

FUND COMMENTARY

For the September quarter, the Fund returned 6.8% compared to the Small Ord Accumulation Index return of -1.9%, reflecting outperformance over the period of 8.7%.

The top three contributors to performance during the quarter were Joyce Corporation (+1.6%), Nick Scali (+1.5%) and Premier Investments (+1.4%). The top three detractors from performance were Tabcorp (-0.9%), IRESS (-0.7%) and Objective Corp (-0.4%).

This quarter marked the Fund's first reporting season. Results were generally strong across the board, but particularly in our retail holdings. Our largest retailers – Premier Investments, Joyce Corporation and Nick Scali – all posted record profits and dividends on the back of resilient consumer spending. The standout result here was Joyce Corporation, where operating profit increased 32% in its key segment, KWB Group. These retailers are not out of the woods yet – the macroeconomic environment remains uncertain and a slowdown in consumer spending seems an inevitable consequence of reducing inflation. While the current level of profitability for these retailers may prove unsustainable, we believe this is factored into current share prices. Furthermore, the dividends received during this period of elevated earnings serve to reduce our effective cost price. We remain optimistic about our retail holdings over the medium term, each of which are dominant players within their respective niches, with fortress-like balance sheets, stewarded by world-class owner-managers.

Another highlight from reporting season was Mader Group, a mining services company that provides maintenance work on heavy-duty vehicles. Mader reported revenue and net profit growth of 51% and 48% respectively, including a watershed performance in the company's North American division, which generated >100% growth in both revenue and net profit. The company has guided to a further 30% growth in revenue and net profit for FY24. Mader ticks a lot of our quality boxes – the company is founder-led, has a long history of generating strong returns, and operates in a far less cyclical part of the mining services sector than its peers. We believe the market continues to undervalue these qualities.

News Corp also produced a strong result against the backdrop of a tough advertising market and continued disruption in the book publishing space. We continue to see enormous value in our News Corp holding, particularly in the Dow Jones segment, which we explore in further detail in the stock story below.

On the other side of the ledger, IRESS produced a very weak result, with net profit declining 31% on sluggish revenue growth. The company also reduced full-year profit guidance by ~20%. IRESS was only a small position in the Fund, sitting outside of our top 15 holdings, but its sharp share price decline has hurt performance nonetheless.

Our investment thesis for IRESS is predicated on the divestment of underperforming assets and associated value realisation. Unfortunately, operations in the core business have started to deteriorate and the level of shared costs across divisions appears difficult to unwind and obfuscates our assessment of value. As such, we have not yet added meaningfully to the position despite the steep decline in share price.

STOCK STORY - NEWSCORP

(Will Granger – Portfolio Manager)

News Corp

As discussed in our previous quarterly, there are two key pillars of the Fund’s investment philosophy: we want to own quality businesses and we only want to invest in those businesses at a price well below our estimate of intrinsic value. The first part of that equation is not particularly difficult; there are many great businesses listed on the ASX. However, these businesses usually attract eye-watering prices. The difficulty comes in finding situations in which the quality of the business is not reflected in the price. We believe News Corp (NWS-ASX), currently our largest holding in the Fund, reflects such a situation. For those unfamiliar, News Corp is a media conglomerate that owns a vast collection of some of the world’s most recognisable brands including The Wall Street Journal, Barron’s, The New York Post, HarperCollins, realestate.com, realtor.com, and Foxtel. When most investors think of News Corp, ‘quality’ probably isn’t the first adjective that springs to mind. Indeed, returns for News Corp shareholders have been far from stellar, with the company slightly underperforming the S&P/ASX 300 index over the past decade. However, this past performance belies the enormous transformation that has occurred within the company that has significantly improved its quality and which we think the market has overlooked.

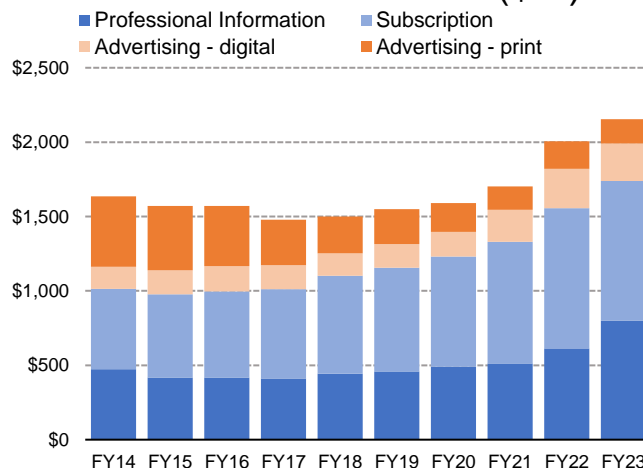
This transformation is most apparent in the company’s largest segment, Dow Jones. Dow Jones operates two divisions: a newspaper publishing division and a professional information business. The flagship asset in the newspaper division is The Wall Street Journal, which over its 134-year history has established itself as the world’s leading financial newspaper, boasting a subscriber base 3x that of its nearest competitor. The newspaper industry has faced significant disruption over the past two decades as the advertising market shifted towards online competitors. The Dow Jones mastheads were no exception, with print advertising revenue declining by 65% over the past decade. These declines masked strong growth in subscription revenue, which increased 74% over that same period. The good news for Dow Jones is that this headwind has largely abated – print advertising accounts for just 12% of revenue today compared to 40% a decade ago – and the strong subscription growth is set to continue – management have estimated the total addressable market for The Wall Street Journal subscribers at 3x the current base. This is now a significantly higher-quality revenue stream from which the publishing business can continue to grow.

At the same time, the Dow Jones professional information division has continued to scale, both organically and through acquisition. The ‘jewel in the crown’ here is the Risk & Compliance business, which sells access to a proprietary database used primarily by banks to fulfil ‘know your customer’ requirements.

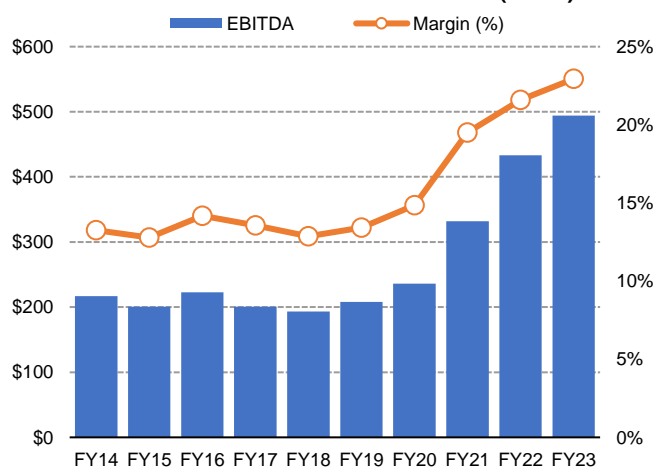
Leveraging its hard-to-replicate dataset, Risk & Compliance has grown revenues at a 20% compound annual growth rate over the past five years and now accounts for 34% of the division’s revenues. This division also includes the recently acquired Oil Price Information Service (OPIS), a global industry standard for benchmark pricing across a variety of energy commodities. OPIS was founded in 1977, generates 50% operating profit margins, and was opportunistically acquired as part of a forced divestment during the S&P/IHS merger.

Pulling all of this together, you have a Dow Jones segment that has materially improved in quality across both its divisions, the fruits of which are only now starting to show up in the financials: segment revenue has returned to rapid growth and segment profits have doubled over the past three years. Adjusted for the amortisation of acquired intangibles, Dow Jones now generates ~\$400m in pre-tax operating profit on only ~\$1bn of average tangible assets, reflecting an attractive pre-tax return on tangible assets of 40%.

Dow Jones Revenue (\$m)



Dow Jones EBITDA (\$m)



Source: Airlie Funds Management estimates, company filings

Dow Jones enjoys many of the quality features we look for in our businesses – strong pricing power, brand strength, scale advantages, a capital-light model, and a long runway for future growth. And yet, despite these quality attributes, the current valuation is undemanding. If we take the market value of News Corp's 61% stake in REA Group (REA-ASX) and apply a 10x multiple to corporate costs, the implied valuation for Dow Jones is \$6bn. For comparison, The New York Times (NYT-US) has an enterprise value of \$6.5bn and generates ~30% less operating profit on lower margins. Furthermore, this assumes the remaining stable of News Corp assets is worthless. This includes HarperCollins, the world's second largest consumer books publisher – a durable business that routinely generates operating profits north of \$200m. It includes an 80% stake in realtor.com, the second largest real estate portal in the U.S., which News Corp were reportedly in talks to sell for >\$3bn. It includes a 65% stake in Foxtel, which generated ~A\$250m of free cash flow in FY22 according to account filings with ASIC. And finally, it includes a range of other News Media assets, including The New York Post, The Australian, The Sun and The Sunday Times, which contributed ~\$75m of operating profit this year. There is significant value in these remaining assets, and just by valuing Dow Jones at a steep discount to its closest peer, you can effectively get these assets for free!

News Corp's valuation is also attractive if viewed on a consolidated basis. We estimate News Corp's earnings power, adjusted for non-controlling interests and the amortisation of acquired intangibles, sits at ~\$800m in operating profit before interest and tax. At present, the company's enterprise value is ~\$12.2bn, implying a 15x multiple, in line with the S&P/ASX 300 multiple ex-resources and financials. Breaking down these earnings, ~25% come from REA Group, ~50% from Dow Jones, and ~25% from HarperCollins – this is a better-than-market earnings stream trading at just a market price. It is also important to note that this valuation approach significantly understates News Corp's value, as it implies a negative valuation for loss-making assets like realtor.com.

There are many great businesses available on the ASX, but very few are available at prices that do not reflect their quality. We believe News Corp offers investors the rare opportunity to purchase a collection of durable, high-quality assets at a significant discount to fair value. While the acquisition track record does have the occasional blemish, in our view management are above-average capital allocators. Perhaps more importantly, they have not diluted shareholders' ownership of the existing quality assets by issuing new shares. In fact, shares on issue have declined, meaning News Corp investors own more of these quality assets today than they did a decade ago.

**All figures are in USD unless stated otherwise*

Important Information: Units in the fund(s) referred to herein are issued by Magellan Asset Management Limited (ABN 31 120 593 946, AFS Licence No. 304 301) trading as Airlie Funds Management ('Airlie'). This material is issued by Airlie and has been prepared for general information purposes only and must not be construed as investment advice or as an investment recommendation. This material does not take into account your investment objectives, financial situation or particular needs. This material does not constitute an offer or inducement to engage in an investment activity nor does it form part of any offer documentation, offer or invitation to purchase, sell or subscribe for interests in any type of investment product or service. You should obtain and consider the relevant Product Disclosure Statement ('PDS') and Target Market Determination ('TMD') and consider obtaining professional investment advice tailored to your specific circumstances before making a decision to acquire, or continue to hold, the relevant financial product. A copy of the relevant PDS and TMD relating to an Airlie financial product may be obtained by calling +61 2 9235 4760 or by visiting www.airlifundsmangement.com.au.

Past performance is not necessarily indicative of future results and no person guarantees the future performance of any fund, the amount or timing of any return from it, that asset allocations will be met, that it will be able to implement its investment strategy or that its investment objectives will be achieved. Statements contained in this material that are not historical facts are based on current expectations, estimates, projections, opinions and beliefs of Airlie, or the third party responsible for making those statements (as relevant). Such statements involve known and unknown risks, uncertainties and other factors, and undue reliance should not be placed thereon. This material may contain 'forward-looking statements'. Actual events or results or the actual performance of an Airlie financial product or service may differ materially from those reflected or contemplated in such forward-looking statements. This material may include data, research and other information from third party sources. Airlie makes no guarantee that such information is accurate, complete or timely and does not provide any warranties regarding results obtained from its use. No representation or warranty is made with respect to the accuracy or completeness of any of the information contained in this material. Airlie will not be responsible or liable for any losses arising from your use or reliance upon any part of the information contained in this material.

Further information regarding any benchmark referred to herein can be found at www.airlifundsmangement.com.au. Any third-party trademarks contained herein are used for information purposes only and are the property of their respective owners. Magellan claims no ownership in, nor any affiliation with, such trademarks. This material and the information contained within it may not be reproduced, or disclosed, in whole or in part, without the prior written consent of Airlie.

ASCO45199