Maple-Brown Abbott Australian Small Companies Fund

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QUARTERLY COMMENTARY | 31 March 2025

Performance commentary

The Maple-Brown Abbott Australian Small Companies Fund (the Fund) delivered an absolute return of 1.7% (after fees) over the quarter, outperforming its benchmark, the S&P/ASX Small Ordinaries Total Return Index by +3.7%. The Fund has continued to deliver a strong track record since inception (24 June 2022), with an annualised return of 17.6%, which is +10.5% above the benchmark. The Fund's outperformance since inception has been driven by idiosyncratic exposures and sustainable earnings delivery above the market which are aligned to our investment process.

Commentary on select Fund holdings

— The Fund initiated a position in oOh!media (OML) in early February, as the stock transitioned from the 'Value Trap' phase to the 'Improving Fundamentals' stage of the earnings lifecycle, demonstrating signs of earnings growth and a valuation significantly below historical average. OML is poised to benefit from the ongoing shift from traditional media, such as TV and radio, to Out-of-Home (OOH) advertising, coupled with a cyclical increase in marketing expenditures. This trend was evident in the CY24 results, which showcased solid growth at the beginning of CY25, alongside a recent restructuring of the sales team that is expected to enhance market share and reduce costs. The Fund continued to bolster its position throughout the remainder of the quarter.

— The Fund divested its position in EBOS Group (EBO) during the quarter. While the 1H25 results were satisfactory (with a slight EPS downgrade), we have concerns regarding two critical developments. Firstly, the retirement of long-serving CEO John Cullity, who has been instrumental in driving the group's organic and acquisitive growth over the past decade. Secondly, we are apprehensive about the competitive threats posed by Chemist Warehouse, which may begin to encroach on certain segments of EBO's business over the next 2-3 years.

Key investment themes over the March 2025 quarter

Equity market rotation or just a blip?

In equity markets, the March 2025 quarter starkly contrasted with the 2024 calendar year. Globally, several prominent investment themes from 2024, such as a more resilient outlook for US economic growth, moderating inflation, and the notion of US exceptionalism, have given way to heightened policy uncertainty in the US, primarily due to tariffs, and growing fears of a recession, albeit from a low base. This shift has negatively impacted US market performance. However, it has been somewhat mitigated by positive economic surprises outside the US and a reallocation of investor capital towards European and Asian equity markets.

Domestically, a similar trend has emerged, with many popular holdings among Australian small-cap managers including technology, quality, growth, and defensively positioned companies underperforming over the quarter. This is notable given that many of these companies have continued to meet or even exceed market earnings expectations. A clear investor trend has emerged, focusing on reallocating capital from these crowded trades, which are trading at elevated multiples compared to historical averages, into more affordable quality stocks and/or value and cyclical companies that exhibit improving earnings momentum.

Over the past six months, the Fund has actively reduced its positions in several 'winners' while selectively reallocating capital into value and cyclical investments with promising earnings outlooks.

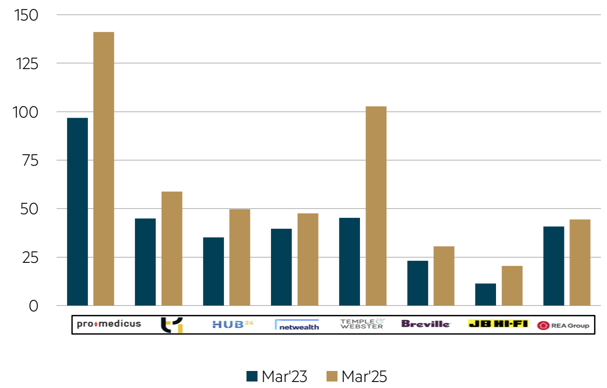
'Winner takes all' unwind?

Throughout the quarter, a significant investment theme has emerged: the potential unwinding of the 'winner takes all' narrative. Over the past two years, the market has been favouring certain industry leaders, leading to a substantial revaluation of companies that have successfully increased their market share despite a challenging macroeconomic landscape. Noteworthy examples include HUB24 and Netwealth Group in the wealth management platform sector, Temple & Webster in online furniture retail, JB Hi-Fi in electronics, and REA Group in online residential classifieds.

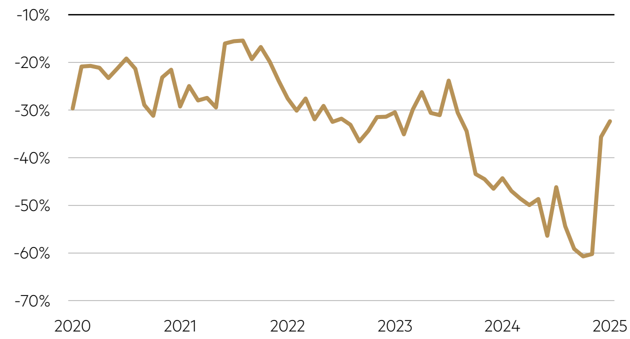
The pressing question for investors is whether the 'winner takes all' trend will fully materialise. The recent takeover proposal of Doman Holdings Australia by CoStar Group suggests otherwise. Domain ranks as the second player in the domestic online real estate portal market, typically trading at a 25-30% discount to the market leader, REA Group, which has been outpacing its competitors in volume growth and yield generation. However, over the last two years, the relative P/E discount has expanded to 50%-60%, as the market anticipates REA's continued market share growth.

CoStar Group, a US-based property marketplace with a market capitalization exceeding US$30 billion and deeper marketing resources than REA, appears to see significant value in the Australian online marketplace. On 21 February, CoStar made an initial bid of $4.20 per share, representing a 35% premium over the previous closing price. On 27 March, this bid was subsequently increased to $4.43 per share. In conclusion, we contend that the market's pricing of the 'winner takes all' theme for select stocks is unwarranted.

P/E multiple change over the past 2 years for high quality companies taking market share



P/E discount of Domain Holdings vs. REA Group



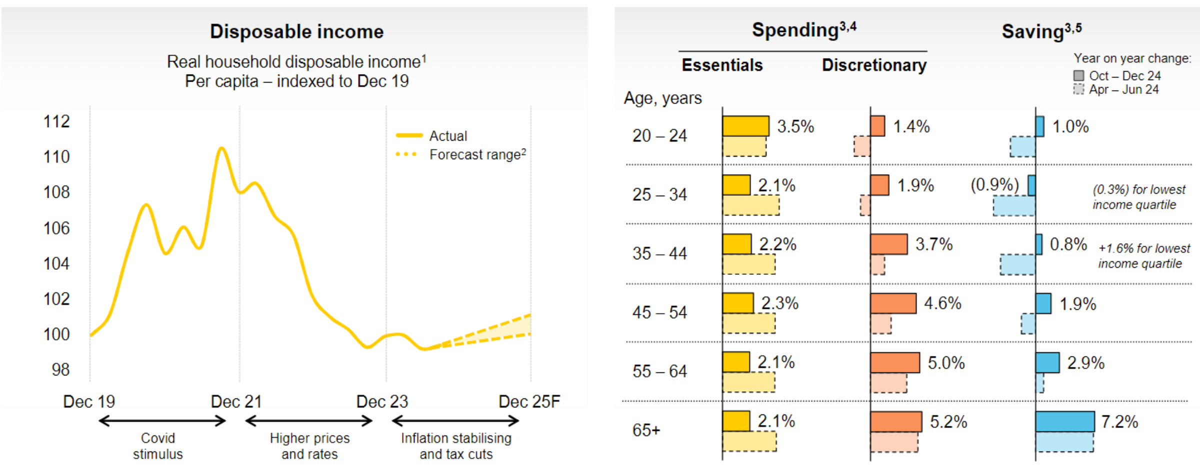
Source: MBA, FactSet, 31 March 2025.

Consumer relief for stretched households?

Throughout the quarter, trading updates from companies in the consumer discretionary sector have been disappointing, largely due to extensive promotional activities during critical sales periods. This trend has been fuelled by a more value-conscious consumer navigating a challenging cost-of-living environment, which has adversely affected gross margins for retailers such as Myer Holdings, Adairs, and Accent Group.

The pivotal question for investors is whether there is a more optimistic outlook for the domestic consumer. CBA believes there is, citing strong employment figures, wage increases, moderating inflation, and anticipated tax cuts. These factors are expected to enhance disposable income and boost discretionary spending across various age groups.

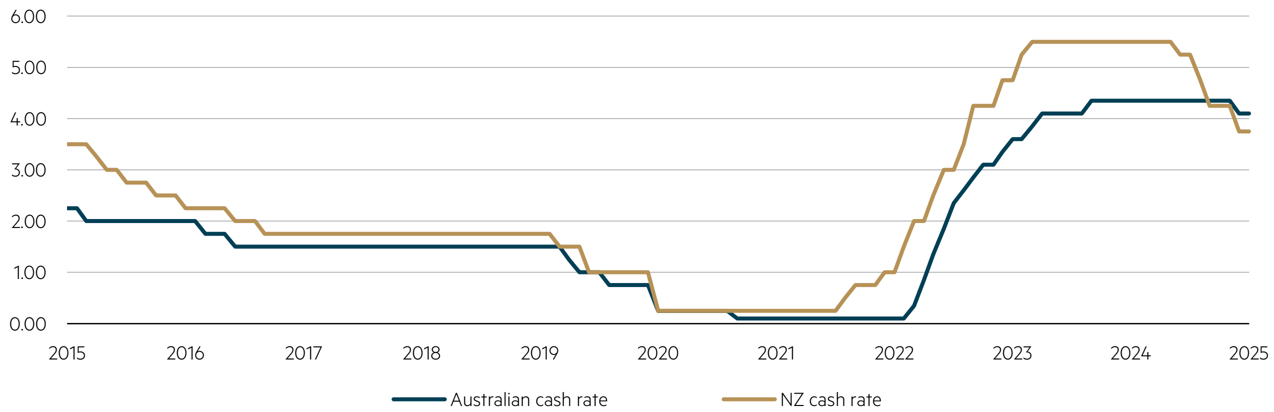
Disposable income, spending, and savings dynamics across age cohorts



Source: Commonwealth Bank (CBA) ASX presentation, Australian Bureau of Statistics (ABS), Reserve Bank of Australia (RBA), 12 February 2025.

A crucial question for investors is whether the commencement of the domestic interest rate cutting cycle by the RBA will benefit consumers. Analysing New Zealand's experience suggests otherwise. New Zealand has been approximately six months ahead of Australia in implementing interest rate cuts, reducing rates from a peak of 5.5% in mid-2024 to 3.75%. In contrast, Australia was its first cut in February 2025, decreasing from 4.35% to 4.10%. Initially, the New Zealand experience generated optimism with the first interest rate cut; however, this optimism has quickly diminished, as evidenced by the recent subdued trading updates from retailers such as Michael Hill International, KMD Brands, and Biscoe Group. We perceive a risk that the RBA's shallow interest rate cutting cycle may have minimal positive impact on the struggling retail sector, leading us to favour structural growth companies.

Australian and New Zealand` cash rates (%)



Source: Maple-Brown Abbott, FactSet, 31 March 2025.

Other key themes from the quarter include:

1 Banks: Share prices for major banks have begun to decline due to growing concerns about Net Interest Margin (NIM) compression.

2 Index changes: The rise of passive investing and index modifications is contributing to stock volatility.

3 Corporate activity: There has been a noticeable increase in activity, with private equity and offshore firms capitalising on opportunities in the 'value' segment of the market, such as Insignia Financial and Mayne Pharma Group.

4 Corporate governance: Ongoing concerns regarding founder-led businesses continue to draw investor attention, particularly towards Wistech Global and Mineral Resources.

5 Federal election: The uncertainty surrounding the upcoming May election, particularly the potential for a minority government, is a key point of concern for investors, despite minimal cost of living policy differences between the major parties (tax cuts vs. fuel excise tax cuts) aside from energy and climate change.

6 Reporting season volatility: Share price volatility during the February 2025 reporting season for the Australian small caps market reached unprecedented levels, with company performance showing significant disparities compared to consensus earnings revisions.

In summary, these thematic shifts and increased market volatility are creating valuable opportunities for active Australian small cap managers who possess a competitive information advantage.

We remain committed to our investment philosophy, focusing on the core pillars of our investment process: earnings delivery and sustainability. Looking ahead, we anticipate solid earnings potential, superior sustainability characteristics compared to benchmarks, and an enhanced risk profile for the stocks within the Fund.

Responsible investment

Stewardship is a key pillar of Maple-Brown Abbott's approach to environmental, social and governance (ESG) integration. We engage regularly with the companies we invest in, taking the view that there is greater benefit to influence change as a shareholder rather than simply divest and pass the challenge to a potentially less ESG-focused investor. Our long-term investment horizon facilitates this approach, as it enables us to take a longer view on ESG risks and engenders stable, influential relationships with the Board and management of our portfolio companies.

Over the course of the last year we met with a range of companies held in the Australian Small Companies Fund, with climate risk, emissions and remuneration policies the most discussed topics. Other engagement themes that were repeated regularly in our meetings included safety, board composition, human capital and incentives.

Our engagements are integrated with regularly occurring management meetings allowing for ongoing engagement with portfolio holdings.

Most of our direct engagement meetings cover multiple topics, and insights are fed back into our company research and evaluation. Our engagement priorities are identified through assessment of the most material ESG risks and opportunities at a company and portfolio level, analysis of macroeconomic trends and regulatory focus, real-world impacts, and the responsiveness of the target company.

For latest Fund factsheet click here.

Fund ratings

Highly Recommended Lonsec Research

Zenith RECOMMENDED

Morningstar Medalist Rating*
As of 08/01/2025
Analyst Driven %100
Data Coverage %100

Responsible Investment Leader 2024
A proud RIAA member

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