FUND COMMENTARY

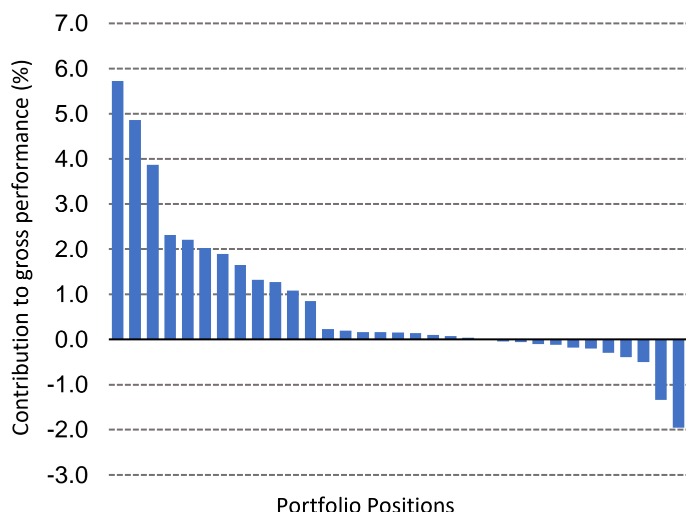
For the March quarter, the Fund returned 9.1% compared to the Small Ordinaries Accumulation Index return of 7.5%, reflecting outperformance over the period of 1.6%.

The top three contributors to gross performance during the quarter were Gentrack (+2.0%), Nick Scali (+1.6%) and Premier Investments (+1.4%). The top three detractors from gross performance were Tabcorp (-0.6%), Mader Group (-0.3%) and Dicker Data (-0.3%).

The end of this quarter marks the Fund's approximate one-year anniversary since its launch on 4 April 2023. While we do not place much importance on short-term performance – we would prefer for the Fund to be assessed over a more suitable time frame that better reflects our long-term philosophy – we will nonetheless take this opportunity to reflect on the performance of the Fund so far and analyse some of the key drivers.

The Fund is off to a strong start. Since inception, it has returned 22.2% net of fees compared to the Small Ordinaries Accumulation Index, which returned 13.1%, reflecting outperformance over the period of 9.1%.

Pleasingly, this performance can be attributed to a number of material 'winners' during the year, offset by only a small subset of material detractors. To put some numbers around this, there were eleven stocks in the portfolio that contributed more than 1% to gross Fund performance and just two stocks that contributed more than negative 1% to gross Fund performance. Importantly, no individual stock contributed more than -2% to gross Fund performance. We have provided a chart of the contribution to gross performance for each stock held in the Fund since inception below.



There were a few noteworthy contributors worth individual mention. Gentrack was the Fund's strongest performer over the year, contributing +5.7% to gross Fund performance. For those new to the story, Gentrack is a global tech company that provides customer billing software to the utility sector and customer management software to the airport sector. We like businesses that sell this type of 'mission-critical' enterprise software as typically the customer churn is very low due to how costly and disruptive it can be to switch providers. That low customer churn creates resilient, annuity-style revenues. Prior to our purchase, Gentrack had endured a tough few years navigating some customer closures related to regulatory issues in the UK that resulted in materially reduced profit margins. We viewed these issues as mostly temporary and added to our position on signs of improving revenue growth and a recovery in margins. While the stock has had a great run, Gentrack has a long pipeline for growth as utilities continue to upgrade their systems to meet the demands of the energy transition and profit margins return towards historical levels.

News Corp has been another strong performer for the Fund, contributing +4.9% to gross Fund performance. Our thesis here focused on the Dow Jones segment, which has vastly improved in quality over the past decade, transitioning from an advertising to a subscription-led model, which we believed the market had underappreciated. This thesis has largely played out, with Dow Jones posting some stellar results in recent periods. We wrote a more in-depth analysis of News Corp in our September Fund Update, which can be found on the Airlie website.

The Fund's retail positions have also been strong performers, collectively contributing +6.7% to gross performance since inception. The largest contributors here were Nick Scali, Premier Investments and Joyce Corporation. Retail has been an interesting sector during the past year – who would have predicted that many retailers would still be making close to record profits and margins after such a rapid rise in interest rates and further cost-of-living pressures? That resilience has certainly exceeded our expectations, and we think there's an important lesson there in the fallibility of making macroeconomic predictions. While we've held large retail positions in the Fund since inception, our theses for these stocks were never predicated on any special insight into the macro, but rather an insight into the resilience of their business models, their stellar management, and their fortress-like balance sheets, all of which we believed would allow them not only to weather a severe downturn in consumer spending but emerge out the other side in a stronger competitive position.

This uncertain economic backdrop resulted in extremely volatile valuations in the sector. Premier and Nick Scali, for example, are up around 60 and 85 per cent off their lows set in June last year. That's a substantial change in valuation over a very short period that surely doesn't reflect a commensurate change in intrinsic value. And we think therein lies the opportunity for active managers – we love that volatility because it throws up opportunities to buy great businesses at attractive prices.

It is also worth reflecting that, collectively, these retail holdings were the Fund’s worst performers during its first quarter, driving material underperformance relative to the benchmark. Fast forward to today, and these retailers are collectively the Fund’s strongest contributors. This illustrates one of the pitfalls of focusing too much on short-term performance; had we been too concerned with putting out good short-term numbers, we might not have taken on those retail positions, and as it stands that would have been to the detriment of our investors. That’s why we consistently communicate to our investors the importance of focusing on long-term numbers, and why we are always looking for investors who share that long-term mindset, who understand the Fund’s philosophy, and who will afford us the latitude to invest with a long-term view.

On the other side of the ledger, Tabcorp has been the fund’s weakest performer, contributing just under -2% to Fund performance. While operationally the company has achieved some milestones in terms of levelling the playing field with online bookmakers, the stock has struggled against the backdrop of a soft wagering market. We had probably underestimated how much the business was overearning due to covid, which has dampened our expectations for future returns. Regardless, we believe the stock is cheap here, trading on around 10x our estimate of free cash flow, so we remain patient holders. For a more in-depth discussion on Tabcorp, see our December Fund Update, which can be found on the Airlie website.

In summary, we are pleased with the performance of the Fund over its inaugural year. While we would caution investors from taking too much comfort from one year’s returns, what they can take comfort in is the fact that I have a large personal investment in the Fund and I’m invested on exactly the same terms as every other investor.

Looking forward, while the market has rallied sharply in recent months, our Fund enjoys a broad mandate with a deep universe of opportunities to be uncovered. As a team, Airliehave been investing in small companies for several years now and we have a robust process for sifting through the weeds and identifying the really nascent, high-quality businesses. And we think we can continue to do that. So we remain excited about the Fund’s future prospects.

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