Professional Selection

Investor Update

London calling – Investment research trip, November 2017

December 2017

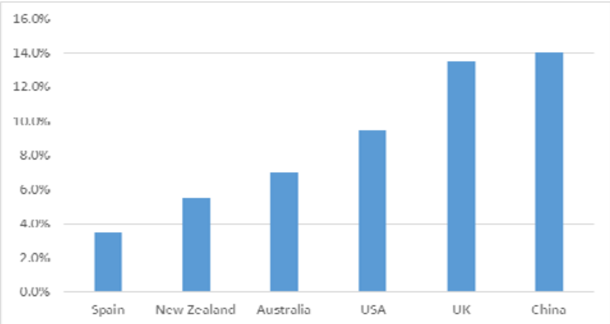
During the quarter we conducted a number of site visits and meetings in London. The trip covered REITs, property developers, fund managers and a number of industry contacts in the retail sector.

These research trips form an important part of our investment research process, where we aim to generate investment insights that feed into our bottom-up stock and sector analysis, which in turn will hopefully contribute to profitable investment decisions in our portfolios. We detail some of our key findings below.

Retail:

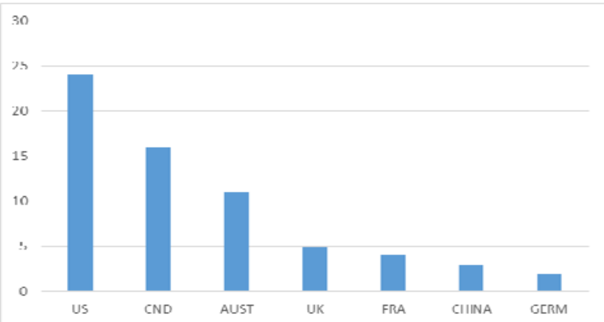
The UK market is a good case study for the Australian retail market, as it is ahead in terms of online adoption, it has less physical space, and its department stores have already consolidated.

Chart 1: Online market share



Source: Euromonitor, Morgan Stanley

Chart 2: ICSC – Retail Space spf per capita



Source: ICSC

Shopping centres are not dead – despite all the media reports and depressed share prices of almost anything related to retail. One of the key reasons behind our view is that we believe that all retailers need some physical stores – even 'online' retailers. But they need much less than they previously did. As an example, the online retailer 'Missguided' have just opened a large format store at Westfield Stratford. This is one of only two stores that they have opened in the UK, the other being at Bluewater Shopping Centre.

Westfield Stratford:

Based on our visits, the only centres that have a positive long term outlook are the few prime destination centres that people actually want to go to, as well as some dominant centres in smaller regional areas.

Prime centres should continue to win market share at the expense of High St and lower quality shopping centre. This is due to the concentration of retailers physical stores in only the best assets, plus the best located malls will see their catchment areas increase due to surrounding residential development.

Westfield London and Westfield Stratford are the best examples of the select few 'prime' centres that we refer to.

Source: Antares

Westfield London and Stratford

Source: Antares

The contrast with Brent Cross Shopping Centre was stark. Brent Cross – owned by the UK listed Hammerson - is located in the north of London and is in the top 15 shopping centres in the UK by size. The center looked tired and outdated, especially when compared to Westfield's flagship assets.

Brent Cross (HMSO LN)

Source: Antares

Another advantage held by well-located centres such as Westfield London and Westfield Stratford is the ability to develop residential real estate on land adjacent to the shopping centres. Westfield are currently planning to develop around 1400 apartments at both of these centres over the next few years. The potential profits from these development projects are an additional source of growth for the value of these assets over time.

We also received an update on the current development project at Westfield London, which involves an expansion of the existing shopping centre. The new part of the centre is due to progressively open from March 2018. Department store 'John Lewis' – who chose not to be an anchor tenant of the original centre when it opened in 2008 – are set to unveil their new flagship store on opening day. The expansion space is about 90% leased, with rents above feasibility.

Westfield London - development progress

Source: Antares

So overall we continue to hold a positive view on prime retail shopping centres, which underpins our investment case for Westfield Corporation (WFD) and Scentre Group (SCG). But we think lesser quality shopping centres will continue to be under pressure as online shopping and prime shopping centres take market share.

Global REITs

We also attended a Global REIT conference in London, where a number of REIT management teams and industry experts presented on a variety of topics. Our overall take on the sentiment of the presentations was very poor for retail, positive on industrial, negative London office and positive German residential. We feel that in many cases this sentiment is overdone, leading to some share prices moving too far from fundamental valuation.

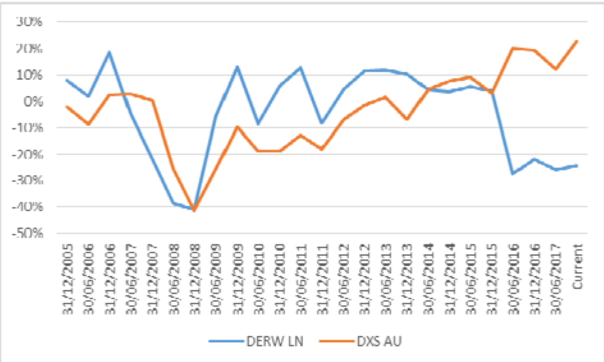
For example, while we have detailed the many challenges facing shopping centres, we think that the share market has factored in too much negativity in some cases. This is part of our current positive view on WFD and SCG.

At the same time we think the equity market has become too optimistic towards industrial real estate. As we detailed in our last quarterly report, our selling of Goodman Group (GMG) was driven by our view that the share price had gone way ahead of our valuation, rather than us taking a view that the company was fundamentally challenged.

Interestingly, an expert from Savills Real Estate made the comment that retail is the sector every investor loves to hate at the moment, and that industrial has become flavour of the month.

In the case of the office market, we find it very interesting to compare Dexus Property Group (DXS) – an Australian office REIT, with Derwent London (DERW) – a London office REIT. DERW currently trades at a 25% discount to its stated Net Asset Value (NAV), while DXS trades at 25% premium to its stated Net Tangible Assets (NTA). This is despite DERW having a stronger balance sheet, a superior development capability and a well proven management team.

Chart 3: Premium to NTA/NAV – DERW LN vs DXS AU



Source: Company Reports, Bloomberg

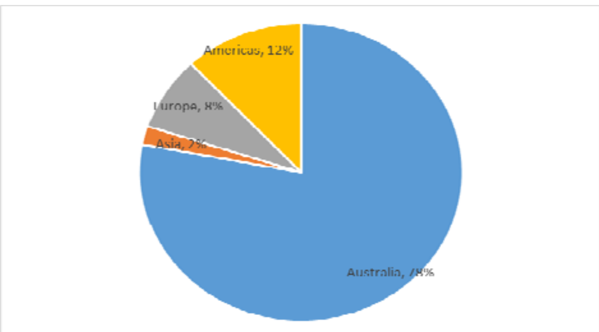
Other Company Meetings

Lend Lease (LLC): LLC's current development pipeline includes remaining work at major projects including Stratford and Elephant & Castle – both in London - as well as their new project win at Haringey, located in the north of London. Haringey is a planned mixed use, urban regeneration scheme that involves the private developer – in this case LLC – working with the local Government authorities to deliver an improved community outcome.

LLC's track record of delivering the right outcomes for local councils is what has enabled them to win new projects like Haringey. Their integrated model appears to be the key, as they have basically no competitors in this space. Lend Lease (LLC) look to be coming into a period of strong performance in their UK and Europe business.

The UK/Europe region is only a small contributor to LLC's Operating Profit at present, but we think it can become a more significant contributor in the medium term.

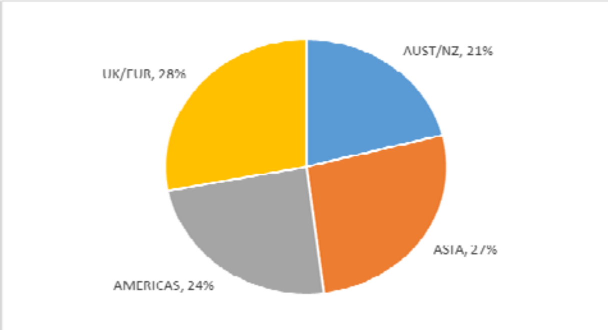
Chart 4: LLC Operating profit – geographic split %



Source: Company Reports, Antares

Goodman Group (GMG): GMG have a well performing UK/Europe business. Their funds management business is in good shape post the recent sale of the Arlington Business Parks Partnership, and they see development volumes as being around trend levels at the moment. They expect this to be steady with some growth, but definitely not supercharged growth - unless a huge online retailer like Alibaba came into the market.

Chart 5: GMG Development Book split %



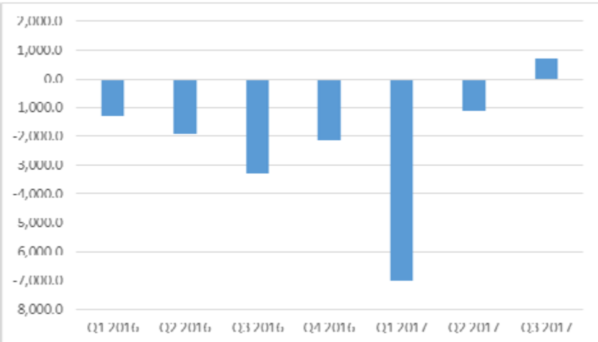
Source: Company Reports, Antares

Janus Henderson Group (JHG): JHG is the group resulting from the recent merger of the UK based Henderson Group, and the US based Janus Capital. JHG is headquartered in London, and is dual listed on the ASX and the NYSE.

JHG is a global fund manager with US$360 billion in assets under management. The business is currently going through the process of integrating the best capabilities of Henderson and Janus, which naturally involves a huge amount of upheaval in terms of staff and systems.

Management have so far indicated that they are on track to achieve the financial targets they set for JHG at the time of the merger proposal. It was very pleasing to see Net Funds Flow – a key metric for funds management firms – turn positive at the most recent third quarter result. We think JHG is attractively priced compared to many of its listed fund management peers, and that management is well placed to deliver the performance expected post merger.

Chart 6: JHG: Net flows $m

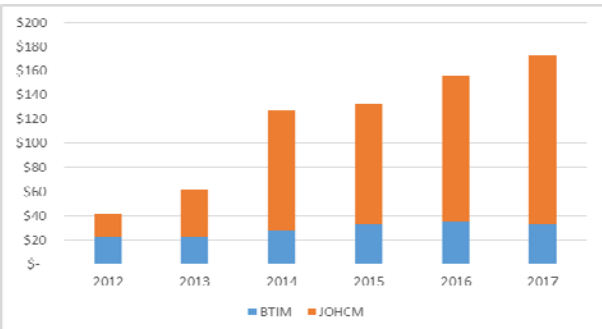


Source: Company Reports

BT Investment Management (BTT): BTT own a funds management business called 'JO Hambro Capital Management' (JOHCM), which is headquartered in London. JOHCM has been a spectacular performer for BTT, but the company recently disclosed that it is under investigation from the UK's Financial Conduct Authority (FCA)

While we don't have any insight into what the investigation may uncover, we do believe that such investigations can have a hurtful impact on a firm's reputation, even if it is only short lived. The extent to which BTT has relied on the huge growth in JOHCM can be seen in the chart below. Therefore we think it is wise to be cautious about any negative development at JOHCM, preferring to wait until the issue is resolved before becoming more positive on BTT.

Chart 7: BTT – Profit split $m



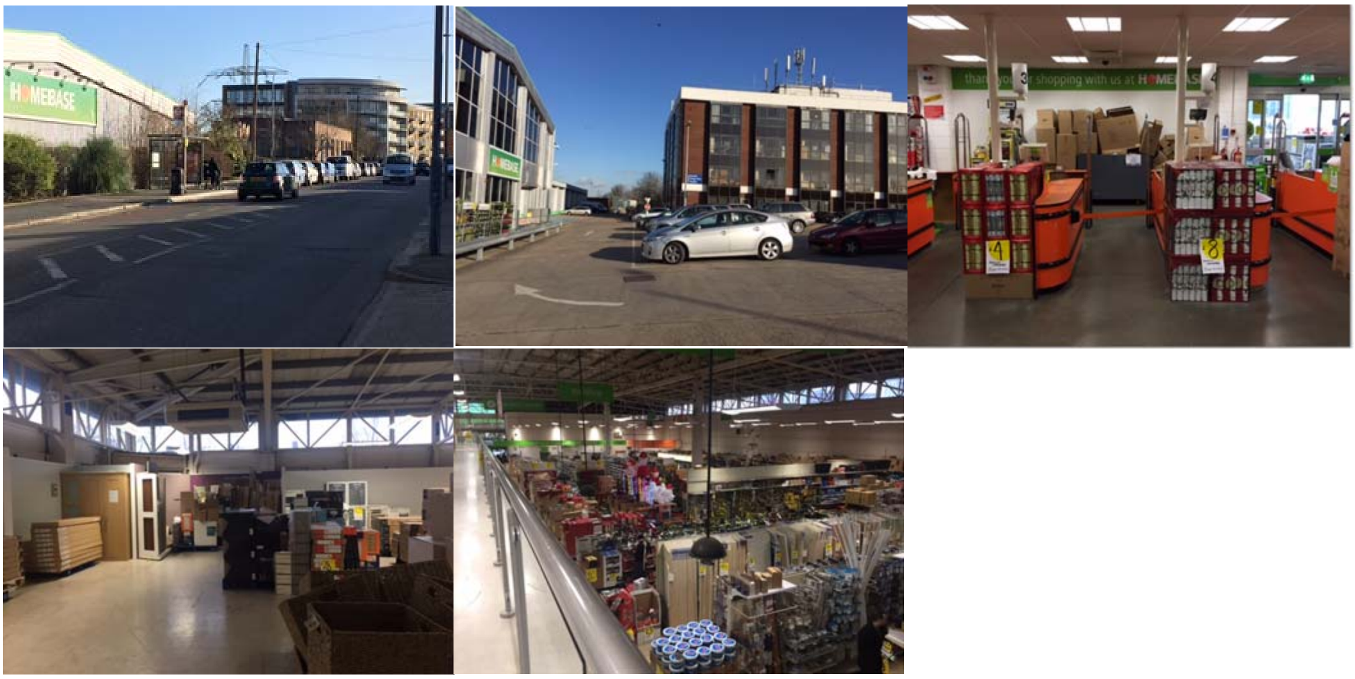
Source: Company Reports

Wesfarmers (WES): Since WES announced their plans to export the hugely successful Bunnings Warehouse Australia business into the UK market via the acquisition of Homebase UK, the share market has been very cynical about its prospects for success. Some commentators have even likened Bunnings UK to Woolworths' Masters debacle.

The poor sentiment has been increased by the recent weak sales numbers reported for the Homebase chain. We decided to take a look for ourselves by visiting a number of Homebase and Bunnings stores in the UK. We thought that Homebase was very poor, with the stores badly presented and with little foot traffic. But the new Bunnings stores were terrific, looking exactly the same as the Australian stores in terms of branding, layout, product range, café and playground - even the community run sausage sizzle! They had noticeably more customers than the Homebase stores.

We came away thinking that the market may have underestimated WES' ability to succeed in the UK with its roll out of Bunnings stores.

Homebase UK:



Source: Antares

Bunnings UK

Source: Antares

Antares market & fund updates

Below is a brief review of how the Australian share market performed during the quarter as well as short commentaries on each Antares Fund, outlining their net performance and the main contributors to performance.

Australia share market review

The Australian share market finished the year strong in the December quarter, with global geopolitical tensions surrounding North Korea abating and simultaneous global economic growth continuing to improve. The S&P/ASX 200 Accumulation Index rose 7.6%. The resource sector (+14.7%) was boosted by rising commodity prices throughout the quarter, whilst energy stocks (+18%) were supported by a continuing rise in the oil price. Information technology (+15.6%) also outperformed.

By contrast, Utilities (+3.2%), Financials ex REITs (+3.6%) and Industrials (+5.16%) all underperformed the broader market. Financials were largely impacted by the royal commission that was announced into the "misconduct in the banking, superannuation and financial services industry."

Corporate deals during the quarter included Tattersalls (TTS) and Westfield (WFD). Shareholders of TTS approved TAH's proposal to acquire 100% of TTS. The new merger will create a combined company with pro-forma annual revenue of c.$5bn and EBITDA over $915m. WFD received an offer from Unibail-Rodamco to acquire WFD in a cash and scrip offer. The offer valued WFD at US$24.7bn. The deal is expected to create a global leader of flagship shopping destinations across Europe and America with a gross market value of US$72.2bn and the transaction has been unanimously recommended by WFD's board of directors.

Australian Shares Fund*

The Antares Australian Shares Fund delivered a return of 8.5% (net of fees) for the six months to December 31, outperforming the benchmark S&P/ASX 200 Accumulation Index return of 8.4% by 0.1%. Over the past 12 months, the Fund returned 10.2% (net of fees), underperforming its benchmark by 1.6%.

The main contributors to relative performance over the past year were overweight positions in Santos, Qantas Airways, Rio Tinto and Tabcorp Holdings. Detracted from yearly performance were underweight positions in CSL and BHP Billiton and an overweight position in Vocus Group. Holding some cash also detracted from relative performance given the strong rise in the share market.

Elite Opportunities Shares Fund*

The Antares Elite Opportunities Shares Fund returned 7.9% (net of fees) for the six months to December 31, underperforming the benchmark S&P/ASX 200 Accumulation Index return of 8.4% by 0.5%. Over the past 12 months, the Fund returned 12.4% (net of fees), outperforming its benchmark by 0.6%.

Overweight positions in Rio Tinto, Qantas Airways and Santos were the main positive contributors to relative performance over the year, along with an underweight position in Telstra Corporation. Being overweight Vocus Group and Brambles detracted from relative performance, along with the decision not to hold a position in CSL and an underweight position in BHP Billiton that both performed well.

High Growth Shares Fund*

The Antares High Growth Shares Fund returned 10.4% (net of fees) for the six months to December 31, outperforming the benchmark S&P/ASX 200 Accumulation Index return of 8.4% by 2.0%. Over the past 12 months, the Fund returned 14.8% (net of fees), outperforming its benchmark by 3.0%.

The main contributors to relative performance over the year were overweight positions in Aristocrat Leisure, Treasury Wine Estates and Computershare, along with an underweight position in Telstra Corporation. Detracting from annual performance were overweight positions in Vocus Group, and underweight positions in CSL and Whitehaven Coal. Holding some cash in the Fund also detracted from relative performance given the strong rise in the share market.

Listed Property Fund*

The Antares Listed Property Fund delivered a return of 10.0% (net of fees) for the six months to December 31, outperforming the benchmark S&P/ASX 200 A-REIT Accumulation Index return of 9.8% by 0.2%. Over the past 12 months, the Fund returned 6.3% (net of fees), outperforming the benchmark index by 0.6%.

Overweight positions in Peet, Goodman Group and Abacus Property Group contributed positively to the Fund's annual performance. Being overweight Scentre Group detracted from relative performance in conjunction with the Fund's underweight position in Mirvac Group along with the decision not to hold a position in Charter Hall Group.

Antares Investment Returns

Performance to 31 December 2017[1]

		6 mths %	1 yr %	3 yrs % pa	5 yrs % pa	10 yrs % pa	Since inception % pa
Australian Equities							
	Net return[3] %	8.5	10.2	7.7	8.6	3.8	8.7
Australian Shares Fund*	Gross return[4] %	9.5	12.4	9.9	10.7	5.8	10.7
Inception date: 28/02/1987	Benchmark return	8.4	11.8	8.6	10.2	4.1	8.9
	Net excess return	0.1	-1.6	-0.9	-1.6	-0.3	-0.2
	Gross excess	1.1	0.6	1.3	0.5	1.7	1.8
	Net return[3] %	7.9	12.4	9.3	9.9	5.4	10.5
Elite Opportunities Shares Fund*	Gross return[4] %	8.7	14.0	10.9	11.5	6.9	12.1
Inception date: 29/11/2002	Benchmark return	8.4	11.8	8.6	10.2	4.1	9.4
	Net excess return	-0.5	0.6	0.7	-0.3	1.3	1.1
	Gross excess	0.3	2.2	2.3	1.3	2.8	2.7
	Net return[3] %	10.4	14.8	9.7	10.4	5.2	10.4
High Growth Shares Fund*	Gross return[4] %	11.5	17.0	11.9	12.5	7.3	12.8
Inception date: 02/12/1999	Benchmark return	8.4	11.8	8.6	10.2	4.1	8.3
	Net excess return	2.0	3.0	1.1	0.2	1.1	2.1
	Gross excess	3.1	5.2	3.3	2.3	3.2	4.5
Listed Property							
	Net return[3] %	10.0	6.3	9.1	11.0	1.6	6.9
Listed Property Fund*	Gross return[4] %	11.1	8.4	11.3	13.2	3.6	8.9
Inception date: 20/01/1998	Benchmark return	9.8	5.7	11.0	13.2	1.9	7.1
	Net excess return	0.2	0.6	-1.9	-2.2	-0.3	-0.2
	Gross excess	1.3	2.7	0.3	0.0	1.7	1.8

Disclaimer:

[1] Past performance is not a reliable indicator of future performance. Returns are not guaranteed and actual returns may vary from any target returns described in this document.

[2] Investment returns are based on exit prices, and are net of management fees and assume reinvestment of all distributions.

[3] Gross returns are provided to show performance against the investment objective.

*Closed to new investments

Get in contact

antarescapital.com.au

Toll free: 1800 671 849
Email: investorservices@antaresequities.com.au
Mail: GPO Box 2007 Melbourne VIC 3001

Antares Capital Partners Ltd, Level 20 8 Exhibition Street Melbourne 3000 GPO Box 2007, Melbourne VIC 3001 Telephone: (03) 9220 0300 Facsimile: (03) 9220 0333. Email: investorservices@antaresequities.com.au Website: www.antarescapital.com.au.