having a defensive revenue stream, significant pricing power and growth opportunities driven by online penetration (which currently sits at 32%, below the global average of 50%). While we are more negative towards TAH's wagering & media business (30% of FY21 EBITDA), recent takeover bids have placed a floor under the division's valuation.

Reliance (RWC, overweight) – the building materials company rallied late in the period in response to stronger-than-expected results from US peers, indicating that residential demand remains solid. In our view RWC is a quality industrial company which has been over-sold based on short term earnings headwinds (the roll-off of the COVID benefit, higher raw material costs), which we expect to ease over our longer-term investment horizon. Further, we are more positive on the US Repair & Remodel (R&R) market than consensus, which comprises 38% of RWC's EBITDA and is more resilient to macro factors than new housing. In terms of quality attributes, we note RWC's brand power through products such as SharkBite, loyal customers in both Lowes, and Home Depot and end customers, excellent supply chain management in normal times (98% OTIF, on-time in-full, in the Americas retail channel), and strong pricing power (in-house R&D). As a result, we see its valuation (at a 13.1 times forward P/E) as attractive.

Key Detractors

Megaport (MP1, overweight) – the company underperformed following a weaker-than-expected 3Q22 update. Revenue grew 5% to $27.9mn for the quarter sequentially, slower than analyst forecasts, following its strategy to increase emphasis on indirect sales. We see the slower revenue growth as temporary based on the view the strategy shift is a short-term headwind but, in the long term, will likely create greater opportunities. We see strong growth from the core business connecting data centres to the cloud, with a strong pipeline in its key US geography as businesses invest in IT projects. With its expansion into telecommunication services – which leverages the same infrastructure – the total addressable market likely more than doubles. While the company is currently at an inflection point for earnings and cashflow we believe it will turn positive in the next year.

Evolution Mining (EVN, overweight) – the gold miner underperformed after downgrading production and cost guidance for FY22, FY23 and FY24 during the period, with production for the next two years 8-10% below consensus forecasts. Management cited a slower-than-expected turnaround at its Red Lake project and higher industry costs as the main causes of the downgrades. Nevertheless, EVN is our preferred gold exposure within the S&P/ASX Midcap 50 Index, based on its diversified, high-quality assets and strong management team. While the growth outlook may not be as compelling as peer Northern Star (NST), we still see upside based on the company's production at Cowal and Red Lake assets and superior cost profile.

Nine Entertainment (NEC, overweight) – the media company underperformed despite delivering a solid trading update during the period, with the market more focused on the deteriorating macro environment. Management expects FY22 EBITDA to be up 22% y/y, unchanged versus its previous guidance, supported by slightly stronger underlying metrics. Our positive view remains premised on a supportive valuation, its high-quality digital assets (Stan, 9Now and Domain), and a number of cost saving initiatives in the short term. We believe the ad market's recovery is only partially factored into NEC's valuation, with the stock trading at 9.1 times forward earnings. At these levels, we also do not believe sufficient value is attributed to its subsidiaries when considering their long-term growth profile.

IGO Limited (IGO, overweight) – the battery minerals miner partially retraced prior outperformance as the nickel price declined 29% to $US22,643/t. Our positive thesis is premised on the miner's $US1.4bn 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).

OZ Minerals (OZL, overweight) – the copper miner declined as the commodity fell 20% to $US8,254/t. Our positive view remains premised on OZL's two high quality, long life, 100% owned copper mines in South Australia - Prominent Hill and Carrapateena. We expect the company's copper production to double to >200ktpa by 2030, as Carrapateena moves to a block caving operation, and as the company develops the greenfield West Musgrave copper/nickel deposit in Western Australia. In our view, OZL is well positioned to fund its growth ambitions through the net cash balance sheet, strong cash flow generation, and flexibility to divest assets such as the Centro Gold deposit in Brazil. We also support OZL's plan to achieve net zero scope 1 and 2 emissions by 2030, which we view as ambitious and considered.

Key Purchases

Pilbara Minerals (PLS) – we established a position in the lithium producer during the period. We see PLS as the most attractive exposure to the future facing commodity. PLS's flagship project, the Pilgangoora spodumene project, is, in our view, well positioned to benefit from higher lithium prices as commercial production ramps up following the successful completion of Phase 1 construction. Further, PLS is assessing the potential to produce a value-added lithium/salts product, compared to spodumene concentrate currently, which we estimate could capture as much 70-80% of the value in the supply chain.

The Lottery Corporation (TLC) – we increased our position in the company following its de-merger from Tabcorp (TAH). Our investment thesis is premised on Lotteries as having a defensive revenue stream, significant pricing power and growth opportunities driven by online penetration (which currently sits at 32%, below the global average of 50%). In particular, we see TLC as resilient in the current market environment, holding a strong market position in a heavily regulated industry with high barriers to entry. While TLC carries ESG risk as a gaming company, we view Lotteries as a low-risk part of the market given small average ticket sizes, limiting player harm, and we see TLC as a global leader relative to peers.

Reliance (RWC) – we increased our position in the plumbing fittings group during the period. In our view RWC is a quality industrial company which has been over-sold based on short term earnings headwinds (the roll-off of the COVID benefit, higher raw material costs), which we expect to ease over our longer-term investment horizon. Further, we are more positive on the US Repair & Remodel (R&R) market than consensus, which comprises 38% of RWC's EBITDA and is more resilient to macro factors than new housing. In terms of quality attributes, we note RWC's brand power through products such as SharkBite, loyal customers in both Lowes, and Home Depot and end customers, excellent supply chain management in normal times (98% OTIF, on-time in-full, in the Americas retail channel), and strong pricing power (in-house R&D). As a result, we see its valuation (at a 13.1 times forward P/E) as attractive.

Key Sales

Metcash (MTS) – we exited our position in the wholesale distributor during the period after strong outperformance. Within Food & Liquor, we continue to see MTS as a beneficiary of higher inflation as the supermarket industry remains rational in passing through higher prices. However, we anticipate the softening macro environment in Australia may limit any further market share gains, with the "shop local" theme likely to dissipate as consumers search for value. Within Hardware (now 41% of group EBIT), we support management's store rollout and refurbishment strategy, but expect we expect this will be more than offset by Australia's slowing housing market. As a result, we no longer see MTS's headline valuation (at a 12-month forward P/E of 14.2 times) as attractive given the risk to earnings as the cycle persists.

Ansell (ANN) – we exited our position in the company to reflect greater uncertainty around the outlook for earnings. In the short term, raw materials costs and slowing demand for its single-use/exam gloves (to pre-COVID levels) likely represent significant risk to consensus forecasts. In the medium to long term, the company will likely have significant exposure to slowing global economic growth through its Industrials division. As a result, we no longer saw the company's valuation as attractive at a headline P/E of 12.0 times on a 12-month forward basis.

Northern Star (NST) – we exited our position during the period, with our exposure to Gold becoming more selective in an environment of rising real interest rates. EVN is our preferred gold exposure within the S&P/ASX Midcap 50 Index, based on its diversified, high-quality assets and strong management team. While the growth outlook may not be as compelling as peer Northern Star (NST), we still see upside based on the company's production at Cowal and Red Lake assets and superior cost profile.

Key Active Overweights

Worley (WOR) – we believe the company is in a strong position to benefit from the recovery in its traditional work and, increasingly, new sustainability projects. Following the Jacobs ECR acquisition, the business is diversified across different markets and is, in our view, well positioned to capture higher structural demand from energy transition work to low carbon solutions. We believe WOR's valuation provides significant support at current levels, with the stock trading on 17.9 times consensus forward earnings, a sharp discount to the Industrials ex-Financials at 21.8 times.

Link Group (LNK) – we are positive on the company because we see compelling value in its base share registry business and electronic conveyancing business PEXA, which has been supported by recent corporate interest. We hold a positive view of PEXA premised on its infrastructure-like characteristics of the property settlement exchange upon maturity, supplemented by numerous growth opportunities in immediate adjacencies. Further, LNK is positively leveraged to higher US interest rates, which we see as a meaningful tailwind over the medium term. Lastly, LNK trades at 15.0

times forward earnings, a discount to the Industrials ex-Financials at 21.8 times.

Atlas Arteria (ALX) – we maintain a high-conviction overweight position based on ALX's strong liquidity and balance sheet position, discounted valuation and exposure to traffic recovery in Europe and the US. ALX trades on less than 11.0 times normalised EV/EBITDA, which sufficiently captures the disruption from COVID-19 as travel restrictions and lockdowns reduce traffic volumes in the short term. Beyond traffic normalisation, we see a path towards value creation for ALX through concession extensions at APRR achieved as a means of funding expansion projects and settling the Dulles Greenway tolling regime. M&A risk, expressed in the period, suggests scope for the value gap to be closed on a shorter time frame.

TPG Telecom (TPG) – our thesis 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.

AUB Group (AUB) – our overweight position is premised on a positive view of its recent acquisition and its resilient earnings in the current environment. The Tysers acquisition is highly EPS accretive (30% on a pro-forma basis for CY22) and offers new growth through global commercial insurance lines. More broadly, AUB is set to benefit from mid-single digit premium rate rises and as the core business sees higher earnings growth via improved product and capacity offerings. As a result, we view the company's valuation as attractive (18.4 times forward earnings), well below peer Steadfast (SDF) (22.5 times) but with stronger growth options.

Key Active Underweights

Ampol (ALD) – our underweight is premised on a negative long-term view of the petrol station industry and oil refining. As electric vehicle (EV) penetration increases amid the growing need to decarbonise, we see a limited ability for ALD to switch its refuelling infrastructure to electric charging stations given increased competition (e.g. shopping malls) and as consumers charge at home. In the short term, higher margins at its Lytton refinery is offsetting relative weakness from the rest of its Fuels & Infrastructure (F&I) division (where ALD is unable to pass on higher fuel costs). In addition, its Convenience Retail division has benefited from the "shop local" theme – a trend we see reversing as consumer behaviour normalises post-COVID.

Lynas Rare Earths (LYC) – we remain underweight. Notwithstanding the positive outlook for the commodity basket, particularly given its leverage to the EV thematic, we see risks due to regulatory uncertainty of its operating licence in Malaysia and its valuation, at a 12-month forward EV/EBITDA of 10.0 times. Our preferred EV exposure is IGO Limited (IGO), which trades at a more attractive 6.1 times despite superior diversification and lower geopolitical risk.

Vicinity Centres (VCX) – we see valuation risk in the shopping mall REIT amid the outlook for higher real rates. Further, we continue to believe that shopping mall REITs face accelerated structural issues, which is not captured with VCX trading at 0.9 times trailing NTA.

Aurizon Holdings (AZJ) – we are underweight AZJ because we find the headline valuation unsupportive (at an EV/EBITDA of 7.5 times) when considering long-term revenue headwinds. We believe the outlook for customer end markets in coal will likely weaken further, with the commodity facing structural challenges as the world's energy mix shifts away from emissions-intensive fossil fuels.

Orica (ORI) – our underweight position is premised on longer-term concerns around three factors. Firstly, ORI has roughly 37% EBIT exposure to coal through its thermal coal customers, which we expect will fall over time as the world transitions to more sustainable energy sources. Secondly, we see stranded asset risk for its assets at Kooragang island, Yarwun and Bontang. Lastly, we expect AN prices to decline from elevated levels, given 40% of demand is from the coal industry. While coal production has benefited from the recent energy crisis, it remains in structural decline over time as clean renewable energy grows in scale.

Market outlook

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

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

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

While the RBA has been later than most other developed nations in tightening policy, tighter financial conditions in 2022 are likely to come via both significantly higher cash rates and a stronger currency. The A$/US$ has in recent months been buffeted by concerns of a peak in global industrial growth indicators and slowing China economic momentum. Nevertheless, Australia's external accounts are in their best position since the early 1970s and surging commodity prices in early 2022 is providing an incentive for the A$/US$ to commence an appreciation cycle, together with the attractive carry on offer. We expect the A$ will finish 2022 at around 76 cents, albeit the risk to this forecast is on the upside.

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

Sector allocation

	Portfolio %	Benchmark %	Active %
Communication Services	12.56	6.55	6.00
Consumer Discretionary	10.28	11.30	-1.03
Consumer Staples	1.61	4.40	-2.79
Energy	5.11	7.53	-2.42
Financials	8.88	10.81	-1.92
Health Care	8.65	3.79	4.85
Industrials	12.39	12.18	0.21
Information Technology	9.14	8.13	1.01
Materials	19.29	23.84	-4.54
Real Estate	3.04	10.28	-7.24
Utilities	0.00	1.18	-1.18

Top 5 holdings

	Portfolio %	Benchmark %	Active %
Worley	5.11	1.13	3.98
Atlas Arteria	4.90	1.64	3.25
Link Administration	4.07	0.46	3.61
TPG Telecom	3.63	0.53	3.11
OZ Minerals	3.46	1.26	2.19

Key active positions

Overweights	Portfolio %	Benchmark %	Active %
Worley	5.11	1.13	3.98
Link Administration	4.07	0.46	3.61
Atlas Arteria	4.90	1.64	3.25
Underweights			
Ampol	0.00	1.74	-1.74
Lynas Rare Earths	0.00	1.68	-1.68
Vicinity Centres	0.00	1.51	-1.51

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	-12.15	2.72	4.97	8.22
Distribution return	1.13	0.69	0.78	1.01

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	November 1994
Fund size	A$89.9 mn as 30 June 2022
APIR codes	JBW0007AU
ARSN code	089 909 106
Distribution frequency	Semi-Annually
Estimated management cost	1.90% p.a.
Buy/sell spread	+/- 0.20%

The Yarra Emerging Leaders Fund (Direct) is not available for new investment. Where existing reinvestment instructions are in place, distributions may be reinvested.

Applications and contacts

The Yarra Emerging Leaders Fund (Direct) is no longer available for new investment. The reinvestment of distributions is still allowed where an existing reinvestment instruction is in place.

Website www.yarracm.com

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