Airlie Australian Share Fund
(Managed Fund)

A concentrated, active portfolio of Australian equities.

Ticker: AASF

Fund Update: 30 September 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 $751.9 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.

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.

DEPUTY PORTFOLIO MANAGER

Joe Wright
Joe has over 10 years experience in the investment industry. Joe joined Airlie in 2021 as an equities analyst and became Deputy Portfolio Manager for the Airlie Australian Share Fund in 2024.

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

PERFORMANCE*

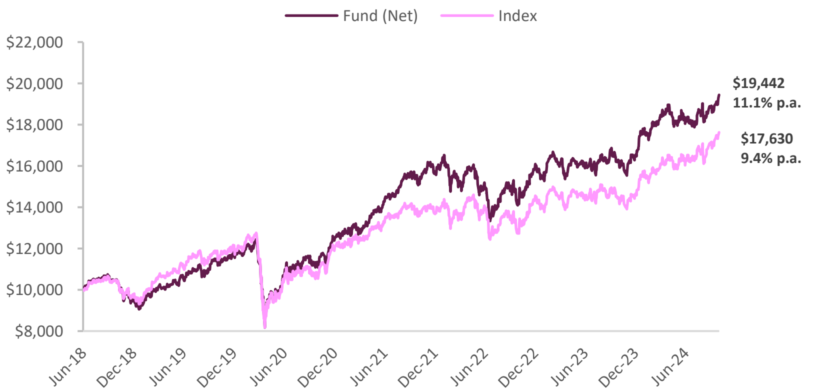
	Fund (%)	Benchmark (%)	Excess (%)
1 Month	3.1	3.0	0.1
3 Months	7.7	7.8	-0.1
6 Months	2.5	6.7	-4.2
1 Year	19.2	21.8	-2.6
3 Years (p.a.)	8.2	8.4	-0.2
5 Years (p.a.)	11.2	8.4	2.8
Since Inception (p.a.)	11.1	9.4	1.7

Past performance is not a reliable indicator of future performance.

TOP 10 POSITIONS (BY WEIGHT)

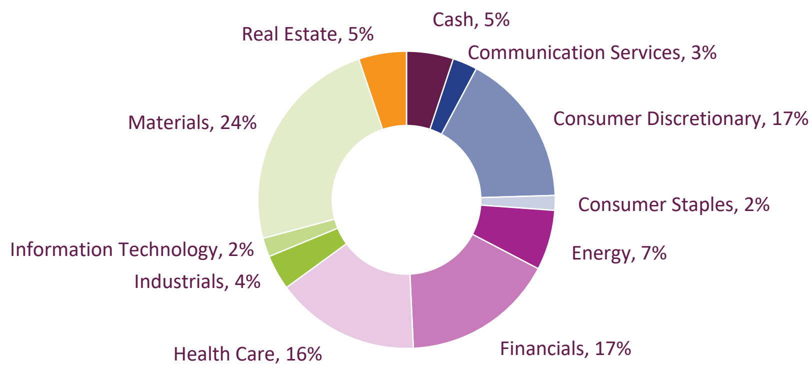
Company	Sector**
BHP Group Ltd	Materials
CSL Ltd	Health Care
Macquarie Group Ltd	Financials
Commonwealth Bank of Australia	Financials
ResMed Inc	Health Care
Aristocrat Leisure Ltd	Consumer Discretionary
Ampol Ltd	Energy
James Hardie Industries	Materials
BlueScope Steel Ltd	Materials
Medibank Pvt Ltd	Financials

PERFORMANCE CHART GROWTH OF AUD $10,000*



Past performance is not a reliable indicator of future performance.

PORTFOLIO POSITIONING**



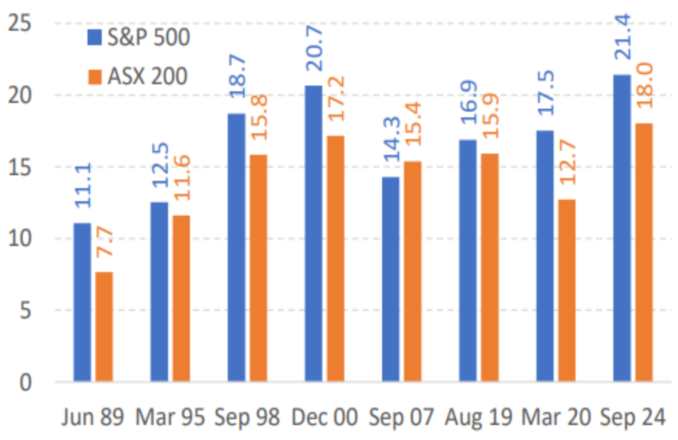
* Calculations are based on exit price with distributions reinvested, after ongoing fees and expenses but excluding individual tax, member fees and entry fees (if applicable). Returns denoted in AUD.
** Based on GICS Sector classification, may not sum to 100% due to rounding.

MARKET COMMENTARY

This has been another extraordinary quarter for the Australian share market, with the ASX 200 rising 7.8%. The rally in the Big Four banks continued, with the share prices of CBA, NAB, WBC and ANZ contributing 2% of the 8% return of the market. Markets enjoyed the long-awaited first rate cut from the Fed, which surprised to the upside at 50bp. Late in the quarter, news of a co-ordinated Chinese policy response to the deteriorating Chinese economy provided a much-needed shot in the arm to global commodities, such that resources joined the party, with the Resources sector returning 13% in September alone.

It would be simple to conclude that the fact that the two largest economies in the world, China and the USA, are now easing means that we are "early cycle". History would suggest these conditions should be supportive of a global cyclical recovery. The fly in the ointment for equity markets are valuations. Markets can stage extraordinary rallies when early-cycle conditions meet depressed valuations (see the Chinese stock market in late September). For Australian investors, however, starting valuations are anything but depressed. If we compare the market PE today for US and Australian equities markets versus the start of prior Fed rate-cutting cycles, starting valuations are higher today than ever. While we believe monetary settings look supportive of a global cyclical recovery, which would benefit portfolio holdings including BHP, MinRes, IGO, BlueScope, Ampol and Santos, we note high starting valuations at an aggregate level may temper the return of the market as a whole.

PE multiple at start of previous Fed rate-cutting cycles



Source: MST Marquee

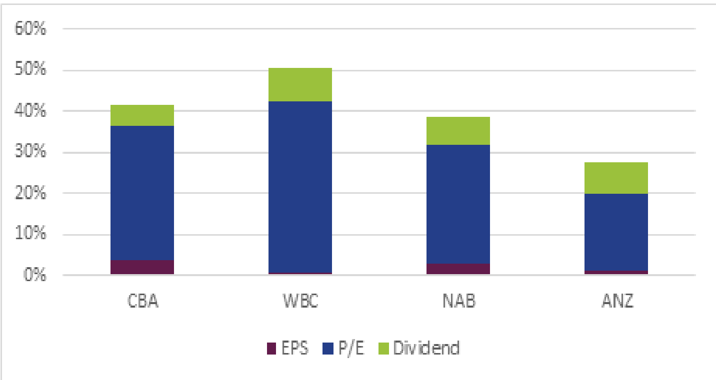
What could derail a cyclical recovery entirely? Anything that derails further easing of policy. For the Fed, this would include any signs of inflation re-accelerating. For China, we note stimulus efforts of the last year have proven ineffective in the face of a total slump in consumer confidence and household wealth.

There has long been a view that Xi "didn't mind" the deflationary effects of the Chinese property bubble bursting, that it was part of his agenda of curbing speculative excess and repositioning the economy away from the old investment-led economy to one focused on technology and innovation. While it remains to be seen whether September's stimulus will be successful in arresting the slump, we do note the comprehensiveness of the stimulus – involving co-ordinated announcements from the Politburo, People's Bank of China, CBIRC (China Banking and Insurance Regulatory Commission) and CSRC (China Securities Regulatory Commission) with monetary and fiscal policy, bank recapitalisation, stock market and property market support measures. At first blush it looks like Xi very much does mind the weakness in the economy.

FUND COMMENTARY

The Airlie Australian Share Fund returned 7.7% for the quarter, underperforming the market by 10bp. The overwhelming driver of this was our sizeable underweight to the Big Four banks, a performance headwind of 140bp this quarter. Put simply, the banks comprise a big part of the market (22% of the ASX 200 index), these four stocks have rallied 40-50% this year, and this rally has cost us considerably from a performance perspective (440bp for the last 12 months). While we acknowledge the position to date has been a costly error, we take comfort from the below chart, which disaggregates the 1-year Total Shareholder Return for the four major banks into EPS, dividends and P/E. As shown below, the bulk of the return has come from a P/E re-rating rather than the sustainable drivers of earnings per share or dividends. In our minds, this is a one-off driver (that can and likely should go the other way).

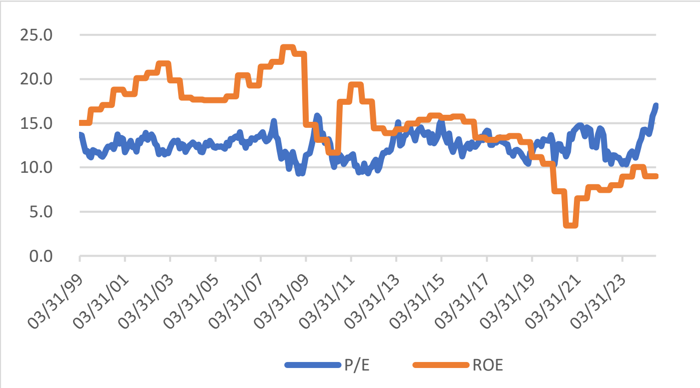
1 yr TSR breakdown, 4 major banks



Source: MST Marquee, Airlie Research

Further, picking on a bank we don't own – Westpac – we can see the re-rate has not been driven by an improvement in fundamentals. In 2011, Westpac generated an ROE of 19% and traded on 10x earnings. Today, it trades on 16x earnings while ROE has collapsed to 9%. To us, the banks look extraordinarily poor risk/reward. While we have owned CBA and NAB in the fund since inception, we have continued to reduce our positions in both over the past year as the stocks have rallied. We remain as underweight in the major banks as we have ever been.

Westpac P/E multiple vs ROE



Source: FactSet, Airlie Research

Detractors over the quarter include:

- **Mineral Resources (-3.5%):** entered July with a share price of $54.95 and briefly touched $29 in the quarter, in an extraordinary share price capitulation as the market absorbed (a) a significant (c$1bn) capex overrun at its Onslow iron ore project, and (b) deteriorating iron ore and lithium market fundamentals, with commodity prices falling in early September. Our concerns about the balance sheet held us off from adding to the position. MinRes went on to stage an extraordinary rally on the back of four pieces of good news: (1) a company announcement that it had identified $300m in cost savings ($180m capex and $120m opex); (2) news that MinRes was exploring the sale of its Perth Basin gas assets, which came with a maiden resource statement; (3) the finalisation of the Onslow Haul Road sale to Morgan Stanley Infrastructure Partners, which meant MinRes received its $1.1bn payment; and (most importantly of all) (4) the iron ore price rebounding to US$100/t on the back of Chinese stimulus. MinRes rallied 70% of its lows to close the quarter at a share price of ~$51. We trimmed our position into this strength to keep the weighting at ~2%, which we feel is right given the execution risk of Onslow coupled with the stretched balance sheet.

- **News Corp (-6%):** News Corp fell as REA lobbed several bids for UK's Rightmove. News Corp holds a 63% stake in REA, which fell 8% over the month. REA eventually walked away from the deal, as Rightmove failed to engage before the date (Sep 30) required under UK Takeover laws. Under these rules, REA must now sit it out for six months.

- **Premier Investments (-1%)**: Premier fell 13% in September from record highs after producing a mixed 2H24 profit result. Smiggle was the key detractor in H2 with sales down 13%. However, Peter Alexander continues to deliver with a record sales result of $509m up 6% YoY. The international rollout of Peter Alexander and potential spinoff of the apparel brands to Myer provides future encouragement. We had trimmed our position before the result.

Contributors over the quarter include:

- **Aristocrat (+18%):** Aristocrat rallied as key competitor Light and Wonder received an injunction from the US District Court of Nevada against the further sale of its Dragon Train product for infringing on Aristocrat's trade secrets. The injunction bans 'any continued or planned sale, leasing, or other commercialization of Dragon Train'. While preliminary, our reading of the injunction document is it is incredibly damning of Light and Wonder, with Dragon Train seeming like a clear-cut (and sloppy) case of copying Aristocrat's Dragon Link product. With other competitors like IGT and Everi distracted by their merger, Light and Wonder was Aristocrat's most viable competitor, hence the misstep here should benefit Aristocrat, at the very least in the short term. Our analyst Jack McNally met with Aristocrat's CEO in Las Vegas in September and came away confident in the business's trajectory in its key gaming ops segment. We added to our position over the quarter.

- **Sigma Healthcare (+13%)** The Sigma profit result included the financials from proposed merger partner Chemist Warehouse, showing 2H24 like-for-like sales growth in Australia of 13% – a remarkable performance. We also note the strength of their overseas stores with sales up +33%.

- **BHP (+11%):** BHP rallied on the back of the co-ordinated Chinese policy announcements that saw iron ore bounce from its US$90/t lows to end the month > US$100/t. We added to our BHP position on weakness early in the month as the share price was sub-$40.

STOCK STORY – MEDIBANK

(Vinay Ranjan – Deputy Portfolio Manager)

medibank

Playing a pivotal role in Australia's health transition

The Medibank and ahm private health insurance brands serve over 4.2m customers and play a vital role in funding medical care in Australia. In the most recent financial year, Medibank paid out $6.3bn in health insurance claims, taking a significant burden off the public healthcare system.

Yet recently, the sector has come under fire from both the government and hospitals accused of making too much profit. In this article, we explore this regulatory tension and why we think Medibank looks an attractive investment opportunity.

Private hospital profits affected by new models of care

There is no doubt the past few years have been challenging for hospitals – labour shortages have affected service levels and inflation has been rampant. Private hospital operators have responded by launching a campaign against the health insurers and pressuring the government for a bailout. While additional payments or a tax may provide short-term relief to hospitals, they do not solve the structural issues facing the sector and ultimately would drive up the cost of healthcare and premiums for millions of Australians. To build a sustainable private healthcare system, all participants must work together to find efficiencies and drive down the overall cost of care.

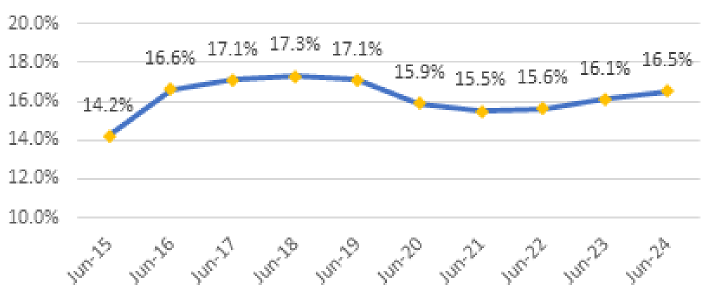
Medibank is doing its part to lower costs by investing in new models of care away from overnight stays in expensive acute care hospitals to virtual, short-stay hospitals and home care. Without this transition, Medibank estimates the government will need to spend 50% more on healthcare as a percentage of GDP in forty years. While this transition does come at the expense of hospitals that typically earn more for longer in-hospital stays, it is beneficial for the wider healthcare system. Higher hospital costs would simply translate to higher premiums, which are likely to push more members out of private health insurance and place further strain on an already stretched public healthcare system.

It is for this reason the Federal Health Minister following a review has conceded, "There's no silver bullet from Canberra or funding solution from taxpayers to deal with what are essentially private pressures in the system". Ultimately, it is not the government's job to prop up unprofitable business models and in some cases it is healthy for some private hospitals to shut where there is overcapacity in the system.

Has Medibank profited at the expense of hospitals?

Medibank has stuck to its promise not to profit from the pandemic and returned a total of $1.46bn in givebacks to customers for permanent claims savings due to COVID-19. This is evident in the chart below which shows Medibank's health insurance gross profit margin is still below FY19 levels.

Figure 1 – Medibank Health Insurance Gross Margin



Source: Company filings

Fear of regulation creates opportunity to invest

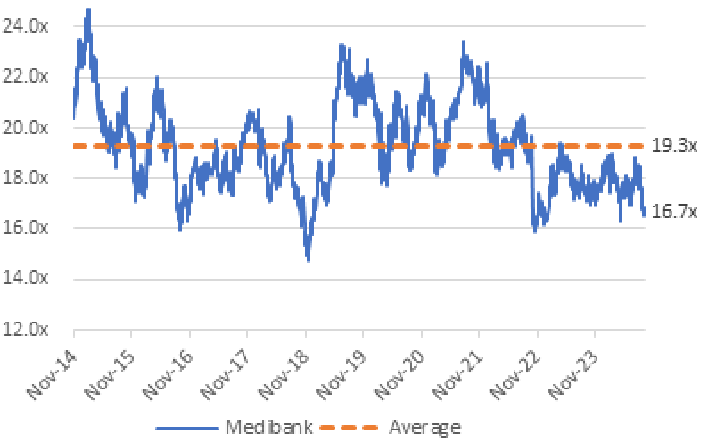
While there remains uncertainty as to how the regulatory situation will unfold with a federal election coming up, we think it's unlikely the government will step in and prop up private hospitals where there is a clear shift to lower-cost care outside the hospital. In the meantime, we believe this creates an opportunity to invest in Australia's largest health insurer, which has grown its earnings per share at 8% p.a. over the past decade.

Medibank screens as a high-quality business under our investment process for the following reasons:

1) **Financial strength**: Medibank has a strong capital position with a capital ratio of 14.1%, well above its 10-12% target range, and has zero debt on its balance sheet.
2) **Business quality**: Medibank is Australia's largest health insurer with 4.2m members (27% market share). This scale enables Medibank to negotiate better terms with hospitals keeping a lid on claims inflation while sharing these savings with members to lower premiums and improve retention.
3) **Management quality**: David Koczkar has been the CEO since 2021 and prior to this was the COO since 2014. Over this period, the company has seen a return to policyholder growth, expanded its health offering and tightly managed its costs.

Finally, from a valuation perspective, Medibank is trading on less than 17x P/E (below its long-term average of 19x) and offers investors an attractive dividend yield of 4.6%.

Figure 2 – Medibank NTM Rolling PE



Source: FactSet, Airlie Research