YARRA CAPITAL MANAGEMENT

Investment Commentary
Month to 31 August 2022

Yarra Australian Equities Fund (Direct)

Gross returns as at 31 August 2022

	1 month %	3 months %	1 year %	3 years % p.a.	5 years % p.a.	10 years % p.a.	Since inception^ % p.a.
Yarra Australian Equities Fund (Direct)	2.44	-1.02	-1.81	5.33	7.25	9.17	9.03
S&P/ASX 200 Accumulation Index†	1.18	-2.39	-3.43	5.51	8.12	9.33	8.40
Excess return (before fees)‡	1.26	1.37	1.63	-0.17	-0.88	-0.17	0.63

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 31 August 2022

	1 month %	3 months %	1 year %	3 years % p.a.	5 years % p.a.	10 years % p.a.	Since inception^ % p.a.
Yarra Australian Equities Fund (Direct)	2.31	-1.40	-3.31	3.55	5.34	7.15	6.97
S&P/ASX 200 Accumulation Index†	1.18	-2.39	-3.43	5.51	8.12	9.33	8.40
Excess return (after fees)‡	1.13	0.99	0.13	-1.96	-2.79	-2.19	-1.43

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 Australian Equities Fund (Direct): October 2001

† The benchmark for the Yarra Australian Equities Fund (Direct) has been amended since the Fund's inception. Effective 28 February 2008 the benchmark is the S&P/ASX 200 Accumulation Index, replacing the S&P/ASX 200 ex Property Accumulation Index Monthly. Further information on changes to the Fund's benchmark is available upon request.

‡ Excess return: The difference between the portfolio's return and the benchmark return.

Market review

Australian equities gained 1.2% during August – taking the S&P/ASX 200 Accumulation Index's 12-month return to -3.4% – reflecting a stronger than expected reporting season, with 1.4 times more beats than misses compared to consensus earnings expectations. The broader ASX300 also gained 1.2% for the month, while global indices were negative (MSCI World Index -3.4%).

Within Energy (+7.8%), the sector has lifted strongly on the back of elevated energy prices (oil, gas and coal), led by Viva Energy (VLD, +12.0%), Santos (STO, +9.7%) and Paladin Energy (PLN, +14.9%)

Materials was a strong performer (+4.3%) led by IGO (IGO, +21.7%), Pilbara Minerals (PLS, +31.7%) Liontown Resources (LTR, +31.4%). Commodities exposed over the medium to long term to an increased uptake in electric vehicles and renewable energy generation were the strong performers.

Conversely, the worst performing sector was Real Estate (-3.2%) led by Centuria Capital (CNI, -11.8%), Arena REIT (ARF, -12.7%) and Shopping Centres Australasia Property Group (SCP, -7.8%), as companies downgraded dividend outlooks due to the rising cost of debt impacting cashflow growth.

Portfolio review

Key Contributors

OZ Minerals (OZL, overweight) – the copper producer was a positive contributor to the portfolio during the period following BHP's takeover offer for the company. The offer, priced at $25 per share, represented a 32% premium to the pre-bid price. 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 emerge is limited, in our view, given BHP's significant available regional synergies. 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 minerals miner was a key contributor during the period on lithium price strength ahead of consensus forecasts. Our positive thesis is 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

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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).

Qantas (QAN, overweight) – the Australian airline outperformed during the month following the announcement of its full year results. The very strong demand environment for domestic and international travel has seen QAN's balance sheet repaired quickly, with net debt now back below targeted levels and the company announcing a $400m buyback. The strong demand environment, the company's strong domestic market position and limited international capacity has enabled QAN to recover higher input costs and maintain positive earnings leverage.

Key Detractors

TPG Telecom (TPG, overweight) – the Australian telco underperformed during the period following a slightly disappointing (4% miss at the EBITDA level) result. We retain a positive view on the company given the mobile market is becoming more rational supporting repricing, as the value brand TPG can gain market share and technology shifts towards fixed wireless and fiber to the basement will favor TPG. We expect the momentum in the business to continue improving through FY23 and the valuation remains attractive at 8 times EV/EBITDA.

Reliance Worldwide (RWC, overweight) – the global provider of water control systems and plumbing solutions underperformed during the month as investor concerns grew around a weakening cycle and de-stocking risk. Following this weakness we built a position, reflecting our constructive view on the company's ability to serve into a shallower than expected activity trough following a period of strong activity in FY21 and FY22. We expect the earnings headwinds will be shorter term in nature and that current trading levels represent an opportunity to gain exposure to a quality industrial company that trades on a modest multiple of 14 times FY24 P/E.

NextDC (NXT, overweight) – the data centre operator underperformed, despite delivering a solid result and upbeat outlook during the period. We believe the high recurring nature of NXT's revenues, its infrastructure like characteristics and tangible asset base are attractive. The company has been excessively discounted and we see no diminution to its growth trajectory. NXT trades on 23.6 times FY24 EV/EBITDA, which compares favourably to its more mature global peers.

Key Purchases

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. UMG also detailed its pathway to reduce leverage, largely through earnings recovery, which has been weighing on the 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 is likely to attract a much higher multiple reflecting the value of the operating business.

Nine Entertainment (NEC) – we added to our position in the media company reflecting our constructive outlook for advertising spend, and NEC's ability to grow higher-margin digital revenues in a potentially softer environment. The company's sell off CYTD 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 regard as attractive for a leading media company which is diversifying its revenue streams to be less cyclical, driven by higher margin digital revenues.

Reliance Worldwide (RWC, overweight) – we added to our position in the global provider of water control systems and plumbing solutions following the sell off after the company's August result. We remain constructive view on the company's ability to serve into a shallower than expected activity trough following a period of strong activity in FY21 and FY22. We expect the earnings headwinds will be shorter term in nature and that current trading levels represent an opportunity to gain exposure to a quality industrial company that trades on a modest multiple of 14 times FY24 P/E.

Key Sales

Worley (WOR) – we modestly reduced our position in the energy, chemicals and resources engineer during the period following a period of strong performance. We remain overweight WOR. 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 accretive capital spend required to decarbonise energy production and provide more sustainable solutions across chemical and resources customers.

Carsales.com (CAR) – we modestly reduced our position in the online automotive classifieds company following a period of strong performance after the company's equity raising to acquire the remaining 51% of Trader Interactive, CAR's US based classifieds business. We remain overweight the company, reflecting our positive view on the opportunity for improving yield from various products including Instant Offer and Select, as well as the improving profitability of CAR's South Korean business Encar.

OZ Minerals (OZL) – we reduced our position in the copper producer to partially crystallise share price outperformance following BHP's takeover offer for the company, priced at a 32% premium to the pre-bid price. With the OZL board rejecting the initial offer, we recognize the potential for BHP to return with a higher bid, and 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. We also support OZL's plan to achieve net zero scope 1 and 2 emissions by 2030.

Key Active Overweights

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 (PXA), which has been supported by recent corporate interest. Our positive view of PEXA is premised on the infrastructure-like characteristics of its property settlement exchange upon maturity, supplemented by numerous growth opportunities in immediate adjacencies.

Aristocrat Leisure (ALL) – our positive investment view remains premised on ALL's dominant position in Land-Based Games and significant opportunities from Digital, which offers a wide range of outcomes. We see the disruption from its exposure to Ukraine as temporary. We see ALL's valuation as undervalued at 19.2 times forward earnings (below the Industrials Ex-Financials multiple) when considering ALL's superior long-term growth potential.

Worley (WOR) – 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 the engineering services firm'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. We also believe that future incremental margins could surprise to the upside following the company's $375m cost-out program announced during the recent COVID-interrupted period.

Key Active Underweights

CSL (CSL) – we remain underweight CSL based on the challenge the business faces returning to pre-COVID profitability, coupled with its forward valuation (35.1 times P/E and 20.9 times EV/EBITDA on a 12-month forward basis), which we believe appropriately captures the earnings outlook at this time. While CSL is a key beneficiary of the post-COVID re-opening theme from a plasma collection perspective, we believe this is already reflected in consensus forecasts. However, in our view the prospect of higher costs going forward is underappreciated by the market, with donor fees and other collection centre costs likely to be higher for longer. We retain a preference for ResMed (RMD) within the Health Care sector, where we see better growth prospects and a strong competitive position versus peers.

National Australia Bank (NAB) – we remain underweight the bank, due to our negative sector view. Favourable dynamics of excess provisions and capital are now well understood, while low bad debts and significant buybacks have seen the sector trade around peak multiples versus pre-provision earnings. We believe consensus estimates for pre-provision forecasts are too high and see material earnings pressure emerging as bad debt expenses normalise. We hold small overweight positions in Westpac Bank (WBC) and ANZ Bank (ANZ), where the valuations are more supportive at current levels.

Macquarie Group (MQG) – we remain underweight the stock based on the view the recent earnings uplift is driven by its lower quality and highly cyclical businesses, which we regard as unsustainable into the medium term. We see significant downside risk to consensus forecasts beyond FY23, which currently reflects a strong contribution from lumpy items including gains on sale, performance fees and low loan-loss provisions. We do not expect growth in the more stable business to be able to offset this. As a result, we view MQG's headline forecast P/E multiple of 15.3 times consensus forward earnings as unattractive.

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 are likely to come via both significantly higher cash rates and a stronger currency. We expect that the RBA cash rate will finish the year at 2.85%, below market expectations of 3.25%, and view A$ as risks skewed to the upside. Australia's external accounts are in their best position since the early 1970s, providing an incentive for the A$/US$ to commence an appreciation cycle, together with the attractive carry on offer and the prospect the US$ uptrend will peak as the Fed pivots from its aggressive hiking strategy. We expect the A$ will finish 2022-23 at around 76 cents.

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

Income and growth

	1 year %	3 years % p.a.	5 years % p.a.	10 years % p.a.
Growth return	-10.88	-5.81	-4.02	-0.71
Distribution return	7.58	9.36	9.36	7.86

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.

Sector allocation

	Portfolio %	Benchmark %	Active %
Communication Services	12.89	3.89	9.00
Consumer Discretionary	9.69	6.48	3.21
Consumer Staples	1.67	5.01	-3.34
Energy	6.76	6.09	0.67
Financials	21.46	28.45	-7.00
Health Care	4.52	10.33	-5.81
Industrials	8.16	5.91	2.25
Information Technology	9.04	2.95	6.09
Materials	22.46	23.07	-0.60
Real Estate	0.00	6.40	-6.40
Utilities	2.26	1.42	0.84

Top 5 holdings

	Portfolio %	Benchmark %	Active %
BHP	8.93	9.96	-1.03
Commonwealth Bank of Australia	6.51	8.06	-1.55
Westpac Banking	5.35	3.67	1.69
Telstra	4.12	2.23	1.89
Aristocrat Leisure	4.02	1.16	2.86

Key active positions

Overweights	Portfolio %	Benchmark %	Active %
Link Administration	3.14	0.11	3.04
Aristocrat Leisure	4.02	1.16	2.86
Worley	2.81	0.26	2.55
Underweights			
CSL	1.86	6.86	-4.99
National Australia Bank	0.00	4.77	-4.77
Macquarie Group	0.00	3.10	-3.10

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.

Features

Investment objective	To achieve medium-to-long term capital growth through exposure to companies listed on the Australian Securities Exchange. In doing so, the aim is to outperform the S&P/ASX 200 Accumulation Index over rolling 3-year periods.
Recommended investment time frame	5 - 7 + years
Fund inception	October 2001
Fund size	A$4.6 mn as at 31 August 2022
APIR code	JBW0114AU
ARSN code	097 862 247
Distribution frequency	Semi-Annually
Estimated management cost	1.55% p.a.
Buy/sell spread	+/- 0.15%

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

Applications and contacts

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

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