Airlie Australian Share Fund
(Managed Fund)

A concentrated, active portfolio of Australian equities.

Airlie Funds Management

Ticker: AASF

Fund Update: 31 March 2024 ARSN: 623 378 487

FUND FEATURES

- 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'.

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'

Investment Risks
All investments carry risk. While it is not possible to identify every risk relevant to an investment in a fund, we have provided details of risks in the Fund's Product Disclosure Statement. You can view the PDS for the Fund on Airlie's website: www.airliefundsmanagement.com.au

Inception Date	1 June 2018
Benchmark	S&P/ASX 200 Accum. Index
Portfolio Size	AUD $528.7 million
Distribution Frequency	Semi-annually
Management Fee^	0.78% p.a. (inclusive of net effect of GST)
Ticker	AASF
APIR	MGE9705AU
Minimum Initial Investment#	AUD$10,000
Buy/Sell Spread#	0.14%/0.14%

^ Transaction costs may also apply – refer to the Product Disclosure Statement. All fees are inclusive of the net effect of GST.
# only applicable to investors who apply for units directly with the fund.

PERFORMANCE*

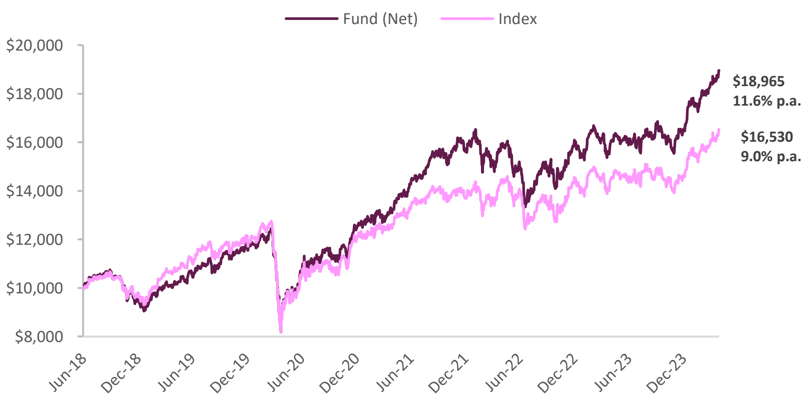
	Fund (%)	Benchmark (%)	Excess (%)
1 Month	3.1	3.3	-0.2
3 Months	6.7	5.3	1.4
6 Months	16.3	14.2	2.1
1 Year	19.0	14.4	4.6
3 Years (p.a.)	12.9	9.6	3.3
5 Years (p.a.)	13.4	9.2	4.2
Since Inception (p.a.)	11.6	9.0	2.6

Past performance is not a reliable indicator of future performance.

TOP 10 POSITIONS (BY WEIGHT)

Company	Sector**
BHP Group Ltd	Materials
CSL Ltd	Health Care
Commonwealth Bank of Australia	Financials
ResMed Inc	Health Care
Ampol Ltd	Energy
Mineral Resources Ltd	Materials
Charter Hall Group	Real Estate
James Hardie Industries	Materials
National Australia Bank Ltd	Financials
Aristocrat Leisure Ltd	Consumer Discretionary

PERFORMANCE CHART GROWTH OF AUD $10,000*



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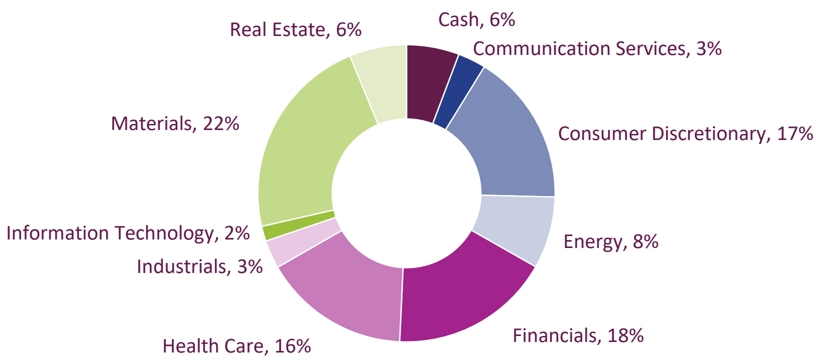
PORTFOLIO MANAGERS

Emma Fisher
Over 13 years investment experience. Formerly an investment analyst within the Australian equities team at Fidelity International and prior to that Nomura Securities.

Matt Williams
Matt has over 25 years industry experience. Matt joined Airlie in July 2016 managing Australian share strategies for institutional clients and is co-portfolio manager for the Airlie Australian Share Fund for retail clients.

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

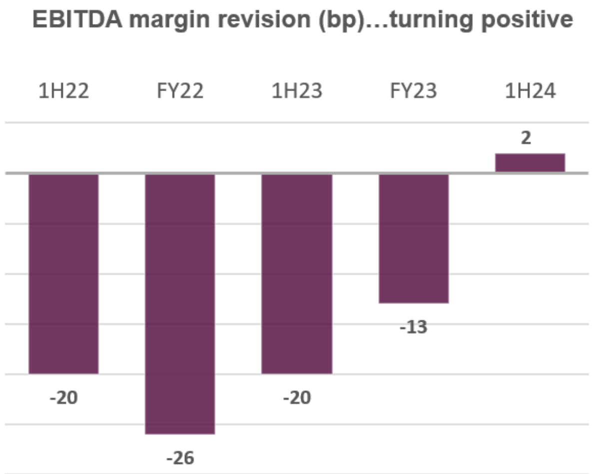
PORTFOLIO POSITIONING**



* 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

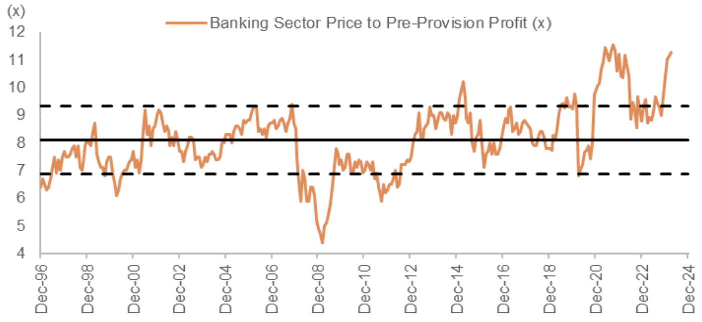
The ASX 200 returned a strong 5.33% for the March quarter 2024, in part due to the February reporting season, which confirmed that the economic Armageddon predicted by many last year has simply not come to fruition. The consumer has remained remarkably resilient in the face of many interest rate hikes, and while parts of the economy have slowed, the overall slowdown has been less severe than feared. As per the chart below, this was the first reporting season in two years when we saw EBITDA margins revised up slightly. We noticed many companies experiencing raw material input relief driving a solid gross margin result, which flowed through to earnings.



Source: MST Marquee, Airlie Research

The other takeaway from our discussions with management teams was the return to a more normal pricing environment. Last year, most companies were citing 5%+ price increases, with some building materials companies we met with talking double-digit price increases, as inflation wrought havoc on cost bases. This year it was marked how many companies were now talking of a return to a more normal pricing cadence (typically 2-3%). This should feed through to lower inflation pressures in the economy, albeit the listed market lens we look through is not the entire set of inputs to CPI, which also includes rent, services and other components.

It would be remiss of me not to mention the extraordinary rally in the big 4 banks, which has left many (us included) scratching their heads.



Source: Barrenjoey, Airlie Research

As per the above chart, based on normalised profits the banks are the most expensive they've been in 30 years. Against this we would set the simple question: is the outlook today better for the banks than in the last 30 years? While we are no economic doomsdayers, we would argue the answer to that question is a resounding no, and hence we view the big 4 as exceptionally poor value. In the portfolio we own CBA and NAB and have been reducing our positions as the share prices have rallied.

FUND COMMENTARY

The Airlie Australian Share Fund returned 6.7% for the March quarter 2024, outperforming the benchmark (S&P/ASX 200 Accumulation Index) by 1.4%. Key portfolio contributors have included ResMed (+19%), QBE (+25%), Ampol (+15%) and Wesfarmers (+22%). Key detractors over the quarter included BHP (-10%) and Tabcorp (-9%).

Over the quarter, we added IDP Education to the portfolio, and exited CSR on the announcement of a takeover from Saint-Gobain at $9 a share. We trimmed our largest position, ResMed, as the stock has staged a strong recovery as GLP-1 fears have receded. It remains one of our largest positions. We also reduced our position in Wesfarmers – while the Kmart result was a belter, we feel the valuation upside is markedly reduced post the recent rally.

Drive to survive markets

I'm one of a class of people whom purist, long-time Formula One fans probably find very annoying, those who have discovered the sport through Netflix's Drive to Survive. One thing I find very interesting about Formula One is the interplay of two variables: the quality of the driver, and the quality of the car. If you had to bet who would win the race, the job would be easy if everyone were in the same car: just bet on the guy who has won the most races. However, the fact that the drivers are driving cars of differing quality makes it complex…is the driver who wins the Championship the best driver in the field, or were they simply driving the best car? This complex interplay between two variables reminds me of investing. If we think of the "driver" as the business and the valuation as the "car", we can see the game is not all about picking the best drivers or businesses with the best prospects. The valuation at which you purchase the business can also probabilistically change the outcome of your investment. Ideally you get a very good business (great driver) at a very cheap valuation (great car).

This will maximise the chance of success of your investment. The performance of portfolio holding Premier Investments is a good example this year. The share price has rallied 21% this quarter and is up over 60% since it bottomed out in June last year, by which time the Consumer Armageddon thesis had taken hold. By way of illustration, sector broker reports in June last year included the emotive titles "The retail recession we had to have", "The honeymoon is over" and "Winter has come". What is interesting is that Premier's actual EBIT fell 4.8% in 1H24, which seems at odds with the strong share price performance, until you realise that consensus expectations in June last year were for a decline in earnings for FY24 of 25-30%. Very bearish expectations were priced into Premier in June last year, which made it very cheap (it traded on 12x these low forward earnings estimates). Put another way, buying Premier in June was backing a great driver in a great car.

By contrast, up until this year, recent portfolio addition IDP Education was an example of a great driver in a poor car. The business was one of the highest-quality and best-performing stocks on the ASX, it had generated a five-year return on invested capital of >50%, and EBIT was up 10x in the last decade. In the six years from listing to the share price peak of $40 in 2021, it had compounded total shareholder return at 54% p.a. However, since listing it has traded on an average PE multiple of 43x, i.e. you were paying up for this quality. To us, this made it a "bad car". The market is usually happy to pay up for a structural growth story; however, there is some hidden cyclicality in IDP's earnings. It is not the economic cycle that hurts, but the political/regulatory cycle, and right now it is hurting. Post covid, the Western economies in which IDP places students have opened the floodgates to immigrants, both to clear student backlogs from those who couldn't physically attend campus during covid, and to drive some recovery in fragile post-covid economies. Historic immigration booms have always eventually met domestic backlash, and this time is no different, with housing/rental crises, strain on healthcare services, etc., cited as reasons immigration levels have gone too far. Three of IDP's core destination markets, Australia, Canada and the UK, are reducing immigration through various policy tools. This has caused the share price to collapse from a high of $40 to $17.50 today. The PE multiple has similarly de-rated, from >60x earnings to 26x today. We think this is an attractive entry point for a quality business. While we acknowledge the near-term regulatory (and earnings) risk, ultimately we believe IDP's core markets are not having enough babies to grow their populations organically, and will be structurally reliant on overseas migration for decades to come to grow their economies. At some point IDP will re-rate as these headwinds turn to tailwinds, and we see the business as a good driver in a good car.

Very occasionally, we will invest in what we view as an average driver, if the car is very good, i.e. the valuation is so cheap that we think the investment has asymmetric upside, despite the lower quality of the business. QBE is a case in point. QBE was up 25% this quarter, one of the strongest contributors to the portfolio's return. To us, QBE was a classic turnaround story. When we first invested two years ago, we saw it as a decent global insurer with an underperforming North American business. We believed the new CEO, Andrew Horton, had the appropriate pedigree to fix the problems, given he had successfully grown Beazley's North American insurance business. Further, trading on just 9x earnings, we felt QBE was not pricing in any improvement. The turnaround has progressed well under Horton, with the share price up over 50% since we invested.

That said, we are very cognisant that few turnarounds work. For this reason, we rarely own more than two or three turnarounds in the portfolio at any one time. While QBE's turnaround is going well, it's turned out to date we've backed a dud driver in a dud car with our investment in Tabcorp. Tabcorp's share price has fallen from $1.15 last August to 75c today. Following the 1H24 result, we have had a serious downgrade in our confidence in the likelihood of the turnaround succeeding and have reduced our position accordingly. At the current price, and given we believe we're near a cyclical bottom in wagering spend, we're reluctant to give up completely. However, we acknowledge it has been the largest mistake in the portfolio this year, and a good reminder of the saying, 'turnarounds seldom turn'.

STOCK STORY – AMPOL

One of the most solid results for us this reporting season was Ampol, one of our top 5 holdings. It is the largest fuel supplier to the Australian and New Zealand market with a vertically integrated operation, supplying fuel to industrial customers and retail customers through the Ampol brand in Australia and the Z Energy brand in New Zealand. It also operates one of the two refineries left in Australia, Lytton.

Coming out of Covid, Ampol has recovered strongly. Our positive view rests on not just the short-term tailwinds but also on a favourable medium-term outlook and improved business quality. Ampol today is more cash generative, can sustain higher dividends, and many areas of the business have been derisked and are well set up.

Business quality

Australia and New Zealand currently have one of the largest short positions of petroleum product in APAC. Over the last decade, Australia has shifted from relying on fuel imports for 25% of its supply to now 75%. New Zealand has gone further, shutting down all its domestic refineries and importing 100% of its fuel. Increasing reliance on imports favours players like Ampol with their extensive infrastructure assets that can yield better asset returns and supply fuel at a competitive cost. This dynamic also underpins the rationale behind the company's acquisition of Z Energy, which has been performing strongly and is a greater than 20% Return on Invested Capital (ROIC) investment for the company.

Refining margins are inherently volatile, and at times we have seen Lytton swing to a loss. In 2021, the threat of Lytton's closure led to a favourable agreement with the Australian government, which will provide government support in a downturn to ensure the asset remains viable to supply into the domestic market. The Australian government did not want to go down the New Zealand route of closing all refineries and relying on fuel imports. This would leave Australia in a precarious situation if global geopolitics shifted and we did not have a domestic source of production. This deal effectively caps potential losses at Lytton at zero, and allows Ampol all the earnings upside, dramatically reducing the volatility of Ampol's earnings. That said, we don't believe the agreement will cost the government much – we expect restricted global supply and stronger controls over Chinese refining exports should be supportive of Lytton's medium-term earnings outlook.

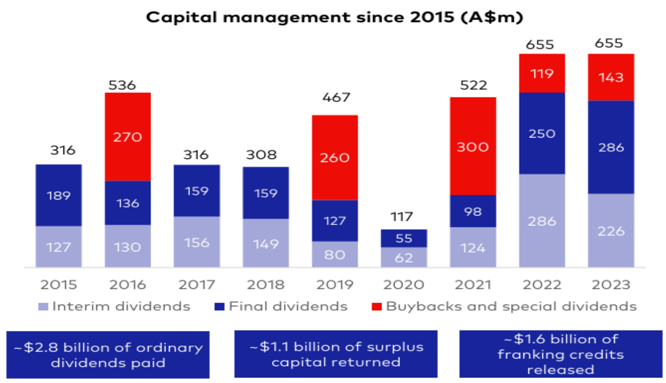
In convenience retail, business quality and industry setup have also improved. Ampol and others are investing to improve their retail offering (Quick Service Restaurant, improving range, store refurbishment) and we think Ampol has a strong competitive position. This strategy will also be increasingly important to adapt to a future of EVs.

Ampol was earlier to embark on this strategy than its peers, starting in 2016, and although it has not been the smoothest journey, we think Ampol is well positioned now. Investors, ourselves included, can often underestimate the complexity involved in a retail transformation. It's easy for us to look to growth without appreciating the nuances like procurement, costs or systems. After seven years of hard work, we think Ampol finally has a strong foundation. The company has taken control of its network from franchisees, allowing it to better implement retail initiatives, reconsolidated to a smaller set of profitable sites with a focus on highway sites, which have stronger returns, and built retail capabilities. Incidentally, I recently drove to and from Sydney and the Gold Coast over the Easter break. With two young kids in the car, we must have stopped at least eight or nine times. Every single petrol station we visited up and down the Pacific Highway was an Ampol site – we think Ampol's highway-heavy site portfolio has stronger earnings potential and less EV disruption risk.

Beyond the shop, the retail fuel side has also improved. Counterintuitively, headwinds like inflation, tobacco and EV help widen the gap between the most profitable and scaled players from the marginal players. In a fragmented industry like this, marginal retail operators need to remain viable through fuel pricing, and the high cost of doing business helps enforce rational competition. We see similar trends playing out in North America. Again, going back to the network strength, we think Ampol is well positioned here with profitable sites, more premium fuel, and rent advantage through more freehold property. All in all, we think the quality and earnings potential in Convenience Retail is underappreciated.

Management quality

Management has executed well with their reset of the convenience retail, securing Lytton support, Z Energy acquisition and track record in capital recycling. Since 2015, Ampol has returned $5.5bn of capital to shareholders (more than half of its market cap today).



Source: Ampol

Financial strength

When we compare Ampol to its peers on the ASX, like energy and utilities, we come away with the following assessments: 1) it is more cash generative and can sustain higher dividends; 2) the market structure, especially retail, is much more favourable and reliable; 3) strong ROIC (15% pre-tax); and 4) strong balance sheet. At 13.8x PE, we think the risk/reward looks attractive, particularly considering the average ASX Industrial stock trades on 23x PE despite earning an inferior 13% pre-tax ROIC.

ESG consideration

We believe the energy transition has weighed on Ampol's multiple, as it is viewed as a 'loser' in the inevitable shift to EVs. While it's probably fair to say that EV penetration might take longer in Australia, we also don't want to fool ourselves into thinking that "it will take so long that it won't affect our investments". Although the company is actively involved in future energy (piloting EV charging, potential biofuel operation), it's important for us to understand the potential economic impact. This is essential to our process.

We spoke to Alimentation Couche-Tard, one of the largest convenience retail operators globally with the #1 position in Norway. Norway is an important test case for the impact of EV penetration on convenience retail profitability, given EVs comprise >90% of new car sales there. Couche-Tard sees strong demand for on-the-go charging, healthy charging economics for the electrons, uplift in shop sales from longer dwell time, and strong fuel performance. Couche-Tard made it clear to us that EVs do not displace fuel earnings but rather add to it. Fuel performance continues to surprise to the upside, especially in industries that find it even more difficult to transition. Couche-Tard is more profitable in Norway with EVs than without.

Similarly, McKinsey estimates that by 2030 on-the-go charging and destination charging in Norway will make up ~75% of EV charging profit pools but only around 40% percent of total power demand. In contrast, home charging will provide 25% of power demand but will account for only 12% of profit pools[1]

Regardless of geographies, we think the economics of public EV charging will be driven by the limited availability of attractive charging locations. We think this adds to the model in Australia with a constrained electricity transmission network and vast distances between cities, making the real estate and network strength even more critical and valuable.

[1] *https://www.mckinsey.com/industries/automotive-and-assembly/our-insights/what-norways-experience-reveals-about-the-ev-charging-market#/*