PENDAL

Factsheet

Pendal MidCap Fund

Equity Strategies

ARSN: 130 466 581

April 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	2.11	2.18	3.19
3 months	7.60	7.83	8.84
6 months	4.03	4.49	7.61
1 year (pa)	-2.08	-1.58	5.20
3 years (pa)	12.52	13.82	12.66
5 years (pa)	11.66	13.02	11.77
7 years (pa)	12.88	14.64	10.99
10 years (pa)	13.53	15.38	10.98
Since Inception (pa)	9.90	12.04	5.97

Sector Allocation (as at 30 April 2019)

Energy	6.2%
Materials	17.7%
Industrials	12.3%
Consumer Discretionary	12.6%
Consumer Staples	8.6%
Health Care	5.3%
Information Technology	8.4%
Telecommunication Services	9.1%
Financials ex Property Trusts	4.1%
Property Trusts	2.2%
Cash & other	13.5%

Top 10 Holdings (as at 30 April 2019)

Metcash Trading Limited	5.1%
Nine Entertainment Co Ltd	4.8%
Xero Limited	4.7%
JB Hi-Fi Limited	4.1%
Resmed Inc	3.9%
Seven Group Holdings Ltd	3.3%
Monadelphous Group Limited	3.2%
Tabcorp Holdings Limited	3.1%
Flight Centre Limited	2.9%
Bendigo & Adelaide Bank Limited	2.8%

Other Information

Fund size (as at 30 Apr 2019)	$506 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

The strong performance of the Australian market extended in April, with the S&P/ASX 51-150 Accumulation index advancing by 3.2% over the month. Industrials (+5.4%) led the gains; whereas Resources (-5.7%) were the laggard.

Materials (-1.9%) was the largest performance detracting sector over the month. As gold retraced during the month amid buoyant investor sentiment, most gold miners pulled back accordingly. Amongst all, Evolution Mining (EVN, -12.8%) released its quarterly production report. Due to weather impacts at Ernest Henry and Mt. Calton, production came in lower as expected; whereas Mungari and Cracow were also soft. All-in sustaining costs (AISC) of A$925/oz were 5% lower than the previous quarter, but exceeded the FY19 guidance at the current run-rate. Management maintained cost guidance for the full year nevertheless. Similarly, Northern Star Resources (NST, -8.5%) reported its quarterly production for March. Gold volume came in at 186koz whereas the AISC of A$1,369/oz was flat compared to the previous quarter. Management however lifted the cost guidance again for FY19, despite that production guidance was retained. Offsetting some of these losses, the share price of Duluxgroup (DLX, +31.8%) soared after the paint manufacturer received an attractive takeover off from Nippon Paint, valuating the business at $9.8/share. The offer represented a 27.8% premium to DLX's then closing price, and has been unanimously recommended by the board. It serves as a reminder that, with the yield trade seemingly back on, there are global companies with very low cost of capital – particularly in Europe and Japan – which do step in selectively to our market.

Outside Materials, Energy (-2.1%) also finished the month in the red, with Washington H. Soul Pattinson (SOL, -11.7%) and Viva Energy (VEA, -9.8%) being the largest drags; more than offsetting the gains from Beach Energy (BPT, +3.4%) and Whitehaven Coal (WHC, +3.7%). VEA released its March Geelong Refining Margin (GRM), which improved from January (US$3.9/bbl) and February (US$4.0/bbl) to US$6.5/bbl. Whilst this is somewhat pleasing, what caught the market off guard was VEA's Retail business update. For the four months of 2019, Management now expects a A$30-35m hit to the division's pre-tax earnings, due to lower retail fuel margins on the back of the rising oil prices, and the lag in passing them on to the end pump. Although the update was disappointing, it was in line with the recent update from Caltex (CTX, +3.8%) at March end.

On the other side of the spectrum, Information Technology (+8.2%) led the sector gains with Afterpay Touch (APT, +22.1%) and Xero (XRO, +11.9%) contributing the most. The buy-now-pay-later service provider continues to deliver solid growth in transaction volumes as more retailers adopt its system, and the market is giving Management the benefit of doubt for them to retain sustainable margin, despite the likelihood of increased competition. XRO on the other hand took a leg higher in April as sentiment shifted towards an expectation of lower interest rates, which benefited growth stocks in general.

Lastly, Financials (+6.6%) also fared better over the month, where fund manager Magellan (MFG, +22.5%) was the standout. Reported net flows for March were +1.2bn, consisting of ~$0.4bn in retail and $0.8bn institutional money. It is well above average when compared to peers, which propelled investor sentiment. That said, due to the recent strong performance of the stock, some investors have become somewhat wary with the valuations MFG now trades at.

Fund performance

The midcap sector made good gains in April. The Fund's holdings in accounting software company Xero (XRO), retail wholesaler Metcash (MTS) and mining services company Seven Group (SVW) all made good gains.

The Fund underperformed the index, in part from the underweight in some of the high growth stocks that have continued their recent surge. There is some exposure to this cohort within the portfolio, through the position in Xero, for instance. However underweights in companies such as A2 Milk (A2M), Afterpay Touch (APT) and Appen (APX) dragged on relative performance.

Contributors

Overweight Xero

Growth stocks, such as Xero, took a leg higher in April as sentiment shifted towards an expectation of lower interest rates. We struggle to justify the valuations paid for many of these stocks, however we have conviction in Xero's ability to establish market share in overseas markets such as the UK, which can underpin its valuation multiple.

Underweight Evolution Mining

Gold stocks got hit in April as investor sentiment remained buoyant. Evolution Mining retraced amongst its peers after releasing a somewhat downbeat quarterly production report. Due to weather impacts at Ernest Henry and Mt. Calton, production came in lower as expected; whereas Mungari and Cracow were also softer. All-in sustaining costs of A$925/oz were 5% lower than the previous quarter, but exceeded the FY19 guidance at current run-rate. Management maintained cost guidance for the full year nevertheless.

Detractors

Underweight A2 Milk

Growth stocks, such as A2 milk, took a leg higher in April as sentiment shifted towards an expectation of lower interest rates. Whilst we like the quality of A2M's business, we continue to find it hard to justify the valuation multiples for it, which remains predicated on double-digit sales growth for years to come.

Does not hold Magellan

Fund manager Magellan (MFG, +22.5%) was the standout within the Financials sector in April. Reported net flows for March were +1.2bn, consisting of ~$0.4bn in retail and $0.8bn institutional money. It is well above average when compared to peers, which propelled investor sentiment. That said, due to the recent strong performance of the stock, some investors have become somewhat wary with the valuations MFG now trades at.

Strategy and outlook

We continue to find it hard to justify the valuation multiples for many of these growth stocks. Australian high growth stocks (classed as stocks with expected earnings-per-share growth greater than 20% pa over the next three years) are now the most expensive in the world following the strong run in recent months. They also trade at the largest premium to the local index. We continue to look for ways to gain exposure to this theme while retaining our valuation discipline, however this is a key challenge of investing in the current market.

Elsewhere our position in Flight Centre and lack of a stake in DuluxGroup – which came under takeover offer – also dragged.

We are seeing clear signs of an economic deceleration in recent weeks and evidence that companies are holding back on spending. The question is how much of this is due to the usual effect of a federal election and how much it is a function of a more subdued backdrop. Trends post-election will be important in this regard, as will any inclination towards stimulus form the incoming government.

In the meantime it has been a tough environment for large parts of the mid cap market. There has been a clear divergence between the performance of the high growth stocks and a more muted return from other parts of the market. We continue to focus on those parts of the market which enjoy a degree of resilience in a tougher environment or those pockets of growth where valuation remains reasonable.

In recent months we have been adding to online property group REA (REA) as well as to financial technology company IRESS (IRE).

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

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