PENDAL

Pendal MidCap Fund

ARSN: 130 466 581

Factsheet

Equity Strategies

March 2019

About the Fund

The Pendal MidCap Fund (**Fund**) is an actively managed portfolio of Australian mid cap shares.

Investment Return Objective

The Fund aims to provide a return (before fees, costs and taxes) that exceeds the Pendal MidCap Custom Index over the medium to long term. The suggested investment timeframe is five years or more.

Description of Fund

This Fund is designed for investors who want the potential for long term capital growth and tax effective income from a portfolio of primarily 40-60 Australian mid cap shares and are prepared to accept higher variability of returns. Pendal defines the mid cap universe to include companies ranked between 51 and 150 of the S&P/ASX 200 Index. The Fund may also invest in equivalent companies listed on the New Zealand Stock Exchange, hold cash and may use derivatives.

Pendal's investment process for Australian shares is based on our core investment style and aims to add value through active stock selection and fundamental company research. Pendal's core investment style is to select stocks based on our assessment of their long term worth and ability to outperform the market, without being restricted by a growth or value bias. Our fundamental company research focuses on valuation, franchise, management quality and risk factors (both financial and non-financial risk).

The Fund may have assets denominated in foreign currencies. This means that changes in the value of the Australian dollar relative to foreign currencies may affect the value of the assets of the Fund. The Fund's foreign currency exposure may be hedged from time to time, in whole or part.

Derivatives may be used to reduce risk and can act as a hedge against adverse movements in a particular market and/or in the underlying assets. Derivatives can also be used to gain exposure to assets and markets.

Investment Team

Pendal's Equity team is headed up by Crispin Murray who has extensive experience and a strong record in equities research. Andrew Waddington is the portfolio manager for the Fund.

A combination of the Australian equities large cap and small cap teams' research is used to construct the Pendal MidCap Fund.

Investment Guidelines

Investable universe	ASX and NZX listed and soon to be listed companies, generally with a market capitalisation of A$0.5 billion to A$5 billion; derivatives; cash
Investment ranges	Australian shares 80 - 100% New Zealand shares 0 - 10% Cash 0 - 20%
Ex-ante tracking error	3 – 8%
Number of stocks	Typically 40 – 60
Absolute stock position	15%
Maximum active stock position	+/- 5%[1]
Maximum active sector position relative to index	+/- 10%[1]

[1] compared to benchmark.

Performance

(%)	Total Returns (post-fee)	Total Returns (pre-fee)	Benchmark Return
1 month	0.14	0.22	0.00
3 months	8.06	8.30	10.73
6 months	-7.19	-6.77	-4.01
1 year (pa)	-0.26	0.44	5.39
3 years (pa)	11.63	12.93	12.39
5 years (pa)	11.46	12.82	11.31
7 years (pa)	12.56	14.31	10.58
10 years (pa)	14.27	16.14	11.60
Since Inception (pa)	9.77	11.92	5.71

Sector Allocation (as at 31 March 2019)

Energy	6.3%
Materials	19.4%
Industrials	11.6%
Consumer Discretionary	12.7%
Consumer Staples	8.4%
Health Care	5.0%
Information Technology	7.8%
Telecommunication Services	8.9%
Financials ex Property Trusts	3.9%
Property Trusts	2.3%
Cash & other	13.7%

Top 10 Holdings (as at 31 March 2019)

Metcash Trading Limited	4.7%
Nine Entertainment Co Ltd	4.7%
Xero Limited	4.3%
JB Hi-Fi Limited	4.1%
Resmed Inc	3.9%
Flight Centre Limited	3.3%
Tabcorp Holdings Limited	3.0%
Seven Group Holdings Ltd	3.0%
Monadelphous Group Limited	3.0%
Regis Resources Limited	2.9%

Other Information

Fund size (as at 31 Mar 2019)	$498 million
Date of inception	June 2008
Minimum investment	$25,000
Buy-sell spread[2]	0.50% (0.25%/0.25%)
Distribution frequency	Quarterly
APIR code	BTA0313AU

[2] The buy-sell spread represents transaction costs incurred whenever you invest or withdraw funds, and may vary from time to time without notice.

Management Costs[3]

Issuer fee[4]	0.90% p.a.
Performance fee[5]	20% x the Fund's performance (before fees) in excess of the performance hurdle

[3] You should refer to the latest Product Disclosure Statement for full details of fees and other costs you may be charged.

[4] This is the fee we charge for overseeing the operations of the Fund and managing the assets of the Fund. The Issuer fee is paid from the assets of the Fund and is reflected in the unit price of your investment.

[5] The Fund's performance fee is 20% of the Fund's performance in excess of the performance hurdle. The performance hurdle is the performance of the benchmark (Pendal MidCap Custom Index) plus the issuer fee of 0.90% pa. If a performance fee is payable, it is charged in addition to the issuer fee. The fee is calculated each Business Day based on the investment performance and value of the Fund on that day. If we are entitled to a performance fee, it is paid to us as at 30 June each year.

Risks

An investment in the Fund involves risk, including:

- **Market risk**: The risk that factors affecting one or more countries that can influence the direction and volatility of an overall market, as opposed to security-specific risks.
- **Security specific risk**: The risks associated with an individual security.

Please read the Fund's Product Disclosure Statement (**PDS**) for a detailed explanation of each of these risks.

Market review

As investors took a breather from the strong rebound over the year's first two months, performance of the domestic equity market was muted in March. The S&P/ASX 51-150 Accumulation Index finished the month flat, with Resources down 2.0% whereas Industrials (+0.5%) eking out marginal gains. At the macro level, US yield curve inversion has some calling for an American recession, while the Brexit saga provided a new twist each day as the British parliament neared – and then passed - the deadline by which its divorce from the EU was supposed to have happened.

Sector performance in March was mixed. Whilst Real Estate (+7.5%) and Information Technology (+4.1%) were strong, their gains were more than offset by losses from Energy (-5.6%), and heavyweight Materials (-2.1%). Returns from other key sectors, including Financials (+0.2%), Consumer Discretionary (+0.2%) and Industrials (-0.7%) were somewhat lacklustre.

Within Real Estate, the decline in long-term bond yields – the Australia 10-Year bond ended the month at 1.77%, a level that was last seen in mid-2016 – helped to propel the rotation towards the traditional bond-sensitives. Amongst all, Charter Hall (CHC, +16.7%) outperformed the most, despite the lack of new company specific news. The Street upgraded their numbers on the property manager, following its results release in late February when Net earnings for 1H19 came in at 108m, or ~10% above consensus. Management also upgraded FY19 guidance consequently.

Within IT, Wisetech Global (WTC, +20.1%) and Afterpay Touch (APT, +13.6%) continued to lift the sector higher. For the former, in order to continue supporting its strategic inorganic growth, the international logistics service provider announced a ~$280m capital raising, which was largely done in the form of institutional placement ($250m). As previously communicated by management, WTC has been expanding its geographic presence through mergers and acquisitions. The strategy has proven successful to date and as such, the capital raising was well received by the market. Offsetting some of these gains, Appen (APX, -3.8%) and Altium (ALU, -1.6%) were the largest performance detractors of the sector. Appen announced its acquisition of US-based Figure Eight Technologies for US$175m, with a maximum contingent payout of US$125m based on incremental FY19 subscription revenue targets. Management expects the acquisition to increase the quality of the company's revenues and enable greater participation in the AI market. In order to fund the upfront payment, Appen also arranged a placement deal for A$285m, which potentially weighed on its stock performance over the month.

On the other end of the spectrum, mid-tier gold miner St. Barbara (SBM, -23.9%) was the largest performance detractor within Materials. SBM released its findings from the Gwalia Mass Extraction study, an expansion project at its Gwalia asset. The study shows that continued trucking would present the highest net present value of the alternatives considered, including the development of an underground process facility. As such, Management downgraded production guidance for both FY19 and FY20. Elsewhere, Alumina (AWC, -5.1%) pulled back, as Norsk Hydro and Brazilian prosecutors agreed to the steps by which the Alunorte aluminium refinery – the world's largest – could return to full production. Alunorte has been running at 50% production since breaching pollution regulations in early 2018, which has seen tighter aluminium markets. Signs of agreement in Brazil potentially signal the end of this sweet spot for the Australian-listed producers.

Fund performance

The Fund marginally outperformed the benchmark over the month of March.

Contributors

Overweight JB Hi-Fi

Electronic retailer JB Hi-Fi (JBH, +15.0%) outperformed the market by a double-digit return in March, despite the lack of new company specific news. With the Federal government lined up to deliver the latest Budget in early April, the market expected some generous spending that will help stimulate the domestic retail market.

Does not hold St Barbara

Gold miner SBM fell -23.9% as management announced material changes in the feasibility of the Gwalia Mass Extraction project in Western Australia. The outcome is significant capex and higher operational risk than first thought as well as a delay in commissioning. This disappointed the market, despite upgraded production guidance for the company's Simberi mine in PNG. We do not hold SBM, instead gaining gold exposure via Independence Group (IGO) and Regis Resources (RRL).

Detractors

Overweight Seven Group

SVN consolidated in March, giving back some of its recent strong gains (but remains a material outperformer over the year to date). We continue to see SVW's growth underpinned on a multi-year basis by the pipeline of transport infrastructure projects on the east coast. At the same time, mining services is showing signs of life as companies begin to commission new mines – and embark on fleet maintenance – following several years of tight purse strings.

Does not hold Wisetech Global

In order to continue supporting its strategic inorganic growth, Wisetech (WTC, +20.1%) announced a ~$280m capital raising, which was largely done in the form of institutional placement ($250m). As previously communicated by management, WTC has been expanding its geographic presence through mergers and acquisitions. The strategy has proven successful to date and as such, the capital raising was well received by the market. We do not own WTC as we continue to find stock valuations challenging, which weighed on portfolio performance in March

Strategy and Outlook

The portfolio's return was slightly ahead of the benchmark index in March as the midcap sector trod water and remained flat for the month.

The portfolio's coal exposure dragged in March. Whitehaven Coal (WHC) was one of the largest detractors, down -8.0% on concerns over the embargo on Australian thermal coal at Dalian port in China's north. Although the unofficial ban does not directly affect WHC – which ships primarily to India, Korea, Japan and Taiwan – there are concerns that it might put extended pressure on the price of Newcastle coal.

At this point we remain reasonably sanguine about the medium term outlook for coal, while mindful that this issue could continue to drag in the short term. Ultimately, we believe the Chinese authorities will be reluctant to pursue a policy which drives the price of its domestically-produced coal up too far, given the knock-on effects for power generation and pricing.

The holding in Seven Group (SVW) also detracted as it gave back some of its strong gains of the last few months. Our conviction remains undiminished, based on a strong pipeline of contract work stemming from the pick up in mining capex and infrastructure projects.

The higher-growth tech stocks resumed their surge and our underweight in Wisetech Global (WTC) and Afterpay Touch (APT) dragged. This highlights one of the key challenges in the midcap sector; it is home to some of the higher growth companies in the market, however they currently trade at heady valuations, leaving them vulnerable to swift reversals is the market's high expectations are disappointed. Our preference remains for Xero (XRO), which we believe offers a strong growth outlook, but with better valuation support.

Ultimately these factors were all offset by a positive contribution from several of the portfolio's more non-consensus positions, such as JB Hi-Fi (JBH, +15.0%) and Nine Entertainment (NEC, +3.2).

March capped a remarkable quarter in which the market rebounded from its slump in Q4 2018. February's reporting season confirmed that large parts of the Australian market face the twin challenges of low revenue growth and higher cost pressures. However the earnings results and outlooks were really no worse than the market expected – and in some cases weren't as bad as some feared. As a result it presented no impediment to the improvement in sentiment on several key macro issues, including the pace of Fed tightening and outlook for Chinese growth.

We continue to see attractive opportunities in the mid cap market, with the caveat that we are very selective in the valuations that we are prepared to pay. We have exposure to growth opportunities in areas such as technology (Xero) and health care (ResMed). We also like mining and infrastructure services, which are enjoying the cyclical tailwinds of increased capex spending and transport infrastructure investment. Several of our highest conviction stocks are among the more cyclical parts of the economy, including JB Hi-Fi and Nine Entertainment, where we see compelling valuation coupled with company-specific opportunities to deliver attractive shareholder return.

For more information please call **1800 813 886**,
contact your key account manager or visit **pendalgroup.com**

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