

PENGANA INTERNATIONAL EQUITIES LIMITED (ASX: PIA)

**DECEMBER 2018
PERFORMANCE
UPDATE**

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DESCRIPTION AND FEATURES

Pengana International Equities Limited provides access to the benefits of an actively managed core portfolio of 30-50 ethically screened companies across developed and developing global markets via a listed investment company structure.

Investments are made predominantly in companies that deliver stable yet growing free cash flow throughout cycles (which we classify as 'Core' holdings) whilst also taking positions in more cyclical companies ('Cyclical') and those whose valuation has been materially misconstrued by the market ('Opportunistic').

Visit our website for more information on the Company.

FOR FURTHER
INFORMATION
PLEASE VISIT
OUR WEBSITE:
PENGANA.COM/PIA

Portfolio managers	Jordan Cvetanovski Steven Glass
ASX code shares	PIA
ASX code options	PIAO
Founded	19 March 2004
Mandate inception	1 July 2017
Asset class	International Equities
Fees	Management fee: 1.23% p.a. Performance fee: 15.38% of any return greater than the MSCI World ³
DRP	Yes
Share price ¹	A\$1.060
Option price ¹	A\$0.001
NTA (pre-tax) ^{1,2}	A\$1.1467
NTA (post-tax) ^{1,2}	A\$1.1522
Premium/discount to pre-tax NTA ¹	(7.56%)
Ordinary shares on issue ¹	252.99m
Bonus options on issue ¹	237.80m
Benchmark	MSCI World ³

¹ At 31 December 2018.

² The figures are unaudited.

³ MSCI World refers to the MSCI World Total Return Index, Net Dividends Reinvested, in A\$.

PERFORMANCE

Net performance for periods ending 31 December 2018⁴

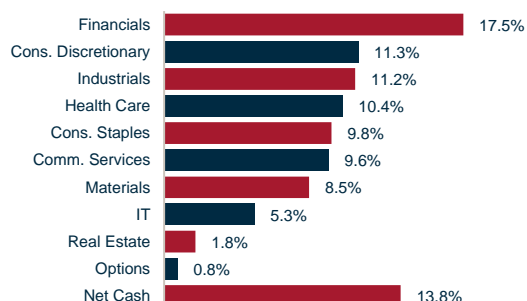
	1 mth	3 mths	1 yr	FYTD	Since Inception p.a. ⁵
PIA	-1.6%	-4.7%	2.0%	-3.3%	7.4%
Benchmark	-4.2%	-11.0%	1.4%	-4.6%	6.6%

Pengana International Equities Limited has been managed under the new investment mandate by the Pengana investment team since 1 July 2017. The performance since inception in the table above refers to the movement in net assets per share since the inception of PIA in March 2004. See footnotes 4 and 5 below for further details.

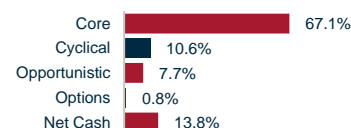
PORTFOLIO INFORMATION

Top 10 stocks		
Name	Country	Sector
Alphabet	United States	Communication Services
Bharti Infratel	India	Communication Services
Cigna	United States	Health Care
CME Group	United States	Financials
Deutsche Boerse	Germany	Financials
Dollar General	United States	Consumer Discretionary
Heineken	Netherlands	Consumer Staples
Intercontinental Exchange	United States	Financials
Microsoft	United States	Information Technology
Nutrien	Canada	Materials
Largest 3 contributors (for the quarter)		Largest 3 detractors (for the quarter)
CME Group		Wacker Chemie
Newmont Mining Corp		Corticeira Amorim
Bharti Infratel		Sabre

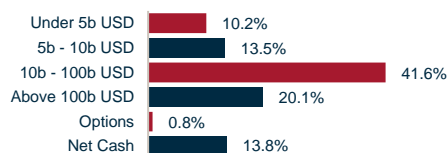
SECTOR BREAKDOWN



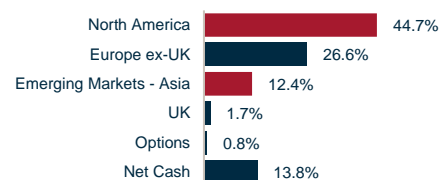
SEGMENT



CAPITALISATION



GEOGRAPHIC



4. Performance figures refer to the movement in net assets per share plus dividends per share paid in the period, reversing out the impact of option exercises, before tax paid or accrued on realised and unrealised gains. Past performance is not a reliable indicator of future performance, the value of investments can go up and down.

5. Inception date of PIA: 19 March 2004, new investment team with new mandate adopted: 1 July 2017

None of Pengana International Equities Limited ("PIA"), Pengana Investment Management Limited (ABN 69 063 081 612, AFSL 219462) nor any of their related entities guarantees the repayment of capital or any particular rate of return from PIA. Past performance is no guarantee of future performance. This document has been prepared by PIA and does not take into account a reader's investment objectives, particular needs or financial situation. It is general information only and should not be considered investment advice and should not be relied on as an investment recommendation.

PERFORMANCE COMMENTARY

Aim

We aim to achieve superior AUD-denominated returns with low volatility. The superior returns aim can be disaggregated into (i) capital preservation; (ii) capital appreciation. While these aims make no mention of the benchmark, we believe that fulfilling our aims will result in superior returns to the benchmark over the medium-to-long term.

Quarterly Performance

The portfolio delivered -4.7% in 4Q18 compared to the MSCI World index which returned -11.0%, the weakest quarter since 1Q09. The quarter was characterised by heightened volatility and weakness across most sectors but it was reassuring to see the portfolio exhibiting defensive qualities in the face of such uncertainty.

Key drivers of the performance include:

- Stocks that were the largest positive contributors – CME Group (US derivatives exchange), Newmont Mining (US gold miner) and Bharti Infratel (Indian telecom towers).
- Stocks that were the largest detractors – Wacker Chemie (German specialty chemical), Corticeira Amorim (Portuguese cork producer), and Sabre (US travel technology company).
- Cash – 19% on average of the portfolio was held in cash and gold stocks during 4Q18. This was a relative performance tailwind as equity markets fell.
- Sector exposure – the portfolio was underweight the Information Technology sector and had no exposure to the Energy sector, the two worst performing sectors during 4Q18.
- Country exposure – the portfolio was underweight the US and Japan, which were relatively weaker performing regions during 4Q18, and overweight China and India, which were relatively stronger performing regions during 4Q18.
- Portfolio insurance (put options) – the put options provided a significant tailwind as equity markets fell.

MARKET COMMENTARY

In 4Q18, the MSCI World was down 13.1% in local currency and down 11.0% in AUD terms as the AUD depreciated against the USD.

The best performing sectors were Utilities, Real Estate and Consumer Staples. In our last quarterly, we commented that Utilities and Consumer Staples were two of the worst performing sectors during 3Q18 as well as

over the last two years. Their outperformance this quarter represents a significant rotation to the more defensive sectors.

The worst performing sectors were Energy, Information Technology and Industrials. Crude oil (WTI) declined by nearly 40% during the quarter, driving the weak performance in Energy. Information Technology has been the best performing sector by far over the last two years and the weak performance was driven by profit taking as well as rotation away from one of the riskier sectors.

The best performing (major) countries during the quarter were Hong Kong, Spain and Switzerland.

The worst performing (major) countries were Germany, Canada and France.

PORTFOLIO

The portfolio is divided into three segments:

- (1) Core (60-80% of the portfolio) – Core is intended to provide a stable base for the portfolio. Companies in this segment are growing, reasonably priced, have low business cyclicality, strong cash generation, dominant presence in their industries, strong management teams and favourable structural tailwinds.
- (2) Cyclical (0-30% of the portfolio) – Cyclical contains companies we expect to benefit from shorter duration trends. As these cycles tend to be transitory, timing is more important in our investment decisions than in Core. Cyclical companies offer the potential for materially more substantial short-term gains than Core, however, they are also riskier. Financials, basic materials, and agriculture are examples of industries that may be represented in this segment.
- (3) Opportunistic (0-20% of the portfolio) – Opportunistic includes companies we believe are materially undervalued or whose growth has been underappreciated. These companies offer potentially more attractive shorter-term gains than Core, however, they also tend to be riskier. Examples of Opportunistic investments include companies in the midst of a takeover, earlier stage internet/health/retail companies and companies whose share prices have markedly declined.

The portfolio's positioning at 31 December 2018 is summarised as:

- 85% of the portfolio is invested in equities, 2% of the equities exposure is in gold-linked shares, and 14% is held in cash.
- Segment exposure is 60-70% in "Core", 10-20% in "Cyclical" and 5-10% in "Opportunistic".
- Geographic exposure – the portfolio's key underweights (relative to the Market) are the US and Japan. The key overweights are Europe and China. The portfolio currently has no direct Latin America or Africa exposure.
- Sector exposure – the portfolio is notably overweight Materials and is materially underweight Information Technology, Energy and Utilities.
- 24% of the portfolio is invested in small or mid-cap companies, 42% is in large-caps, and 20% is in mega-caps.

We have been warning in recent monthly and quarterly publications of the possibility of a market selloff and heightened uncertainty. Not only did we warn about this possibility, we also acted. Entering the fourth quarter we had largely repositioned the portfolio to a significantly more defensive stance. The cash and derivative protection levels were increased to a maximum. In addition, we had also increased our exposure to companies such as derivative exchanges that would benefit from an increase in volatility in markets.

Throughout the many years that we have been meeting companies around the world we have developed a comprehensive list of businesses that largely fit all of our investment criteria bar one important factor, their valuation. Simply put, not only do we monitor companies that we hold in our portfolio, but we also monitor many high-quality companies that are simply too expensive. Over the last quarter, we took the opportunity to invest in upward of seven new companies. This is a record number of investments for us to be making in such a short period of time. We feel the market selloff has greatly improved the attributes of the overall portfolio leaving us with an optimistic outlook for our portfolio of holdings.

STOCK FOCUS

Bharti Infratel is a telecom tower infrastructure provider in India. Bharti's share price and operations have suffered in the last year as a result of bankruptcies and consolidation within the telecom sector, which has reduced the demand for telecom towers. A year ago, there were more than ten telecom operators in India but the entry of Reliance Jio two years ago resulted in a severe increase in competition and the Indian telecom sector has now been reduced to a three-player market. With the merger of Vodafone India and Idea Cellular finally complete, the worst should be behind Bharti.

Bharti is currently in the process of merging with Indus, the largest telecom tower infrastructure provider in India (in which Bharti already has a 42% stake). This was originally expected to be completed by the end of March 2019 but has since been pushed back slightly to the end of June 2019. Post-merger, Bharti and Indus combined will have more than 160,000 telecom towers and more than 40% market share in terms of tenancies. India has less than half a million telecom towers while China has around two million telecom towers, which suggests significant long-term growth potential.

Underpinning the demand for additional telecom towers is the fact that India has very little cable and Internet access is mainly via the mobile phone. With the rollout of 4G in 2016, mobile data usage has skyrocketed in India from less than 500 petabytes (1 petabyte = 1 million gigabytes) in the quarter ending June 2016 to more than 12,000 petabytes in the quarter ending September 2018. With mobile data usage in the September 2018 quarter increasing 130% year on year and 20% quarter on quarter, the telecom providers will need additional towers to continue densifying their network.

The average revenue per user per month (ARPU) generated by the telecom providers in India has been declining and is currently less than US\$2. By way of comparison, ARPU is about US\$8 in China, less than US\$20 in Europe and about US\$40 in the US. Although GDP per capital is currently significantly lower in India than in China, Europe and the US, this is expected to increase in the longer term as should the ARPU. An increase in ARPU in India will lift profits for the telecom providers, which will in turn allow them to invest more into their networks, benefiting Bharti.

Bharti has no debt and is currently trading on 8x EV/EBITDA with more than 4% dividend yield. KKR and the Canada Pension Plan Investment Board own 10.3% of Bharti and they have been rumoured to make a bid post-merger. KKR and the Canada Pension Plan Investment Board purchased their Bharti stake at INR325 in March 2017 and if they were to make a bid at that price, this would be a 17% premium to current price of INR277. Both Bharti Airtel and Vodafone have appeared keen to dispose of their stakes in order to fund their network investment and a deal should be forthcoming as long as the price is right.



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