Pendal Smaller Companies Fund

ARSN: 089 939 328

Factsheet

Equity Strategies

December 2019

About the Fund

The Pendal Smaller Companies Fund (**Fund**) is an actively managed portfolio investing in companies outside the top 100 listed on the Australian Stock Exchange and their equivalent on the New Zealand Stock Exchange that we believe are trading below their assessed valuation, and which we expect to grow their profits quickly.

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.

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 smaller companies and industries and are prepared to accept higher variability of returns. The Fund invests primarily in companies outside the top 100 listed on the Australian Securities Exchange. The Fund may also invest in equivalent companies listed on the New Zealand Stock Exchange, hold cash and may use derivatives.

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

The Fund may have assets denominated in foreign currencies. This means that changes in the value of the Australian dollar relative to foreign currencies may affect the value of the assets of the Fund. The Fund's foreign currency exposure may be hedged from time to time, in whole or part.

Derivatives may be used to reduce risk and can act as a hedge against adverse movements in a particular market and/or in the underlying assets. Derivatives can also be used to gain exposure to assets and markets.

Investment Team

The Pendal Smaller Companies Fund is managed by Pendal's highly experienced Small Caps team. The portfolio manager for the Fund is Paul Hannan who is also the head of Smaller Companies in the Equity team. Paul has over 26 years industry experience.

Portfolio characteristics

Benchmark	S&P/ASX Small Ordinaries (TR) Index
Number of stocks	Between 60 -90
Maximum cash weighting	20%
Ex-ante tracking error	Typically between 0% - 9%
Active single stock position	+/-5%

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.
- **Liquidity risk** - The risk that an asset may not be converted to cash in a timely manner.
- **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.

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
3 months	-0.98	-0.67	0.76
FYTD	1.82	2.46	3.89
6 months	1.82	2.46	3.89
1 year (pa)	14.39	15.82	21.36
2 years (pa)	2.90	4.18	5.28
3 years (pa)	7.40	8.74	9.98
5 years (pa)	9.94	11.31	10.65

Sector Allocation (as at 31 December 2019)

Energy	4.5%
Materials	9.7%
Industrials	14.8%
Consumer Discretionary	17.2%
Consumer Staples	5.4%
Health Care	7.8%
Information Technology	10.5%
Telecommunication Services	4.6%
Financials ex Property Trusts	12.5%
Property Trusts	6.2%
Cash & other	6.8%

Other Information

Fund size (as at 31 Dec 2019)	$475 million
Date of inception	December 1992
Minimum investment	$25,000
Buy-sell spread[1]	0.50% (0.25%/0.25%)
Distribution frequency	Half-yearly
APIR code	RFA0819AU

[1] 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[2]

Issuer fee[3]	1.22% pa
Estimated expense recoveries[4]	0.02% pa

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

[3] 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.

[4] This represents a reimbursement from the Fund to cover those expenses we incur in connection with the day-to-day operation of the Fund. This is an estimate based on the latest available figures. Actual expenses recovered may increase or decrease over time.

Market review

The S&P/ASX Small Ordinaries traded largely sideways over the fourth quarter, ending up +0.76%.

This brings the full year return to +21.4%, a very strong result driven largely by a valuation re-rating on the back of looser monetary policy and lower bond yields.

The fourth quarter news flow was dominated by threats and brinkmanship on the trade front between US and China. Sentiment shifted on the likelihood of a deal or the implementation of further tariffs slated for mid-December. Ultimately, the two nations agreed to a phase one deal which was short on detail – and only partially rolled back the most recent set of tariffs - but served to deescalate tension and uncertainty around near term global growth.

Elsewhere Boris Johnsons emphatic victory in the UK election, implying a mandate for his initial Brexit deal, also served to decrease geopolitical uncertainly at the margin.

Consumer staples (-4.5%) was the worst performing sector over the quarter. Investors expressed concern over a contract loss for Metcash (MTS, -12.1%), which overshadowed signs of an end to grocery price deflation. Graincorp, GNC, -4.2%) another of the larger staples companies, continued to bear the brunt of the ongoing drought. Costa Group (CGC, -29.0%) also endured some drought issues, but this was but one of a number of seasonal and one-off issues which drove a downgrade for full year earnings.

Consumer discretionaries (-3.8%) also underperformed. Here, several stocks exemplified the pressure on Australian retail in the face of muted consumer demand. Harvey Norman (HVN) was off -5.6%, Nick Scali (NCK) -4.9% and Myer (MYR) - 21.3%.

Information technology (+11.5%) was the stand out performer. Several of the higher profile technology companies such as Afterpay Touch (APT), Wisetech (WTC) and Xero (XRO) have graduated to the ASX 100 in recent times. Nevertheless those in the Small Ordinaries staged a strong quarter, led by stocks such as Bravura Solutions (BVS, +25.6%), Iress (IRE, +12.6%) and Appen (APX, +6.1%). Technology One (TNE), our largest overweight in the sector, was up +16.6%.

Financials (+3.5%) also outperformed, in stark contrast to their larger cap counterparts. Wealth manager IOOF (IFL, +23%) rose on the news that its proposed purchase of ANZ's OnePath advice and superannuation arm would go ahead, following a review by the Onepath trustees. The priced was lowered by $125m from $950m to $825m. Elsewhere fund managers generally had a good quarter. Pendal (PDL) was up +19.8%, Perpetual (PPT) +9.8%, Janus Henderson (JHG) +9.1% and Platinum (PTM) +6.6%.

Fund performance

The Fund underperformed its benchmark over the December quarter.

Contributors

Overweight Ryman Healthcare (RYM.NZ)

Ryman Healthcare (RYM.NZ, +27.6%) is a New Zealand-listed retirement home operator, which has been growing its Australian footprint in recent years. Its stock price enjoyed a surge in the wake of its November results. The company delivered NZ$207.8m in revenue from continuing operations for the half, up from NZ$187.2m a year ago. Management guided full year underlying profit to be between NZ$250m and NZ$265m, which would be 10% and 17% higher than the previous financial year. It also highlighted strong activity in Victoria, where it expects to have five villages open by the end of 2020.

Overweight Technology One (TNE)

Enterprise software company Technology One (TNE, +16.6%) did well following a strong set of annual results. It profit before tax (PBT) was $76.4m, a touch above the high point of management's guidance range and ahead of consensus expectations. The recurring revenue from its software-as-a-service (SaaS) model was up over 44% year-on-year and management pointed to a strong sales pipeline as an indication that its SaaS business should maintain strong momentum well into the new year.

Detractors

Overweight Smartgroup

The largest detraction came from salary packaging and employee management service provider Smartgroup (SIQ, -43.2%). The stock initially declined in response to the news that its long-standing CEO was retiring. This was followed in December by the announcement of a change in terms with its insurance underwriting partner, which is expected to reduce SIQ's 2020 after tax profit by approximately $4m, or roughly 10% of 2019 earnings. In combination with ongoing weakness in areas such as auto sales, we now see the mid-term risk reward as less attractive and have exited this position.

Underweight Fisher & Paykel Healthcare

Fisher & Paykel (FPH, +32.3%) had a strong quarter following a management guidance upgrade early in the quarter, confirmed by a strong set of results in November. Our preference in this space is for companies such as Nanosonics (NAN) and the underweight in FPH dragged on relative performance

Strategy and outlook

The current investment environment is characterized by global macro uncertainty. The US-China trade deal has alleviated some near-term concern but does not remove what we expect to be ongoing tension between the two countries. Global growth remains muted, while geopolitical risk - not least in the form of a US Presidential election year - remains high.

The domestic outlook also remains challenged, which has fed through to weak demand in some areas. There is also the potential for the devastating bushfires to weigh on consumer sentiment in the key December/January trading period for retail.

Nevertheless, a more stable housing market is helping to stall further deterioration in the domestic economy. We also see the potential for further monetary and fiscal stimulus. Should this occur, we remain mindful that any signs of improvement could see a rotation to those parts of the market which have underperformed over recent times.

With the backdrop of strong investment returns in CY19, combined with uncertain macro outlook, CY20 is likely to be a year of more modest index returns, with volatility and sector rotation having potential to drive divergent returns depending on stock selection.

Bond yields lifted in December, bit still remain low by historical standards. The historically high valuations in growth parts of the market remains a key challenge for small cap investors. We retain exposure to growth stocks, but remain focused on the valuation discipline which underpins our process.

Looking into 2020, the portfolio is positioned to benefit from a number of non-correlated performance drivers. This includes companies with organic earnings growth (eg Ryman Healthcare, Seven Group), strong free cash flow generators (eg Elders, AP Eagers), companies which are leveraging disruption (eg Nanosonics, Technology One), and those which are delivering on self-help strategies (eg Invocare, Austal).

The portfolio delivered reasonable absolute gains in 2019, however it ended behind the index, for only the third year since the team assumed management in 2004. While underperformance is disappointing, we retain conviction in the approach which has underpinned the Fund's long-term track record of performance. There is clear valuation upside in our key positions, coupled with what we believe are catalysts for the realisation of this value. As a result, we believe the portfolio is well positioned to generate meaningful outperformance looking forward.

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

PENDAL

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