PENDAL

Factsheet

Equity Strategies

July 2019

Pendal Sustainable Australian Share Fund

ARSN: 097 661 857

About the Fund

The Pendal Sustainable Australian Share Fund (**Fund**) is an actively managed portfolio of Australian shares. Investments are selected based on a range of sustainable, ethical and financial criteria.

Investment Return Objective

The Fund aims to provide a return (before fees, costs and taxes) that exceeds the S&P/ASX 200 (TR) Index over the medium to long term, whilst maximising the portfolio's focus on sustainability. The recommended 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, diversification across a broad range of Australian companies and industries.

The Fund uses an active stock selection process that combines sustainable and ethical criteria with Pendal's financial analysis. The Fund actively seeks exposure to companies that demonstrate leading environmental, social and corporate governance (ESG) and ethical practices and avoiding exposure to companies with activities we consider to negatively impact the environment or society.

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, risk factors (financial and non-financial), franchise and management quality.

The Fund will not invest in companies with material business involvement in the following activities:

- the production of tobacco or alcohol,
- manufacture or provision of gaming facilities,
- manufacture of weapons or armaments,
- manufacture or distribution of pornography,
- directly mine uranium for the purpose of weapons manufacturing,
- extraction of thermal coal and oil sands production.

We consider that a company has a material business involvement in an activity if 10% or more of its total revenue is derived from that activity.
Pendal actively engages with the management of the companies we invest in to manage risk, effect change and realise potential value over the long term.

Investment Team

The Fund is managed by Rajinder Singh in Pendal's Australian Equity team who has more than 18 years' industry experience.

Management Costs[1]

Issuer fee[2]	0.85% pa

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

[2] 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.

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.

Performance

(%)	Total Returns (post-fee)	Total Returns (pre-fee)	Benchmark Return
1 month	2.40	2.48	2.94
3 months	8.80	9.04	8.58
6 months	18.99	19.50	18.66
1 year (pa)	10.47	11.41	13.26
2 years (pa)	11.63	12.58	13.92
3 years (pa)	10.16	11.10	11.68
5 years (pa)	7.59	8.52	8.55

Sector Allocation (as at 31 July 2019)

Energy	5.6%
Materials	22.8%
Industrials	11.3%
Consumer Discretionary	2.1%
Consumer Staples	0.4%
Health Care	12.3%
Information Technology	2.0%
Telecommunication Services	6.9%
Financials ex Property Trusts	29.0%
Property Trusts	6.3%
Cash & other	1.3%

Top 10 Holdings (as at 31 July 2019)

CSL Limited	8.8%
BHP Billiton Limited	8.4%
ANZ Banking Group Limited	7.7%
Westpac Banking Corporation	7.0%
Telstra Corporation Limited	5.5%
National Australia Bank Limited	4.7%
Insurance Group Australia	4.0%
Qantas Airways Limited	3.8%
Transurban Group	3.6%
Amcor Limited	3.2%

Other Information

Fund size (as at 31 Jul 2019)	$366 million
Date of inception	October 2001
Minimum investment	$25,000
Buy-sell spread[3]	0.50% (0.25%/0.25%)
Distribution frequency	Half-yearly
APIR code	WFS0285AU

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

The Pendal Sustainable Australian Share Fund has been certified by RIAA according to the strict operational and disclosure practices required under the Responsible Investment Certification Program. See www.responsibleinvestment.org for details.

The Responsible Investment Certification Program does not constitute financial product advice. Neither the Certification Symbol nor RIAA recommends to any person that any financial product is a suitable investment or that returns are guaranteed. Appropriate professional advice should be sought prior to making an investment decision. RIAA does not hold an Australian Financial Services Licence.

Market review

Performance was strong for the Australian market in July, with the S&P/ASX 300 Accumulation index recording another 3%. While all sectors finished the month in the black, both index heavyweights Financials (-1.8%) and Materials (+1.2%) were laggards. The latter's muted performance was also in a stark contrast to the stronger iron ore price over the period (+10%).

Brazil's Vale has been successful in bringing around one-third of its shuttered production back on line, following the shut-downs that occurred after the tragic tailings dam disaster earlier in the year. It will take Vale's production between 60 and 90 days to find its way back into the market – and it is still a long way short of previous production. The iron ore price has subsided from its highs and an increase in trade friction may prompt further volatility. As such, the iron ore trio, BHP (-1.0%), Fortescue Metals (FMG, -7.6%) and Rio Tinto (RIO, -4.7%) all pulled back over the month.

Within Financials, bank performance remained muted: CBA (-0.6%) received several downgrades from brokers ahead of August reporting season, as it was trading at a valuation premium to its Big Four peers, which is getting harder to justify given the subdued operating environment domestically. CYB Group (CYB) also fell -9.4% for the month following its quarterly update, which disappointed on margins as competitive pressure remains strong. Management have pointed to the fact that front book pricing has started to improve (i.e. their most recent loans). That said, the back book remains a headwind for margins. NAB (+6.7%) was the standout from the cohort, as its appointment of the new CEO was well received by the market. Ross McEwan, who is currently the outgoing CEO of RBS in the UK and previously the head of CBA's Retail Banking Services division, has committed himself to protecting and accelerating NAB's transformation program. Outside the banks, AMP (AMP, -15.6%) came under pressure as management announced that the sale of its life insurance and mature business to Resolution Life is unlikely to proceed following intervention by the Reserve Bank of New Zealand (RBNZ). The RBNZ requires New Zealand-related assets to be ring-fenced, which would require a renegotiation of terms with Resolution Life. Management cancelled its interim dividend as a result.

Turning to the other side of the tally board, Consumer Staples (+9.6%) led the gainers, with Woolworths (WOW, +7.2%) being the largest contributor. The supermarket giant is combining its liquor business, Endeavour Drinks – the owner of Dan Murphy's and BWS – with its ALH Group, which is Australia's largest poker machine operator to create Endeavour Group. WOW is also planning to spin off this newly created entity in 2020, which will be a $7-8bn standalone business, with an implied EV/EBITDA multiple of 12x based on the market's current pricing. Also within the sector, China growth related market darlings, a2 Milk (A2M, +23.6%) and Treasury Wine (TWE, +18.6%) both rallied. The recent retail price increase for A2M's infant formula has given some investors more confidence that the company is likely to beat earnings expectation in August. TWE also rose in anticipation of a decent FY19 result, although there is a sense that they may be pulling forward some Chinese demand.

Lastly, CIMIC (CIM, -18.0%) saw a backlash to its quarterly update, with the market concerned over weaker cash flows. CIM has been under some pressure from an institutional short-seller, who noted the use of "reverse-factoring" arrangements as an accounting tool which can potentially help improve the optics on working capital. The practice, which involves using third-party institutions to honour accounts payable, then repaying the institution, may prove to be a niche issue in the upcoming reporting season if its use is wider spread.

Fund performance

The Fund underperformed its benchmark over the month of July.

Contributors

Commonwealth Bank – no holding

Bank's performance remained muted in July, as regulatory headwinds continue to blow. APRA announced that ANZ, Westpac and National Australia Bank would each have to hold an additional $500m in operational risk capital following their self-assessment reports to the regulator. CBA had already been ordered to hold an additional $1b in May last year. In addition, CBA received several downgrades from brokers ahead of August reporting season, as it was trading at a valuation premium to its Big Four peers, which is getting harder to justify given the subdued operating environment domestically.

Overweight Evolution Mining

The ongoing decline in long-term bond yields, coupled with elevated geopolitical uncertainties has seen the gold price continue its recent strong run. As such, gold miners including Evolution Mining saw their share price rise in July. In addition, EVN provided its 4QFY19 production report, where volume came in at 194.9koz with an All-in sustaining costs (AISC) of A$915/oz. Management also updated the market with FY20 guidance, with production volume at 725-775koz at an AISC of A$890-940/oz.

Overweight JB Hi-Fi

Domestic cyclicals enjoyed a rally throughout July, including our long-term holding JB Hi-Fi. We continue to like the company on a medium term view. It is one of the best-managed franchises in Australia – and one which is doing a good job of navigating the changes in industry structure brought about by online retail. It is also well placed to benefit from pressure on smaller competitors and has the ability to drive better returns via an improvement in the operational performance of its Good Guys business. That said, we are mindful that there are signs that broad domestic demand has remained subdued post-election. The combination of recent rate cuts, tax cuts and the potential for further fiscal stimulus could help revive a soft environment, however the risk is that near-term softness leads to disappointing outlooks for the domestic consumer over the near term.

Detractors

Overweight Fortescue Metals

Fortescue Metals (FMG, -7.6%) pulled back in July alongside its iron ore miner peers. The company's most recent quarterly update was reasonably constructive. The discount for its lower-grade ore – which had blown out at points in the last couple of years – was slimmer than most had expected. The miners remain hugely cash generative and recent dividends and buybacks can be sustained in the near term. We have been reducing our overweight in iron ore in recent weeks, mainly via a reduction in Rio Tinto, but retain our exposure in FMG.

Overweight Amcor

Packaging company Amcor (AMC, -4.1%) sold off over July, despite the lack of any company specific news. Pepsi did report the 2Q19 results where its North America volume was down 2% over the reported periods. Some investors might take the weak trend as a negative read through for Amcor, as its North American rigid plastics accounts for ~20% of the company's revenues.

Overweight ANZ

Measures to stabilise housing prices have provided some recent respite for bank shares, however July served as a reminder that regulatory headwinds continue to blow. APRA announced that ANZ, Westpac and National Australia Bank would each have to hold an additional $500m in operational risk capital following their self-assessment reports to the regulator. The Commonwealth Bank (CBA, -0.9%) had already been ordered to hold an additional $1b in May last year. APRA also finalised its proposal for total loss absorbing capital (TLAC). Its original discussion paper in November 2018 called for an additional 4-5% of Tier 2 capital, which has been revised down to 3%. This will lead to a substantial increase is the amount of bonds that Australian banks will have to issue, in addition to their ongoing wholesale funding requirements, which will see bank funding costs go higher. The net effect will be to shave ~3bps off already thin margins. It would also require mortgage rates to be increased ~7bps if it is to be funded by repricing. This is better than the 10bp increase that APRA's initial proposal would have required and the regulator's model was not as penal as many feared it could have been. However, taken together with the capital charges announced, it is a reminder that banks remain in a very challenged environment despite an improvement in sentiment on housing.

Strategy and outlook

The market is entering the FY19 reporting season at an interesting juncture, having enjoyed a very strong surge over the previous six months but with macro uncertainty (trade wars, Brexit) driving bouts of volatility. At the same time, there are clear signals that domestic demand has not recovered post-election.

We are taking a cautious approach to consumer cyclicals as a result - reducing those which have done well in recent months - or where we see risk of near term disappointment. We retain exposure, but only in those where we see an overly negative outlook already factored into valuations.

There are two broad views of the current environment. One states that data signals a continuing slowdown in the global economy, which will lead to recession. The other is that we are likely to see a policy response, which will help support both the economy and also the equity market. We subscribe to the latter.

Domestically we are seeing a version of this debate play out. The Coalition Federal government has set its stall out on maintaining a fiscal surplus - whereas arguably this is the one year where we need fiscal stimulus, given moribund growth and diminishing utility of monetary policy. The means are there, in the form of the windfall of iron ore royalties, as well as government borrowing costs at less than 1%. What's more, any more pressure on depositors – seeing term deposit rates likely going to 1.3% - is likely to prompt a political backlash. So the debate will be whether logic prevails over political heel-digging.

The outlook for the banking sector remains muted. Lower rates are good for sentiment and will help keep bad debts at low levels, but they will also ultimately crimp margins. Hedging programmes mean this effect will be delayed, but any further cuts are likely to mean further pressure on margins over the next three years. That said, dividends remain reasonable and supported for the time being - which should help support bank stocks in the current low yield environment.

The resource sector has seen a sudden drop in iron ore prices - although they remain above consensus expectations and the sector remains enormously cash generative. The iron ore miners have done well and we have been scaling back our position in recent months. Iron ore prices are retreating from their highs due to two reasons. First, Brazil's Vale is restarting some shuttered production. Second, there are increased concerns over global growth and Chinese demand. On the first issue, Vale has only managed to restart around one third of the production it took off line - and this will take between six and nine months to feed through to the system. On the second, we remain mindful that China can quickly pull the stimulus lever in response to subdued demand - as we saw in 2016. As a result, we do not believe it is time yet to go aggressively underweight the resource sector.

The overall market's valuation looks reasonable, at just under 16x next-12-month earnings, and should retain a degree of support from low yields in alternative asset classes.

Regnan Sustainability Snapshots#

Telstra Ltd (TLS)

As Australia's largest telecommunications company, Telstra is exposed to a range of ethical and stakeholder related issues given its diversity of operations. These issues include responsible marketing, privacy, cyber security and online safety. The company recognises that long term success, via delivery of strategy, depends on how it 'does business'. These commitments are enshrined in the code of conduct, which is supported by mandatory ethics and compliance training. Board oversight is provided by the Ethics Committee, and the Audit and Risk Committee, and TLS publicly discloses the number of whistleblowing alerts raised, resolved and in progress. Recent security breaches demonstrate the nature of cyber security risks for TLS. The company exhibits high level acknowledgement of the importance of protecting the privacy and security of customers' data, which is managed via codes of practice, policies and security controls, and by 500 professionals globally, building technical and organisational capacity to prepare and deal with threats.

Effective management of human capital is key to fulfilling the Telstra 22 strategy. Regnan notes that the company is confident that initiatives, culture and capability building will be successful and that Telstra is making a concerted effort to build digital skills, for example. The 'MyCareer' portal tracks individual abilities and knowledge, and maps these against skills that will be needed, for example, as automation and artificial intelligence change many occupations, and provides a tailored training program to each individual.

TLS is exposed to the effects of extreme weather (prolonged hot periods, bushfires, floods, cyclones) on its network infrastructure, with impacts on service obligation, disaster management, network repair and customer perception. The company acknowledges that the severity and frequency of extreme weather events will likely increase as the climate changes. TLS has implemented a robust climate change management plan and its environment strategy includes a focus on minimising carbon emissions, building resilience (the Climate Resilience Plan was introduced in 2018), and enabling low carbon growth via technological innovation. Regnan sees the focus on cloud computing, video conferencing and programs to assist corporate and government clients monitor and reduce their own energy use and emissions, contributing to a medium-long term strategic advantage relative to peers. TLS has also demonstrated strong performance in reducing its own energy consumption and emissions and has made investments in sustainable energy developments (TLS entered a power purchasing agreement with ANZ and Coca-Cola Amatil in 2018 to have a wind farm in Victoria provide long term energy at lower prices).

Carsales.com Ltd (CAR)

Carsales.com is an online automotive, motorcycle and marine classifieds business. The company continues to expand its operations into Latin America and Asia, which now make up 20% of revenue.

CAR's ongoing investments into research and development, and innovation-focused approaches to human capital management, are supportive of medium term strategies. These efforts contribute to the development of new capabilities including artificial intelligence and machine learning. We also note the deployment of two executives to Latin America (Guadalajara, Mexico and Santiago, Chile) which should aid in the integration of businesses acquired in the region, which is of growing importance given the softer consumer market in Australia. CAR reports an 85% employee retention rate in its Australian business and the company also discloses that 25% of its recruits are internally recommended. We view these metrics as potential signals of a healthy workforce and positive reflection of company culture. Attraction of graduates also appears strong, with 700 applicants for six vacancies in FY18. Retention efforts are supported by reportedly improved employee engagement scores. However, given elevated risks to business model disruption from 'Transport as a Service' and autonomous vehicles, Regnan sees an escalating requirement to formalise talent strategies in the longer term.

The company has undertaken initiatives to increase energy efficiency including installing low power solid state discs and printers. CAR has moved its systems to the 'cloud', partnering with Amazon Web Services, which has set a long term goal to power its infrastructure with 100% renewable energy. CAR's head office is certified as a 4.5 star NABERS-rated building.

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

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i. any other aspect of the company's performance;
ii. the prospects of the company; or
iii. the company's suitability or attractiveness from an investment perspective.