Airlie Small Companies Fund

A concentrated, active portfolio of Australian listed small companies.

Airlie Funds Management

Fund Update: 30 September 2023 ARSN: 665 882 673

FUND FEATURES

- Leverages the experienced, proven Airlie investment team to provide a focused exposure to Australian small companies.
- A conservative and robust investment process that focuses the team's energies on their 'best ideas'.
- Strong team alignment through co-investment in the fund.

FUND FACTS

Investment Objective
The Fund's primary investment objective is to provide long-term capital growth and income through investment in Australian listed small companies.

Investment Strategy
- Active, long-only Australian small companies fund with a focus on bottom-up, fundamental research.
- High-conviction, concentrated portfolio of 20-40 quality Australian listed small companies which when first acquired do not rank in the S&P/ASX 100.
- Typical cash and cash equivalents exposure between 0% - 10%.

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 relevant Product Disclosure Statement. You can view the PDS for the Fund on Airlie's website: www.airliefundsmanagement.com.au

Inception Date	4 April 2023
Benchmark	S&P/ASX Small Ordinaries Accum. Index
Portfolio Size	AUD $3.1 million
Distribution Frequency	Semi-annually
Management Fee[1]	0.98% p.a.
APIR	MGE1188AU
Performance Fee	Performance fees are 20% of the excess return of the units of the Fund above the S&P/ASX Small Ordinaries Accumulation Index over each Calculation Period[2].
Minimum Initial Investment	AUD$10,000
Buy/Sell Spread	0.25%/0.25%

[1] Transaction costs may also apply – refer to the Product Disclosure Statement. All fees are inclusive of the net effect of GST.
[2] As defined in the Fund's PDS.

PORTFOLIO MANAGER

Will Granger
Will Granger joined Airlie in 2020 as an Equities Analyst. Will is now the Portfolio Manager for the Airlie Small Companies Fund which launched in March 2023. Prior to Airlie, Will worked as an analyst at KIS Capital Partners (February 2016 to June 2019). KIS Capital Partners was a market neutral hedge fund with about $270 million of funds under management.

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

PERFORMANCE*

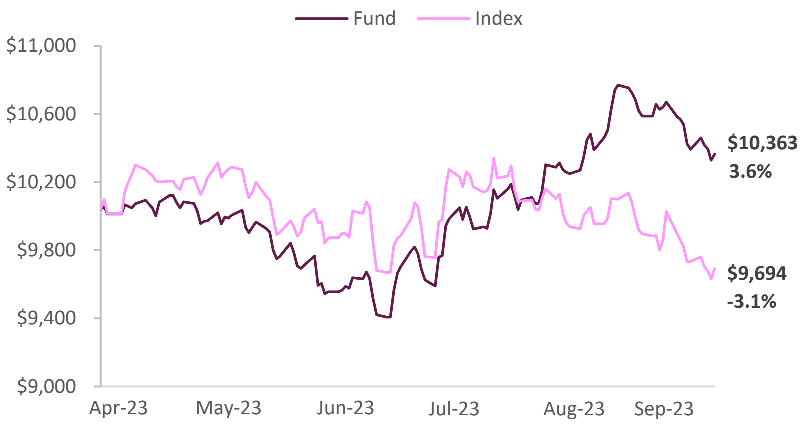
	Fund (%)	Benchmark (%)	Excess (%)
1 Month	-3.5	-4.0	0.5
3 Months	6.8	-1.9	8.7
Since Inception	3.6	-3.1	6.7

Past performance is not a reliable indicator of future performance.

TOP 5 POSITIONS (BY WEIGHT)

Company	Sector**
News Corp	Communication Services
Joyce Corp Ltd	Consumer Discretionary
Premier Investments Ltd	Consumer Discretionary
Data#3 Ltd	Information Technology
Mader Group Ltd	Industrials

PERFORMANCE CHART GROWTH OF AUD $10,000*



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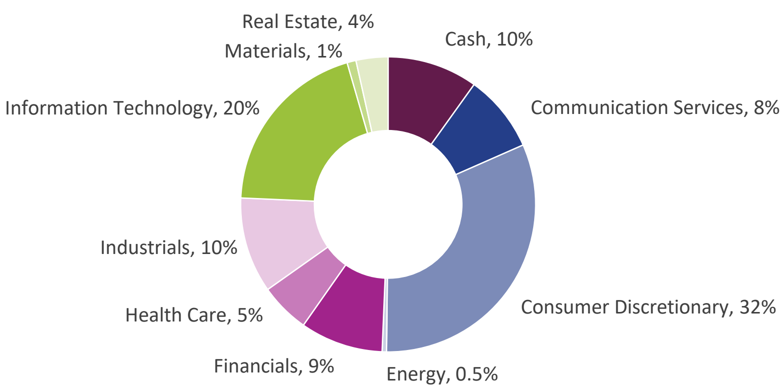
PORTFOLIO POSITIONING**



* 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.

FUND COMMENTARY

For the September quarter, the Fund returned 6.8% compared to the Small Ordinaries Accumulation Index return of -1.9%, reflecting outperformance over the period of 8.7%.

The top three contributors to performance during the quarter were Joyce Corporation (+1.6%), Nick Scali (+1.5%) and Premier Investments (+1.4%). The top three detractors from performance were Tabcorp (-0.9%), IRESS (-0.7%) and Objective Corp (-0.4%).

This quarter marked the Fund's first reporting season. Results were generally strong across the board, but particularly in our retail holdings. Our largest retailers – Premier Investments, Joyce Corporation and Nick Scali – all posted record profits and dividends on the back of resilient consumer spending. The standout result here was Joyce Corporation, where operating profit increased 32% in its key segment, KWB Group. These retailers are not out of the woods yet – the macroeconomic environment remains uncertain and a slowdown in consumer spending seems an inevitable consequence of reducing inflation. While the current level of profitability for these retailers may prove unsustainable, we believe this is factored into current share prices. Furthermore, the dividends received during this period of elevated earnings serve to reduce our effective cost price. We remain optimistic about our retail holdings over the medium term, each of which are dominant players within their respective niches, with fortress-like balance sheets, stewarded by world-class owner-managers.

Another highlight from reporting season was Mader Group, a mining services company that provides maintenance work on heavy-duty vehicles. Mader reported revenue and net profit growth of 51% and 48% respectively, including a watershed performance in the company's North American division, which generated >100% growth in both revenue and net profit. The company has guided to a further 30% growth in revenue and net profit for FY24. Mader ticks a lot of our quality boxes – the company is founder-led, has a long history of generating strong returns, and operates in a far less cyclical part of the mining services sector than its peers. We believe the market continues to undervalue these qualities.

News Corp also produced a strong result against the backdrop of a tough advertising market and continued disruption in the book publishing space. We continue to see enormous value in our News Corp holding, particularly in the Dow Jones segment, which we explore in further detail in the stock story below.

On the other side of the ledger, IRESS produced a very weak result, with net profit declining 31% on sluggish revenue growth. The company also reduced full-year profit guidance by ~20%. IRESS was only a small position in the Fund, sitting outside of our top 15 holdings, but its sharp share price decline has hurt performance nonetheless.

Our investment thesis for IRESS is predicated on the divestment of underperforming assets and associated value realisation. Unfortunately, operations in the core business have started to deteriorate and the level of shared costs across divisions appears difficult to unwind and obfuscates our assessment of value. As such, we have not yet added meaningfully to the position despite the steep decline in share price.

STOCK STORY - NEWSCORP
(Will Granger – Portfolio Manager)

News Corp

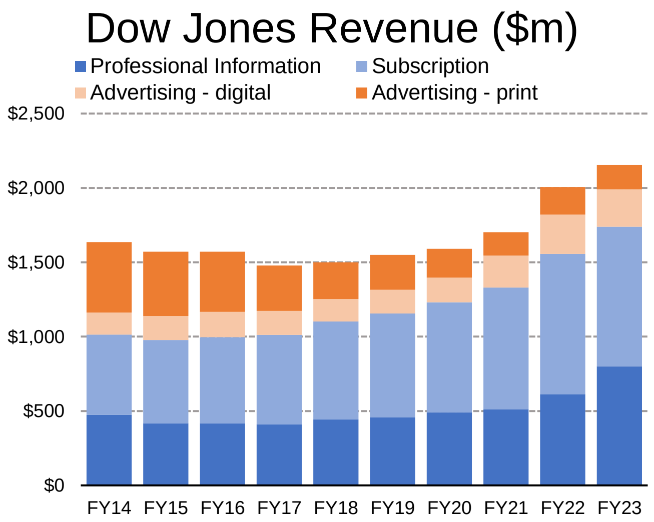
As discussed in our previous quarterly, there are two key pillars of the Fund's investment philosophy: we want to own quality businesses and we only want to invest in those businesses at a price well below our estimate of intrinsic value. The first part of that equation is not particularly difficult; there are many great businesses listed on the ASX. However, these businesses usually attract eye-watering prices. The difficulty comes in finding situations in which the quality of the business is not reflected in the price. We believe News Corp (NWS-ASX), currently our largest holding in the Fund, reflects such a situation. For those unfamiliar, News Corp is a media conglomerate that owns a vast collection of some of the world's most recognisable brands including The Wall Street Journal, Barron's, The New York Post, HarperCollins, realestate.com, realtor.com, and Foxtel. When most investors think of News Corp, 'quality' probably isn't the first adjective that springs to mind. Indeed, returns for News Corp shareholders have been far from stellar, with the company slightly underperforming the S&P/ASX 300 index over the past decade. However, this past performance belies the enormous transformation that has occurred within the company that has significantly improved its quality and which we think the market has overlooked.

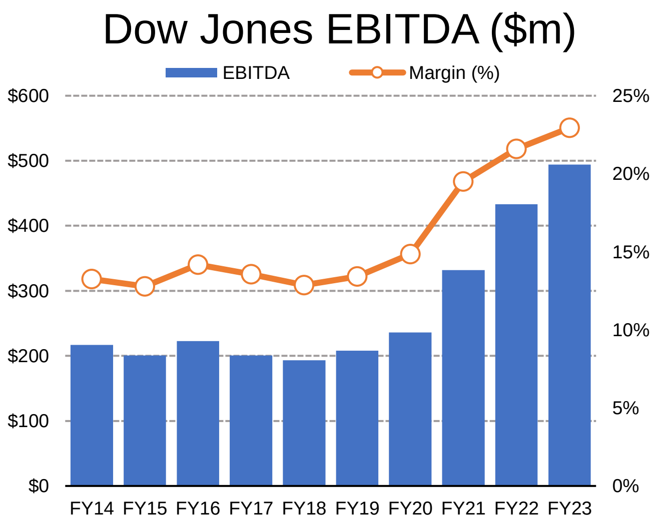
This transformation is most apparent in the company's largest segment, Dow Jones. Dow Jones operates two divisions: a newspaper publishing division and a professional information business. The flagship asset in the newspaper division is The Wall Street Journal, which over its 134-year history has established itself as the world's leading financial newspaper, boasting a subscriber base 3x that of its nearest competitor. The newspaper industry has faced significant disruption over the past two decades as the advertising market shifted towards online competitors. The Dow Jones mastheads were no exception, with print advertising revenue declining by 65% over the past decade. These declines masked strong growth in subscription revenue, which increased 74% over that same period. The good news for Dow Jones is that this headwind has largely abated – print advertising accounts for just 12% of revenue today compared to 40% a decade ago – and the strong subscription growth is set to continue – management have estimated the total addressable market for The Wall Street Journal subscribers at 3x the current base. This is now a significantly higher-quality revenue stream from which the publishing business can continue to grow.

At the same time, the Dow Jones professional information division has continued to scale, both organically and through acquisition. The 'jewel in the crown' here is the Risk & Compliance business, which sells access to a proprietary database used primarily by banks to fulfil 'know your customer' requirements.

Leveraging its hard-to-replicate dataset, Risk & Compliance has grown revenues at a 20% compound annual growth rate over the past five years and now accounts for 34% of the division's revenues. This division also includes the recently acquired Oil Price Information Service (OPIS), a global industry standard for benchmark pricing across a variety of energy commodities. OPIS was founded in 1977, generates 50% operating profit margins, and was opportunistically acquired as part of a forced divestment during the S&P/IHS merger.

Pulling all of this together, you have a Dow Jones segment that has materially improved in quality across both its divisions, the fruits of which are only now starting to show up in the financials: segment revenue has returned to rapid growth and segment profits have doubled over the past three years. Adjusted for the amortisation of acquired intangibles, Dow Jones now generates ~$400m in pre-tax operating profit on only ~$1bn of average tangible assets, reflecting an attractive pre-tax return on tangible assets of 40%.





Source: Airlie Funds Management estimates, company filings

Dow Jones enjoys many of the quality features we look for in our businesses – strong pricing power, brand strength, scale advantages, a capital-light model, and a long runway for future growth. And yet, despite these quality attributes, the current valuation is undemanding. If we take the market value of News Corp's 61% stake in REA Group (REA-ASX) and apply a 10x multiple to corporate costs, the implied valuation for Dow Jones is $6bn. For comparison, The New York Times (NYT-US) has an enterprise value of $6.5bn and generates ~30% less operating profit on lower margins. Furthermore, this assumes the remaining stable of News Corp assets is worthless. This includes HarperCollins, the world's second largest consumer books publisher – a durable business that routinely generates operating profits north of $200m. It includes an 80% stake in realtor.com, the second largest real estate portal in the U.S., which News Corp were reportedly in talks to sell for >$3bn. It includes a 65% stake in Foxtel, which generated ~A$250m of free cash flow in FY22 according to account filings with ASIC. And finally, it includes a range of other News Media assets, including The New York Post, The Australian, The Sun and The Sunday Times, which contributed ~$75m of operating profit this year. There is significant value in these remaining assets, and just by valuing Dow Jones at a steep discount to its closest peer, you can effectively get these assets for free!

News Corp's valuation is also attractive if viewed on a consolidated basis. We estimate News Corp's earnings power, adjusted for non-controlling interests and the amortisation of acquired intangibles, sits at ~$800m in operating profit before interest and tax. At present, the company's enterprise value is ~$12.2bn, implying a 15x multiple, in line with the S&P/ASX 300 multiple ex-resources and financials. Breaking down these earnings, ~25% come from REA Group, ~50% from Dow Jones, and ~25% from HarperCollins – this is a better-than-market earnings stream trading at just a market price. It is also important to note that this valuation approach significantly understates News Corp's value, as it implies a negative valuation for loss-making assets like realtor.com.

There are many great businesses available on the ASX, but very few are available at prices that do not reflect their quality. We believe News Corp offers investors the rare opportunity to purchase a collection of durable, high-quality assets at a significant discount to fair value. While the acquisition track record does have the occasional blemish, in our view management are above-average capital allocators. Perhaps more importantly, they have not diluted shareholders' ownership of the existing quality assets by issuing new shares. In fact, shares on issue have declined, meaning News Corp investors own more of these quality assets today than they did a decade ago.

**All figures are in USD unless stated otherwise*