PENDAL

Pendal Sustainable Australian Share Fund

ARSN: 097 661 857

Factsheet

Equity Strategies

February 2020

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	-7.50	-7.44	-7.69
3 months	-4.39	-4.18	-5.18
6 months	0.77	1.20	-0.63
1 year (pa)	10.05	10.99	8.64
2 years (pa)	6.86	7.77	7.84
3 years (pa)	7.30	8.22	8.59
5 years (pa)	5.23	6.13	6.17

Sector Allocation (as at 29 February 2020)

Sector	%
Energy	5.2%
Materials	18.2%
Industrials	12.3%
Consumer Discretionary	2.4%
Consumer Staples	1.4%
Health Care	13.2%
Information Technology	2.1%
Telecommunication Services	8.2%
Financials ex Property Trusts	26.1%
Property Trusts	8.5%
Cash & other	2.4%

Top 10 Holdings (as at 29 February 2020)

Holding	%
CSL Limited	11.4%
Commonwealth Bank of Australia Ltd	8.7%
BHP Billiton Limited	6.4%
Telstra Corporation Limited	5.4%
ANZ Banking Group Limited	4.7%
Macquarie Group Limited	4.3%
National Australia Bank Limited	4.2%
Qantas Airways Limited	3.5%
Amcor Limited	3.4%
Atlas Arteria	3.1%

Other Information

Item	Detail
Fund size (as at 29 Feb 2020)	$347 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

Australian equities, as measured by the S&P/ASX 300 Accumulation index fell by -7.8% over February, amid growing concerns of Covid-19 becoming a pandemic. US 10 year bond yields dropped from 1.52% to 1.14% while Australian 10 year government bonds fell from 0.95% to 0.82% as investors turned risk-averse. Resources (-13.2%) were hit the hardest, whilst Industrials (-6.4%) held up relatively better.

In terms of sector performance, a broad market de-rating weighed across the board and Information Technology (-16.2%) retreated the most on that basis. Link (LNK, -31.0%) played a role in this, however the WAAAX stocks also underperformed. Afterpay (APT) gave up -14.0%, Xero (XRO) -13.9% and Wisetech (WTC) -39.7%. WTC delivered another half of profit growth, but slashed its full year earnings guidance as the effect of Chinese production closures feeds through into global supply chains and logistics. WTC is now down -55.9% from its high point in September 2019.

Elsewhere, cyclical sectors such as Energy (-17.4%), Consumer Discretionary (-8.7%) and Materials (-11.7%) underperformed; and the traditional defensives of Utilities (-4.0%) and Real Estate (-4.5%) held up best, while still losing ground.

There were only 8 stocks in the ASX 100 that held their ground and recorded a gain over the month, including Cleanaway Waste Management (CWY, +11.3%), Evolution Mining (EVN, +10.6%), Northern Star Resources (NST, +6.8%) and a2 Milk (A2M, +6.3%). CWY defied market concerns to post a 6.8% increase in underlying EBIT and 15.2% gain in underlying NPAT. It has been an eventful year for CWY as it digests several recent acquisitions and flagged further capex, however it delivered an increased dividend and increased its guidance for the second half of FY20; and was well received by the market. Similarly, A2M reported a great set of results, with EPS growing by +22% to 25.3c, beating market consensus.

Turning to the other side of the spectrum, Rio Tinto (RIO, -11.6%) delivered in-line with the market's expectation in terms of earnings. Management maintained the recently lowered guidance on production, which reflects weather-related outages in the Pilbarra. Costs were also up in both the copper and iron ore portfolios. However the key facet was that its dividend was lower than expected – it also disappointed some segments of the market who were looking for another special dividend. The miners have increasingly become a major source of dividend income in the past few years. While this does help provide a degree of stock support, it also raises the risk of disappointment when the market is uncertain over the outlook for the dividend.

Bluescope Steel (BSL, -16.6%) delivered a good half but, like so many other companies, now faces an increasingly uncertain outlook for the next half given the effect of Covid-19. BSL faces headwinds in terms of volumes - given a reduction in production activity in China – but also on steel spreads as the price of coal and iron ore has held up relatively well in relation to the steel price.

Flight Centre (FLT, -17.0%) was another which delivered a reasonable half given a soft domestic environment, with revenue growth of 11%. However this was swamped by the cautious outlook, with management indicating that the full year effect from Covid-19 could be up to $200m.

Plumbing supplies manufacturer Reliance Worldwide (RWC, -24.9%) came under pressure as profits fell 20% for the half, even as revenue remains flat. It is facing stiff competition in the US as retailers have begun to offer their own private label versions of RWC products, putting pressure on pricing and margins.

Lastly, Ramsay Health Care (RHC, -14.1%) is at an interesting juncture. The result demonstrated that trends are improving in its key overseas markets. Tariff trends are now positive in France, while it is starting to see an increase in volumes in the UK – following a tough period – which may now provide scope to improve on price. While the result may have put these issues to bed, the focus is now on Australia. Group revenue ex-Europe grew at 4.8%, and there are signs that it has gone through the worst in terms of declining volumes. It has also recontracted with Bupa, removing some uncertainty over pricing. However it does remain locked in negotiation with Medibank, having come off contract in 1HFY20. This will be a key area to watch in coming months, although RHC is well positioned in these negotiations given its strong market position.

Fund performance

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

Contributors

Overweight CSL

Uncertainty drove bond yields lower, which helped support some of the portfolio's key bond-sensitive exposures. Growth stock CSL (CSL) was helped by a combination of decent results and the bond yield thematic. The combination of strong demand in growth and constrained supply drove a strong result for CSL, with 11% revenue growth slightly ahead of consensus. Management upgraded FY20 profit guidance. Low bond yields continue to support growth stocks like CSL and we are mindful of its valuation premium to history; although there is a degree of support for CSL compared to peers in the strong fundamentals and the scale and visibility on growth that it enjoys.

Overweight Atlas Arteria

In terms of defensive yield for the fund, the overweight in Atlas Arteria (ALX) was among the strongest contributors. ALX delivered a well-received result, growing underlying profit by 9% for the full year and delivering a better-than-expected 20% growth in dividends. Consensus earnings were revised up by 5% for FY21. That said, the thematic effect was also a material driver as bond yields fell. ALX offers defensive yield exposure without either the near-term challenges that Transurban (TCL) faces in terms of project delays, or the exposure to travel disruption that comes with Sydney Airport (SYD).

Detractors

Overweight Oil Search

Underperformance from the energy was largely thematic in February as concerns over the demand effect of Chinese shutdowns has weighed on the oil price; Brent crude has fallen from US$68bbl to US$56bbl (-17.8%) over the year to date, dragging down the oil/LNG producers. Also weighing on the share price of Oil Search (OSH), negotiations with the PNG government over the Papua LNG project broke down. The market's valuation now implies that neither this project – nor development of its Alaskan assets – will take place. We think this outcome is unlikely.

Overweight Qantas

QAN's result was well received by the market, however the stock has been volatile given its exposure to the effects of Covid-19. Here, management do have some tools to help mitigate the effect on demand. Management have indicated that they will cut capacity further, by 2.3% in domestic and 3.8% in international, helped by the acceleration of scheduled aircraft maintenance. There will also be some partial offset from lower fuel costs given a weaker oil price. At this point, management have guided to a 2H20 EBIT impact of $100-$150m. Given the broadening of the virus' spread the near term earnings consequences may be higher, but this needs to be viewed in the context of the company's strong balance sheet and the supportive industry structure with Virgin (VAH) remaining financially challenged. The strength of QAN market position was reflected in a better than expected H1 result, profits down 1% vs pcp in a period which affected by softer domestic demand and Hong Kong protests. Sequential quarterly improvements in revenue per average seat kilometer (RASK) over the half demonstrate the beneficial effect of QAN's ability to manage capacity to offset headwinds. Capital management is a key part of our thesis and remains intact. QAN is on track to return another $350m to shareholders for the next half, including a $150m buyback.

Outlook

On Covid-19 the focus is on China (ex-Hubei province), Singapore and Taiwan – which were among the first countries affected and thus guiding expectations elsewhere in the world. In these countries containment measures have focused on delaying the virus's spread and extending peak infections over a period long enough to enable medical infrastructure to cope with demand.

The trade-off has been a virtual economic shutdown for an extended period. If other governments follow this lead, the question becomes how long and severe is the downturn in each country – and how effectively can governments stimulate to plug the gap.

If these countries can successfully normalise economic activity without a spike in infections, then it suggests that the hit may be short term and potentially manageable with stimulus. One key question will be the strength of behavioural factors – will stimulus be able to outweigh the effect of "social distancing" as people look to reduce interactions with others.

We can look at the way forward in terms of four broad scenarios.

1) **Worst case is a widespread global pandemic**, provoking a sustained global recession, zero rates, unconventional policy responses and further material falls (>20%) in the equity market. We think this is a low probability outcome.
2) **Rolling outbreaks globally**, prompting short-term economic downturns of 2-4% followed by quick recovery. Policy responses could include zero rates and targeted fiscal stimulus. This scenario could see further markets falls – potentially of up to ~10% - but a bounce back by the year's end.
3) **A milder outbreak** – with containment measures and the Northern hemisphere Spring curtailing the spread. This could see a short-term slowdown, with rate cuts and limited fiscal stimulus. The market may already have seen its lows if this is the case, with a good chance of a 10-20% bounce.
4) **A quick resolution** driven by a medical breakthrough. This could see economic acceleration, a reversal in rate cuts, bonds falling sharply and a 20%+ rally in equities. Like the negative extreme, we see this as a low probability outcome.

It is in uncertain situations such as this – with a degree of binary outcomes – that portfolio construction becomes critical. We are positioning the portfolio to weather the more likely outcomes – scenarios (2) and (3) - and to take advantage of the buying opportunities that have emerged. However we also need to be mindful of protecting it in the case of one of the more extreme scenarios – positive or negative - playing out. In this context, the portfolio's key positions can be considered as follows:

1) **Recession insurance.** We want stocks with the potential to hold up well if economic conditions deteriorate. We have some gold exposure – and also hold positions in bond-sensitives that should do well if sentiment worsens. In terms of the traditional defensives it is important to be selective. We want to hold A-REITs backed by good assets with low gearing, avoiding those with a high exposure to consumer discretionaries. In infrastructure, it is also important to recognise that in some stocks traditional correlations to bond yields may be swamped by fundamental factors.
2) **Buying opportunities** in good businesses which are unlikely to see a structural deterioration, but which have been sold down on the risk-off trade. Here, we want companies which are well positioned in terms of balance sheets and competitive position to withstand a slowdown and which look attractively valued on a two to three year view.
3) **Beneficiaries of fiscal stimulus.** While central banks have already moved to cut rates, governments are also increasingly expected to inject stimulus to help companies and the economy bridge the expected slowdown. We think the iron ore miners would benefit from stimulus in China, while domestically we see certain retailers as well positioned to benefit from government spending to support the economy.
4) **Resolution insurance.** There are several stocks which we would expect to surge quickly on any sign of slowing infection rates or a medical breakthrough. These include the travel-related stocks and certain specific oil/LNG plays.
5) **Areas to remain cautious near-term.** If this was just a short-term hit to demand then the sharp drop in the oil price might make energy look more interesting, however the break between Russia and OPEC on production cuts over the weekend has complicated the issue. If we are entering a grab for share – with some signs that Russia is looking to put pressure on the US shale industry - then the risks here are elevated relative to other commodities. We also remain cautious on the banks. Dividend yields remain attractive, but additional rate cuts just bring further margin pressure to bear. A stimulus package could also include some measures to allow struggling businesses to defer interest payments – although there is speculation that such a measure may include the quid pro quo of cheap funding for the banks.

Regnan Sustainability Snapshots#

Coles Group Limited (COL)

Coles Group operates supermarkets and retail stores throughout Australia. Its businesses include Coles supermarkets, Coles online, Coles liquor, Coles Express, Flybuys, Coles Financial Services, and Spirit Hotels.

The group's 'Better Together' program continues to deliver initiatives across its five diversity and inclusion pillars: accessibility, gender balance, pride, flexibility, and indigenous. Notable achievements include the launch of the group's second 'accessibility action plan', increasing female representation at the executive level to 38%, compared to 18% in FY18, and achieving a higher rate of retention for indigenous staff than the broader Coles Group average. However, Coles has not been immune to the widespread underpayment of staff in retail businesses across Australia. It has admitted to underpaying staff $20m over six years due to differences between remuneration and the General Retail Industry Award (GRIA). COL is continuing investigations into further underpayments and, once finalised, has committed to paying all affected staff in full.

Coles has several supply chain initiatives to support local, responsible and ethical sourcing. These include the 'Australian first sourcing policy', which the company claims has helped ensure that 96% of 'own brand' produce is sourced from Australian suppliers, a partnership with SecondBite to reduce food waste, and high standards of animal welfare for 'own brand' meat and eggs. Coles has a range of certified products and ingredients in the 'own brand' range, including sustainable palm oil and certified coffee and cocoa. All Coles brand seafood products have Marine Stewardship Council (MSC) certification. 'Own brand' supplier assessments have been conducted in an effort to ensure supply chains are free from modern slavery and other labour rights issues.

Since 2009, GHG emissions have fallen by 36%. This has been achieved through energy efficiency initiatives (15% reduction) and a 72% reduction from refrigerant use. Initiatives include an instore LED rollout, and installing solar panels across 30 supermarkets. COL supports supply chain resilience via the Nature Fund which has helped several food and grocery suppliers protect themselves against drought.

Insurance Australia Group Limited (IAG)

IAG is engaged in the underwriting of general consumer and business insurance, predominantly in the Australian and New Zealand markets.

Increased incidences of extreme weather events attributable to climate change pose challenges for IAG to appropriately assess, price and reinsure against risk. While IAG continues to demonstrate a sector leading approach to climate change risks, recent bushfires and hailstorms in eastern Australia have hit IAG's profitability, highlighting the challenges for general insurers as the physical impacts of climate change increase as forecast.

The programs and initiatives outlined in the company's 2018 Climate Action Plan (CAP) provide evidence of a robust and holistic approach to climate risk identification, assessment and management., including allocating direct accountability for climate change objectives to senior executives. In-depth scenario analysis of physical and transitional risks and planning, which commenced in FY18, has continued, with plans for it to be embedded in the enterprise risk profile during FY21. In late 2019, IAG launched the 'Severe Weather in a Changing Climate' report in partnership with the National Centre for Atmospheric Research (NCAR). The report includes the latest data on the state of the climate and predictions on future extreme weather events based on a range of warming global temperatures, with insights being used to inform IAG's products and pricing. It is also envisioned that the work will increase understanding of the future climate in Australia and aims to encourage greater collaboration between industry and government to strengthen property resilience from natural disasters.

IAG has committed to develop new products and services with the aim of increasing customer resilience and safety as well as foster a low carbon transition. IAG and the Australian Red Cross' 'Get Prepared' app, programs such as 'Good Hoods', and products such as 'InsureLite', aim to address these objectives and insurance affordability constraints as premiums increase in response to greater insurance risks, including natural perils.

IAG maintains a strategic focus on building an innovative and agile workplace culture as it seeks to attract and retain customers. Upskilling the company's workforce to meet the demands of a business that is digitally driven is a key tenet of the strategy, and Regnan sees evidence of this shift in programs such as the 'Leading@IAG' program and 'Future ME' initiative. IAG argues that the combination of these initiatives and programs, by building culture and workforce capabilities, should also benefit customer service and retention as they are implemented and integrated across the company.

Following criticism during the Hayne Royal Commission for questionable practices under the Swann Insurance brand, IAG has acknowledged an increased focus on business culture and has committed to improvements in this area, including remediating $22.4m to approximately 39,000 Swann customers. The group has also implemented a 'product governance framework' in an effort to ensure that similar instances do not occur in future.

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

PENDAL

The information in the Sustainability Snapshots is provided by Regnan Governance Research and Engagement Pty Limited (ABN 93 125 320 041). It should not be relied upon in making a decision to invest or a decision in relation to an existing investment. The information relates only to Regnan's assessment, based on its research and the information available to it, of the performance of the company in relation to environmental and social issues and should ***not*** be regarded as a recommendation or statement of opinion by Regnan on:

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.

This factsheet has been prepared by Pendal Fund Services Limited (**PFSL**) ABN 13 161 249 332, AFSL No 431426 and the information contained within is current as at the date of this factsheet. It is not to be published, or otherwise made available to any person other than the party to whom it is provided.

PFSL is the responsible entity and issuer of units in the Pendal Sustainable Australian Share Fund (**Fund**) ARSN: 097 661 857. A product disclosure statement (**PDS**) is available for the Fund and can be obtained by calling 1800 813 886 or visiting www.pendalgroup.com. You should obtain and consider the PDS before deciding whether to acquire, continue to hold or dispose of units in the Fund. An investment in the Fund is subject to investment risk, including possible delays in repayment of withdrawal proceeds and loss of income and principal invested.

This factsheet is for general information purposes only, should not be considered as a comprehensive statement on any matter and should not be relied upon as such. It has been prepared without taking into account any recipient's personal objectives, financial situation or needs. Because of this, recipients should, before acting on this information, consider its appropriateness having regard to their individual objectives, financial situation and needs. This information is not to be regarded as a securities recommendation.

The information in this factsheet may contain material provided by third parties, is given in good faith and has been derived from sources believed to be accurate as at its issue date. While such material is published with necessary permission, and while all reasonable care has been taken to ensure that the information in this factsheet is complete and correct, to the maximum extent permitted by law neither PFSL nor any company in the Pendal group accepts any responsibility or liability for the accuracy or completeness of this information.

Performance figures are calculated in accordance with the Financial Services Council (**FSC**) standards. Where performance returns are quoted "Post fees" then this assumes reinvestment of distributions and is calculated using exit prices which take into account management costs but not tax you may pay as an investor. Where performance returns are quoted "Pre fees and tax", they exclude the effects of management costs and any taxes. Past performance is not a reliable indicator of future performance.

If market movements, cash flows or changes in the nature of an investment (e.g. a change in credit rating) cause the Fund to exceed any of the investment ranges or limits specified, this will be rectified by PFSL as soon as reasonably practicable after becoming aware of it. If PFSL does so, it will have no other obligations in relation to these circumstances. The procedures, investment ranges, benchmarks and limits specified are accurate as at the date of this factsheet and PFSL reserves the right to vary these from time to time.