Airlie Australian Share Fund

A concentrated, active portfolio of Australian equities
Accessing the Airlie investment team and Magellan's fund capability

Fund Update: 30 June 2018 ARSN: 623 378 487

FUND FACTS

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

AIPR	MGE9705AU
Inception Date	1 June 2018
Benchmark	S&P/ASX 200 Accum. Index
Minimum Initial Investment	AUD$10,000
Portfolio Size	AUD $7.2 million
Distribution Frequency	Bi-annual
Buy/Sell Spread	0.14%/0.14%
Management & Administration Fee	▪ 0.78% p.a. (inclusive of net effect of GST) ▪ No performance fee
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'

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 Goodsell
Over 8 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 on:

- Fund performance
- Unit prices
- Investment Insights

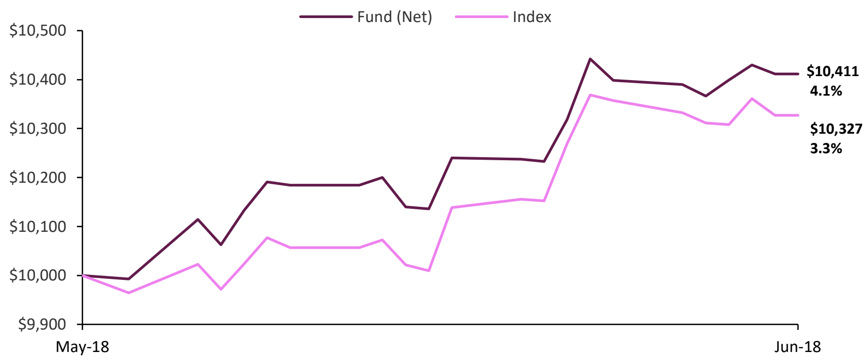
PERFORMANCE*

	Fund (%)	Index (%)	Excess (%)
1 Month	4.1	3.3	0.8
Since Inception	4.1	3.3	0.8

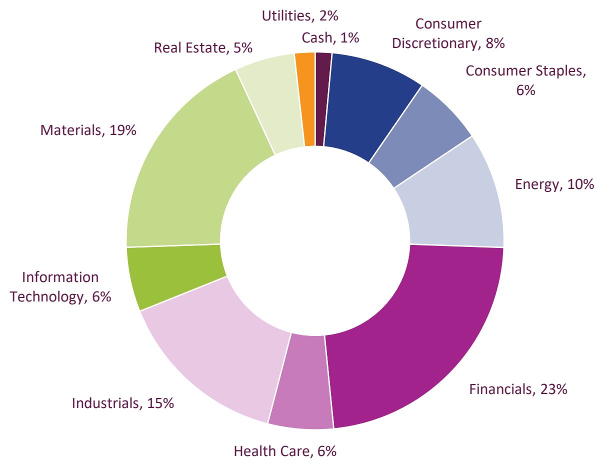
TOP 10 POSITIONS (BY WEIGHT)

Company	Sector
Commonwealth Bank of Australia	Financials
BHP Billiton Ltd	Materials
Wesfarmers Ltd	Consumer Staples
CSL Ltd	Health Care
Macquarie Group Ltd	Financials
Suncorp Group Ltd	Financials
Reece Ltd	Industrials
Qantas Airways Ltd	Industrials
Aristocrat Leisure Ltd	Consumer Discretionary
Origin Energy Ltd	Energy

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.

MARKET COMMENTARY

Australian stocks in June rose for the fourth month in five, to outperform falling global stocks, after a report showed the economy was growing strongly, higher oil prices boosted energy stocks, a lower currency helped exporters, and the country enjoyed a haven status in looming trade wars as none of its goods were threatened. During the month, 10 of the 11 sectors rose. Energy (+7.8%) and information technology (+6.3%) rose most while telecoms (-5.8%) was the sector that fell. The S&P/ASX 200 Accumulation Index rose 3.3%.

A 2.2% drop in the Australian dollar against the US dollar helped exporters while energy stocks gained after the US benchmark price for oil surged 11% to US$74.15 a barrel. Other stocks benefited from the fact that Australia is removed from the US clashes with China and the EU over tariffs.

In economic news, a report showed that Australia's economy expanded a higher-than-expected 1% over the March quarter, to produce a reading of 3.1% for the 12 months to March, due to rising consumer spending and higher exports. In other buoyant news, the jobless rate fell to 5.4% in May, its lowest in six months, and retail sales rose 0.4% in April. The Reserve Bank's policy-setting board kept the cash rate at the 1.5% on which it has sat since August 2016.

Global stocks in June fell for the first time in three months as European and Chinese threats to retaliate against US tariffs heightened the prospect of a global trade war, Germany's coalition government threatened to collapse, and higher US interest rates and a rising US dollar hampered emerging markets. The decline was slight, however, as economic reports pointed to the US economy expanding over the second quarter

FUND COMMENTARY

The Airlie Australian Share Fund rose 4.1% in its inaugural month. Among the stocks that performed well, Caltex gained 10% after the company raised profit guidance for the first half of fiscal 2018. Wesfarmers rose 8% on asset sales and on announcing it would spin off its Coles supermarket chain. Macquarie Group rose 8% as investors appreciated its diversified global business model. Suncorp added 8% after the company was re-rated as investors sought out the stable financial earnings provided by the company's general insurance business versus the scandal-plagued major banks and financial firms that are the focus of the Royal Commission into financial services.

Poor performers over the month included retirement village developer and operator Aveo, which declined 5% on concerns the company would miss year end unit sales targets. Furniture retailer Nick Scali edged down 1% due to the liquidity crisis facing competitor Steinhoff (which owns Freedom Furniture and Fantastic Furniture). This may turn into an opportunity for Nick Scali as the company is well placed to acquire any asset sold by Steinhoff in Australia.

KEY STOCK IN FOCUS - REECE

Reece supplies bathroom and plumbing products through more than 300 branches supported by a national distribution centre in Melbourne with additional state-based hubs. In the past quarter, Reece made its largest-ever acquisition when it purchased US plumbing products wholesaler MORSCO.

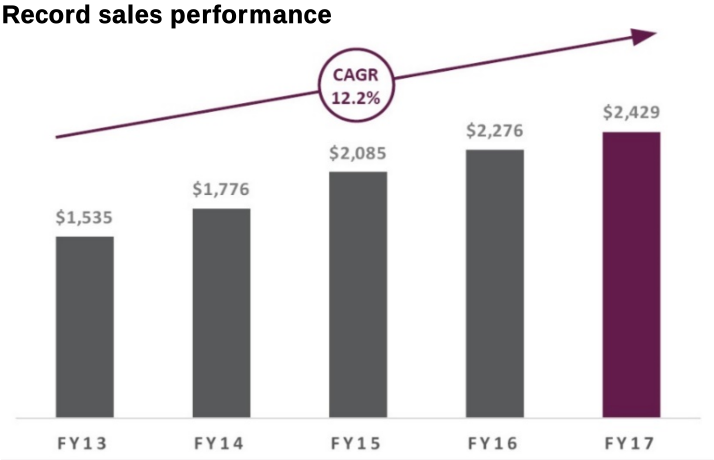
Reece runs well through our investment process. Management has a strong track record. The business is No. 1 in its industry by a long way. Reece enjoys world-leading profits margins due to the 'network effect and its strong cash flows will enable the company to reduce the debt it has taken on to pay for MORSCO. Reece is trading at valuations that are reasonable for such a quality business with bright growth prospects.

Reece under the Airlie filters

Management	Very positive	Strong track record
Business quality	Very positive	No.1 in the market by a long way. World-leading margins driven by a strong network effect.
Financial strength	Neutral	Post-acquisition of MORSCO the balance sheet has gone from zero debt to 2.9x EBITDA but seven-year debt will reduce quickly due to strong cash flows.
Valuation	Positive	FY20 PE 20x, EV/EBIT 15x. Prima facie not cheap but very reasonable for the quality and medium-term growth platform provided by MORSCO.

Reece has been a strong consistent performer driven by rollout of stores and strong underlying demand. The charts below show that over the past five years sales and profits have compounded at 12% p.a. and 17% p.a. respectively.

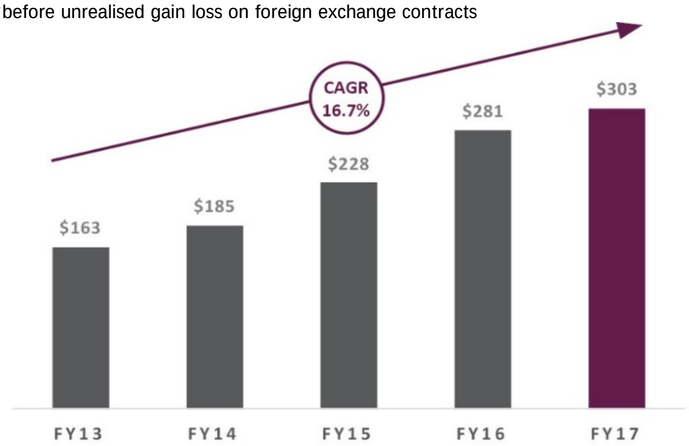
Record sales performance



Source: Reece Annual Report 2018

Increased NPBT*

*before unrealised gain loss on foreign exchange contracts



Source: Reece Annual Report 2018

While maintaining these impressive growth figures, the company has invested in:

- **Technology capability**: Apps to make ordering, invoicing, etc. for plumbers as easy as possible. Result? Plumbing customers will become more reliant on the Reece 'network'.
- **Warehousing and logistics:** Expansion and automation of distribution centres and store delivery logistics. Result? Reece will be made as 'Amazon proof' as possible.
- **Staff development**: Heavy investment in training and graduate development. Result? A strong culture based around an enforced set of company values.
- **Acquisitions**: Historically Reece has made relatively small acquisitions in adjacent air conditioning (Actrol) and civil water markets (Viadux). The MORSCO acquisition is a game changer as it gives the company a new 10-year runway of potential growth. Result? Additional growth in sales and earnings are likely.

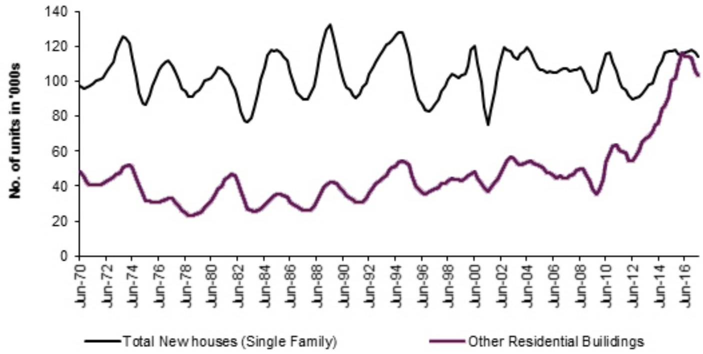
Other positive attributes include:

- Return on assets and return on equity are consistently greater than 15% despite the sustained investment listed above.
- Ownership of physical properties worth about $400 million. The company leases many stores which leads to a rental obligation, however, the fixed charge cover is strong at more than 10 times.
- Stock price valuation that is in-line with the industrial company (ex-financials) averages: FY20 PE 20x, EV/EBIT 15x.
- An experienced passionate management team led by the family founders who have significant ownership at stake.
- A board renewal that has seen three highly credentialed directors appointed in the past 24 months.

What are the risks?

- Reece is exposed to the residential building cycle, which we estimate accounts for about 30% of sales. A severe slowdown in residential building would hit profits. However, Reece profits have fallen (year on year) only twice in the past 15 years, and one of those was 2009. The other 70% or so of sales are tied to maintenance (general plumbing call-outs) and residential remodelling/alterations, which historically are more resilient.
- The chart below shows new home starts that pinpoints multi-family buildings (units) as the growth driver in this cycle. Unit developments are not overly represented in Reece's sales.

Annualised single-family and multi-family starts (only new buildings)



Source: ABS Data

Another major risk (and opportunity) is the performance of the recently acquired MORSCO. Key points of the MORSCO acquisition include that:

- The purchase price of $A1.9 billion from Advent Private Equity. MORSCO is a plumbing, water and HVAC wholesaler with 170 branches in 16 (predominantly Sunbelt) US states. Nearly half the branches are in Texas.
- The price was 14.4x EBITDA. MORCO's margins of 6% are below Reece's at 14%
- The plan is to run autonomously (no synergies forecast) but over time introduce Reece best practices and technology while pursuing organic market growth plus further acquisitions.
- The Wilson family (management and major shareholder) subscribed for $300m of the capital raising.
- Business conditions are strong in both markets.

This large-scale acquisition sets up an exciting growth path for Reece (the US industry is fragmented, and best practices are behind Australia) but this will take time due to the price paid and management's conservative manner. Meanwhile, Reece's growth continues in Australia with FY18 expectations of sales and profit growth of 9% and 6% respectively.