PENDAL

Factsheet

Equity Strategies

September 2020

Pendal Smaller Companies Fund

ARSN: 089 939 328

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	6.51	6.85	5.67
FYTD	6.51	6.85	5.67
6 months	32.84	33.68	30.93
1 year (pa)	0.40	1.64	-3.33
2 years (pa)	-0.89	0.35	0.24
3 years (pa)	5.77	7.10	6.53
5 years (pa)	7.87	9.21	9.97

Sector Allocation (as at 30 September 2020)

Energy	1.4%
Materials	11.4%
Industrials	16.1%
Consumer Discretionary	21.1%
Consumer Staples	4.1%
Health Care	6.9%
Information Technology	11.9%
Telecommunication Services	4.6%
Financials ex Property Trusts	11.9%
Property Trusts	6.0%
Cash & other	4.6%

Other Information

Fund size (as at 30 Sep 2020)	$408 million
Date of inception	December 1992
Minimum investment	$25,000
Buy-sell spread[1] For the Fund's current buy-sell spread information, visit www.pendalgroup.com	
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 Australian equities market lost momentum during the last month of the quarter. The S&P/ASX 300 Accumulation index dropped by -3.6% in September; making its performance over the quarter flat (-0.1%). In contrast, whilst the Small Ordinaries also pulled back by -2.8% over the month, it finished the quarter with a gain of +5.7%.

Small Resources (+0.9%) were the laggards when compared to Small Industrials (+6.9%), as some of the gold miners, and most of the energy companies underperformed on weaker commodity prices. In particular, oil slid in September as markets tempered expectations of the rebound in demand. The impact of aircraft fuel is playing a role in this, however diesel demand has also been weaker than many would have expected by this point.

Turning to sector performance, most of the sectors finished the quarter in the black. Consumer Discretionary (+26.1%) and Communication Services (+10.8%) both recorded double-digit gains, followed by Real Estate (+4.0%) and Materials (+2.9%). In contrast, Energy (-7.0%) was the worst performing sector over the quarter, followed by Utilities (-2.1%) and Healthcare (+0.5%).

Some of the key company updates over the quarter include:

- IDP (IEL, +22.7%) provides placement of international students into education institutions in Australia, the United Kingdom, the United States, Canada, and New Zealand. As international boarders have largely closed since the onset of COVID-19, the short-term outlook for the company was rather subdued. The company reported in August, and the unexpectedly strong FY results and promising growth outlook saw its stock price rebound sharply. IELTS, an English proficiency language test that is administrated by IEL reopened in 53 out of 55 countries, reinstated 55% of capacity and had a pipeline of 82K student applicants. In terms of guidance, management commented that demand was matching available capacity.

- PointsBet (PBH, +114.3%), which is a corporate bookmaker offering racing and sports betting products and services direct to clients reported FY20 NPAT of A$39.7m. Whilst this undershot market expectation somewhat, the share price of PBH skyrocketed after the company announced the 5-year media partnership with NBCUniversal. Lastly, CTD rose on the back of expectation for the return of corporate travel in offshore markets, as noted by management in its FY21 outlook statement. The company reported underlying EBITDA of $65.0m and underlying NPAT of $32.0m for FY20.

- ZIP (Z1P, +18.0%). There were a few updates from the buy-now-pay-later (BNPL) player, including a trading update of its newly acquired US business, QuadPay; the announcement of its partnership with eBay Australia as well as its FY20 results. Momentum remained strong for QuadPay, which achieved monthly transaction volume in excess of $70M in July, representing +30% increase on June quarter average and +600% year-on-year. The business added 133,000 customers in July and surpassed the 2m customer milestone in August. ZIP did give back some of the gains in September following the news that Paypal intends to enter the BNPL market in the US.

- Unibail-Rodamco (URW, -40.1%) fell after announcing a €9bn reset program, which included a €3.5bn capital raise and €4bn of disposals. The aim of the plan is to strengthen URW's balance sheet and increase financial flexibility to execute its long-term strategy. Management also took the opportunity to provide an update on footfall, tenant sales and rent collection. URW has reopened all of it shopping centres globally, though indoor operations in five centres in Los Angeles County continue to be suspended, which represent 4% of the shopping centre portfolio by value.

Fund performance

The Fund outperformed the benchmark over the September quarter.

Contributors

Overweight Reece (REH)

Plumbing supplies company Reece (REH) delivered a strong set of results despite a challenging year. For the year ending 30 June, REH saw sales revenue grow by only 1% across Australia and New Zealand, given the combined impact of the bushfires and COvid-19. However this was more than offset by 20% revenue growth in the US, which saw Group growth in revenue of 10%. Net profit after tax grew 19%.

Overweight Adairs (ADH)

Homewares company Adairs also delivered a strong result during the quarter, demonstrating resilience in the face of the challenge from Covid. In-store sales fell -7.3% for the year following a five week store closure. However a 110.5% surge in online sales saw total group sales grow 12.9%. Underlying earnings before interest and tax grew 39.7% for the year.

Detractors

Underweight Pointsbet (PBH)

Cloud-based corporate book maker Pointsbet surged after announcing a five year deal to become the official sports betting partner of NBC Sport in the US. There is a position in the portfolio, however it was lower than the index, which dragged on the portfolio's relative performance.

Overweight Technology One (TNE)

Technology One had a volatile quarter after the release of a research report from a short-selling firm based in Hong Kong. In our view, key issues raised in the report around some accounting outcomes were backward looking, already addressed and reasonably well known. They largely pertain to the company's shift from a perpetual license to recurring license fee model. We maintain conviction in the company's continued underlying business success and competitive advantage as a first mover in fully fledged cloud enterprise software solutions. We continue to believe further value will be unlocked as transitional accounting runs its natural course and investors increasingly see a pure SaaS/(recurring) business clearly emerge in both business and financial accounting terms.

Strategy and outlook

The Australian Federal budget was stimulatory, as expected. On balance, the size of the total package was probably a touch larger than consensus was looking for. The scale of measures, which will drive the budget deficit close to 12%, demonstrates the willingness of policy makers to underpin the economy.

This is a material shift in mindset away from the fiscal prudence and balanced budgets that Western governments have generally adopted over the last three to four decades. It is an important factor at play in the determining the ultimate economic impact of Covid 19 and the speed of the recovery.

Both government and central bank rhetoric – in Australia and in many countries overseas – is emphasizing the determination to limit the structural economic and social damage from the virus and shutdowns. The outcome is likely to be loose monetary policy for some time – alongside large scale stimulus from the government.

At this point the constraint on fiscal stimulus is either rampant inflation of loss of confidence in government credit. Neither issue is in play at the moment. Over time, we think there is a chance of a period of negative real interest rates, as inflation expectations rise while nominal rates are kept low. This is one factor in the portfolio's exposure to gold miners – as real assets such as gold, commodities and property tend to do well in period of negative real rates.

We remain mindful of the resurgence of Covid cases in the US and, more recently, in Europe. The second wave in the US has thus far not stalled the economic recovery and the hospitalization and mortality rates remain far below the levels of the first wave. Likewise, in Europe, there has not been any material impact on economic activity so far.

In the US the rate of the rebound is slowing as household income falls. However at this point it seems that accrued savings from the previous months – when the savings rate spiked – is helping offset the effect of previous support rolling off.

The impasse over the next stimulus package remains and it appears increasingly unlikely that an agreement will be reached prior to the Presidential election, with Senate Republicans focused instead on nomination of a new Supreme Court Justice. At this point the notion of a Democrat sweep of the White House and Senate – supported by current bookmaker odds – and therefore a larger package post-election is doing enough to calm market fears on this front.

We maintain the portfolio's balanced construction. While policy support is rendering the possibility of a double dip recession less likely, there is still the risk of a market downturn and hence we retain the portfolio's protection in the form of companies with defensive earnings – such as Elders and AUB Group. We also maintain the exposure to gold via a diversified basket of miners, including Saracen Minerals.

At the same time, there is a sense that perhaps the worst has passed for some cyclicals which have seen a large impact from Covid-19. For example, we have seen the portfolio's positions in IDP Education and Sky City Entertainment start performing over the last two months. There are still stocks that are trading well below pre-Covid highs and are in decent shape and aligned with the recovery. We have been adding here selectively in recent months.

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

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