Airlie Australian Share Fund

A concentrated, active portfolio of Australian equities.
Accessing the Airlie investment team and Magellan fund capacity.

Airlie Funds Management

Fund Update: 30 September 2019 | 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 $19.9 million
Distribution Frequency	Bi-annual
Buy/Sell Spread	0.14%/0.14%
Management 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

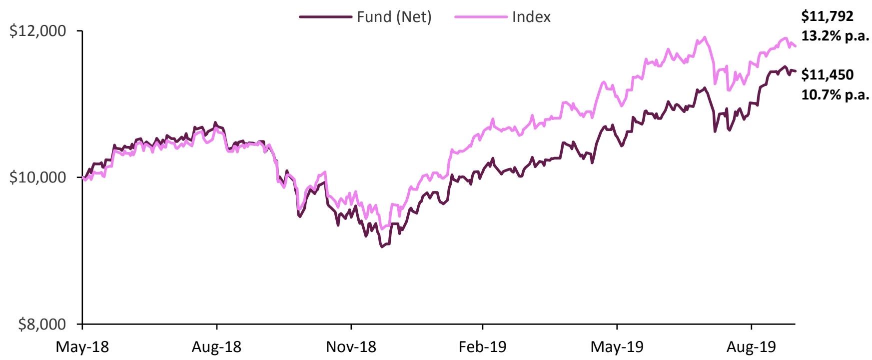
PERFORMANCE*

	Fund (%)	Index (%)	Excess (%)
1 Month	3.9	1.8	2.1
3 Months	6.0	2.4	3.6
6 Months	13.0	10.5	2.5
1 Year	9.2	12.5	-3.3
Since Inception (% p.a.)	10.7	13.2	-2.5

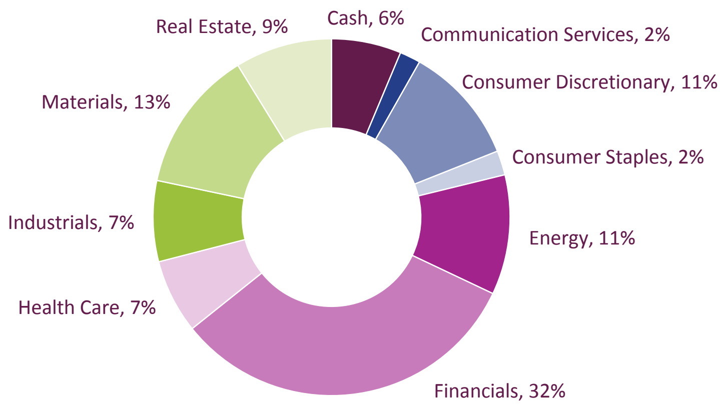
TOP 10 POSITIONS (BY WEIGHT)

Company	Sector#
Westpac Bank	Financials
Commonwealth Bank of Australia	Financials
BHP Billiton Ltd	Materials
CSL Ltd	Health Care
Suncorp Group Ltd	Financials
Origin Energy Ltd	Energy
Macquarie Group Ltd	Financials
Aristocrat Leisure Ltd	Consumer Discretionary
Caltex Australia Ltd	Energy
Centuria Industrial REIT	Real Estate

PERFORMANCE CHART GROWTH OF AUD $10,000*



PORTFOLIO PSITIONING**



* 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.

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MARKET COMMENTARY

The total return of the Australian share market over the quarter was 2.4%, marking the third straight quarter of positive increases. Since the large sell-off in the December 2018 quarter (-8.3%) over worries about the end of quantitative easing in the US and increases in global interest rates (remember that?), the Australian share market has returned 22.6% on a total-return basis. Even over the past 12 months, the return is still a respectable 12.5%, despite worries over federal and state elections, housing weakness, supply of credit, trade wars, oil spikes and energy pricing, to name just some concerns.

The best-returning sector over the past quarter was consumer staples. Investors were attracted to the stability of the sector but also the boost afforded to consumers from the Reserve Bank of Australia's rate reductions and impending tax cuts. Consumer-discretionary stocks also performed strongly, contrary to many predictions for these retailers. The consumer is proving reasonably resilient and low expectations for most retail stocks proved too pessimistic during the overall soft reporting season for the period ended June 30.

The worst-performing sector was materials (-3.7%) as iron ore fell from recent highs and worries mounted as to the effect the trade stoush between the US and China might have on global growth and, hence, commodity prices. The materials return would have been worse except for the strong performance from the gold miners that continued their good run from the June quarter. Gold has regained favour as a preferred store of value as interest rates decline globally. Yields on Australian 10-year government bonds, for instance, fell from 1.32% to 1% over the three months.

The technology sector had a strong quarter (+4.6%). However, the failure of the WeWork IPO and the marshalling of global regulatory forces against Big Tech gave domestic investors pause in the latter part of the quarter.

FUND COMMENTARY

The fund outperformed over the period. The best-performing stocks in the fund over the quarter included Smartgroup Corp, James Hardie Industries and Premier Investments. Smartgroup soared 46% thanks to the resilient sell-through of novated car leasing product. James Hardie surged 32% due to the return of primary demand growth in the US and lower input costs. Premier rallied 28% on strong retail sales in Peter Alexander and Smiggle in Asia.

The worst performers were BHP Billiton and Mineral Resources. Both miners fell 11% due to the weakness in iron ore.

Key Stock in Focus – Aristocrat Leisure & James Hardie Industries

Post reporting season, our analysts travelled overseas to see locally listed companies that have significant offshore operations. Here are some observations from visiting two of our portfolio positions.

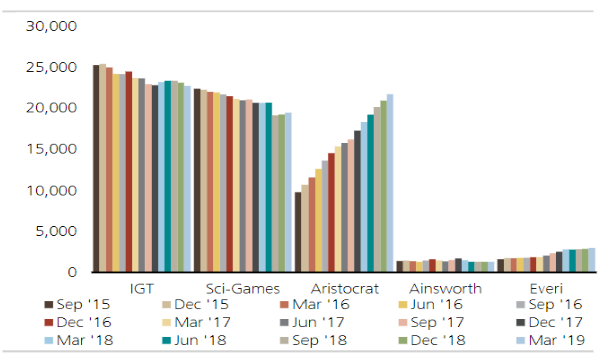
Aristocrat Leisure

Aristocrat Leisure (ALL.ASX) is one of the leading slot machine manufacturers in the world. We met with the company's senior managers at their offices in Las Vegas and spent two hours discussing the business. We also conducted several meetings with customers and competitors. We came away thinking that the land-based business, which sells slot machines to casinos, remains a powerhouse. This is despite a flat market, as casinos in the US aren't expanding their floor space nor capex budgets.

Aristocrat is taking share due to ongoing demand for its high-performing games, which often generate more than two times the floor average for net machine revenue per day. Put simply, casinos make more money on Aristocrat products. This was reflected in a comment from a significant slot machine buyer at a major casino. When asked: "If you had an empty gaming floor today, how would you fill it?", he replied: "I would start with Aristocrat product, get that in, then think about the rest."

The Airlie Australian Share Fund seeks to own high-quality businesses at attractive valuations. We consider Aristocrat's design and development team to be the best in the business, and a core competitive advantage. As per the chart below, Aristocrat has been gaining share for several years at the expense of competitors IGT and SciGames. Design teams usually earn a variable take of a game's success.
As Aristocrat gains share and now has a bigger share of floor

Figure 4: North America: Premium Gaming Ops installed base over time



Source: Company Filings, UBSe

than most of its competitors, its designers are paid more for a successful game, making them difficult to poach. As such, we expect Aristocrat to continue to take share on the back of its successful product.

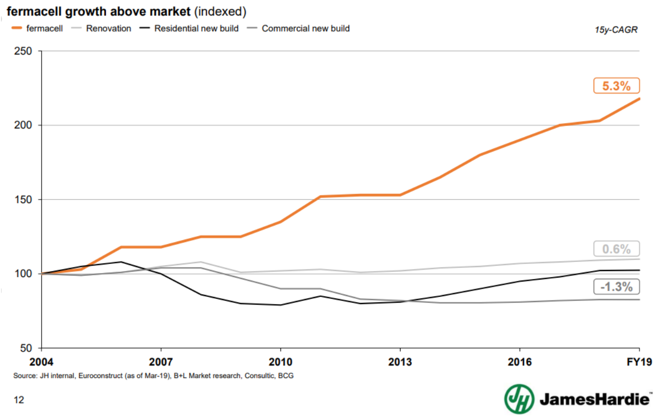
James Hardie Industries

We attended a tour of James Hardie Industries' (JHX.ASX) US and European operations. James Hardie acquired the European building products business Fermacell two years ago. This was our first opportunity to visit Fermacell's manufacturing facilities and meet the Fermacell team.

James Hardie has a fantastic position in North America, which accounts for more than 70% of group profit. However, it has always struggled to generate a profit in Europe. Each country in Europe is completely different from a housing style, language, building regulation, and customs perspective. The European business generates revenue of A$368 million with 1,000 employees, i.e. an average revenue per employee of $368,000 versus the North American business that employs 2,700 people and generates A$1.67 billion, for an average revenue per employee of A$620,000. Put simply, you need a lot more people on the ground in each country in Europe talking to local builders and architects to generate a sale.

James Hardie acquired the Fermacell business to address its consistently poor performance in Europe. While James Hardie primarily sells exterior siding products in the US, Fermacell offers mostly interior product, fibre gypsum. This is like James Hardie's existing range in that it is a highly technical product with superior durability, fireproofing and soundproofing capabilities. Where James Hardie's exterior products are taking market share from inferior siding products like vinyl, Fermacell's fibre gypsum is taking share from traditional plasterboard. The rationale for the purchase of Fermacell was that the two businesses speak to the exact same customer base, which is primarily architects and builders. The aim of discussions is to get the product 'specced' (specified) in building plans, creating pull-through demand when construction commences.

As per below, Fermacell has grown at a decent clip above market for the past 15 years. As such, it has developed 15 years of relationships with key customers, with an aim to now also sell James Hardie exterior products.



While we think this rationale makes sense and is "worth a shot", we do think European success is far from guaranteed and will be long dated, given it is a conservative, fragmented market and the pace of change is slow.

That said, after touring the manufacturing sites and meeting with customers and retailers, we were impressed with the Fermacell team's commitment to cross-selling James Hardie products. We were particularly impressed to visit its fibre gypsum plant, which was fully automated! We did not see one person involved in the production of a piece of fibre gypsum, from the start of the process up until packaging for the end client. In our view, James Hardie paid a fair price for the quality of the business, with a 'free' option for success in building the existing James Hardie brand into Europe.

We also met with the US team, including Sean Gadd, head of the US business. We came away feeling confident that primary demand growth is gaining traction, at the same time as input cost relief washes through. Overall, our meetings in the US and Europe reaffirmed our conviction in the quality of this holding in our portfolio.