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.

Airlie Funds Management

Ticker:AASF

Fund Update: 31 March 2021 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 $66.4 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 10 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

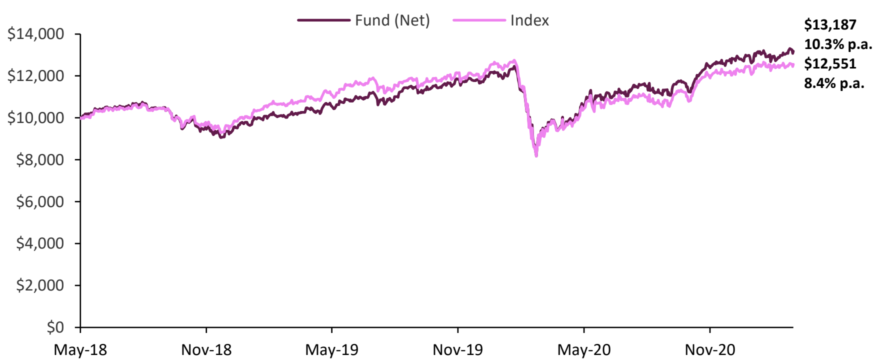
PERFORMANCE*

	Fund (%)	Benchmark (%)	Excess (%)
1 Month	3.9	2.4	1.5
3 Months	4.5	4.3	0.2
6 Months	18.7	18.5	0.2
1 Year	43.6	37.5	6.1
2 Years (p.a.)	14.1	8.5	5.6
Since Inception (p.a.)	10.3	8.4	1.9

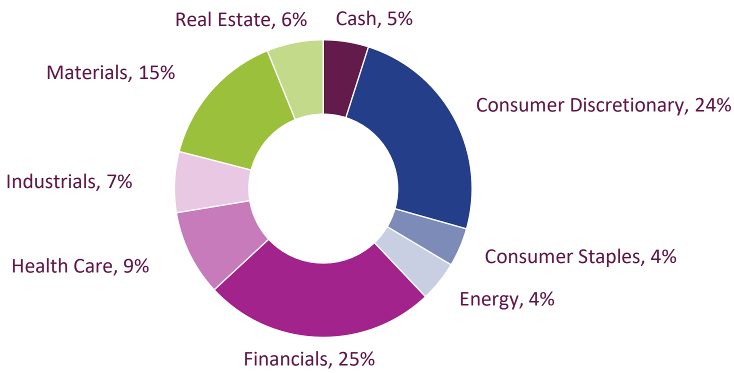
TOP 10 POSITIONS (BY WEIGHT)

Company	Sector**
Commonwealth Bank of Australia	Financials
BHP Group Ltd	Materials
CSL Ltd	Health Care
National Australia Bank Ltd	Financials
Wesfarmers Ltd	Consumer Discretionary
Aristocrat Leisure Ltd	Consumer Discretionary
Woolworths Limited	Consumer Staples
PWR Holdings Ltd	Consumer Discretionary
Macquarie Group Ltd	Financials
Healius Ltd	Health Care

PERFORMANCE CHART GROWTH OF AUD $10,000*



PORTFOLIO POSITIONING**

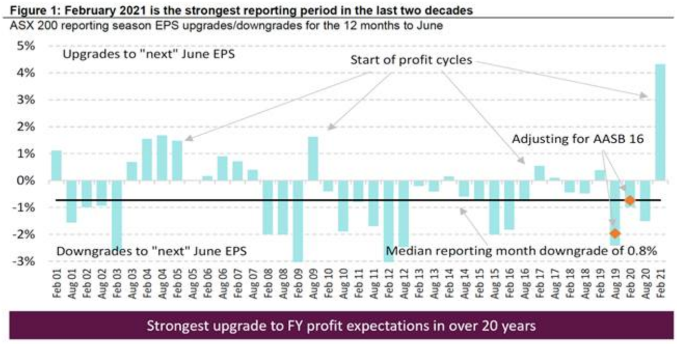


* Calculations are based on exit price with distributions reinvested, after ongoing fees and expenses but excluding individual tax, member fees and entry fees (if applicable).Returns denoted in AUD.
** Based on GICS Sector classification, may not sum to 100% due to rounding.

MARKET COMMENTARY

The February profit reporting season that fell during the quarter saw very strong results from portfolio companies including BHP, but also from James Hardie (USA housing strength), Wesfarmers (phenomenal Bunnings sales growth) , Mineral Resources (iron ore strength), and retailers Nick Scali and Premier Investments (reflecting ongoing strength in the Australian consumer).

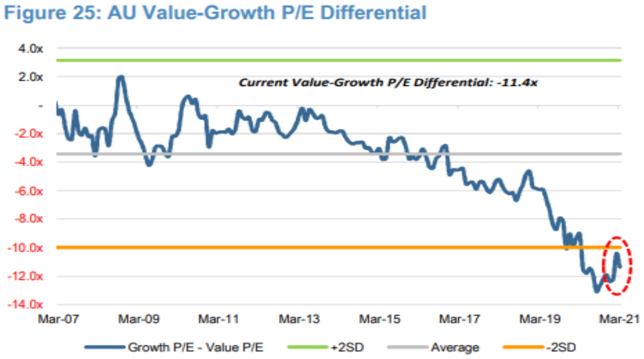
The profit outlook for the ASX200 overall looks strong. The chart below shows the level of profit upgrades/downgrades over the last 20 years. As shown, this season was one for the ages, and bodes well for the next few reporting periods, even despite the wind back of the bulk of the stimulus.



Source: MST Marquee

What to make of the value/growth debate?

The big debate playing out in investment markets over the last quarter is whether the current interplay between equity valuations, inflation expectations, rising long bond rates, central bank actions, and economic recovery mean that the strong rally in so-called "value" stocks can be sustained. The chart below (courtesy of JP Morgan) shows the long-term dispersion in PE's in the Australian market. The movement in the PE differential over the March quarter is highlighted in red - value continues to make a comeback.



Source: J.P. Morgan calculations, Bloomberg Finance L.P

Further mean reversion from here would require meaningful moves upwards in real interest rates, driven by rising inflation expectations, given central banks have reiterated their easy-money stance and intentions to keep nominal rates low.

We are seeing plenty of signs that rising inflation could very well come to bear- however we remain unsure as to whether this would be a short term "blip" in inflation, or a long-term breakout. If it's the latter, we suspect we won't be talking about value vs growth, so much as how every asset class globally appears overvalued. However, our base case would be the former: as supply chains and demand normalises post-pandemic, temporary drivers of inflation will likely dissipate. The good news is that's what the Fed appears to expect, with its September 2020 shift to "averaging inflation targeting" allowing it to weather periods of inflation "overshooting" its long term 2% target without having to increase rates. Put simply, the Fed wants to let the economy run hot for a while. This is good news for the types of reasonably priced, cyclical businesses that typically comprise the "value" camp of the market (and a good chunk of our portfolio!).

Perhaps the value vs growth debate is misplaced – the reality is investors were paying a lot for growth far out into the future in a world where near term growth was very sluggish. Now that near-term growth looks exciting with a hint of an inflationary cycle, these growth-sensitive cyclicals are rallying. We feel the AASF portfolio is well placed for whatever outcome, as we focus on owning quality, attractively-priced companies that generate good returns through the cycle, while hopefully avoiding those segments of the market that over the last few years have become a bit of a one-way bet on bond yields.

FUND COMMENTARY

The AASF return over the March 2021 quarter was +4.51% whilst the benchmark (S&P ASX 200 Accumulation index) returned +4.26%. Pleasingly, this brings the total return for the AASF over the last twelve months to 43.6%, 6.1% above a very strong benchmark return of 37.5% (net of fees).

A good quarter overall for the Australian equity market, marking its sixth straight positive month. Eleven of the past 12 months have seen positive gains since the 21% fall in March 2020. Best performing stocks in the portfolio over the quarter included Tabcorp (corporate approaches for its wagering business) and BHP (strong profit result amid a persistently high iron ore price), as well as recent addition to the portfolio, PWR Holdings. PWR Holdings is an Australian global success story, supplying cooling systems to Formula 1 teams (amongst other motorsports), and we are excited about the prospects for future growth in its emerging technologies division. A solid owner-managed business with a net cash balance sheet, it has become one of our largest positions in the AASF.

Two core portfolio positions that detracted from performance were Ampol, on lower refinery earnings, and CSL. Despite a record 1H that exceeded our and consensus expectations, CSL underperformed as the market grappled with concerns around the impact of COVID-19 and US stimulus checks on plasma supply. Plasma donors in the US are paid, and most donors are typically low-income or unemployed people that supplement their income with regular paid donations. Given Biden's stimulus package has increased unemployment benefits for the next few months, and many will be receiving US$1,400 stimulus checks this month, we expect plasma donations to drop further, and industry supply to be tight. Fortunately, we consider this issue a one-off, and believe the sell-off provides an attractive entry-point in to a business with arguably the best track record of value creation on the ASX.

STOCK STORY: COLLINS FOOD GROUP

COLLINS FOODS LIMITED

When it comes to the consumer-discretionaries sector, there are some businesses that are less discretionary than others. These businesses tend to be incredibly valuable as their earnings are predictable, less susceptible to managerial error and are more generally insulated from changes in consumer trends. We think Collins Foods is one of these businesses.

Collins Foods is the largest operator of KFC franchises in Australia with 242 restaurants spread mainly across Queensland and Western Australia. The company opened its first KFC restaurant in Queensland in 1969 and Australian consumers have flocked to its restaurants for fried chicken ever since. Indeed, even the pandemic was unable to dent consumer demand for KFC's products. In the five weeks of trading to 3 May 2020, Collins Foods reported a 4% increase in same-store sales for its restaurants (excluding food courts). By June, Collins Foods reported a remarkable 11.6% increase in same-store sales for the first seven weeks of trading from 30 April 2020, with customer demand for drive-thru and home delivery more than offsetting the blow from government restrictions on dine-in.

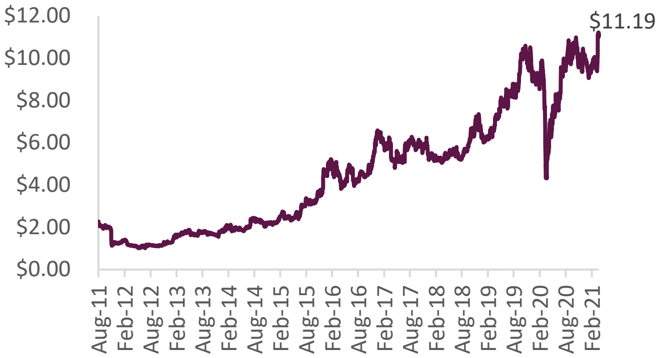
It is this incredibly loyal customer base and repeat purchasing behaviour that attracted us to Collins Foods.

Franchisees pay a royalty in exchange for a moat

As a franchisee, Collins Foods is responsible for the fit-out, remodelling and day-to-day operation of restaurants and must also pay a royalty to Yum! Brands (the owner of the KFC brand) for use of its intellectual property. Given that franchisees are responsible for the operating and capital costs of restaurants, they have a lower return on invested capital and therefore trade on lower multiples than franchisors.

This does not necessarily make them poor investments. Since listing in 2011, Collins Foods' share price has increased more than fourfold and the company has paid a dividend every year over the past decade.

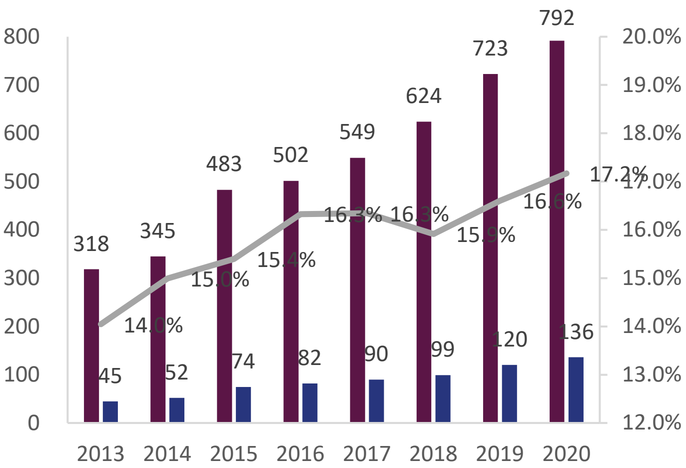
Figure 1 – Long-term share price performance



Source: FactSet

We think one reason for this success is that Collins Foods has effectively purchased its own moat. In paying away some margin in the form of a royalty, Collins is able to market its restaurants under the powerful KFC brand and leverage almost a century's worth of product development and IP (namely, the 11 secret herbs and spices!) When you consider that other businesses spend 10% of sales or more on R&D to protect their moat, we think a 6% royalty to Yum! Brands is a fair trade-off. The KFC brand attracts a global customer base and has developed a product that is difficult to compete with in terms of flavour, value, and accessibility. Indeed, there are not too many restaurants we can think of that have operated successfully and are still expanding after 50 years in operation.

Figure 2 – KFC Australia long-term sales and EBITDA



Source: Collins Foods company filings

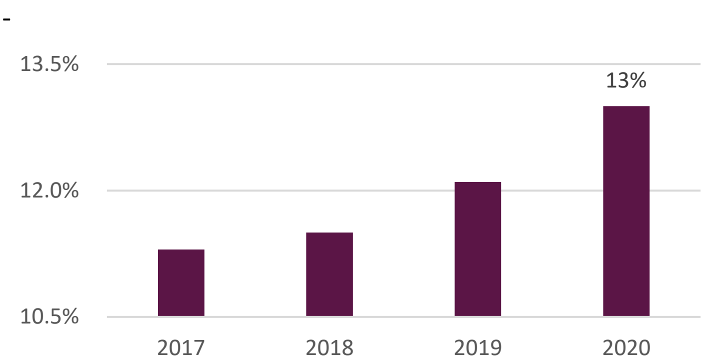
Long runway for reinvestment

Another reason for Collins Foods' success is its reinvestment plans. Since listing in 2011, Collins Foods has added 125 stores to its KFC network in Australia with each store generating a positive return on its invested capital. While this return on capital might be lower than a franchisor, the duration of the reinvestment period is incredibly powerful.

The company is on track to open 10 restaurants this year and we think there is scope for Collins Foods to reach 300 KFC restaurants over the coming decade (a 20% increase in the existing number). Add to this 2%-to-3% same-store sales growth and you are looking at a business that can grow revenue at 5% to 6% p.a. over the next decade.

While there is clearly risk in operating a restaurant business, we think the quality of the KFC franchise removes most of this risk. There is no direct competitor of scale to KFC in the fried chicken category in Australia as demonstrated by its growing market share in recent years (see Figure 3).

Figure 3 – KFC market share in foodservice chains



Source: Euromonitor, BofA Global Research

Delivery tailwinds

These gains in market share should continue as KFC indexes to the fast-growing food delivery market. KFC's core fried chicken offering is highly conducive to delivery as the chicken is served on the bone, which retains heat. As a quick-service chain, KFC restaurants are designed to flex during peak hours and delivery is a powerful tool to drive incremental sales to its stores and operating leverage. While delivery aggregators do take a margin of sales, Collins Foods is able to recoup this by pricing its products higher on these platforms and also leverages its brand and scale to negotiate better take rates than the average restaurant or café. If you consider that Pizza comprises 80% of the food-delivery category, there is still considerable space for KFC's delivery sales to grow.

European expansion

While KFC Australia accounts for over 90% of Collins Foods' profit, a potential growth driver for the business is KFC Europe. Collins Foods is the largest KFC franchisee in the Netherlands, operating 24 restaurants in that market, and also owns 17 KFC franchises in Germany. The KFC brand remains significantly underpenetrated in Europe relative to other global quick-service restaurant chains. In Germany, for example, there are 10 times the number of McDonalds as there are KFCs (see Figure 4). KFC restaurant density per population is also light in Europe relative to other developed countries (see Figure 5). Assuming Collins Foods can get the model right in Europe, this is potentially a huge growth opportunity that is not fully reflected in the share price today.

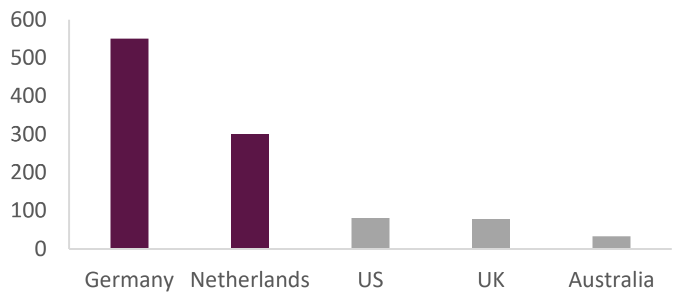
Figure 4 – Number of restaurants for major QSR chains

QSR Market # Restaurants*				
Netherlands	255	71	304	76
Germany	1,475	696	339	174
Australia	978	463	700	685

* This chart depicts the approximate number of restaurants per country. This information has been obtained from various public sources.

Source: Company presentations

Figure 5 – Restaurant density (Population (000s) / KFC restaurant)



Source: Collins Foods company filings

Valuation

Collins Foods in March was trading at a price-to-earnings multiple of 21 times. We feel this valuation is undemanding for a defensive asset with plans for store expansion here and abroad over the coming decade. In a sector that is typically characterised by high levels of competition and is subject to changing consumer preferences, we think Collins Foods stands out as a promising investment opportunity.