Airlie Australian Share Fund

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

Airlie Funds Management

Fund Update: 30 June 2022 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 $308.3 million	
Distribution Frequency	Semi-annually	
Management Fee	0.78% p.a. (inclusive of net effect of GST)	
Ticker	AASF	
Tickers	**Solactive**	**ICE**
Bloomberg (AASF AU Equity)	AASFAUIV	AASFIV Index
Thompson Reuters (AASF.AX)	AASFAUDINAV=SOLA	AASFAUiv.P
IRESS (AASF.AXW)	AASFAUDINAV	AASF-AUINAV.NGIF
APIR	MGE9705AU	
Minimum Initial Investment#	AUD$10,000	
Buy/Sell Spread	0.14%/0.14%	

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 11 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

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

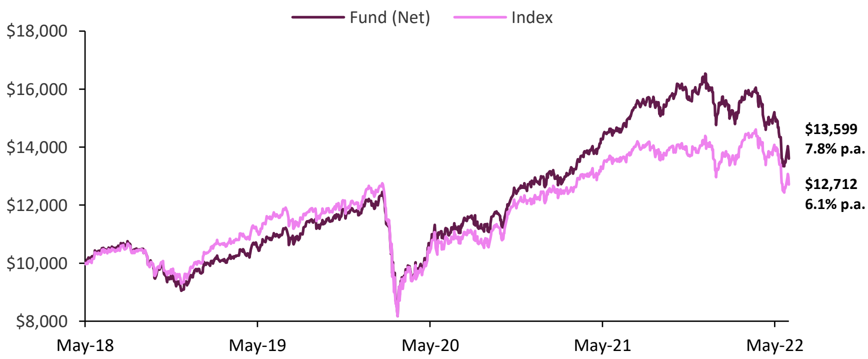
PERFORMANCE*

	Fund (%)	Benchmark (%)	Excess (%)
1 Month	-9.7	-8.8	-0.9
3 Months	-14.5	-11.9	-2.6
6 Months	-16.3	-9.9	-6.4
1 Year	-7.4	-6.5	-0.9
3 Years (p.a.)	8.0	3.3	4.7
4 Years (p.a.)	6.9	5.3	1.6
Since Inception (p.a.)	7.8	6.1	1.7

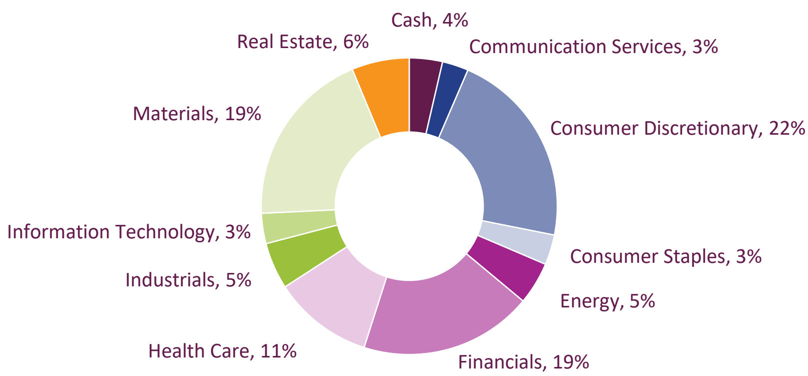
TOP 10 POSITIONS (BY WEIGHT)

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

MARKET COMMENTARY

This was the worst quarter for the market since the covid March quarter of 2020 as investors experienced both falling equity markets and bond prices. For the typical 60/40 (equities/bonds) portfolio this was the second worst six-month performance period on record. Maximum inflation fears fed a narrative of an inevitable future recession. Central banks, particularly the Fed and RBA, talked aggressively of their determination to curtail the spectre of entrenched inflation above their target ranges.

FUND COMMENTARY

The Airlie Australian Share Fund fell 14.5% in the June quarter whilst the benchmark (the S&P ASX 200 Index) was down 11.9%. A disappointing quarter for the Fund. Historically we'd expect to outperform in such a hefty down market given our focus on financial strength and business quality – attributes that usually prove resilient in times of market stress. However, our underweight in the Energy sector and overweight in Consumer Discretionary caused the underperformance. Despite being on the wrong side of the current 'macro' influences we can make a solid case for all our individual portfolio holdings.

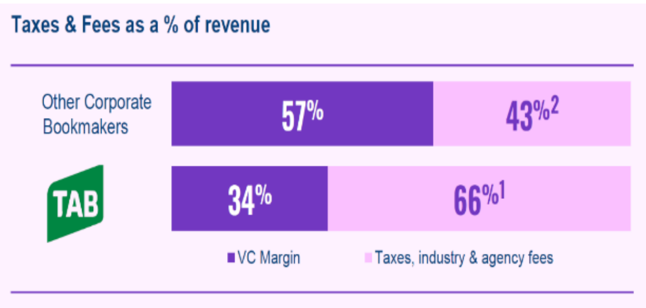
Key portfolio holdings are discussed further below:

- The Fund's oil sector exposure Ampol (+12%) had a great quarter as refining margins widened massively due to the Ukrainian situation and global under-investment in refining capacity. This is a remarkable turnaround from last year when the Federal government stepped into provide support to refiners to prevent their closure. Ampol also completed the Z Energy acquisition during the quarter which should be double digit EPS accretive. As previously argued, we believed the 'fade' on ICE (internal combustion engines) has been overestimated by the market and this should provide further demand for the stock.
- Tabcorp (+5%) demerged its lotteries and Keno businesses as The Lotteries Corporation and the early signs are encouraging for yet another successful demerger story. Tabcorp announced some encouraging wagering renegotiations with Queensland stakeholders and the NSW government. These moves should ultimately help the company become more competitive with their digital rivals.
- Insurance holding, Medibank Private (+6%) benefitted from the rise in interest rates over the quarter as investors factor in higher returns on their large 'float'.
- Conversely it was negatively correlated interest rate sensitive stocks (the banks and REITs) that really hurt the portfolio. Despite being well underweight the banks our holdings of CBA (-15%), and Macquarie (-19%) were poor performers. Our largest overweight REIT, Charter Hall (-34%) fared particularly badly – reflecting its high leverage, as a fund manager, to changes in valuation of properties and hence FUM - whilst our more inflation protected REITS – supermarket landlord SCA Property (-6%) and petrol station owner Waypoint (-13%) – fared much better.
- The Consumer Discretionary sector (-15%) was only the fourth worst sector (Information Technology -27%, Real Estate -19%, and Materials -16%) however our overweight to the sector hurt considerably. We believe our major exposures each have a unique offering with great prospects and rock-solid balance sheets. Wesfarmers (-17%) with Bunnings dominant franchise; Premier Investments (-30%) with global growth prospects; and Nick Scali (-27%) domestic store roll-out growth.
- Lithium and iron ore miner Mineral Resources (-8%) had a relatively better quarter after its poor March quarter. After a recovery to near record highs ($64.18) the stock experienced a sharp sell-off later in the quarter as both lithium and iron ore names came under pressure. A number of sell-side reports detailed looming lithium supply. This may be correct but the various lithium prices we use in our modelling of spodumene and hydroxide is many deviations lower than current pricing. Iron ore fell later in the quarter as the situation in China is very unclear. Methods of dealing with covid have negatively impacted the Chinese economic outlook balanced by the seemingly interminable 'stimulus'.
- Healius (-17%) was exited in the quarter after a re-evaluation of a recent acquisition. Healius bought Agilex - a laboratory services business which is a step-out from their traditional pathology and imaging business.

Stock Story: Tabcorp

Back in April we wrote up our thoughts on one of Airlie's core holdings, Tabcorp, prior to its demerger of The Lotteries Corporation. As part of the demerger, Tabcorp shareholders received one share in The Lotteries Corporation for every one share of Tabcorp they owned. Now that the demerger has taken place, we thought it prudent to provide a short update on some of the recent developments. At the time of writing, the demerger trade has performed well. From 24 May 2022 when the demerger took effect, the combined Tabcorp-Lotteries trade has risen 5% versus an 8% decline in the S&P/ASX 200 Index.

While our last update focused on the infrastructure-like qualities of The Lotteries Corporation, we are now starting to see some value emerging in the remaining Tabcorp entity, where the wagering, media and gaming services businesses are held. The lion's share of value here comes from the wagering business which, operating under the TAB brand, holds the exclusive retail and totalisator licences across all Australian States and Territories, excluding Western Australia. In compensation for this retail and totalisator exclusivity, Tabcorp pay higher taxes and product fees than online bookmakers such as Sportsbet. As punters increasingly elect to bet through digital channels as well as in fixed odds rather than the tote, the value of this exclusivity has declined, and the associated higher fees and taxes are no longer economic for Tabcorp. While the introduction of the point of consumption tax (POCT) in 2019 has rectified some of this imbalance, there continues to be a material ongoing cost disadvantage for the company. For instance, Tabcorp currently pay around 66% of revenue towards taxes and industry fees compared to just 43% of revenue for market leader Sportsbet.



Source: Tabcorp 2022 Investor Day

In just the few weeks since the demerger, Tabcorp management has already made substantial progress in reducing this cost disadvantage. As part of the settlement of Tabcorp's dispute with Racing QLD, the Queensland Government has announced reforms to the State wagering tax, which will have the effect of levelling the playing field between Tabcorp and online bookmakers. Had these reforms been in place in 2021, Tabcorp's tax rate would have fallen from 44.5% of revenue to 35% of revenue, generating an extra $30 million of profit.

Furthermore, the New South Wales Government has also announced an increase in the POCT to increase from 10% to 15% with effect from 1 July 2022, as well as announcing its intention to review the wagering tax regime over the coming years. From 1 July 2022, Tabcorp will receive transition payments over 18 months to ensure they are 'no worse off' under the POCT increase. Once the transition period is over, and if no further reforms have been implemented, this would theoretically result in a $16 million reduction in EBITDA for Tabcorp based on 2021 numbers. At face value this may not seem like a great result for the company; however, we consider the impact on online bookmakers is likely to be far more severe, helping to reduce the margin differential.

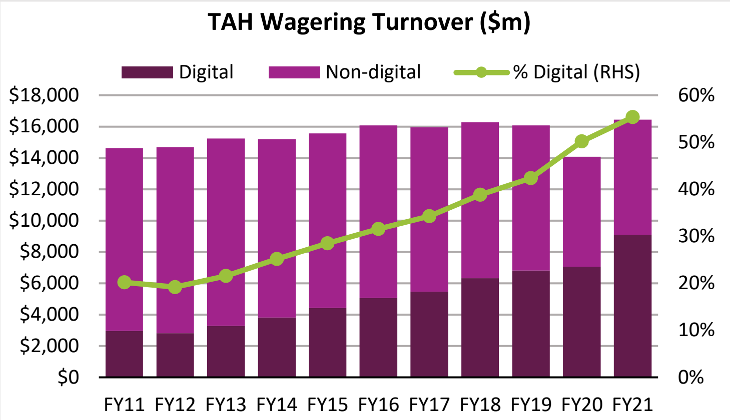
Tabcorp has formed the Fair Play Coalition with the Australian Hotels Association to jointly lobby the remaining State Governments for further wagering tax reform. At the recent Tabcorp investor day, management also suggested a change in the POCT in the Australian Capital Territory was likely imminent. We consider these likely developments will represent material progress towards levelling the field between Tabcorp and online bookmakers.

While increases in regulation are often assumed to hamper the affected industry, the increases can actually have the opposite effect, increasing barriers to entry and resulting in a more rational market. Changes to the POCT have dramatically decreased the variable contribution margin for industry participants. For instance, Sportsbet's variable contribution margin has fallen from 75% in 2017 to 57% today, and we expect a further decline given the announced changes to the POCT in Queensland and New South Wales[1]. From the perspective of a new entrant, this is a dramatic reduction in the percentage of turnover that can be spent on product development, marketing, and other expenses essential to gaining scale and creating a viable business. This perhaps explains why the industry has undergone material consolidation over the last decade, shrinking from around 10 key players in 2009 to around just 6 today.

Despite the regulatory changes, we consider that the industry economics remain attractive; total market wagering turnover has grown at 6% compound annual rate over the decade to 2019 and scale operators exhibit healthy margins and strong returns on capital employed. Tabcorp are the second largest operator in the Australian wagering industry[2], with over $16 billion in turnover. Tabcorp are also the second largest operator in that industry on a digital stand-alone basis, with over $9 billion in digital turnover equating to around 20% market share. While this market share has declined over time, in recent periods it has begun to stabilise. Now that Tabcorp is its own separate entity, this could mean management can make more long-dated investments in product functionality and customer service. For instance, the company is in the process of launching its new app that will allow for quicker time-to-market for new products and features, which had previously been a sticking point for the company due to regulatory hurdles. We consider that these steps should help to further stabilise market share moving forward.

[1] Sportsbet Investor Day presentation, September 2021.

[2] Tabcorp Investor Day, June 2022.



Source: Company filings.

It's also worth mentioning that there have been material on-market share purchases by Tabcorp management in recent weeks. While insider buying is never the foundation of a thesis, it is nonetheless an important signal, particularly for a situation like Tabcorp where the business is facing material structural headwinds, navigation of which will in part rely on strong management execution.

Tabcorp's enterprise value currently sits at around $2.5 billion (including the Queensland settlement), which implies earnings before interest and tax (EBIT) multiple of ~13x on a normalised basis. The balance sheet is healthy with net debt of less than $100 million and very strong free cash flow generation. Capital expenditure is currently running around $120 million below depreciation and amortisation, so the free cash flow multiple is closer to 10x[3]. Scale begets scale in wagering, allowing for higher investment in product functionality, generosities and marketing, all of which can lead to greater scale and profitability. While there is no guarantee of success and some material hurdles for management to overcome, we think that buying Australia's second-largest operator on 13x EBIT looks like a solid bet.

[3]Company filings, Airlie estimates.