Airlie Australian Share Fund
(Managed Fund)

A concentrated, active portfolio of Australian equities.
Accessing the Airlie investment team and Magellan's operational and client service capabilities.

Ticker:AASF

Fund Update: 31 December 2020 ARSN: 623 378 487

FUND FACTS

Investment Objective: To provide long-term capital growth and regular income through investment in Australian equities.

Investment Strategy
- Long only, bottom up specialised and focused Australian equities fund
- Concentrated portfolio of 15-35 stocks (target 25)
- Active, high conviction approach - Airlie's 'best ideas'

Inception Date	1 June 2018	
Benchmark	S&P/ASX 200 Accum. Index	
Portfolio Size	AUD $45.0 million	
Distribution Frequency	Semi-annually	
Management Fee	0.78% p.a. (inclusive of net effect of GST)	
Ticker	AASF	
Tickers	**Security**	**iNAV**
Bloomberg	AASF AU Equity	AASFIV Index
Thompson Reuters	AASF.AX	AASFAUiv.P
IRESS	AASF.AXW	AASFINAV.ETF
APIR	MGE9705AU	
Minimum Initial Investment#	AUD$10,000	
Buy/Sell Spread	0.14%/0.14%	

 # only applicable to investors who apply for units directly with the fund

WHY CHOOSE THE AIRLIE AUSTRALIAN SHARE FUND?

- Access to an experienced, proven investment team specialising in Australian Equities, with a long track record of prudent common-sense investing
- A conservative and robust investment process that focuses the team's energies on their best ideas
- The strategy is now available to retail investors for the first time through the partnership with Magellan

PORTFOLIO MANAGERS

Matt Williams
Over 25 years investment experience.
Formerly Head of Equities and portfolio manager at Perpetual Investments.

Emma Fisher
Over 9 years investment experience.
Formerly an investment analyst within the Australian equities team at Fidelity International and prior to that Nomura Securities.

Visit www.airlieaustraliansharefund.com.au for more information, including: fund performance, unit prices and iNAV, investment insights, PDS & forms

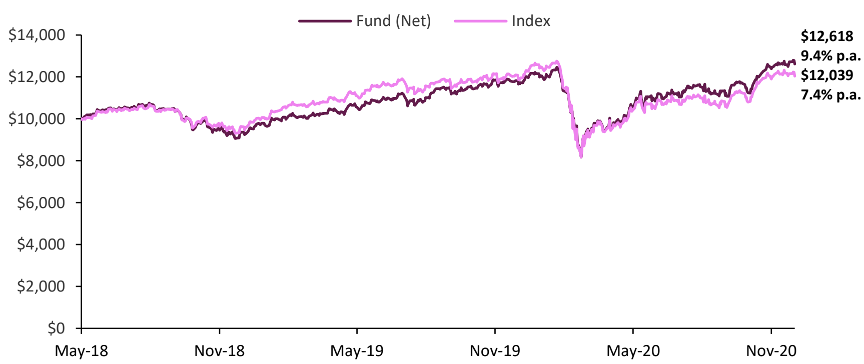
PERFORMANCE*

	Fund (%)	Benchmark (%)	Excess (%)
1 Month	1.9	1.2	0.7
3 Months	13.6	13.7	-0.1
6 Months	14.9	13.2	1.7
1 Year	8.3	1.4	6.9
2 Years (% p.a.)	16.0	11.9	4.1
Since Inception (% p.a.)	9.4	7.4	2.0

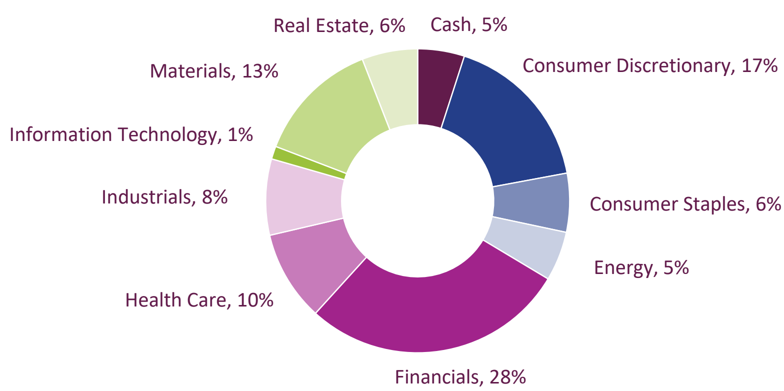
TOP 10 POSITIONS (BY WEIGHT)

Company	Sector**
Commonwealth Bank of Australia	Financials
BHP Group Ltd	Materials
CSL Ltd	Health Care
Wesfarmers Ltd	Consumer Discretionary
Credit Corp Group Ltd	Financials
Westpac Banking Corporation	Financials
Aurizon Holdings Ltd	Industrials
Mineral Resources Ltd	Materials
Macquarie Group Ltd	Financials
Coles Group Ltd	Consumer Staples

PERFORMANCE CHART GROWTH OF AUD $10,000*



PORTFOLIO POSITIONING**



* Calculations are based on exit price with distributions reinvested, after ongoing fees and expenses but excluding individual tax, member fees and entry fees (if applicable).Returns denoted in AUD.
** Based on GICS Sector classification, may not sum to 100% due to rounding.

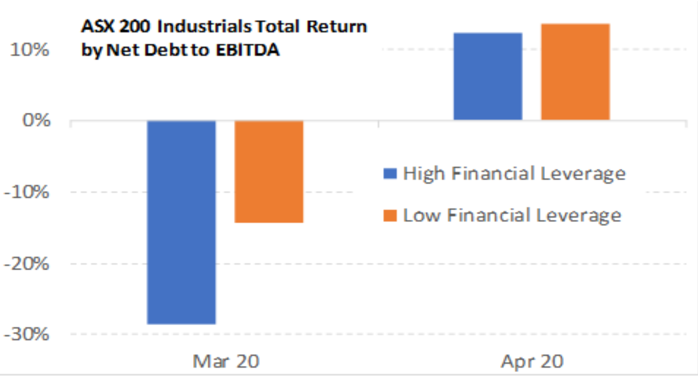
FUND COMMENTARY

Annual Commentary 2020

The AASF total return was 8.27% for the 2020 calendar year, whilst the benchmark (the S&P ASX 200 Accumulation index) returned 1.4%, for a total excess return of 6.87% net of fees. For the December quarter, the AASF returned 13.56%, broadly in line with the benchmark return of 13.7%.

The fund was able to navigate the tumultuous year well, with outperformance in the first half of the year partly driven by our focus on financial strength, as many Australian companies were forced into equity raises, often at substantial discounts to already beaten-down share prices. Our focus on balance sheet strength typically pays off during times of crisis, as per the below chart those companies with lower levels of financial leverage outperformed during the significant drawdown in March, as well as outperforming the subsequent rally in April.

Figure 1: Outperformance of stocks with low financial leverage in March/April 2020



Source: FactSet

What worked?

Mineral Resources was our strongest performer over the year, with the share price rising 127% in 2020. This was driven largely by the uplift in iron ore prices over the year, as well as management articulating long-term plans to substantially increase iron ore production in WA. We continue to like the business for its high-returning mining services business, with upside to future earnings from lithium assets yet to come online.

Other investments that contributed solidly over the quarter and year included James Hardie (+34% in 2020), Nick Scali (+39%) and Metcash (+34%). The share price of Credit Corp rose 74% over the December quarter as it acquired a large book of Purchased Debt Ledgers from a distressed competitor at attractive prices.

In the December quarter, companies that were in the so-called "value" basket benefitted from a market rotation, including portfolio holdings Commonwealth Bank, Westpac, Macquarie Bank and BHP.

What didn't work?

We own a number of businesses with favourable economics, excellent balance sheets and good management teams, that have failed to keep pace with the market's very strong December-quarter rally. We will always be unable to pick whether these investments will "work" over a quarter or even a year. One example would be Medibank Private, which enjoys a net cash balance sheet and market-leading position in an essential industry.

Elsewhere, we made some outright mistakes in investments over the year. These include investing in Aurizon at $5, with the share price falling over the year to around $3.80, as the Chinese coal ban hit coal pricing and sentiment. While Aurizon's earnings aren't directly linked to the coal price, half its business is railing coal to port, and this business has seen volumes suffer due to the blacklisting. We have added to our position at the current share price, which offers a grossed up dividend yield of close to 9%, with share price upside if/when the coal ban is lifted. Clearly in hindsight our entry price failed to account for the growing risks of collateral damage in a trade war with China.

Our costliest investment mistake this year was a large position in Suncorp, which fell over 30% before we exited the position. Typically, we sell a stock for one of three reasons:

1) Our thesis changes (i.e. the original reason we bought the stock no longer holds);

2) The risk/reward is no longer attractive;

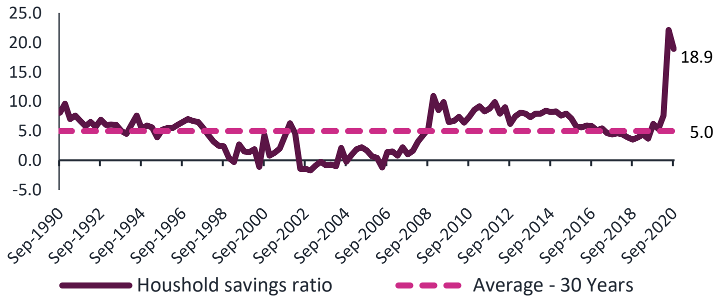
3) Opportunity cost: we have a better idea.

We exited Suncorp for all three reasons. Our original thesis saw the business as a turnaround story with excess capital to come back to shareholders post the sale of the Life business. Unfortunately, our thesis was wrong, as interest rate cuts and falling markets hit investment and bank earnings, and Business Interruption claims looking set to eat into any excess capital.

While Suncorp has enjoyed a +15% bounce since our exit, we redeployed the capital into our position in Commonwealth Bank which has risen 28% over the same period.

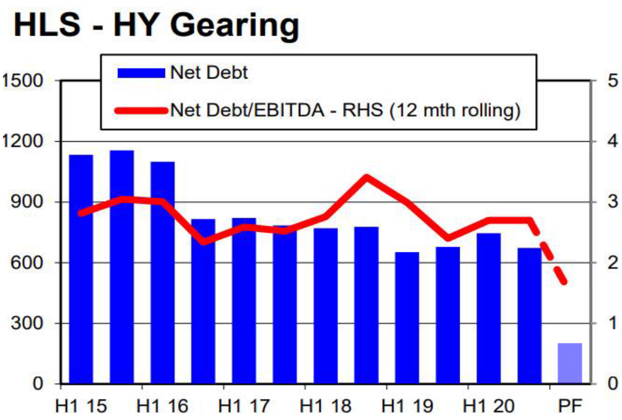
Where to from here?

We feel there is plenty of "value" in the portfolio yet to be fully appreciated by the market. However, coming through the other side of COVID-19 is proving more difficult and taking longer than previously hoped. Nevertheless, Australia remains extremely well placed relative to the rest of the world, and so we expect continuation of strong economic conditions during the first half of CY21. Worries about the "cliff edge" of reduced stimulus we think are misplaced given the extraordinary surge in household savings as shown in the chart below. This level of savings bodes well for continued consumer spending, which benefits a number of core portfolio holdings including Wesfarmers, Nick Scali, Smartgroup, as well as cushioning some of the downside risks for bank portfolio holdings CBA and Westpac.



Source: RBA, Airlie research

We are always fans of investing in asset rationalisation plays, where businesses are "shrinking to greatness". Healius is one such stock in the portfolio. The business formerly known as Primary Health Care used to own medical centres (GPs), pathology and imaging assets. The medical centre business was the core "problem child"- soaking up capex and delivering consistently poor returns. Further, the balance sheet precluded us from investing, as we considered net debt to EBITDA of over 4x too high for the capital intensity of the business. This year, Healius sold the medical centre business to private equity for $500m, using the proceeds to repay debt and resetting the balance sheet:



Source: Diogenes Research.

Rejigging the business towards pathology

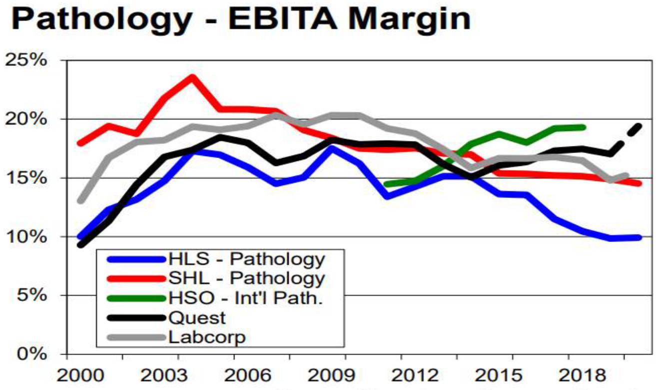
Now that HLS has sold its poor performing medical centre business, it is left with 3 businesses:

(1) Pathology (c75% of group EBIT)
(2) Imaging (c25% group EBIT)
(3) Day Hospitals- currently loss-making.

The core driver of earnings going forward is the pathology division. Healius' pathology business has had basically flat earnings for 5 years. This is despite very steady 3-5% p.a. top-line growth.

Pathology has had a margin issue

This has been an industry-wide phenomenon, but the worst for Healius. (Note Sonic's pathology margin is misleading as it includes international businesses that account for 75% of earnings).

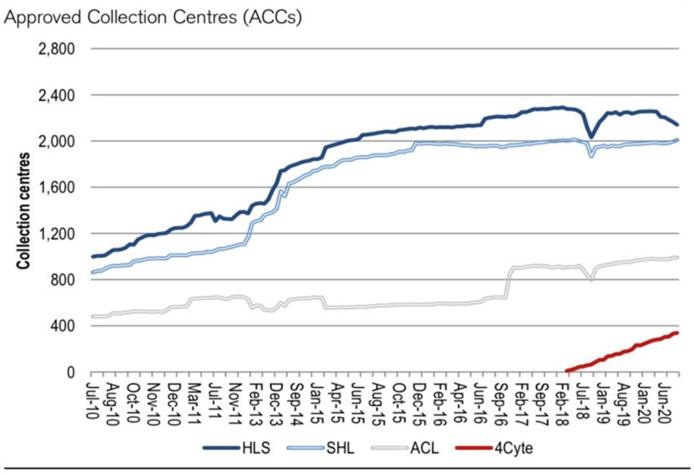


Source: Diogenes Research

The driver of margin pressure has been an arms race to open new collection centres. Healius and Sonic have both spent the last 5 years rolling out collection centres very aggressively to lock in referral volumes, often paying GPs huge rents to have a pathology collection centre opened in their GP offices.

This dynamic is now changing. Healius have a new, more rational management team. They are closing centres. They have closed c170 centres to date, and have identified another 200 in total that could close. This would bring their centre numbers back in line with peer Sonic (which generates $1.5bn revenue vs HLS $1.1bn, hence it makes no sense for Healius to have a higher centre footprint).

Figure 3: HLS reducing collection centres…



Source: Medicare, Company data, Credit Suisse estimates

At its mid-December investor day, management outlined cost initiatives to drive around 300 basis points of EBIT margin improvement in this division. While execution risks remain, we think risk/reward looks attractive.

We believe Healius can grow pathology earnings at 7% p.a. from here, and this isn't a heroic assumption- given industry revenue has historically grown at 5.8% p.a. plus margin improvements. If this occurs, lower corporate and interest costs following the medical centre sale would see group EBIT nearly double over the next four years.