YARRA CAPITAL MANAGEMENT

Yarra Emerging Leaders Fund (Direct)

Gross returns as at 30 June 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)	-1.44	-5.91	3.89	4.24	7.99	9.83	12.69
Emerging Leaders Combined Benchmark†	-1.39	-3.72	7.98	1.48	6.49	8.76	8.06
Excess return (before fees)‡	-0.05	-2.18	-4.09	2.77	1.50	1.06	4.63

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 30 June 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)	-1.59	-6.35	1.94	2.30	5.87	7.54	10.40
Emerging Leaders Combined Benchmark†	-1.39	-3.72	7.98	1.48	6.49	8.76	8.06
Excess return (after fees)‡	-0.20	-2.62	-6.03	0.82	-0.61	-1.23	2.34

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 weakened during the second quarter of 2024.

The Emerging Leaders Benchmark returned -3.7% for the quarter, taking its 12-month return to +8.0%. By comparison, the broader S&P/ASX 300 Accumulation Index fell 1.2% for the period. Globally, the MSCI World Index recorded a +2.2% return.

Health Care (+16.5%) was the best performing sector with significant contributors stemming from across the sector. Pro Medicus (PME, +38.1%) outperformed following new contract wins during the period while Telix Pharmaceuticals (TLX, +44.7%) strengthened following positive drug trial results. Other positive contributors included Fisher & Paykel Healthcare (FPH, +18.4%) and Mesoblast (MSB, +78.4%).

In contrast, Consumer Discretionary (-11.2%) was the worst performing sector. Cettire (CTT, -71.1%) was a notable detractor following a trading update in June which was significantly below market expectations while Eagers Automotive (APE, -25.7%) saw its share price fall during the period following weak 1H results. Other negative contributors included IDP Education (IEL, -15.5%) and Harvey Norman (HVN, -17.4%).

Portfolio review

Key Contributors

Pinnacle Investment Management (PNI, overweight) – Pinnacle reported a strong Jan-Apr 24 flows of +$4.5b despite a tough market. We are seeing an acceleration in revenue growth with material longer term growth potential as market conditions normalise from depressed levels, inflows reaccelerate across the diverse range of products and from international distribution, performance fees increase from depressed levels and new products mature. Furthermore, margin expansion will be supported by the high fixed cost nature of funds management businesses and new manager formation both organically and via acquisitions will create additional shareholder value.

Netwealth (NWL, overweight) – the leading independent wealth management platform positively contributed during the period with no price sensitive news. 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.

NO LONGER AVAILABLE FOR NEW INVESTMENT

Ampol (ALD, underweight) – our underweight position in the fuel retailer contributed to outperformance during the period, with the stock underperforming on softening refining margins, weaker trading activity and some signs of consumer weakness in retail volumes. Despite reporting a reasonable 1Q24 result in May, crack spreads have moderated to more normalised levels on improved global supply and weaker Chinese demand, driving consensus downgrades.

AUB Group (AUB, overweight) – the insurance broking business was a contributor in Q2 with an earnings upgrade supporting the stock. Continued strong premium rate momentum, combined with strong operating performances across AUB's segments drove the upgrade. AUB also announced the acquisition of Pacific Indemnity in May. This agency business is strongly complementary to the existing AUB agencies business with clear revenue and cost synergies.

NEXTDC (NXT, overweight) – the leading Australian data centre owner and developer outperformed during the period on limited company specific news flow, more than reversing the prior month's underperformance, as the market again focused on the company's strong long-term outlook. NXT has an enviable position as Australia's leading co-location data centre provider, leaving it well placed to capture the surging demand for data centre capacity driven by public to private cloud switching, growing data usage and artificial intelligence.

Key Detractors

Reliance Worldwide (RWC, overweight) – the plumbing supplies company gave back some of its strong CYTD returns during the period as the combination of higher interest rates in the USA and rising copper prices weighed on the share price. A push back in expectations of rate cuts in the US has the market applying a lower probability to a US housing market recovery in CY25, while a rising copper price creates an input cost headwind that RWC will need to address through active price increases into FY25. Nonetheless, at current levels, we believe the stock 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.

Megaport (MP1, overweight) – our overweight position in the software technology company underperformed after a weaker than expected quarterly result for new customer growth albeit full year earnings guidance was reiterated. We continue to hold the position as we believe customer volume trends will improve in the medium to long term as market conditions and execution improves following management changes. Furthermore, we would highlight that yield growth, low customer churn, margin expansion and lower capex will support a transition to free cashflow positive in CY24 with significant cashflow potential longer term.

Pro Medicus (PME, underweight) – the health imaging company outperformed following its announcement of five new contracts with a combined minimum contract value of $45 million. PME is a highly attractive global leader however we believe this is more than captured within the high valuation metrics with some risk future earnings growth is constrained by the current high levels of market share and cost reinvestment.

Telix Pharmaceuticals (TLX, underweight) – the radiopharmaceutical company outperformed during the month following a read-out of the ProstACT Select trial for TLX-591 which demonstrated stronger efficacy than the market expected. TLX-591 is TLX's key therapeutic drug which is looking to compete with Novartis' Pluvicto in the nascent prostate cancer radiopharmaceutical space. We remain underweight due to concern around pricing outcomes when Illuccix comes off pass through status.

Sims (SGM, overweight) – the steel producer underperformed following an operational update that disappointed relative to expectations. The company expects to report an underlying 2H EBIT marginally lower than that achieved in 1HFY24. The outlook for SGM near term remains tough given China continues to over-produce steel and export the excess, but with the stock trading well below NTA, and evidence that NAM is finally turning a corner, we are happy to retain our overweight position.

Key Active Overweights

NEXTDC (NXT) – the portfolio maintains an overweight position in the leading Australian data centre owner and developer NXT. The company has a unique combination of structural long-term earnings growth 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.

CAR Group (CAR) – we are overweight the online vehicle classifieds company which has strong growth potential across Australia (42% revenue), Trader Interactive (25% revenue), and Webmotors (16% revenue). CAR Group has materially stepped-up investment into product development recently which should permit for further yield growth across all geographies. In Australia, CAR's market position has strengthened in the private segment, in particular. The offshore businesses are less mature and have further runway for growth as key learnings (i.e. dynamic pricing) from the Australian business are applied offshore. The visibility on CAR's medium term revenue growth has improved, and we think the 33.0-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 does not 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.

Netwealth (NWL) – we maintain an overweight position in the leading independent wealth management platform. 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.

Worley (WOR) – we remain overweight the leading provider of global engineering services. While industry activity has slowed after a strong post-COVID recovery, we continue to like the longer-term opportunity for the company. With global energy demand only set to grow, demand for Traditional O&G has increased, but with CCUS as a solution. We see the slowdown in spend on more sustainable projects being shorter term in nature with a number of global elections being held in CY24. Margins are also set to increase over the coming years as WOR benefits from a more consolidated industry structure, operating leverage, and active mix management towards higher margin sustainability work.

Key Active Underweights

REA Group (REA) – we hold an underweight position to Australia's largest online residential real estate platform business, and instead gain indirect exposure to the online real estate segment via Domain Holdings (DHG) through the portfolios position in Nine Entertainment (NEC) (which owns 60% of DHG). REA trades on a multiple of 45.0-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 32.8-times FY24 P/E.

Orica (ORI) – we retain an underweight position to the Australian-based explosives company ORI. From a chemicals exposure perspective, our stock preference is Incitec Pivot (IPL). Notwithstanding a number of improvements in the visibility of earnings growth for ORI (repricing low margin contracts, premiumization strategy in detonators), we believe the stock factors in these benefits with the company trading on a FY25 P/E of 16.4-times.

Altium (ALU) – we are underweight the software company Altium. The company is currently subject to a takeover offer from Renesas Electronics, and ALU's share price has traded largely in-line with Renesas's on the expectation of a successful transaction, a view we share.

Ampol (ALD) – we retain an underweight position in ALD, reflecting our view that refining margins remain subdued while Future Energy remains a drag. While ALD appear 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 FY25 earnings multiple of 12.2-times and a 6.4% dividend yield we believe better opportunities can be found elsewhere.

Washington H Soul Pattinson (SOL) – we do not hold a position in the diversified investment company. At this time, we see better direct investment opportunities available than those offered through SOL's broad suite of investments across the telco, mining, manufacturing, healthcare, and funds management sectors. We also remain cautious on the company's exposure to thermal coal via its 38% stake in coal miner New Hope (NHC).

Market outlook

The 2023-24 financial year is now complete and concludes what we have broadly labelled the "hope" phase for financial markets – an environment where equities rally via PE expansion rather than via earnings growth. It's now time for the individual stocks to deliver on those growth expectations, which typically is a bumpier experience for markets. In broad terms, it was a good financial year for markets. A 20% return for global equity markets, regardless of whether you bothered to hedge or not, was only just eclipsed by a 21% return from gold, thanks in part to central bank buying. REITs returned a solid 17%, commodities rose a respectable 15%, and although it was a weaker finish to the financial year the AS200 returned an above average 12% - the same return generated by alternative assets. In contrast, Australian fixed interest returned 3.7% and global bonds a paltry 0.9%.

We adopted a top-down pro-risk stance heading into Q4 2023, in part because we expected consensus to lift their economic growth forecasts, lower their inflation forecasts and for interest rates to commence declining across the major economies from mid-2024. Interest rate reductions in Sweden, Switzerland, Canada and the Euro Area are likely to be met with the Bank of England likely easing in August and we believe the Fed will commence its easing cycle in September. All of this is good news, however, there is now less of a gap between our long held more optimist views on global growth and the consensus. There are also signs that the positive momentum for global economic growth is starting to falter. Broadly, we think most of the good news we have been flagging is now largely imbedded in market pricing and we are somewhat uncomfortable with the narrow nature of the equity rally and what promises to be a drawn out and we think ultimately demoralising US election campaign. In short, we are expecting that transitioning from the more thematic driven "hope" phase of the cycle to the more stock specific mid-cycle phase for financial markets will not come without some growing pains in Q3 2024.

Turning to Australia, a recession has been avoided, yet Australia continues to operate near stall speed. GDP increased just 0.1%qoq taking the annual rate to 1.1%yoy. Excluding COVID this is the slowest annual rate of growth in 32 years. GDP per capita declined 0.4%qoq – the 4th consecutive decline - taking the annual rate to negative 1.3%yoy. This is the worst contraction since December quarter 1991 excluding the COVID period, and this measure has only expanded once in the past 7 quarters. No one should be disputing that the past 12 months likely felt like a recession for many Australians.

The Reserve Bank of Australia (RBA) is caught between a relatively weak economy and persistent wage growth and consumer inflation, nevertheless, the RBA should be buoyed by signs that the decline in productivity appears to have passed and wage pressures appear to have peaked. With respect to the latter, the 3.75% increase in awards, compared to the

5.75% in 2023, will help expedite an easing in wage pressures through 2H2024.

Australia, like many of its developed nation peers, also printed above consensus inflation in 1Q and the volatile monthly CPI measure points to high and persistent inflation in 2Q. However, we believe the upside surprise in Australia's CPI overstates the real-time price pressures. Much of the upside came via government administered prices, which tend to reflect where inflation was in the prior year rather than current cost pressures, and the prevalence of residual seasonality in inflation pressures at the start of the calendar year. Traded goods prices are trending lower and once administered prices are removed, private sector services prices are expanding at an inflation target consistent pace. While we can't rule out the RBA choosing to hike again in August, we remain of the view that inflation will finish 2024 inside the RBA's target band of 2-3% and the RBA will commence a modest easing cycle for interest rates in 4Q 2024.

Against this moderation in inflationary pressure we expect economic growth to accelerate sequentially through 2024, albeit remaining well below 'potential' growth. We expect the upswing in global industrial production to provide a tailwind for Australian economic growth. Rising capex intentions in concert with investment backlogs should support business investment growth and the consumer outlook should be supported by a recovery in real household income growth driven by ongoing wage growth, income tax cuts, cost of living support delivered in the Budget and the commencement of the rate easing cycle later in 2024.

As a consequence, we are relatively constructive on the outlook for the Australian economy and the equity market outlook for 2024-25, even if there are some nearer term headwinds. We expect economic growth to average 1.75% v a consensus forecast of 1.3% in 2024, bond yields to finish the year at 4.5%, the $A/$US to reach 72c, and Australian equities to return 10%.

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

Sector allocation

	Portfolio %	Benchmark %	Active %
Communication Services	12.24	6.93	5.32
Consumer Discretionary	7.93	11.16	-3.23
Consumer Staples	0.63	4.23	-3.60
Energy	0.00	6.52	-6.52
Financials	14.54	13.23	1.32
Health Care	9.31	6.61	2.70
Industrials	14.12	14.41	-0.28
Information Technology	8.70	7.68	1.02
Materials	19.41	18.57	0.84
Real Estate	12.95	9.50	3.46
Utilities	0.00	1.17	-1.17

Top 3 holdings

	Portfolio %	Benchmark %	Active %
CAR Group	6.97	2.37	4.60
NEXTDC	6.77	1.89	4.88
Worley	4.92	1.25	3.67

Key active positions

Overweights	Portfolio %	Benchmark %	Active %
NEXTDC	6.77	1.89	4.88
CAR Group	6.97	2.37	4.60
Reliance Worldwide	4.36	0.64	3.73
Underweights			
REA Group	0.00	1.81	-1.81
Orica	0.00	1.55	-1.55
Altium	0.00	1.49	-1.49

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	0.98	1.14	5.00	6.63
Distribution return	0.96	1.16	0.87	0.90

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$97.2 mn as 30 June 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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