YARRA CAPITAL MANAGEMENT

Yarra Emerging Leaders Fund (Direct)

Gross returns as at 29 February 2024

	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)	3.78	10.71	10.48	8.24	9.50	10.16	12.93
Emerging Leaders Combined Benchmark†	3.53	10.13	8.11	5.05	7.34	8.65	8.15
Excess return (before fees)‡	0.25	0.58	2.37	3.19	2.15	1.51	4.79

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 29 February 2024

	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)	3.63	10.19	8.41	6.23	7.32	7.85	10.63
Emerging Leaders Combined Benchmark†	3.53	10.13	8.11	5.05	7.34	8.65	8.15
Excess return (after fees)‡	0.09	0.06	0.30	1.17	-0.02	-0.80	2.49

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

The Australian mid and small cap market was positive for the month of February.

The Emerging Leaders Benchmark returned +3.5% for the month, taking its 12-month return to +8.1%. By comparison, the broader S&P/ASX 300 Accumulation Index gained 1.0% for the period. Globally, the MSCI World Index also recorded a +4.1% return.

Information Technology (+20.6%) was the largest contributor for the month, led by WiseTech (WTC, +29.4%). The leading developer of software solutions rallied during the period following the release of strong earnings with robust revenue and EBITDA figures, beating analysts' forecasts. Altium (ALU, +30.4%) was another key contributor, largely driven by the announcement of its acquisition by Japanese chipmaker Renesas Electronics.

The industrials (+6.2%) sector also significantly contributed to performance for the period with Reliance Worldwide (RWC, +29.3%) and Worley (WOR, +12.9%) leading the gains. Strong 1H24 results were the driver for strong performance, with Reliance Worldwide's revenue results beating market expectations while Worley reported a 13% rise in revenue.

In contrast, Energy (-5.1%) was the worst performing sector. Losses were led by Whitehaven Coal (WHC, -17.1%), with the share price falling following its weak first half results release. Key results included a decrease of revenue by 58% while EBITDA tumbled by 77%. Another detractor was Strike Energy (STX, -50.0%) after facing a setback in its South Erregulla project.

Portfolio review

Key Contributors

Reliance Worldwide (RWC, overweight) – the plumbing supplies company outperformed with an encouraging 1H24 result ahead of consensus driven by the core American division. We anticipate recovering activity estimates (USA, EMEA) as CY24 unfolds. New construction data is gaining momentum, and RWC is executing well, rolling out its new product range at better margins. We believe that current stock valuation doesn't give appropriately credit to the mid-cycle earnings power of the group, considering the resilience of its end markets, the majority of which relates to more non-discretionary, repair type housing activity.

NEXTDC (NXT, overweight) – Australia's leading data centre owner reported a solid 1H24 result with contracted capacity of 149MW. Whilst the result was solid, NXT's qualitative outlook commentary was much stronger than expected, pointing to

very large deals in their sale pipeline and hyperscale pricing 20-30% above average levels. The company has a unique combination of structural long term growth earnings growth profile combined with infrastructure like characteristics, solid returns on capital and backed by a tangible asset base.

Netwealth Group (NWL, overweight) – the leading independent wealth management platform positively contributed during the period. Outperformance was supported by the release of the 1H24 result where NWL reported a 27.2% increase in EBITDA with margin expansion to 47.6%. NWL is set to continue delivering strong revenue growth for the foreseeable future, capturing an outsized level of funds under administration as Australia's wealth management industry fragments away from the historically dominant players. In our view, the company's multiple for FY25 does not capture its long-term growth opportunity, high incremental margins, conservative accounting, and strong cash flow generation.

Key Detractors

WiseTech Global (WTC, underweight) – the leading developer of software solutions for the logistics industry outperformed during the period followed by the release of its 1H24 result which was solid with a strong beat of revenue (+2%) and EBITDA (+14%). We prefer other names in the technology sector given WTC's demanding valuation of 117.7-times FY24 forward P/E. We believe WTC have and are continuing to build an exceptional product in CargoWise which should continue to attract and retain large freight forwarders.

Kelsian (KLS, overweight) – the bus and tourism provider underperformed during the period following its 1H24 result. The result highlighted a strong revenue outcome and operating partially offset by elevated D&A expenses. The Australian bus business has returned to earnings growth given the defensive nature of existing contacts with cost pass through, extra charter work and improved staff availability. The US bus business has a strong demand outlook from new and existing customers with pricing increases to offset cost inflation. The Australian tourism assets will benefit from the post COVID-19 recovery across both international and domestic visitors with a number of years of pent-up demand.

Sims (SGM, overweight) – the steel recycler underperformed during the period following a weak 1H24 result driven by lower metal trading margins and inflationary pressures. We believe Sims is trading below mid-cycle earnings and represents attractive value at these levels. SGM remains a highly cyclical stock with valuable strategic assets that offers good trading opportunities. A skew towards improving environmental performance on increased capital spend should position the business favourably relative to peers, as environmental regulations tighten.

Key Purchases

Lifestyle Communities (LIC) – during the month we added to our small existing position in one of Australia's leading and highest quality land lease owning and developing business, LIC. While the equity raise and 1H24 earnings update drove EPS downgrades (-15% FY25, -12% FY26) we like the medium-longer term outlook – with the equity raise providing balance sheet support, and well as materially boosting the production capacity at supportive acquisition prices over the coming decade. The equity raise has served to both solve for the nearer term funding tightness and allowed LIC to secure 5 strategic land parcels at a good point in the cycle de-risking the development delivery timeline out to FY27-FY29.

Sims (SGM) – we added to our existing position in the steel recycler during the period. We believe Sims is trading below mid-cycle earnings and represents attractive value at these levels. SGM remains a highly cyclical stock that offers good trading opportunities. A skew towards improving environmental performance on increased capital spend should position the business strongly relative to peers as environmental regulations tighten.

Key Sales

Region Group (RGN) – we resized our position in Region in light of the risk-adjusted return (10%+ equity IRR proposition) following a solid 1H24 result update. Funds were reallocated within the real asset universe (assisted to fund TCL purchases). RGN continues to remain an attractive position delivering .6.3% dividend yield, and trading at 8% discount to NTA.

Netwealth Group (NWL) – we modestly resized the position following its strong outperformance. NWL is set to continue delivering strong revenue growth for the foreseeable future, capturing an outsized level of funds under administration as Australia's wealth management industry fragments away from the historically dominant players. In our view, the company's multiple for FY25 does not capture its long-term growth opportunity, high incremental margins, conservative accounting, and strong cash flow generation.

Key Active Overweights

CAR Group (CAR) – we are overweight the online car classifieds company which has demonstrated strong yield growth potential across all its operating segments. In Australia, which represents approximately 50% of its valuation, CAR is seeing improving yields from products such as Instant Offer and Select in Australia, along with a strengthened competitive position in private sales. CAR's recent acquisitions of US business, Trader Interactive, and Brazilian business Webmotors have both demonstrated strong yield growth as new dynamic pricing models are introduced. The visibility on CAR's medium term revenue growth has improved, meaning the 35-times FY25 earnings trading multiple is relatively undemanding given these tailwinds.

Reliance Worldwide (RWC) – we view the plumbing supplies company as a compelling opportunity, with cyclical upside as end-markets recover over the period ahead and improved product mix rolls out. We believe this valuation doesn't give appropriate credit to the mid-cycle earnings power of the group considering the resilience of its end markets, the majority of which relates to more non-discretionary, repair type housing activity.

NEXTDC (NXT) – the portfolio maintains an overweight position in leading Australian data centre owner and developer NXT. The company has a unique combination of structural long term earnings growth profile driven by the adoption of cloud and artificial intelligence capabilities, combined with infrastructure like characteristics, solid returns on capital and backed by a tangible asset base. NXT trades on 39.3 times FY25 EV/EBITDA, which compares favourably to global peers.

Key Active Underweights

WiseTech Global (WTC) – we remain underweight the leading developer of software solutions for the logistics industry with a preference for other names in the technology sector given WTC's demanding valuation of 11.7.7 times FY24 forward P/E. We believe WTC have and are continuing to build an exceptional product in CargoWise which should continue to attract and retain large freight forwarders.

REA Group (REA) – we hold an underweight position to Australia's largest online residential real estate platform business, and instead gain indirect preferred exposure to the online real estate segment via Domain Holdings (DHG) through the portfolio's position in Nine Entertainment (NEC) (which owns 60% of DHG). REA trades on a multiple of 55.6-times FY24 P/E and we see superior risk adjusted returns in other high-growth online businesses such as Carsales.com (CAR) which trades on 40.2-times FY24 P/E.

Ampol (ALD) – we retain an underweight position in ALD, reflecting our view that F&I and Lytton are overearning versus long-run averages while Future Energy remains a drag. While ALD appears to be navigating the structural issues in Convenience (tobacco, declining fuel volumes), the long-term nature of the format remains uncertain even amid a long-dated energy transition with limited impact to date. With the company trading on a FY24 earnings multiple of 12.9-times and a 5.8% dividend yield we believe better opportunities can be found elsewhere.

Market outlook

The financial market strength of late 2023 continued into the first two months of 2024 with the Australian equity market returning 2% CYTD and global equity markets returning an exceptional 10.3%. Indeed the past 3 months have delivered the best 3 month returns in over 10 years.

Optimism continues to be driven by financial markets becoming increasingly convinced that central banks are now preparing to ease interest rates around mid-2024.

Good news on inflation has also been met with signs of economic resilience in the US and Japan. Although Europe continues to toy with a technical recession, the strength of the recovery in Emerging Market industrial production bodes well for a recovery in European demand in 2024. This strength in Emerging Market growth has largely been in spite of China rather than because of China. Nevertheless, the bout disinflation in China has largely run its course and economic data has become more mixed rather than universally poor. We continue to expect China to deliver on a more meaningful infrastructure package into 2024 and further encourage credit expansion to the real economy which should underpin economic growth of around 5% in 2024 – a target that the Chinese government also adopted in recent days. As such we expect China to begin to provide a more meaningful support to global economic growth as we move through 2024.

Turning to Australia's prospects despite a weak finish for economic growth in 2023 – expanding just 0.2%qoq and 1.5%yoy - we continue to suggest that not only will Australia avoid a recession it will likely accelerate sequentially through 2024 with the improving global backdrop acting as a tailwind. No one should be disputing that 2023 likely felt like a recession for many Australians. A per capita recession and a negative income shock for those with high debt and young families has cascaded into weak discretionary spending as high interest rates coalesced with surging insurance, utilities, rates, education and food prices. Nevertheless, economic growth was held up by several unusual features this economic cycle vis-à-vis prior cycles;

1. Commodities. Prior commodity price strength continued to underwrite double digit nominal economic growth and profitability.
2. Backlogs. Much has been made of the backlog of work in housing construction that has nullified the typical cyclical shock that is transmitted via the housing construction sector during rate hiking cycles. Approvals and affordability are at very poor levels yet the level of home building has barely declined at all. The backlog in work yet to be done is now peaking at a very high level suggesting we shouldn't be looking at the housing sector as a source of new economic growth, but equally we shouldn't be expecting a precipitous collapse in 2024. That may come in 2025 if interest rates remain at current levels, but that is not our expectation. But less has been made of the backlogs in non-residential building (led by offices, warehouses, health and transport) which equates to 7% of GDP and the backlog of engineering construction (led by roads, railways, electricity and mining which equates to 16% of GDP. This enormous backlog of work has kept upward pressure on the labour market and on input prices at a time when typically a global slow down would have seen investment tumble between 10-15%.
3. Buffers and Asset prices. Newly indebted households without other forms of income producing assets feel the full force of rate hikes. However, the economy wide impact of interest rates is diluted the more that growth in income producing assets outstrip the growth in debt. The rising trend in net household assets as a share of income over time means that income from term deposits, financial assets and investment property ownership have all risen over time and all produce an income stream which even after 13 rate hikes this cycle is still in excess of the rise in interest payments on the outstanding debt. This explains the bifurcated nature of spending

growth. Older asset rich households are largely impervious to the rate hikes and as such luxury spending categories remain strong whereas younger indebted households cashflow has turned negative and spending is being seriously challenged. In aggregate a rate hike pack less of punch compared to prior cycles but the young and indebted are taking a disproportioned beating.

4. Population pump priming. Net immigration has surged well through government projections taking population growth close to 2.5%yoy growth in 2H23. Quite simply, it is very hard to record a recession with that type of population growth at your back. We do expect net migration to slow in 2024 as the government seeks to tighten up some education programs and entitlements, yet the risk remains that the flood of people entering Australia surprises on the upside until a more material rise in the unemployment rate is realised.

As we move into 2024 some additional factors are worth noting that support a more positive outlook into 2024.

1. Commodity prices are rising again. A falling USD and stronger global demand has seen commodity prices rising in Q4 which will provide a fillip for profits, tax revenue and nominal economic growth.
2. Fiscal support and tax cuts. Despite a change to the details of the Stage 3 income tax cuts the package is equivalent to 1.0% of disposable income. In conjunction with the Federal Budget in surplus, the RBA rate cycle likely complete and an election looming in 2025 is likely that addition fiscal support will be announce in 1H24 to support lower and middle income households.
3. Inflation moderation to drive rate cuts. We expect inflation to move into the top of the RBA target band before the end of 2024, setting up the prospect of the RBA easing in August and again in November 2024. While we are expecting a relatively shallow rate easing cycle it will likely come earlier than most expect and importantly the RBA has renewed firepower to drive a more powerful economic recovery should inflation surprise on the downside.
4. Capex intentions have lifted. We were pleasantly surprised to see that the ABS measure of investment intentions rose through 2H23 and now suggests business investment will rise 10% in 2023-24 – well above the RBA's 1-2% forecast. Indeed, not only has business investment been robust, there are signs it is accelerating.

As a consequence, we are relatively optimistic on the outlook for the Australian economy and constructive on the equity market outlook for 2024. We expect economic growth to average 2.25% v a consensus forecast of 1.5%, bond yields to finish the year at 4.0%, the $A/$US to reach 74c, and Australian equities to return 10% in in large caps and 15% in small caps. We are most overweight stocks within the Communication Services, Real Estate and Financials sectors, and are underweight Energy, Consumer Discretionary and Materials.

Sector allocation

	Portfolio %	Benchmark %	Active %
Communication Services	11.28	7.05	4.23
Consumer Discretionary	8.57	11.92	-3.36
Consumer Staples	1.07	2.78	-1.71
Energy	0.00	6.20	-6.20
Financials	13.84	12.44	1.40
Health Care	5.10	5.12	-0.03
Industrials	14.81	14.07	0.74
Information Technology	10.24	10.44	-0.20
Materials	16.44	19.26	-2.82
Real Estate	13.13	9.79	3.33
Utilities	0.00	0.92	-0.92

Top 5 holdings

	Portfolio %	Benchmark %	Active %
CAR Group	6.97	2.48	4.49
NEXTDC	6.12	1.62	4.49
Reliance Worldwide	5.06	0.77	4.29
Worley	4.74	1.10	3.64
Netwealth Group	3.99	0.44	3.55

Key active positions

Overweights	Portfolio %	Benchmark %	Active %
NEXTDC	6.12	1.62	4.49
CAR Group	6.97	2.48	4.49
Reliance Worldwide	5.06	0.77	4.29
Underweights			
WiseTech Global	0.00	3.09	-3.09
REA Group	0.00	1.79	-1.79
Ampol	0.00	1.65	-1.65

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	7.57	5.12	6.40	6.90
Distribution return	0.84	1.11	0.92	0.95

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$99.9 mn as 29 February 2024
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.

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