

# Airlie Small Companies Fund

A concentrated, active portfolio of Australian listed small companies.



Fund Update: 31 March 2025

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, returns are not guaranteed and there is a risk that investors may lose money on any investment they make. The Fund's Product Disclosure Statement (PDS) sets out the significant risks relevant to the Fund. You can view the PDS at: [www.airlifundsmangement.com.au](http://www.airlifundsmangement.com.au)

<b>Inception Date</b>	4 April 2023
<b>Benchmark</b>	S&P/ASX Small Ordinaries Accum. Index
<b>Portfolio Size</b>	AUD \$25.3 million
<b>Distribution Frequency</b>	Semi-annually
<b>Management Fee<sup>1</sup></b>	0.98% p.a.
<b>APIR</b>	MGE1188AU
<b>Performance Fee</b>	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 <sup>2</sup> .
<b>Minimum Initial Investment</b>	AUD\$25,000
<b>Buy/Sell Spread</b>	0.25%/0.25%

<sup>1</sup> Transaction costs may also apply – refer to the Product Disclosure Statement. All fees are inclusive of the net effect of the GST.

<sup>2</sup> 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.airlifundsmangement.com.au](http://www.airlifundsmangement.com.au) for more information, including: fund performance, unit prices, investment insights, PDS & forms

## PERFORMANCE\*

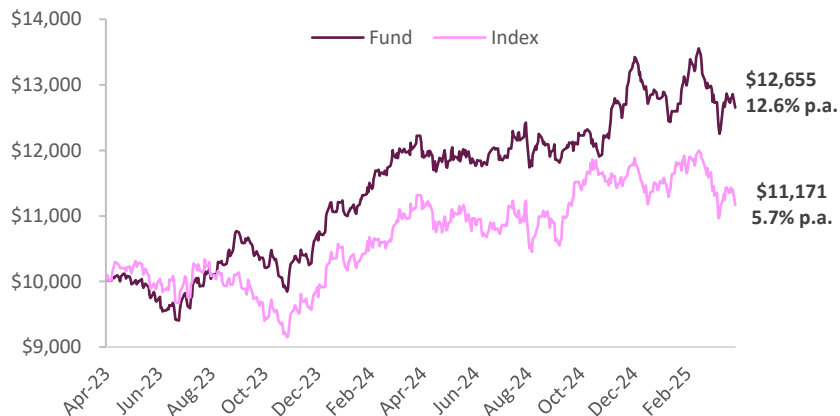
	Fund (%)	Benchmark (%)	Excess (%)
<b>1 Month</b>	-2.3	-3.6	1.3
<b>3 Months</b>	-1.1	-2.0	0.9
<b>6 Months</b>	4.6	-3.0	7.6
<b>1 Year</b>	3.5	-1.3	4.8
<b>Since Inception (p.a.)</b>	12.6	5.7	6.9

Past performance is not a reliable indicator of future performance.

## TOP 5 POSITIONS (BY WEIGHT)

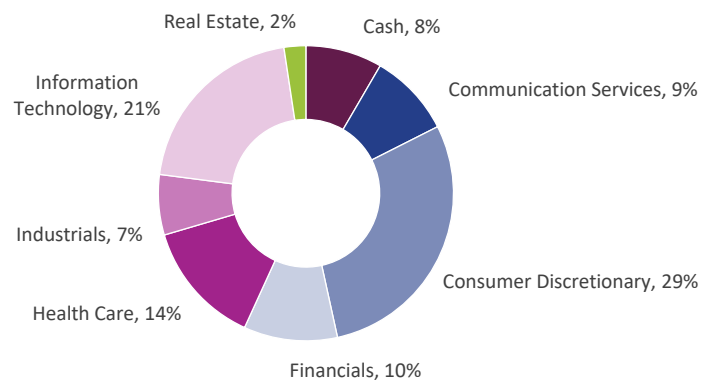
Company	Sector**
News Corp	Communication Services
Gentrack Group Ltd	Information Technology
Sigma Healthcare Ltd	Health Care
Joyce Corp Ltd	Consumer Discretionary
Nick Scali Ltd	Consumer Discretionary

## 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 March 2025 quarter, the Fund returned -1.1% compared to the Small Ords Accumulation Index return of -2.0%, reflecting outperformance over the period of 0.9%.

The top three contributors to gross performance during the quarter were Smartpay (+2.0%), Sigma Healthcare (+0.6%) and Nick Scali (+0.6%). The top three detractors from gross performance were Premier Investments (-1.3%), Gentrack (-1.1%) and PWR Holdings (-0.4%).

While our usual quarterly commentaries focus on the performance driven by stocks during the period, it would be remiss of us not to address the recent sharp decline in equity markets sparked by the April 2nd 'Liberation Day' tariffs announcement. At the time of writing this commentary, the S&P 500 index has declined 12% in just four days of trading, including one of the sharpest two-day declines on record. The Australian market has not fared much better, with the S&P/ASX 200 down around 7% over that same period. While this correction in equities has been sharp, it's worth noting that the S&P 500 is currently trading about where it was this time last year.

The impact of these tariffs on our portfolio holdings can be categorised into two buckets: the first-order impacts – how the tariffs directly affect the companies we own; and second-order impacts – the impact of these tariffs on the broader economy and the flow-on effects on our holdings. We expect the first-order impacts to be relatively limited: of our top 15 holdings, which account for close to 80% of the fund, only three of those holdings sell physical goods into the US, and of those three holdings, two have local manufacturing that may fully or partially shield them from these tariffs. There will be further implications for some of the remaining holdings that have supply chain exposure to the US, but again we expect this impact to be minimal. Assessing the second-order impacts from these tariffs is a much more difficult problem. It's important to reflect on just how little we know at this stage. For instance, will the tariffs be used as a short-term strategic tool or will they be in place for the long term? How will other countries respond to the tariffs? What will be the impact on inflation and interest rates? There are many factors at play here that make it impossible to predict with any confidence what kind of economic environment lies ahead.

This unpredictability is a feature of many of these types of exogenous shocks. Whether it be a financial crisis, a housing bubble, a pandemic or these tariffs, our primary risk management tool is our investment process, where we aim to own a collection of businesses that can survive and thrive no matter the prevailing economic environment. In particular, our investment process focuses on buying quality businesses – those businesses with durable competitive advantages and resilient earnings streams – and buying businesses with strong financial strength – those companies with the requisite balance sheet to absorb even a prolonged hit to profitability. These are the types of businesses that can not only endure any

exogenous shock but emerge out the other side in a stronger competitive position.

These types of sell-offs can be exciting times for active managers, as typically stocks are sold indiscriminately across the board, offering the opportunity to buy some quality businesses at substantial discounts where the intrinsic value may not have changed materially. We currently hold close to 9% of the Fund in cash and are waiting patiently to deploy that capital into any attractive opportunities that arise.

One ancillary item of note – Smartpay's share price rose 48% during the quarter following the receipt of two separate takeover proposals: one from an undisclosed international strategic player and the other from listed competitor Tyro at NZ\$1.00 per share. These bids followed the announcement in March that the company has successfully completed its initial customer pilot of its New Zealand acquiring solution. As discussed in previous quarterly notes, we believe Smartpay is on the brink of unlocking material value in its New Zealand operations, which should result in a step change in profitability for the company. While the NZ\$1.00 bid reflected a substantial premium to last traded, in our view it does not provide sufficient compensation for shareholders given the substantial opportunity in the New Zealand business.

In place of our usual stock story, we have included a write-up from a senior member of the Airlie investment team, Vinay Ranjan, who visited the UK during the quarter. Vinay spent much of his time assessing the progress of Nick Scali's UK expansion, including meeting with local manager Rodd Orrock, as well as spending some time with Chemist Warehouse Ireland's local CEO and JV partner Colin Galligan. Vinay shares some of his valuable insights below.

## UK AND IRELAND TRIP OBSERVATIONS

During the period we visited the UK and Ireland to see a few of our portfolio holdings with offshore operations.

### Nick Scali – UK expansion

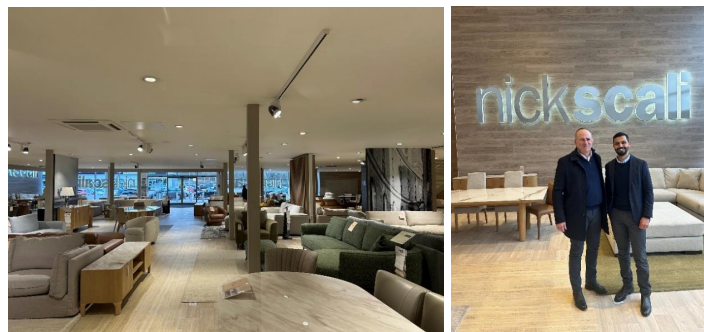
Nick Scali has been a long-term holding in the Fund. The business demonstrates all the characteristics we look for in an investment: net cash balance sheet, market-leading position in the sofa category domestically with best-in-class operating margins, a founder-led management team with Anthony Scali at the helm for the past 20 years, and an attractive valuation. In April 2024, after many years of market diligence, the company made the decision to enter the UK via the acquisition of furniture retailer Fabb Furniture ('Fabb'), gaining access to an initial store network of 21 stores. While the loss-making Fabb was acquired for just £2, the company raised A\$50m to fund store refurbishments and working capital. We consider this a relatively low-risk entry to a new geography.

We met with Rodd Orrock (Head of Nick Scali UK) at one of Nick Scali's recently converted stores in Thurrock (just outside of London) to get an update on the progress of converting

stores to Nick Scali branding and product as well as the initial customer response. We walked away positively disposed towards the transaction and made the following key observations:

- Nick Scali's product range is unique relative to local competitors, with a more modern look and brighter colour palettes. Some adjustments need to be made to dining and coffee table sizes to account for smaller houses in the UK. Nevertheless, Anthony on the most recent results call noted the best-selling sofa in the UK is the same as the best seller in Australia.
- To date, six stores have been converted to Nick Scali format in the UK and these stores are all located in retail parks outside the major city centres. Anecdotally, foot traffic at these retail parks is high and indeed the Lakeside Retail Park we visited rivals some of Sydney's busiest centres such as the Moore Park Supa Centa.
- There are ~30m dwellings in the UK vs ~11m in Australia so the market opportunity is significant. Given population density is higher as well, management expect the UK stores to generate higher sales per square metre than Australia.
- Conversion rates to date have been solid at ~75% on customer quotes, but store traffic remains below Australian levels, indicating the brand is still building awareness among customers.
- Interest-free promotions are highly advertised in store. Unlike Australia, ~40% of transactions in the UK are done using interest-free credit for terms of between 6 and 48 months.
- Some operating cost synergies have already been realised with the Fabb headcount reduced from 270 people to 120 by leveraging the Australian operations for key functions such as buying and marketing.
- Pre-acquisition, Fabb was generating gross margins of just 41% vs 65% for Nick Scali in ANZ. Nick Scali has made changes to the way sales staff operate, removing on-floor discounting and customer returns, which lifted gross margins immediately. As they start to sell more Nick Scali product that is sourced from low-cost Asian factories, gross margins are expected to move into the high 50s.

While it remains early days, we are optimistic the brand will gain traction in the UK market.



*Nick Scali Thurrock showroom with Rod Orrock (Head of Nick Scali)*

### **Chemist Warehouse – Ireland**

Another portfolio company we visited was Chemist Warehouse in Ireland where we met with local CEO and joint venture partner Colin Galligan. Chemist Warehouse has been operating in Ireland for five years now and our key observation was that the discount pharmacy model is gaining traction. Anecdotally, Aldi and Lidl entered the Irish market 20 years ago and from a standing start have been able to capture a combined 26% market share, completely disrupting the local grocery industry. We believe Chemist Warehouse is on a similar trajectory.

We visited three stores in Dublin (Blanchardstown, Henry St and Talbot St) and store traffic was elevated at each for Tuesday morning trade. Store layouts are similar to Australia with shelves stacked above eye-level with pink and yellow price stickers creating what management describe as 'theatre' in the stores. Most pharmacies in Ireland have a dispensing counter near the front of the store and are focused on prescription medicines. Chemist Warehouse flips this model by placing the dispensary at the back of the store and typically sells more 'front of shop' items; e.g., vitamins, fragrances, skincare. The average pharmacy in Ireland is generating a healthy gross margin of 40%, which allows Chemist Warehouse to undercut prices by 20-30%. These discounts drive a disproportionate increase in sales volumes, which allow Chemist Warehouse to generate significant operating leverage on its fixed costs (labour and rent) and effectively earn a similar profit before tax margin of ~10%.

Some other observations we made:

- Relaxed pharmacy ownership rules have allowed Chemist Warehouse to acquire larger sites in Ireland with the Blanchardstown store we visited occupying ~1,000 sqm vs the ~500 sqm average in Australia.
- Sales mix is over 90% skewed to 'front of shop' items, indicating the local consumer still doesn't view them as a traditional pharmacy. Management have adapted the range to stock more Irish brands but have also kept Australian brands where it makes sense (e.g., Bondi Sands in sunscreen).

- Chemist Warehouse is yet to introduce higher-margin private label products as they are looking to build trust with the consumer by stocking big-name brands such as L'Oréal. They are also in the process of building their own warehouse; this should allow for better inventory management and lays the foundation for launching an e-commerce offering.
- There are ~2,000 pharmacies in Ireland and the market remains highly fragmented with ~60% of the market comprising operators with only one or two pharmacies.
- Boots, a key competitor in Ireland with 92 stores, has been aggressive in securing exclusive leases with shopping centres to limit these precincts to one pharmacy. This has made it difficult to secure new sites and Chemist Warehouse have adapted by taking on bulky goods centres and high street locations.



*Left: Aisle in Blanchardstown store and Right: Henry St shop front*

Chemist Warehouse currently has 12 stores in Ireland and is aiming for 15 stores by the end of June. We think 40-50 stores is a realistic long-term target. If they are successful in capturing market share in Ireland, we expect Chemist Warehouse to enter the UK where Boots is also the major competitor.

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