Airlie Small Companies Fund

A concentrated, active portfolio of Australian listed small companies.

Fund Update: 31 December 2024 **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 $25.4 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$25,000
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*

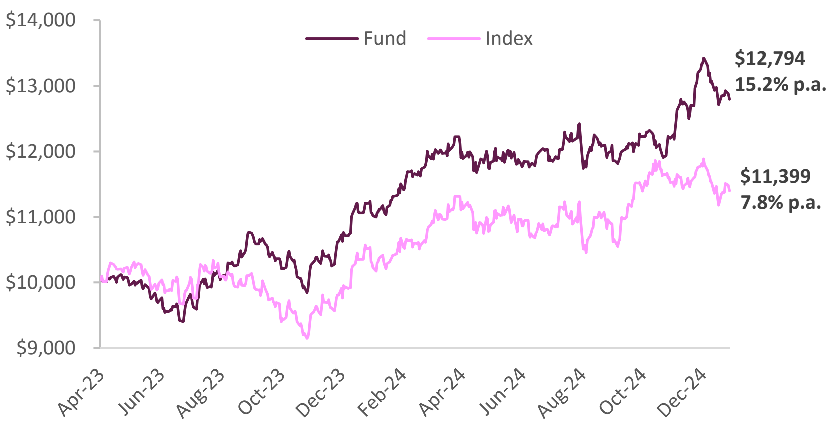
	Fund (%)	Benchmark (%)	Excess (%)
1 Month	-3.0	-3.1	0.1
3 Months	5.8	-1.0	6.8
6 Months	6.4	5.5	0.9
1 Year	14.2	8.4	5.8
Since Inception (p.a.)	15.2	7.8	7.4

Past performance is not a reliable indicator of future performance.

TOP 5 POSITIONS (BY WEIGHT)

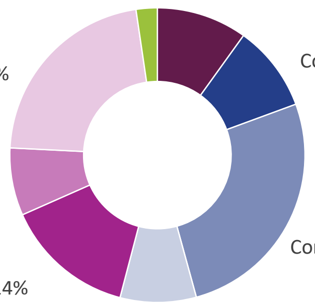
Company	Sector**
Gentrack Group Ltd	Information Technology
News Corp	Communication Services
Nick Scali Ltd	Consumer Discretionary
EBOS Group Ltd	Health Care
Premier Investments Ltd	Consumer Discretionary

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.

FUND COMMENTARY

For the December 2024 quarter, the Fund returned +5.8% compared to the Small Ords Accumulation Index return of -1.0%, reflecting outperformance over the period of +6.8%.

The top three contributors to performance during the quarter were Sigma Healthcare (+2.8%), News Corp (+1.9%), and Mader Group (+1.5%). The top three detractors from performance were Smartpay (-2.9%), Nick Scali (-0.7%), and Data #3 (-0.6%).

There were a few notable updates for our portfolio holdings during the quarter. Foremost among them was the ACCC's approval of Sigma's merger with Chemist Warehouse. As expected, the share price reacted very favourably to the announcement, rising 82% during the quarter. The final hurdle for the merger is the shareholder vote, which we regard as largely a formality at this stage. As part of this process, the companies have released a detailed scheme booklet and other merger-related material, which we have meticulously scrutinised over the past few weeks to deepen our understanding of the business. While the combined group is now trading on a very elevated earnings multiple, we believe Chemist Warehouse is one of the rare businesses that merits such a premium. For a more extensive overview of the Sigma/Chemist Warehouse thesis, please see our stock story in the September quarterly update.

News Corp announced the sale of its 65% stake in Foxtel to global sports streaming platform DAZN Group. In consideration, News Corp will receive a 6% interest in DAZN and full repayment of its shareholder loans, totalling A$578 million. There is limited public information available on DAZN – reportedly, the platform has 20 million subscribers across 200 markets – so it is difficult to assess what this 6% stake is worth to News Corp shareholders. Regardless, we like the deal for a few reasons. For one, DAZN is better placed to maximise the value of the Foxtel asset by leveraging its global scale in sports rights and technology development. Furthermore, the structure of the deal allows News Corp shareholders to participate in any potential value creation while simultaneously cleaning up News Corp's accounts and allowing management to focus on its core business units.

Gentrack released a strong FY24 result, highlighted by 26% revenue growth (50% on an underlying basis, excluding prior-year insolvency revenue), robust underlying profit margin expansion, and significant free cash flow generation. The margin expansion is particularly important, as it provides further evidence that management can restore profit margins to historical levels. We explore the Gentrack thesis in greater detail in the stock story below.

On the other side of the ledger, Smartpay's share price declined 44% during the quarter following the Government's proposal of a ban on debit card surcharging, subject to consultation undertaken by the RBA. While a ban on debit surcharging would hinder Smartpay's growth prospects in Australia and create further price competition, our thesis for the stock is largely predicated on the company's New Zealand opportunity, which is not reliant on a surcharging model. On this front, two noteworthy developments over the past few months have reinforced our conviction. Firstly, the Board released details of the executive team's long-term incentive (LTI) plan, including the profit hurdles required for vesting. These targets exceeded our expectations, with the FY27 EBITDA hurdle set at NZ$60 million, reflecting a greater than 250% increase on FY24 EBITDA of NZ$22m. Secondly, Smartpay purchased the assets of Technologies Holdings Limited out of administration for NZ$4 million. These assets primarily relate to a 5,000-strong terminal rental book in New Zealand, increasing Smartpay's New Zealand terminal base by 17%. We view this acquisition as highly compelling as Smartpay is uniquely positioned to extract value from the terminal base by converting that base across to an acquiring model. In our view, the New Zealand business alone is worth well in excess of Smartpay's current market capitalisation.

STOCK STORY – GENTRACK

gentrack™

The Fund's investment philosophy centres on fundamental research, analysing individual businesses to identify mispricings and devoting little attention to broader investment thematics. As it happens, however, one of our largest holdings is positioned at the coal face of one of the largest global investment thematics: the energy transition. The company in question is Gentrack, a global provider of enterprise software to utilities and airports. Gentrack has been held in the Fund since inception and has been the strongest contributor to performance. In the following, we outline the rationale for our investment.

For simplicity, we will focus on the utilities side of the business, which accounts for most of the company's value. For its utility customers, Gentrack's software handles everything from customer information and billing to data and energy management. We like businesses that sell this type of 'mission-critical' enterprise software, as customer churn is typically very low due to how costly and disruptive it can be to switch providers. Upgrading this software is a massive project for the utility, costing anywhere between $50 million and $250 million and taking 12 to 24 months to implement. It's the kind of project a utility undertakes once every 10 years, which benefits the software providers because it effectively locks in customers for a decade. This creates predictable, annuity-style revenue streams and a business that is uncharacteristically durable for the software industry. Gentrack itself exemplifies this durability, having been in operation for more than 35 years.

The industry's high barriers to entry naturally favour an oligopoly structure, with SAP and Oracle the two incumbents competing against a small selection of specialist providers including, among others, Gentrack, Kraken and Kaluza. The opportunity for these specialist providers lies in the fact that the energy transition is vastly increasing the complexity of the energy grid. Historically, energy grids were largely characterised by centralised power generation and one-way distribution. However, the grid is becoming increasingly decentralised, with assets like solar panels, EVs and batteries enabling consumers to generate, store, and buy and sell energy off the grid. This vast increase in the complexity of the grid means that the software many of these utilities are operating on – some of which is 20 to 25 years old – is no longer fit for purpose and needs to be upgraded. Some energy grids are further along in this transition than others, particularly in Gentrack's core markets of Australia, New Zealand and the UK. In these markets, SAP and Oracle have ceded significant market share to the specialist providers. If this trend serves as a proxy for other global markets, there is a substantial market share opportunity ahead of Gentrack.

Gentrack also boasts a strong management team, led by CEO Gary Miles who joined the business in 2020. While his tenure has been relatively short, Gary has an impressive track record in enterprise software, having run and sold two separate enterprise software businesses, one of which he co-founded. The latter of these two businesses he sold to Amdocs, a market leader in telco enterprise software, where he subsequently held senior executive roles before joining Gentrack. Gary has assembled an impressive team, including Gentrack's chief operating officer, who previously served as the general manager of global delivery at Amdocs, and Gentrack's chief technology officer, who formerly held the same position at Xero.

Quality software companies with long-term growth stories rarely trade at prices we would find attractive. Usually, we only get the chance to invest if the company has gone through some kind of temporary hiccup. In Gentrack's case, the company had been navigating some customer closures in the UK related to price caps imposed on energy retailers, which put many small retailers out of business. These closures, and the resultant loss of revenue, substantially reduced Gentrack's profit margins. We viewed these issues as mostly temporary, and purchased Gentrack on a view that margins could eventually return to historical levels, a possibility that in our opinion was not reflected in the 2x sales valuation.

Fast forward to today, and Gentrack has performed exceptionally well, rising 87% in 2024 following the release of strong financial results. The FY24 result was particularly encouraging, with the company seeing strong profit margin expansion on an underlying basis, giving us further confidence in our margin recovery thesis. While the company now trades on around 33x our estimate of FY25 EBITDA, profit margins remain depressed versus history. If we normalise profit margins back to historical levels of around 30%, that EBITDA multiple falls to just 19x, which we believe looks attractive relative to the market share opportunity ahead of the business as well as other software peers. While we do not expect margins to fully revert to historical levels in the near term, this underscores the potential operating leverage that lies ahead. Consequently, we continue to see compelling long-term value in Gentrack, and it remains a core holding in the Fund.