Pendal MicroCap Opportunities Fund

ARSN: 118 585 354

Factsheet

Equity Strategies

June 2019

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 (TR) 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 52 years of investment experience between them and are supported by a highly experienced Small Cap team.

Portfolio Characteristics

Benchmark	S&P/ASX Small Ordinaries (TR) 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 (TR) 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 (post-fee)	Total Returns (pre-fee)	Benchmark Return
3 months	3.35	3.51	3.75
FYTD	7.77	9.50	1.92
6 months	17.68	18.67	16.81
1 year (pa)	7.77	9.50	1.92
2 years (pa)	13.61	15.21	12.53
3 years (pa)	14.20	16.44	10.66
5 years (pa)	16.72	19.97	9.26

Sector Allocation (as at 30 June 2019)

Energy	3.5%
Materials	10.5%
Industrials	11.8%
Consumer Discretionary	17.1%
Consumer Staples	3.4%
Health Care	4.6%
Information Technology	21.3%
Telecommunication Services	4.8%
Financials ex Property Trusts	3.2%
Property Trusts	6.2%
Cash & other	13.6%

Other Information

Fund size (as at 30 Jun 2019)	$317 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 (TR) 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

There was some performance divergence between the S&P/ASX Small Ordinaries Accumulation Index and its large cap counterpart, the S&P/ASX 100 Accumulation Index over the quarter. The former index finished the period +3.7% higher, whilst underperforming the latter by 4.8%. The small cap universe did not benefit as much from the boost of the miners; whilst weakness among some of the larger index-weights also detracted from relative performance.

Small Resources (-2.3%) finished the quarter in the red. Whilst the Gold miners (+5.5%) performed strongly as the precious metal is fetching multi-year high prices; it was more than offset by the Diversified miners (-7.4%). Rising concerns that demand from China for lithium ore could deteriorate further weighed on investor sentiment for Pilbara Minerals (PLS, -31.0%) and Galaxy Resources (GXY, -44.4%); whereas Aurelia Metals (AMI, -44.4%) missed market expectation on both volume and All-In-Sustainable-Costs for 3Q19. Offsetting some of the losses, Lynas Corporation (LYC) advanced by +23.0%. The rare earth miner was one of the few beneficiaries from intensifying Sino-US trade tensions, with speculation China could strangle global rare earth supplies in retaliation to the latest round of tariffs imposed by the Trump administration. Management also outlined a $500m growth program that will be self-funded.

Also weighing on Resources, Energy (-4.4%) recorded losses over the June quarter. Global oil price, which had been volatile over the period is starting to stabilise somewhat, finishing the quarter at US$65/bbl; down from US$68/bbl at March end - it was fetching $75/bbl and $60/bbt at the highs/lows during the period. Global supply could become tight again given the OPEC+ has decided to extend existing production curtailment. Within the sector, Viva Energy (VEA, -13.9%), which supplies more than 50% of all fuel used in Victoria, and is the sole distributor of Shell-branded fuel in Australia was the largest performance detractor. The refiner margin, which has always been volatile, has been at the downside lately. In addition, VEA's Retail business update in April revealed that lower retail fuel margins on the back of the rising oil prices, and the lag in passing these on to end customers is going to hit the earnings harder than expected.

Elsewhere, Consumer Staples (-6.4%) posted the largest sector loss over the quarter, mainly ascribed to the poor performance of Costa Group (CGC, -21.4%) and Graincorp (GNC, -13.2%). In May, CGC delivered a guidance downgrade that disappointed the market. The company disappointed on a number of fronts, including a later-than-usual blueberries harvest from its Moroccan acreage which brings the product into competition with Spanish suppliers, putting pressure on prices. At the same time, CGC has experienced issues with the quality of its raspberry crop and the discovery of a fruit fly at its NSW citrus farms which could see an increase in costs as fruit is shipped elsewhere for storage and packing. There was also some pressure on costs for its mushroom produce. Conversely, crop grower GNC released its first-half results, where earnings (EBITDA) for the period dropped by 78% year-on-year despite a 25% increase in sales. The persistent east coast drought conditions continue to weigh on the Grains division whereas margin compression was evident in both the malt and oils businesses. The market also remains sceptical about management's commentary around the proposed spin-off of the malts business towards the end of 2019. In contrast, Select Harvests (SHV, +21.4%) reported some strong numbers for its 1H19 results, driven by the best almond crop yield in 6 years and it was well received by market.

On the other side of the tally board, Industrials (+15.9%), Health Care (+14.3%) both recorded double-digit gains over the period; followed by Financials (+9.4%) and Information Technology (+8.4%). Nearmap (NEA, +34.5%), Austal (ASB, +51.6%) and Bingo Industries (BIN, +47.7%) led the gainers within Industrials. NEA is a provider for location intelligence services, with high resolution and timely aerial imagery. Deploying a Software-as-a-Service (SaaS) business model, investors are currently giving Management great credibility in their ability to scale up the business with continuous market expansion in the US.

Fund performance

The Fund returned 3.35% (post-fee, pre-tax) for the quarter, underperforming its benchmark by 0.4%. Key contributors to performance were overweight positions in City Chic Collective, Infomedia, Rhype Limited and Vista Group International. Key detractors from performance were overweight positions in Citadel Group, Sheffield Resources and GTN Limited.

Strategy and outlook

A positive June capped a strong first half to 2019 for the Australian small cap equity sector, which has staged a rapid rebound from the sell-off in late 2018. The S&P/ASX Small Ordinaries is up +0.9% for the month, +3.8% for the quarter and +16.8% for the first half.

Smaller companies have underperformed the larger end of the index over 2019 to date. This has been driven by strength in the iron ore sector, dominated by the big three of Rio Tinto, BHP and Fortescue Metals. At the same time the conclusion to the Royal Commission, coupled with an improvement in sentiment towards the housing sector, has seen the "big four" banks outperform.

Nevertheless, smaller companies have delivered strong absolute returns over the last half in aggregate, although performance has been mixed at a sector level. Information technology is up +43.7% calendar year to date, led by software-as-a-service companies Wisetech and Appen. This high-profile growth cohort continues to perform well and this quarter Altium joined Xero and Afterpay in the ASX 100, leaving the Small Ordinaries.

Consumer staples, in contrast, are down -9.7% over the half. This reflects a combination of challenges including concern over the domestic supermarket sector (Metcash), uncertainty around Chinese growth (Blackmores) and company-specific issues at other companies such as Costa Group and Graincorp.

Looking forward, we continue to see a challenging environment in domestic cyclicals on the back of tighter bank lending and softer house prices, which is showing up in weaker new car sales, media advertising and general retail. That said, government efforts to stimulate demand should provide some degree of support.

Elsewhere in small caps, a weak Australian dollar is supporting offshore earnings and helping those companies with niche growth opportunities in technology, health care and education.

Lower interest rates in Australia and elsewhere is providing further fuel for the growth parts of the market. There are valid opportunities here with some valuation support, however there are also stocks where we believe that valuation has run ahead of reasonable levels and the market is being less discerning between the quality of these companies. While several of the more popular technology stocks have now left the index, finding attractively-priced growth remains a challenge for small cap investors.

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

PENDAL

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