PENDAL

Factsheet

Equity Strategies

August 2020

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		Benchmark
	(post-fee)	(pre-fee)	Return
1 month	3.75	3.83	2.83
3 months	5.33	5.56	6.04
6 months	-3.94	-3.52	-4.48
1 year (pa)	-3.20	-2.36	-5.08
2 years (pa)	1.55	2.42	1.74
3 years (pa)	5.40	6.30	6.10
5 years (pa)	6.67	7.59	7.47

Sector Allocation (as at 31 August 2020)

Sector	%
Energy	3.0%
Materials	19.5%
Industrials	13.5%
Consumer Discretionary	4.3%
Consumer Staples	2.9%
Health Care	11.8%
Information Technology	3.3%
Telecommunication Services	6.6%
Financials ex Property Trusts	23.4%
Property Trusts	8.7%
Cash & other	3.1%

Top 10 Holdings (as at 31 August 2020)

Holding	%
BHP Billiton Limited	9.2%
CSL Limited	8.3%
Commonwealth Bank of Australia Limited	7.7%
National Australia Bank Limited	4.2%
ANZ Banking Group Limited	4.1%
Macquarie Group Limited	3.6%
Atlas Arteria	3.5%
Xero Limited	3.3%
Telstra Corporation Limited	3.2%
Goodman Group	3.1%

Other Information

Item	Detail
Fund size (as at 31 Aug 2020)	$315 million
Date of inception	October 2001
Minimum investment	$25,000
Buy-sell spread[3]	For the Fund's current buy-sell spread information, visit www.pendalgroup.com
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.

Market review

The Australian equities market performed strongly during reporting season, with the S&P/ASX 300 Accumulation index adding +3.0%. Whilst Industrials (+3.6%) outperformed, Resources (+0.9%) were the laggard as gold miners (-8.3%) retreated from the recent highs.

The Victorian lockdown continues to drag on the national economic pulse. The state's decision to pursue an effective elimination strategy is material – it means stricter restrictions for longer, with a greater impact on activity, the economy and budget deficits - Australia is a negative outlier in terms of global trends in industrial survey improvement as a result. This remains a headwind for the domestic equity market and specific companies within it.

In terms of sector performance, Consumer Discretionary (+9.7%), Information Technology (+15.2%), Real Estate (+7.6%) and Health Care (+4.0%) were the largest contributors to the headline index; whereas IT was also the best performing sector by absolute return. In contrast, Communication Services (-3.8%), Utilities (-4.8%) and Consumer Staples (-0.3%) finished the month in the red. Index heavyweights Materials (+1.2%) and Financials (+1.3%) also underperformed the index in August.

Turning to reporting season results, some of the well-received ones include:

- CSL (+5.9%). Provided FY21 guidance of 0-5% earnings growth. The "0%" scenario is one where the current run rate of plasma collection persists – which has been the market's key concern. Management did enough to allay market concerns about the potential downside of this issue.

- Afterpay (APT, +33.4%). Result itself was mixed; gross margin was good but there were some signs of momentum slowing in US - this could be a significant issue in next 3 months. However the stock continued its relentless re-rating, most recently driven by the acquisition of small European and Asian businesses which are being factored into a material uplift in "total addressable market (TAM)".

- Goodman Group (GMG, +8.2%). The stronger than expected order book of new developments demonstrates the current bifurcation in the REITs sector. While malls face challenges form foot traffic, soaring online sales is a stiff tailwind for GMG.

- Qantas (QAN, +22.0%). There was no much new information in the result, but it did provide some more detail about the rate of cash burn. A material proportion relates to shift in working capital – which should reverse as conditions normalise - while restructuring charges should also yield medium term benefits. The rate of cash burn from the operational business – particularly in in the dormant international division – was better than the market expected.

On the other side of the tally board:

- AGL Energy (AGL, -7.9%). Management downgraded earnings based on weaker forward pricing trends for electricity. This is likely to be an ongoing issue.

- Telstra (TLS, -7.7%). Hit its FY20 numbers, but gave a disappointing outlook. There are two issues; first, the losses associated with the rump of its fixed line business, which the market expected to hit in FY22, are now likely to come through earlier, leading to a downgrade in FY21. Second, and more importantly, management have cut the return on capital target for FY23 from 10% to 7%. While consensus had not factored in a 10% return, this shift is seen as a signal that the environment is going to be tougher than management has previously indicated.

- Seek (SEK, -8.6%). Outlined a potential scenario for FY21 in which, if the environment remains as it is now, it will barely make a profit. This demonstrates the challenge for some of the recovery stocks where, having run hard form the rebound, it may transpire that they have run ahead of themselves.

Fund performance

The Fund outperformed its benchmark over the month of August.

Contributors

Overweight Qantas (QAN, +22.0%)

There was no much new information in the Qantas result, but it did provide some more detail about the rate of cash burn. A material proportion relates to shift in working capital – which should reverse as conditions normalise - while restructuring charges should also yield medium term benefits. The rate of cash burn from the operational business – particularly in in the dormant international division – was better than the market expected.

Overweight Nine Entertainment (NEC, +22.5%)

The market's initial reaction to NEC's results was negative given a worse than expected update for TV ad numbers in July. However, signs of improvement are coming through, while the result delivered good cash flow. Potential structural improvements in revenue – from Stan subscriptions and social media payments – coupled with cost out, place NEC in a good spot when the cycle improves.

Detractors

Does not hold Afterpay Limited (APT, +33.4%)

Afterpay continued its relentless re-rating, driven mist recently by the acquisition of small European and Asian businesses which are being factored into a material uplift in "total addressable market (TAM)". The result itself was mixed; gross margin was good but there were some signs of momentum slowing in US - this could be a significant issue in next 3 months. We continue to prefer Xero as our growth exposure.

Overweight Telstra Corporation Limited (TLS, -11.4%)

Telstra hit its FY20 numbers, but gave a disappointing outlook. There are two issues; first, the losses associated with the rump of its fixed line business, which the market expected to hit in FY22, are now likely to come through earlier, leading to a downgrade in FY21. Second, and more importantly, management have cut the return on capital target for FY23 from 10% to 7%. While consensus had not factored in a 10% return, this shift is seen as a signal that the environment is going to be tougher than management has previously indicated. We think the dividend is unlikely to be cut – and the degree of yield in the current environment should see the stock remain supported. However it also may mean that the implied upside case is now smaller.

Strategy and outlook

The net result of earnings season is that earnings were down -38% for the second half of FY20 and -16% for the full year. Dividends fell 30% as companies took a prudent stance on capital management.

This was a worse result that the GFC, where earnings fell -20% in the second half of FY09. Nevertheless, the market continued to rally through August as investors proved willing to look through the near term impact of Covid-19. Instead, the focus was on how management are going about adapting to the new environment.

We saw strong performance from companies which have benefited from stimulus and which met already high expectations – such as JB Hi-Fi, James Hardie and Afterpay. However there was also some relief rallies in stocks which have been hit heavily, but where there is a sense that the worst may be over, including Nine Entertainment, Qantas, the REITs and Coca Cola Amatil.

Stocks which had been held for defensive qualities – but which did not live up to this billing were sold off. Examples included Telstra, APA Group and Transurban. Companies which are facing structural challenges such as low rates (eg Bendigo Bank, Challenger) or lower power prices (eg AGL Energy) also underperformed.

Few sectors saw material earnings upgrades. Miners saw the largest ones, but had already done well and tended to lag in August. The largest downgrades were in telcos – which underperformed – but other sectors such as media, gaming and materials saw downgrades, but still outperformed.

Essentially, there are two widely divergent views on the broader equity market from this point. The bear case is that equity markets are overvalued and due for a prolonged correction driven by a combination of excess government debt, the ultimately deflationary effects of quantitative easing and the economic damage of risk aversion, bankruptcies and structural employment.

The bull case, in contrast, is that we are at the start of a cyclical recovery where sustained expansionary policies and significant surplus capacity, combined with a wave of pent up demand – potentially super charged by the advent of a vaccine – and a lengthy period of low rates continue to boost the equity market. In this vein, it is also important to note that the Australian equity market has lagged global indices – partly driven by a smaller exposure to technology stocks – and has reached nowhere near the same degree of relative valuations.

Uncertainty remains high. As well as questions over the pace of recovery, we must also contend with the run up to the US Presidential election and heightened tensions with China.

We note that the key factors in supporting equity markets – abundant liquidity, low interest rates, and a better than expected pace of economic recovery, remain in place. However, it is not the time to make a heroic call on the outcome. Our approach is to focus on stocks and invest where we can find limited relative downside risk, at the same time as building a balanced portfolio which has some protection against a material deterioration in conditions.

Reporting season highlighted the sometimes extreme divergence we are seeing between industries and between companies driven by a combination of cyclical and structural shifts behaviour and demand. This is proving to be constructive environment for active management.

Regnan Sustainability Snapshots[#]

Cochlear Ltd (COH)

Cochlear develops, manufactures and distributes hearing aids and devices globally. Retaining market leadership depends on successful execution of marketing initiatives and product launches derived from continued R&D and innovation pipelines.

Despite COVID-19 impacts on operations, R&D spend in FY20 has continued in line with FY19, representing 14% of sales revenue, and the company's workforce has remained intact. Execution capability of technology-based service initiatives appears to be supported by enhancements to human capital management, and key management and board appointments also add to capability. In FY20, the company reported a 79% engagement score, consistent with the FY19 result. Within the survey, 91% of employees said they felt proud to work for the company, while 91% also agreed that they understand how their roles contribute to overall company strategy. Ethical conduct controls are comprehensive and include specific reference to competition and consumer laws.

WHS exposure is highlighted by the company's focus on injury prevention (particularly with repetitive-type injuries), ageing workforce injury prevention programs, early intervention for musculoskeletal risks, and a recent emphasis on a psychologically safe workplace. We note that TRIFR rates increased in FY20 which the company attributes to expanding safety monitoring across global sites, and maturing global reporting of incidents. More granular detail on the uptick in incidents would provide investors with greater insight.

Environmental exposures are limited in COH's light manufacturing activities. Nevertheless, it reports a focus on building energy and water efficiency, and recycling of office waste, as well as incorporating sustainability elements into procurement requirements.

Goodman Group (GMG)

GMG is an international industrial property company which owns, develops, and manages industrial real estate in 17 countries including logistics and industrial facilities, warehouses and business parks.

Acceleration of the digital economy as a result of Covid-19 has helped create favourable market conditions for GMG. However, GMG operates in a highly competitive environment with a business heavily reliant upon having the right people to deliver the strategy. GMG claims that business success has been driven by "its ability to focus, motivate and retain employees" given the strength of performance over the past 5 years. Nevertheless, human capital management disclosure is of a high level nature, lacking the detail and metrics provided by sector peers.

Elevated ethical conduct exposures from global operations (including in China and Brazil) are managed by board level risk and compliance committee oversight of ethical compliance, appropriate policies, and an anonymous whistleblower function. Employee safety performance is sector leading with no recorded LTIFR over the past two financial years.

GMG's commitment to carbon neutral operations by 2025 is sector leading. The company has undertaken several initiatives to improve operational efficiency and reduce emissions, including installation of solar PV systems on its facilities. To date, GMG has installed approximately 40MW of solar globally, against a target of 100MW by 2025. A commitment to adopt the TCFD framework by 2022 will also improve climate risk management for its long lived property portfolio, and position GMG well for a forecast increase in demand for sustainable industrial facilities. GMG maintains a 4 Green Star GRESB rating average.

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

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iii. the company's suitability or attractiveness from an investment perspective.

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