PENDAL

Factsheet

Equity Strategies

March 2019

Pendal MicroCap Opportunities Fund

ARSN: 118 585 354

About the Fund

The Pendal MicroCap Opportunities Fund (**Fund**) is a portfolio of stocks in the rapidly expanding and highly diversified micro cap sector. The universe includes more than 1,100 companies listed on the ASX and NZX with a market capitalisation of between $5 million and $150 million.

Investors should be aware that due to the characteristics of micro cap companies there is some additional risk involved in investing in the Fund compared to a conventional Australian equities fund.

Investment Return Objective

The Fund aims to provide a return (before fees, costs and taxes) that exceeds the S&P/ASX Small Ordinaries Accumulation Index over the medium to long term. The suggested investment timeframe is five years or more.

Investment Strategy

The Fund is actively managed and invests primarily in a portfolio of 40-60 Australian companies with market capitalisation or free float of generally less than $150 million at initial investment that we believe are trading below their assessed valuation. The Fund may also invest in equivalent companies listed on the New Zealand Stock Exchange.

Investment Philosophy

At the cornerstone of Pendal's investment philosophy is the view that markets are not always rational and the inefficient market pricing of securities creates investment opportunities. This is particularly the case in micro caps where the sector is under-researched and sentiment will often drive periods of under-valuation and over-valuation. This reflects our belief that in the absence of structural change security prices will revert to their intrinsic value through the course of an investment cycle.

As with Pendal's other Australian equity portfolios, the Fund will be managed in a way that is style indifferent, it will be invested in both 'value' and 'growth' companies, without a predetermined 'value' or 'growth' bias.

Investment Team

The Pendal MicroCap Opportunities Fund is managed by Pendal's highly experienced Small Cap team. The Fund is managed by Paul Hannan, Head of Smaller Companies and Noel Webster, Portfolio Manager in the Equity team. Paul and Noel have over 50 years of investment experience between them and are supported by a highly experienced Small Cap team.

Portfolio Characteristics

Benchmark	S&P/ASX Small Ordinaries Accumulation Index
Number of stocks	Between 40 - 60
Maximum cash weighting[1]	25%
Ex-ante (forward looking) tracking error[2]	5 - 20%
Maximum absolute stock position	10% (5% for developing companies)
Maximum ownership of any company	15%
Shorting	No
Borrowing	No

[1] We may hold higher levels of cash following large applications or if suitable investment opportunities cannot be identified.

[2] The Fund is measured against the S&P/ASX Small Ordinaries Accumulation Index, which is a widely used measure of the performance of micro cap funds. Only a portion of the index will comprise companies with a market capitalisation of less than $150m and as a result the Fund's ex-ante tracking error is expected to vary more widely than the tracking error for most other types of active Australian share funds.

Performance

(%)	Total Returns		Benchmark
	(post-fee)	(pre-fee)	Return
3 months	13.86	14.65	12.59
FYTD	4.28	5.78	-1.76
6 months	-0.11	1.03	-2.83
1 year (pa)	7.56	9.44	5.78
2 years (pa)	13.08	15.19	10.29
3 years (pa)	15.34	17.65	11.40
5 years (pa)	15.47	18.67	7.97

Sector Allocation (as at 31 March 2019)

Energy	3.2%
Materials	11.0%
Industrials	10.4%
Consumer Discretionary	15.7%
Consumer Staples	2.5%
Health Care	2.5%
Information Technology	22.0%
Telecommunication Services	6.0%
Financials ex Property Trusts	4.0%
Property Trusts	5.3%
Cash & other	17.4%

Other Information

Fund size (as at 31 Mar 2019)	$355 million
Date of inception	March 2006
Minimum investment	$25,000
Buy-sell spread[3]	0.70% (0.35%/0.35%)
Distribution frequency	Yearly
APIR code	RFA0061AU

[3] 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[4]

Issuer fee[5]	1.20% pa
Performance fee[6]	20% of the Fund's performance in excess of the performance hurdle.

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

[5] 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.

[6] 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 (S&P/ASX Small Ordinaries Accumulation Index) plus the issuer fee of 1.20% 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 associated with factors that can influence the direction and volatility of an overall market, as opposed to security-specific risks. These factors can affect one country or a number of countries.
- **Security specific risk** - The risk associated with an individual asset.
- **Currency risk -** Currency exchange rate fluctuation risk arising from investing across multiple countries.
- **Interest rate risk -** The risk associated with adverse changes in asset prices as a result of interest rate movements.
- **Credit risk –** The risk of an issuing entity defaulting on its obligation to pay interest/principal when due
- **Derivative risk –** The risk arising from use of derivatives to manage exposures to investment markets.
- **Small company risk –** Shares in smaller companies may trade less frequently and in smaller volumes and may experience greater price volatility than shares in larger companies.
- **Illiquidity risk -** This is the risk that an investment may not be easily converted into cash with little or no loss of capital and minimum delay, because of either inadequate market depth or disruptions in the market place.

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

Market review

As general investor sentiment improved over the March quarter, we saw the domestic small cap equity market rebound strongly. The S&P/ASX Small Ordinaries Accumulation index advanced by 12.6% over the period, outperforming its large cap counterpart by 1.7%. Despite the reporting season being less sanguine and company management teams being generally more conservative, the broad improvement in global macro influences clearly helped. Although risks remain, the market appears to be strengthening the view that we are moving towards some form of resolution in the US/China trade dispute. As such, Small Industrials (+12.7%) and Small Resources (+12.1%) both performed strongly. The market's aggregate evaluation has rebounded almost to it previous highs of 2018 and stands at 16.8x next-12-month price/earnings, an 11% premium to its five-year average.

Sector performance was somewhat bipolar over the quarter: on one side of the spectrum, Information Technology (+32.6%), Energy (+22.5%), Consumer Discretionary (+18.8%), Healthcare (+17.3%), Industrials (+16.4%) and Communication Services (+11.7%) all recorded double-digit gains; whereas heavyweight Materials (+5.3%), Real Estate (+8.4%) and Financials (+4.2%) underperformed the headline index.

Within IT, the market darlings continued higher, including Altium (ALU, +49.7%), Appen (APX, +74.0%) and Afterpay Touch (APT, +69.0%). Coming out of reporting season, strong performance from all divisions helped ALU to deliver a solid print of revenue growth for the first half. In terms of users subscription, management reaffirmed its target of 100,000 users by 2025 which helped to support sentiment. APX also delivered a strong set of results, with second-half earnings (EBITDA) 79% higher than the previous half. Improvement in efficiency and additional operating leverage continue to help APX and resulted in some broking analyst upgrades. Lastly, the losses Wisetech (WTC, +36.9%) incurred in February were quickly proven short-lived, after it announced the latest round of capital raising. In order to continue supporting its strategic inorganic growth, the international logistics service provider announced a ~$280m capital raising in March. As previously communicated by management, WTC has been expanding its geographical presence through mergers and acquisitions. This strategy has proven successful to date and as such, the capital raising was well received by the market.

Elsewhere, a rising oil price helped the Energy sector to outperform over the quarter, as it benefited the likes of Beach Energy (BPT, +53.9%) and Viva Energy (VEA, +38.8%). In addition, VEA, which distributes Shell fuel in Australia, was aided by a deal which saw it purchase the right to set the retail fuel margin at the Coles-operated petrol stations, which had been previously set by Coles management. This will result in a meaningful earnings uplift for VEA, as well as allowing it to drop the fuel price—currently at a material premium to the market—in order to win back some market share.

Consumer Staples (-3.5%) was the only sector that finished the quarter in the red. Despite the strong gains made by infant formula manufacturer Bellamy's (BAL, +51.9%) on the back of its recently launched new formula that helped to raise brand awareness, losses made by Blackmores (BKL, -23.7%) and Costa Group (CGC, -30.7%) more than offset the positives. The latter endured a tough start to the year in January after management downgraded earnings on disappointing volumes for avocados, berries and tomatoes. It was largely attributed to softer demand, although higher supply of key products and some substitution may also be playing a role. The market has de-rated the stock beyond the 10-15% hit to earnings, reflecting in part its previously high rating for an agricultural stock.

Fund performance

The Fund returned 13.86% (post-fee, pre-tax) for the quarter, outperforming its benchmark by 1.27%.

Key contributors to performance were overweight positions in City Chic Collective, Infomedia, Vista Group International, Audinate Group and Elixinol Global. Key detractors from performance were overweight positions in Onevue Holdings, IMDEX, Redhill Education and Adairs.

Strategy and outlook

While March's market result was subdued, it capped a strong quarter which saw the S&P/ASX Small Ordinaries Accumulation index gain 12.6% following the volatility of late 2018. The market's aggregate evaluation has rebounded almost to it previous highs of 2018 and stands at 16.8x next-12-month price/earnings, which stands at an 11% premium to its five year average.

This is obviously not a 'cheap' market, but it is important to recognise the skews that exist below this headline number. The relatively small cohort of high growth tech stocks, for example, are trading at a 1-year forward price/earnings of 35.8x, a 113% valuation premium to the rest of the small caps market. Health care, too, stands out at 21.9x. The upshot is that there are material parts of the market which are not at demanding valuations and where compelling opportunities can be found.

The caveat is, of course, that there are also material parts of the market facing cyclical or structural headwinds. Part of the reason that tech and healthcare are priced so richly is that they are one of the few parts of the market which are offering reasonable organic growth.

That said, the small cap universe is rich with diverse and niche opportunities for us to explore. We are focused upon companies with demonstrable cash flows in parts of the market which are enjoying some form of tailwinds or which are better placed withstand the currents of subdued economic growth or business model disruption.

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

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