

Airlie Australian Share Fund

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



Fund Update: 31 March 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 \$14.9 million
Distribution Frequency	Bi-annual
Buy/Sell Spread	0.14%/0.14%
Management & Administration Fee	<ul style="list-style-type: none"> 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

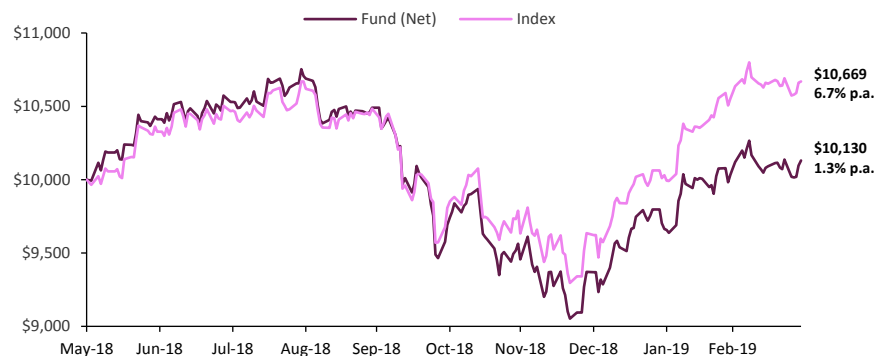
PERFORMANCE*

	Fund (%)	Index (%)	Excess (%)
1 Month	0.6	0.7	-0.1
3 Months	8.1	10.9	-2.8
6 Months	-3.4	1.8	-5.2
Since Inception (% p.a.)	1.3	6.7	-5.4

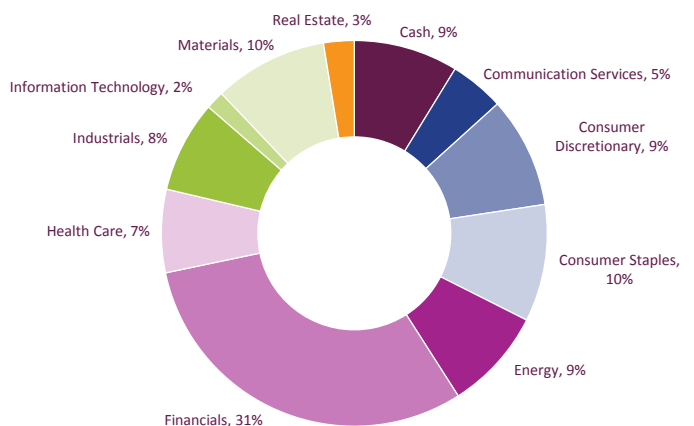
TOP 10 POSITIONS (BY WEIGHT)

Company	Sector#
Commonwealth Bank of Australia	Financials
BHP Billiton Ltd	Materials
Westpac Bank	Financials
CSL Ltd	Health Care
Aristocrat Leisure Ltd	Consumer Discretionary
Origin Energy Ltd	Energy
Suncorp Group Ltd	Financials
Macquarie Group Ltd	Financials
Wesfarmers Ltd	Consumer Staples
Caltex Australia 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, may not sum to 100% due to rounding.

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MARKET COMMENTARY

Australian stocks staged their biggest quarterly gain in more than nine years in the three months to March after the Reserve Bank of Australia was among central banks that signalled they might loosen monetary policy, iron ore and oil prices rose, and the royal commission on financial services made no recommendations that harmed the banking business model. The rally overcame a mediocre reporting season, declining house prices and mounting evidence that the Australian economy is slowing.

RBA Governor Philip Lowe triggered a rally in stocks in February when he said that, while over the past year "the next-move-is-up scenarios were more likely than the next-move-is-down scenarios, today the probabilities appear to be more evenly balanced". Iron ore rose over the quarter after a deadly dam burst in Brazil upset production at a plant owned by the world's biggest producer, Vale, while oil prices gained on the political turmoil in Venezuela. Bank stocks rallied after the final Report into Misconduct in the Banking, Superannuation, and Financial Services Industry came out with relatively modest recommendations and no surprises.

Company earnings reports for the period ended December 31 were mediocre in a longer-term context. Goldman Sachs said only 42% of companies grew earnings per share over the first half of 2019, the lowest result since 2009, while downgrades on future profits were the most since 2009.

Economic reports released over the three months were largely downbeat. They showed the economy expanded only 0.2% in the December quarter. The Westpac-Melbourne Institute's index of consumer sentiment slid to an 18-month low of 98.8 in March, where 100 is the neutral level. CoreLogic's home value index showed Melbourne prices, down 4%, fell at the fastest rate ever recorded over the three months to February, as the aggregate for the five capital cities lost 3.5% over the period. Consumer prices rose only 1.8% in 2018, to be below the RBA's 2% to 3% target. As expected, the RBA's policy-setting board kept the cash rate at the 1.5% on which it has sat since August 2016. The S&P/ASX 200 Accumulation Index surged 10.9% over the quarter, its biggest gain since the third quarter of 2009.

FUND COMMENTARY

Stocks in the fund that outperformed the benchmark included James Hardie Industries (+20%) on better US housing data, Macquarie Group (+19%) after the company said fiscal 2019 profits are likely to rise 15%, and the ASX (+16%) after basically recovering December quarter falls. Stocks held that underperformed included the Commonwealth Bank of Australia (-2%) on the royal commission and falling housing price concerns, Qantas Airways (-2%) due to the higher oil price, and Reece (-1%) on weaker Australian housing approval data. Two big sectors, real estate (+14%) and materials (+17%), had a strong quarter as lower interest rates and strong commodity prices boosted those sectors respectively. The fund is overall underweight these sectors causing us to lag our benchmark over the period.



Value opportunities in domestic cyclicals. Industry structure is key.

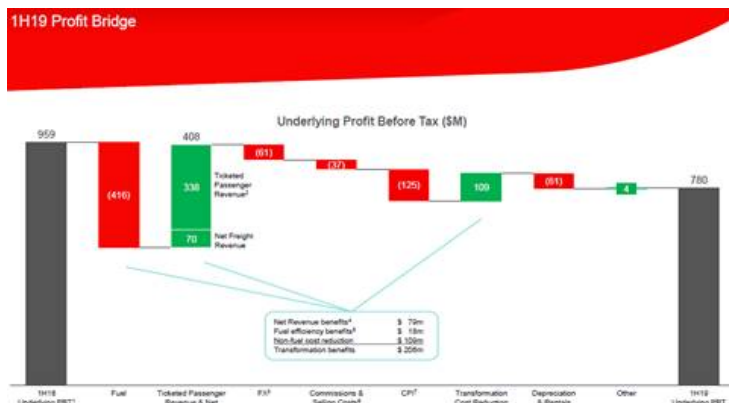
It looks clear that 2019 will be a challenging year for the consumer. The daily headlines on falling house prices, declining car sales, tightening credit, election uncertainty and regulatory changes are having a reinforcing loop. As always, but particularly in such an environment, we've looked to tilt the portfolio away from poorly positioned consumer-exposed stocks. What does poorly positioned mean? Companies that sell goods and services that are easily interchangeable or are in a highly competitive industry. An example of a company that is not poorly positioned is Bunnings (owned by Wesfarmers) – sure, sales growth is slowing but it dominates the hardware segment in Australia and will be untouched by disruption (technological and regulatory).

The balance to this view, though, is that a lot of consumer-facing stocks are looking attractively priced – sometimes up to a 50% valuation discount to the broader market averages. So there are opportunities. Analysing industry structure is how we identify those businesses that should be more resilient in a weaker domestic economy.

One such opportunity is oOh!Media, an outdoor advertising company. The stock has sold off on concerns around advertising spending, which are cyclical and consumer-sentiment driven. However, the outdoor media industry is taking a larger share of the broader advertising market, averaging 9% growth p.a. for the 10 years to June 2018. Outdoor is boosting its reach thanks to digital billboards and because it is an advertising medium that is retaining its audience, allowing it to offer attractive “reach” to advertisers, particularly against free-to-air TV and print that are experiencing audience fragmentation or decline. Generating 47% of outdoor industry revenues, oOh!Media is the market leader and is well placed to capitalise on gains in market share.

Further, we like the market structure, with the market recently consolidating from four main players to two, after oOh!Media acquired Adshel and competitor JC Decaux bought APN Outdoor. As a result, we think the industry is set to become more rational. We've yet to see an industry go from four players to two and see pricing get worse. Trading on eight times enterprise value over earnings before interest, taxes, depreciation and amortisation versus transaction comps and international peers on 10 times, the valuation in our view is yet to reflect an improving industry structure and long-term structural tailwinds for outdoor.

Another stock that we expect to perform well in a softer environment is Qantas Airways. The Qantas first half result for fiscal 2018, while at first glance looked ho-hum as profit was down, showed the incredible strength of its franchise. Battling a fuel cost increase that on its own would have led to a halving of profit (see chart below), the company was able to pass all the fuel cost increase through to customers.



Source: Qantas presentation, 2019.

Since the end of the capacity war with competitor Virgin five years ago, Qantas has experienced a golden run. The shares are up from \$1 to \$5.60; the balance sheet is strong; dividends have been re-instated; and more than 25% of the shares on issue have been bought back – a remarkable turnaround. Can it continue? We think it can (subject to the usual caveats re consumer demand, oil prices and competitor behaviour) for the following reasons:

- The pincer movement Qantas has put on Virgin with Qantas mainline and Jetstar encircling the premium and budget market thus allowing Qantas to achieve more than 60% market share but more than 90% profit share.
- The remaking of international routes and alliances, which should make blowout losses a thing of the past.
- The strength of the loyalty program (more than 10 million members) resulting in consistent delivery of about 25% of Qantas's total profit.

Much can go wrong in an airline business but as we study the industry globally we are hard-pressed to find a company that has the unique advantages possessed by Qantas. The share price values Qantas as if it were no better than most global comparables with a price-earnings ratio (PE) of 9 times. If returns can be maintained, we believe Qantas could justify a PE ratio of 12 times, putting it on a similar valuation to premium-rated airlines such as Southwest Airlines (US) and Ryanair (Europe).

While Qantas and oOh!Media have sold off to low PE multiples of 9 times and 13 times respectively versus the broader market average PE of 17 times, we believe their improving industry structures should drive resilient profitability in the face of a weaker domestic consumer. We own both in the Airlie Australian Share Fund.