Ironbark Paladin Property Securities Fund

Quarterly Investment Report as at 31 December 2017

Asset Class

Property Securities

Investment Objective

Seeks to outperform the benchmark, after fees, over rolling three year periods.

APIR Code

PAL0002AU

ARSN

087 897 667

Fund Inception Date

28 February 1995

Benchmark

S&P/ASX 300 A-REIT Accumulation Index

Buy/Sell Spread

+0.25%/-0.25%

Distribution Frequency

Quarterly

Minimum Investment

$20,000

Fund Size

$301.9m

Exit Price

$0.9628

Number of Stocks

20

Market Review

The S&P/ASX 300 Property Accumulation Index returned 7.8% for the December quarter, marginally underperforming the broader Australian share market (as measured by the S&P/ASX 300 Accumulation Index which posted a return of 8.0%).

Three key themes defined the fourth quarter of 2017 for the Australian REITs:

i) Strong capital flows led to higher asset revaluations across all asset classes, led by office and industrial. Relatively strong asset value growth of approximately 5% has been observed over the past quarter on those stocks that have already reported revaluations in the office sector and 3-4% for the industrial assets. The revaluations of the larger retail landlords are yet to be seen, however transaction activity in regional malls may provide some scope for independent valuers to lift their valuations by 2-5% across the portfolios as well.

ii) A slowing consumer outlook, as real consumption in the third quarter of 2017 dropped to just 0.1% quarter on quarter, the worst since the Global Financial Crisis. Despite strong employment growth, wages are at a record low and consumer savings rates have halved over the past 12 months from rising energy costs, and out of cycle interest rate rises by banks. The retail landlords are now experiencing flatter retail sales after seven quarters of declining sales growth. This led to most of the Australian retail landlords to underperform the index over the fourth quarter. One significant exception was Westfield Corporation, which delivered a total return of 21%, outperforming the index by 13.2%. This was driven by the approach from Unibail Rodamco, a European retail landlord, who has offered to acquire Westfield with cash and scrip.

iii) Residential markets appear to have peaked in the fourth quarter asyear-on-year house price growth is now slowing as affordability, macro-prudential policies and foreign investment taxes have an effect on the asset class. However strong embedded margins and existing presales for listed developers (Stockland, Mirvac and Lend Lease) provides earnings clarity for the medium term.

Performance Review

The Ironbark Paladin Property Securities Fund (the ‘Fund’) returned 8.34% (net) for the December quarter, outperforming the Index return of 7.79% by 0.55%.

Holdings that were major contributors to performance included the average overweight position to outperforming Westfield Corporation and the underweight positions to underperforming Dexus and Vicinity Centres. The major detractors from performance were the average overweight positions to underperforming Goodman Group, Mirvac Group and Arena REIT.

Performance

	Net Fund Return (%)	Benchmark Return (%)	Active Return (%)
1 month	1.22	0.12	1.10
3 months	8.34	7.79	0.55
1 year	7.84	6.44	1.40
3 years (p.a.)	11.76	11.28	0.48
5 years (p.a.)	13.36	13.38	-0.02
7 years (p.a.)	13.58	13.65	-0.07
10 years (p.a.)	1.69	1.76	-0.07
Since inception[1] (p.a.)	7.98	8.39	-0.41

Past performance is not an indicator of future results. Net performance figures are calculated using exit prices, net of fees and reflect the annual reinvestment of distribution. Retail investors should refer to net returns.
If investing through an IDPS Provider, the total after fees performance return of your investment in the Fund may be different from the information in this report.
[1]This figure represents the annualised performance of the Fund from the first full month of operation.

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Fund Strategy

The investment manager is attracted to the social infrastructure sub-sector. Specifically to the length and structure of the long leases within childcare operators, and looks to retain an overweight position. The Fund also retains a net overweight position to the retail sub-sector, however selectively has exposure with the preferred names of GPT and Westfield Group. The Fund also retains a net underweight position to the diversified residential developer sub-sector, with Mirvac being the preferred exposure.

Key Contributors over the Quarter

Stock	Code	Index Return %	Fund position	Attribution impact %	Explanation
Westfield Corporation	WFD	21.05	O/W	0.95	Westfield outperformed during the quarter, delivering a total return of 21%. During December, Unibail-Rodamco ('UL') proposed to acquire Westfield for an implied price of $10.01. Since then, the implied offer has fallen 3.3% to $9.68 as UL's price has fallen 3% and the Australian dollar has been stronger against the Euro and the US dollar. This shows the complexity of the offer, as it is impacted by multiple currencies and UL's share price. After adjusting for dividends ($0.14 decline to the offer price) and valuing OneMarket at net tangible assets ($0.11 increase to the offer price), the estimated adjusted implied offer is $9.51.
Dexus	DXS	5.11	U/W	0.21	Dexus underperformed during the quarter, delivering a total return of 5.1%. During the quarter, Dexus announced revaluations of $660 million across its portfolio, which represent capitalisation rate compression of approximately 29 basis points. This is positive news for the stock, however the investment manager expects that the stock was due for some reversion after strong performance in prior quarters.
Vicinity Centres	VCX	5.29	U/W	0.13	Vicinity underperformed during December, delivering a total return of 5.3%. During the quarter, Vicinity announced a proposed asset swap with GIC (Singapore Sovereign Wealth Fund) that provided a 50% exposure in three strategic Sydney CBD retail assets for a 50% share in Chadstone Shopping Centre.
Iron Mountain	INM	-0.15	U/W	0.09	Iron Mountain underperformed during the quarter, delivering a total return of -0.2%. During the quarter Iron Mountain announced the acquisition of IO Data Centers ('IO') for $1.3 billion (plus an incremental $60 million based on future performance), representing 15 times earnings before interest, tax, depreciation and amortisation multiple (post-synergies of approximately $9 million). The impact to overall Iron Mountain's financials will be modest given the relative size of the contribution near-term.
Investa Office Fund	IOF	3.36	U/W	0.08	Investa Office underperformed during the quarter, delivering a total return of 3.4%. During the quarter, Investa Office revalued five of its assets in Sydney and Brisbane, reflecting 23% of the portfolio, resulting in an uplift of values of approximately 9% on the properties and approximately 3% for the portfolio.

Key Detractors over the Quarter

Stock	Code	Index Return %	Fund Position	Attribution Impact %	Explanation
Goodman Group	GMG	3.83	O/W	-0.22	Goodman Group underperformed during the quarter, delivering a total return of 3.8%. At its third quarter update, Goodman Group announced a stable development work in progress book of $3.5 billion, leasing spreads of 3.2% and occupancy at 98%; and the completion of a new bond tender, new issues and repurchase of hybrids which drove an approximate 1.5% decline in the cost of debt with the average debt expiry increasing from 3.6 years to 7.1 years.
Mirvac Group	MGR	4.78	O/W	-0.15	Mirvac underperformed during the quarter, delivering a total return of 4.8%. Mirvac's September quarter operational update was largely in line with the investment manager's expectations with management reiterating a 2018 financial year earnings guidance of 6-8%. Retail continues to perform well despite a tough retail environment, with strong comparable sales growth. Office and industrial leasing was also relatively strong with operational metrics broadly unchanged from the 2017 financial year. Residential development has continued to remain robust with an increase in pre-sales and settlement targets on track with low default rates.
Arena REIT	ARF	-0.37	O/W	-0.15	Arena underperformed during the quarter, delivering a total return of -0.4%. During the quarter, Arena announced the revaluation of 42 of its assets, resulting in a 3.4% increase to the portfolio's value.
Charter Hall Group	CHC	14.98	U/W	-0.14	Charter Hall outperformed during the quarter, delivering a total return of 15%. The company's first quarter update outlined strong funds under management, increasing from $19.8 billion to $20.4 billion post $0.8 billion of acquisitions (driven by sale and leaseback: 6 Bunnings assets, 10 Primo industrial assets, Coca Cola) and $0.3 billion of divestments.
Scentre Group	SCG	6.62	O/W	-0.10	Scentre underperformed during the quarter, delivering a total return of 6.6%. Scentre's third quarter update revealed comparable specialty sales moving average turnover slowed in September 2017 to 0.9% (versus 2.0% at June 2017), driven by the continued underperformance in Homewares (negative since December 2016) and Leisure. Nevertheless, Scentre outperformed its peers, with Mirvac the only other REIT to record higher comparable specialty moving annual total sales (which the investment manager believes is largely driven by redevelopments).

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Market Outlook

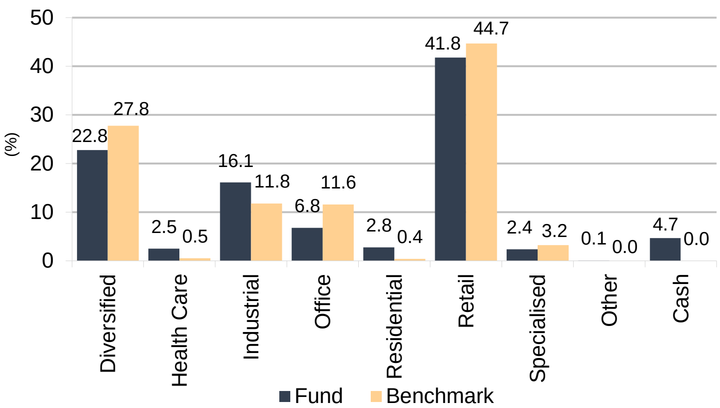
In Australia, the investment manager is forecasting a 6.0% total return over the next twelve months. With record low interest rates, off-shore capital flows and an appetite from companies to grow, the investment manager believes asset values continue to be well supported, despite recent upward movement in the Australian long bond rates.

The investment manager's valuations do not incorporate additional merger activity, which if it were to occur would drive asset values higher and management costs lower. The investment manager expects there is some risk of higher level of corporate activity in the next 1-2 years, as some of the stocks seek growth as the earnings growth tailwinds from lower debt costs in recent years start to slow. Fixed annual escalations embedded into lease terms provide AREIT trust portfolios a defensive earnings profile.

Whilst macro drivers and sector preferences are a part of the Fund's positioning, the investment manager is mainly driven by stock level relative value and upside opportunities. The investment manager expects those REITs with active earnings, including residential development, funds management or asset management to have stronger than sector average earnings growth profiles despite the slowing underlying like-for-like rental growth. However, as the top of the pricing cycle in residential market and other property segments approaches , the investment manager is being selective within this group. Defensive REITs (pure trusts) will show below sector average earnings growth, however remain well supported, until a pick-up in underlying commercial rent growth drivers is observed in Australia.

Portfolio Summary

Asset Allocation



Top 5 Holdings

Security Name	Fund (%)	Benchmark (%)
Scentre Group	19.77	17.98
Westfield Corporation	17.76	14.62
Goodman Group	14.40	10.88
Mirvac Group	10.02	7.02
GPT Group	9.68	7.39
Cash	4.71	0.00
Other	23.66	42.11
Total	**100.00**	**100.00**

Important information

Contact Details

T: 1800 034 402 | **E:** client.services@ironbarkam.com | **W:** www.ironbarkam.com

Ironbark ASSET MANAGEMENT