Airlie Funds Management

Matt Williams, Portfolio Manager of the Airlie Australian Share Fund
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Matt Williams, the Portfolio Manager of the Airlie Australian Share Fund, talks to Frank Casarotti about Australian banks, why the portfolio holds CBA, what company managements are prioritising and what worries them most. An edited transcript is below.

Frank:

Welcome to an update with Matt Williams, the Portfolio Manager of the Airlie Australian Share Fund. Matt, the first question relates to Australian banks. They have challenges. What is your outlook?

Matt:

It's a difficult period for the banks. Right now about 10% of the mortgage books is on payment deferrals and for loans to small- and medium-sized enterprises the number is in the high teens. We don't know what's going to happen with unemployment once the stimulus rolls off. So it's a tricky time for bank investors. On the other side of that, though, the market is well aware of these headwinds. And the pricing of the banks is probably relatively lower than it's been for a long time. All appears unfavourable but everyone knows that. We are thinking about the opportunities that this might present.

Frank:

What's happening with bank dividends?

Matt:

One thing we know for sure is that bank dividends will be lower and payout ratios will be lower. That's a certainty. We are looking at between a 30% cut for the Commonwealth Bank of Australia and a 40% cut for the other three major banks. However, bank share prices have taken this into account somewhat. The upside is that with all these headwinds – unemployment, the stimulus withdrawal, the payment deferrals and reduced dividends – if things turn out to be better than the prevailing pessimistic view then the banks could be interesting investments based on where they are priced now.

Frank:

You talk about unemployment. Immigration's under pressure. We've got low interest rates. Those are normally conditions where you'd say banks would struggle. And yet you have a substantial holding in CBA. Can you explain why?

Matt:

We need to separate sometimes the short-term factors from the medium- and longer-term ones. If someone asked me what three businesses in Australia would I like to own forever, the Commonwealth Bank's retail business would be one of those businesses. It's a fantastic business. The return on equity is very high. It's got a great deposit base. It has so many relationships with so many Australians. Its digital investment makes it seem ahead of the pack. We think on a medium- to long-term basis, CBA is a fantastic business. Yes, there are definitely problems but we're happy to own CBA through these difficult times. We do not own the ANZ or the National Australia Bank at all.

Frank:

One of the key tenets that you often talk about, Matt, is the balance-sheets strength that Airlie looks for. How has it served you over the covid-19 crisis?

Matt:

Financial strength is the key tenet of our investment process. Over the past 10 years, it hasn't really mattered until it's mattered – and that's been in the extraordinary past three or four months. Our companies have weathered the crisis well because they have this strength. The companies with strong balance sheets outperformed during the market's big fall in March and they outperformed on the way up as a collective group. People realise these companies may not need to raise capital and so they've outperformed the companies that people think will need to raise capital. We did not own the companies that had to raise emergency capital though we did get involved in Flight Centre during its placement.

Frank:

Matt, which of the stocks within the portfolio raised capital over the crisis and might any need to raise some more?

Matt:

We own three companies that raised capital. These are Credit Corp., Qantas Airways and Reece. Qantas obviously needed to raise capital to shore itself up when transport was hit. We didn't think Reece needed to raise capital but management is conservative. The company wanted to get in early and was one of the first to raise capital. When we look at the rest of the portfolio and see the financial strength of companies such as the Coles Group, Telstra and Wesfarmers, we don't expect these companies to need to raise capital.

Frank:

Matt, how have you been managing the portfolio during the general market rise? And have you taken the opportunity to sell into the rally?

Matt:

Frank, selectively we've sold down some stocks. One was ASX, which during the crisis fell below $60, which is an absolute gift for a company of that quality. When ASX rebounded to $85 we felt that this was a good point to sell given the earnings headwinds for the stock. TPG Telecom has been a great performer for us before the crisis and during the crisis and it's now merged with Vodafone. The markets got a little bit excited about that merger and at $9 we exited the position. We think the company is a good long-term story but the benefits of the merger will take time to come through.

Frank:

What are some of the more interesting conversations that you've had with management over the past three months?

Matt:

We've had a heap of conversations with management. Companies have really taken to the Zoom lifestyle very well. It's been easy for them to present to investors or to have one-on-ones to talk about their businesses. I think one of the most interesting conversations recently was when we talked to Rob Scott, who is the CEO of Wesfarmers, which is obviously a bigger employer. He's concerned about any sudden withdrawal of stimulus and what that means for Bunnings and Kmart. We really have seen some fantastic numbers come out of some of the retail names thanks to the stimulus packages. Rob is now worried about what happens to unemployment if the stimulus were to stop in the December quarter.

Frank:

What changes are some of the companies in the portfolio planning to introduce into their businesses? What are they prioritising?

Matt:

What they're prioritising is to do more with less. This is what the crisis has shown; that you can run your businesses with less. Unfortunately, they're thinking about reducing the numbers of people they employ. They're thinking about reducing office space. They're thinking about all the resources that they have and how to invest in digitising processes. This crisis is going to accelerate such plans. That's what's coming out of the crisis. The unfortunate thing about that in a way, though, is that the big companies have the money to invest. They're going to get bigger and stronger. The smaller companies just don't have such resources and they could struggle to compete.

Frank:

Do you have a sense of what managements are most worried about?

Matt:

Most companies that are exposed to the consumer in any way, shape or form are worried about unemployment and what happens there and what the consumers' views are on spending, what household sentiment is like. We know that household debt levels in Australia are high. Given we've had a real shock, people will be cautious about how they spend money. Putting aside the great short-term retail numbers, the crisis might prompt households to readjust their spending patterns.