Airlie Australian Share Fund
(Managed Fund)

A concentrated, active portfolio of Australian equities.

Airlie Funds Management

Ticker: AASF

Fund Update: 30 September 2023 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 $416.1 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.

PERFORMANCE*

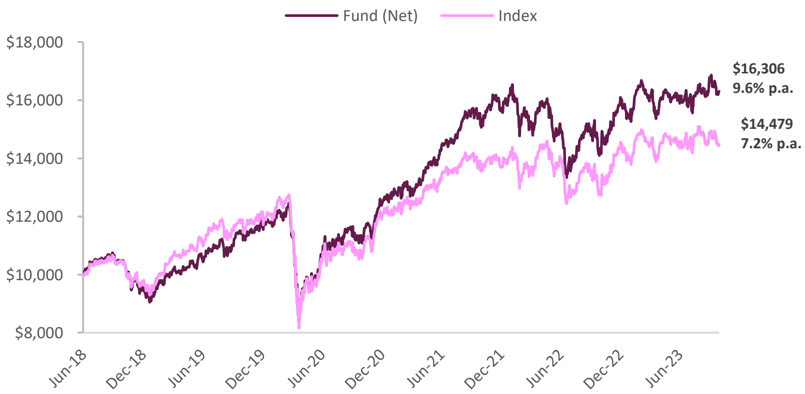
	Fund (%)	Benchmark (%)	Excess (%)
1 Month	-2.8	-2.8	0.0
3 Months	1.6	-0.8	2.4
6 Months	2.3	0.2	2.1
1 Year	15.1	13.5	1.6
3 Years (p.a.)	13.6	11.0	2.6
5 Years (p.a.)	9.2	6.7	2.5
Since Inception (p.a.)	9.6	7.2	2.4

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
Commonwealth Bank of Australia	Financials
ResMed Inc	Health Care
Mineral Resources Ltd	Materials
National Australia Bank Ltd	Financials
Wesfarmers Ltd	Consumer Discretionary
Seven Group Holdings Ltd	Industrials
Aristocrat Leisure Ltd	Consumer Discretionary
Ampol Ltd	Energy

PERFORMANCE CHART GROWTH OF AUD $10,000*



Past performance is not a reliable indicator of future performance.

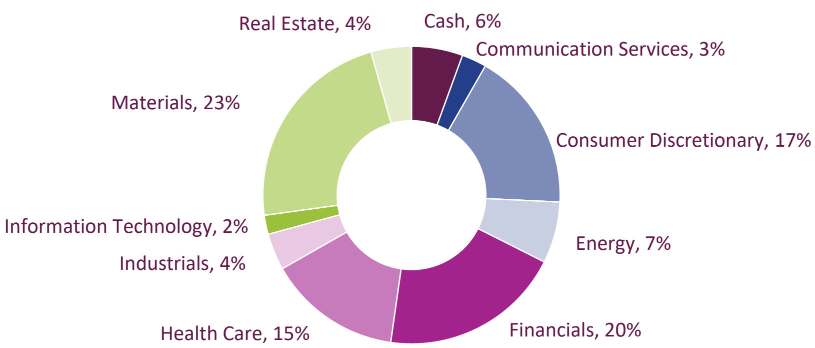
PORTFOLIO MANAGERS

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.

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

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

The Fund rose 1.6% for the quarter, which represented outperformance of 2.4% vs the S&P/ASX 200 benchmark return of -0.8%. While we wrote about the value we saw in discretionary retail names in our investor letter for the June quarter, we were surprised by the speed of the re-rate, with portfolio holdings Premier Investments (+22%), Nick Scali (+23%) and Wesfarmers (+7%) amongst our best-performing holdings in the quarter. We consider that the consumer discretionary sector remained remarkably resilient in the face of 12 consecutive interest rate hikes from the RBA. While for the last four halves, this resilience has been accompanied by commentary of "sure it's resilient now, but the slowdown is coming!", we remain of the view that the balance sheets and differentiated positioning of our portfolio holdings put them in a strong place to navigate the most anticipated downturn of all time when it arrives.

Other contributors include Seven Group (+23%), with a FY23 result highlighting the strength of WesTrac and Coates's market position and end-markets, as well as News Corp (+8%), where tight cost management offset some anticipated weakness in advertising and circulation. Pleasingly, the tilt of the Dow Jones business to more of a subscription-led and professional services focus is taking hold, and we expect this to continue as Rupert Murdoch officially steps down as Chairman.

On the other side of the equation, detractors to the portfolio include all REIT exposures, with Charter Hall Group (-11%), Waypoint REIT (-8%) and Region Group (-10%) underperforming as rates rose and occupancy softened, particularly in the Office sector. We continued to add to our Charter Hall Group (CHC) position as it underperformed the REIT sector. Our view is that CHC faces near-term headwinds to AUM growth due to rising interest rates, which are resulting in devaluations as well as reduced transaction activity as buyers and sellers wait for rates to peak to know where to transact. There is uncertainty on how long it could take for these factors to resolve. However, we consider CHC is fundamentally cheap at 12.6x FY24 EPS guidance (vs ~17x historical average); we believe FY24 represents trough earnings as it consists mostly of the recurring fee streams and has minimal transaction and performance fees. While there are valid concerns around the Office sector more broadly, we would note it only accounts for ~34% of CHC's overall FUM with the balance allocated to Industrial and Logistics (~28%), Retail (~16%), Listed Equities (~18%) and Social Infrastructure (~4%). CHC's Office Portfolio consists of high-quality tenants in good assets as reflected by the 96% occupancy and 89% retention rate on new leasing transactions in FY23.

We were also somewhat blindsided by packaging group Orora's decision to acquire international glass bottle producer Saverglass – a France-based manufacturer of premium glass bottles, primarily for the high-end spirits and wine industries.

While Orora (ORA) management had been upfront about ambitions to pursue M&A, we had anticipated such deals would be incremental, bolt-on and in existing jurisdictions. The transaction is "transformative" in that ORA management are raising ~$1.35b, equivalent to 45% of their market cap, to help finance the ~$2.2b acquisition. Saverglass is currently owned by the PE firm – Carlyle Group – as well as management and staff. At a high level, we think Saverglass looks like a decent business in that a) it is positioned at the specialty, high-margin end of glass bottle production, b) it has a long history of volume growth (6% CAGR over 15 years) and c) has exclusive relationships with premium spirit and wine producers underpinned by its capability in decoration, which the business considers its own IP. What's less clear is why exactly Orora should own this business given there appear to be no material cost synergies and the business is largely based in Europe, while Orora currently operates in Australia (glass, cans) and North America (packaging distribution). Orora's existing glass/cans business consists of a glass bottle production asset in South Australia (Gawler) and six aluminium can production assets around Australia and NZ. The attraction of these businesses is, for different reasons, both glass bottle and aluminium can production in Australia/NZ are duopolies, which affords each business relatively attractive returns (>20% ROIC combined). Expanding the glass business via acquisition into jurisdictions where the competitive advantage is not one of industry structure but of specialty production (over commodity production) changes the investment thesis for the ORA beverages business, which is our primary concern with the transaction. This concern is exacerbated by the size of the transaction and the nature of the seller (PE). Nevertheless, on balance and given the dilutionary impact of the heavily discounted issue we decided to support the transaction and took up our rights at $2.70.

Another detractor from performance was ResMed. We have not owned ResMed in the fund since inception, as it primarily failed on valuation grounds. However, we began establishing a position in June this year, which in hindsight was terrible timing, as a slight miss to gross margin expectations in the company's 4Q23 result saw the stock tumble 15% in early August.

Subsequently, in late August the fundamental thesis for ResMed was entirely derailed by the GLP-1 hype train that followed Novo Nordisk's successful trial read-out for Wegovy, a weight loss drug, in reducing cardiovascular events. We explore our view on ResMed in our stock story below, and believe the current share price is pricing in a ~25-30% reduction in ResMed's addressable market, which does not appear likely to occur in our view. Hence, we have added to our position and ResMed is now one of our largest holdings.

We also re-entered EBOS Group, as the stock fell to a valuation we believed encapsulated the risks regarding pharmacy dispensing changes and the loss of the Chemist Warehouse contract. The company's profit result was strong, showing continuing positive trends in pharmacy and healthcare distribution, and benefits from recent investment in their pet food operations.

AIRLIE ANALYST U.S. TRIP

Senior Airlie analyst Joe Wright spent two weeks in the US this month meeting with several ASX-listed companies, as well as relevant US peers, across the insurance, energy, building materials and steel sectors. A few key takeaways below:

QBE Insurance

QBE is a holding in the portfolio. We met with several of QBE's competitors in the North American market: Chubb, The Hartford, Arch Capital, and Travelers. QBE is in the process of turning around profitability in their North American division, which mostly means exiting underperforming lines of business (largely property CAT (catastrophe)) and returning their "middle market" franchise to profitability. We were looking to better understand the economics of competitors in the U.S. "middle market", and thus test our conviction that QBE's strategy here was well placed. Pleasingly, each of the companies we met with called out their middle market business as a "crown jewel", with attractive economics supported by a fragmented competitive landscape and a less sophisticated end customer (versus large-scale commercial insurance). Given these players already have established, scale middle market businesses, the next question is: Will QBE be able to build a quality middle market business? All the companies we met spoke highly of QBE's new CEO Andrew Horton, and the middle market franchise he built with his previous company, Beazley. They did however mention that scale in the middle market requires strong broker relationships and a quality technology offering and were less confident in QBE's position from this perspective. For us, this is now something we can directly address with QBE management, and should we not see results here, we would prefer to see the sale of this business.

More broadly, we consider that the environment remains incredibly positive for commercial insurers given the strength of premium growth (and the subsequent operating leverage that should result) and the recent lift in investment portfolio yields. A rising tide here lifts all boats, and we still see QBE as a core holding with this backdrop.

James Hardie

James Hardie is a key holding in the portfolio. Given ~70% of the company's earnings come from its U.S. business, we met with a key customer (homebuilder D.R. Horton) and a key competitor (engineered wood siding producer Louisiana Pacific) to get a read-through on the current demand environment as well as Hardie's competitive position. Overall, repair and remodel activity in the U.S. remains weak, largely due to low turnover of the existing home inventory (as the majority of homeowners are on 30-year fixed mortgages at rates well below spot). The point at which someone is most likely to do a renovation is when they buy a house (existing home, not new build) and so, given low existing home inventory churn, there are fewer renovation projects taking place in the U.S. Fortunately for James Hardie, they have the national scale to serve the homebuilder's market in the U.S. With fewer existing homes available to purchase, demand for new homes remains surprisingly resilient given the overall shortage of supply in the U.S. more broadly. James Hardie supplies 24 of the top 25 U.S. homebuilders with siding and trim products, including D.R. Horton where they have an exclusive supply arrangement. For context, D.R. Horton is the largest builder of new homes in North America. James Hardie still looks attractive to us given it continues to trade below its long-run earnings multiple, and we think management continue to demonstrate their ability to navigate the cycle with great skill.

BlueScope Steel

BlueScope is not a stock we currently hold in the portfolio, but it is always on our radar as we believe the asset base is high quality, the balance sheet is strong, and management is excellent. We visited BlueScope's North Star asset in Delta, Ohio and came away more positive on the quality of this asset and the US steel sector more broadly into the medium term, as capacity consolidates, and we think manufacturing "reshoring" and decarbonisation spending should support demand. In North America, BlueScope is looking to leverage its low position on the cost curve upstream to gradually build out a higher-margin, less cyclical downstream business, which in our minds is a sound strategy. At the moment we remain on the sidelines given we have less conviction in the short-term direction of steel prices as the effect of several interest rate rises begin to grip, but we remain keen observers of the stock.

STOCK STORY - RESMED

(Vinay Ranjan – Senior Equities Analyst)

ResMed

ResMed – A high quality ASX investment opportunity

During the quarter, we added ResMed (RMD.ASX) to our top ten holdings. ResMed is the global leader in sleep and respiratory care primarily focused on the development and sale of positive airway pressure devices and accessories for the treatment of obstructive sleep apnoea (OSA). ResMed's share price has fallen 30% since the release of its FY23 results in August largely in response to concerns GLP-1 (Glucagon-Like Peptide-1) drugs may reduce its addressable market. In this article, we discuss the business in more detail and why we think the GLP-1 concerns are overdone.

What is Obstructive Sleep Apnoea (OSA)?

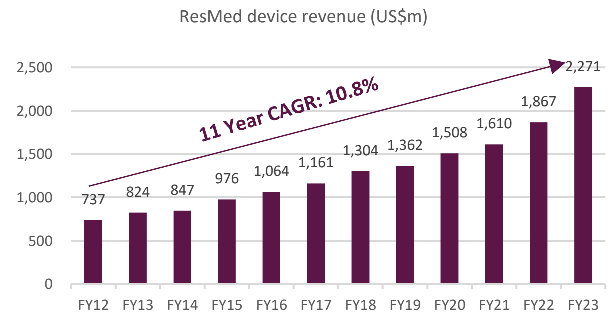
Obstructive sleep apnoea is a chronic illness that occurs when the muscles that support tissues in the back of the throat relax during sleep, blocking or narrowing the upper airway. This obstruction leads to impaired breathing for a short period (usually 10-20 seconds), which results in lower oxygen in the blood. The brain senses the impaired breathing, causing the individual to subconsciously rouse from sleep in order to reopen the airway. The severity of OSA is characterised by the number of events per hour: Normal < 5; Moderate 15-30; Severe > 30.

Continuous Positive Airway Pressure (CPAP) devices are the accepted standard of care for treating OSA, delivering a stream of pressurised air through a mask to prevent the collapse of the upper airway during sleep. ResMed is the largest manufacturer of these products and we estimate the company currently has ~80% market share with its major competitor Philips out of the market for the past two years due to an FDA-imposed product recall.

Large, undiagnosed addressable market

The OSA market is large and mostly undiagnosed. According to the company, there are 936 million people globally with sleep apnoea and 424 million of these suffer from severe sleep apnoea. The size of the addressable market is evidenced by the fact ResMed had grown its device revenue at over 9% p.a. in the six years prior to the Philips recall (FY13-FY19). Recent growth rates have been even higher. ResMed estimates that penetration currently sits at 20% in the US and well below this percentage globally, which implies a long runway for future device and mask sales.

Figure 1 – ResMed device revenue (US$)



Source: Company filings

One of the highest-quality companies on the ASX

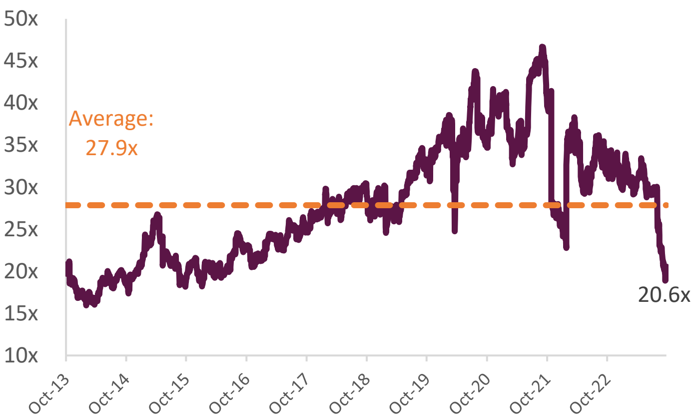
As with any new position, we tested ResMed against our key investment criteria and consider the business to be high quality based on the following factors:

- Financial strength: ResMed has a strong balance sheet with less than 1x ND/EBITDA
- Business quality: ResMed has a dominant market position (~80% share), sells defensive products that improve patient quality of life and are reimbursed by Medicare/health insurers in the US, and earns high returns on capital (22% average over last 5 years).
- Management quality: We consider ResMed a "founder-led" business. Founder Peter Farrell is Chair Emeritus, and his son, CEO and Chair Mick Farrell, has presided over an exceptional track record in product development and market share gains in his 10+ years as CEO.

GLP-1 concerns and valuation

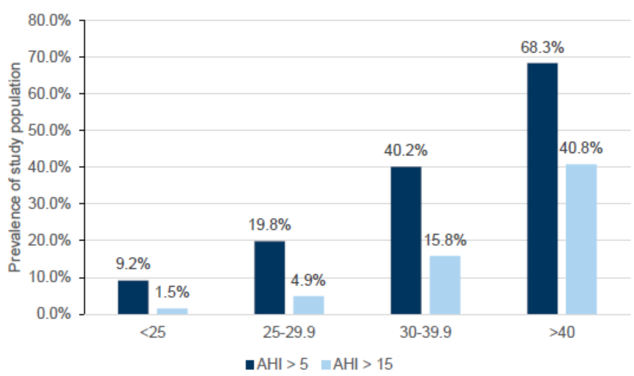
ResMed has historically traded on a forward multiple of 28x PE but is currently trading on less than 21x PE due to market concerns about GLP-1 drugs reducing ResMed's addressable market.

Figure 2 – ResMed NTM Rolling PE



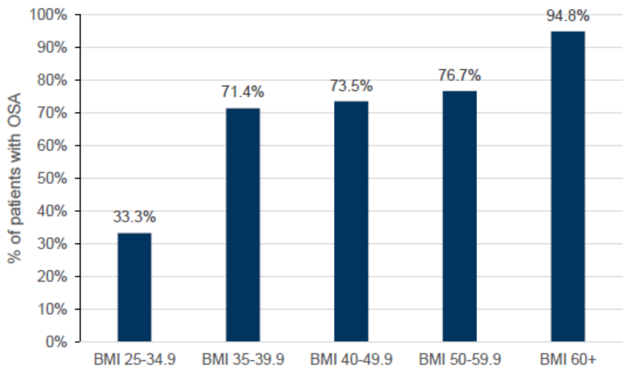
GLP-1 drugs (branded as Ozempic, Wegovy and Mounjaro) act by mimicking hormones that are released into the gastrointestinal tract in response to eating. These drugs were initially developed to target type 2 diabetes by stimulating more insulin production but have evolved to potential applications in weight management and cardiovascular indications. Given obesity is a key risk factor for OSA (see Figures 3 and 4), there is a view that significant weight reduction from taking GLP-1s may result in reduced demand for CPAP therapy.

Figure 3 – OSA severity by AHI (<5 mild) and (>15 moderate)



Source: Goldman Sachs Research

Figure 4 – Prevalence of sleep apnoea in morbidly obese patients who presented for weight loss surgery evaluation



Source: Goldman Sachs Research

While we are not medical experts, we consider the significant de-rate to be an overreaction for the following reasons:

- GLP-1 drugs have been around for almost a decade in managing blood sugar, and other competing therapies such as oral devices and bariatric surgery have not been able to displace CPAP as the standard of care. We note CPAP also has the advantage of being able to track patient adherence and compliance through cloud-connected devices. We believe this data is valuable to third-party payors.
- While we acknowledge weight gain is a leading risk factor in developing OSA, it is not the only cause. Based on our conversations with sleep physicians and the company we estimate one-third of OSA patients are not obese. While the remaining two-thirds of the patient pool is highly likely to test GLP-1 drugs (as they become more accessible and affordable) we don't expect adherence to be 100% given the potential for side effects such as nausea and the impact on lifestyle. We also don't expect GLP-1s to fully eliminate OSA in all cases (the drugs may simply reduce severity). As a result, we think it's more likely you could have a scenario where a combination of GLP-1 drugs and CPAP therapy are prescribed as treatment.
- Finally, these drugs with an average retail price of ~US$1,000/month are currently unaffordable for most patients. Pricing will need to come down significantly to attract broader reimbursement and mass adoption.

Conclusion

Overall, we think the uncertainty as to the potential penetration and success of these drugs in treating OSA has created a rare opportunity to invest in one of the highest quality companies on the ASX. While we are unlikely to pick the bottom, we believe the company is trading well below its intrinsic value.