BEULAH CAPITAL

Beulah Takeover Target Portfolio

Quarterly Fact Sheet | June 2017

13/30 Collins St, Melbourne, VIC 3000
T 61 3 9270 9170 **F** +61 3 8080 5983
W beulahcapital.com

Beulah Capital Pty Ltd
ABN 72 079 169 127
AFSL 330951

beulah

Investment Approach

The portfolio aims to outperform the S&P/ASX 300 Index with the same or lower volatility over a rolling 5 year period.

INVESTMENT STRATEGY

The portfolio invests in a concentrated portfolio of equities from companies included in the S&P/ASX 300 Index. The portfolio is constructed to provide capital growth from companies that have a higher than average probability of being taken over.

Universe

Diversification

Using six proven criteria, construction of a concentrated portfolio of 15 to 25 companies with a higher than average chance of being taken over.

Capture of takeover premiums

Capture of takeover premiums by identifying targets prior to the initiation of any potential takeover transaction provides the potential for above average capital growth.

MINIMUM INITIAL INVESTMENT
$50,000

MINIMUM SUGGESTED TIME FRAME
7 Years

Performance

Takeover Target Portfolio

	3 Month %	6 Month %	1 Year %	3 Year %	5 Year %	Incept %
Portfolio Return	-1.61	2.85	11.73	9.74	12.67	12.61
S&P/ASX 300	-2.42	0.91	9.12	2.01	6.78	5.71
Relative Return	**+0.81**	**+1.94**	**+2.61**	**+7.73**	**+5.89**	**+6.90**

Performance Notes

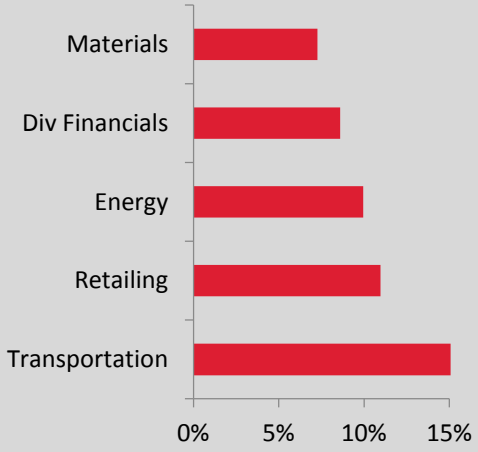
1. *Past performance is not an indication of future performance*
2. *Returns and holdings may vary between investors given the nature and timing of beneficial ownership under an MDA structure*
3. *Model portfolio total returns include dividends and income, but exclude franking credits*
4. *Returns greater than 12 months are annualised*
5. *Returns are quoted after transaction costs, but before portfolio and MDA fees, rounded*
6. *Inception date is 20 December 2011*

Top 5 Stock Holdings

Company	Allocation %
Mantra Group	5.74
IRESS	5.46
South32	5.34
Transurban Group	5.24
Challenger	5.19
Total	**26.97**

Holdings as at 30 June 2017

Sector Allocation



Key Portfolio Features

Key Portfolio features	
Portfolio PE (Expected 2017)	18.28x
Portfolio Yield (Expected 2017)	3.98%
Percentage of positive months	67.2%
Percentage of cash held	15.5%

Top 5 Performers

Company	Contribution to performance %
Flight Centre	0.72
IRESS	0.41
OzForex	0.33
Challenger	0.32
Spark Infrastructure	0.28

Worst 5 Performers

Company	Contribution to performance %
Automotive Holdings	-0.90
Myer	-0.71
Fairfax Media	-0.53
Vocus Group	-0.52
Greencross	-0.46

Market Review

Global equity markets had another strong quarter in Q2, with gains led by defensive growth, income, and low volatility stocks. European and Asian markets outpaced US equity markets on optimism about stronger economic growth. A strong corporate earnings season and mostly positive economic data supported gains.

Most major equity markets saw a continuation of the strong performance from the first quarter while after steadily increasing through the quarter, bond markets sold off towards the end of the quarter on the prospect of tighter monetary stimulus in the developed markets. Despite this, long term interest rates stayed at low levels, flattening the yield curve.

The US economy continued to steadily improve. Most measures of unemployment suggest the labour market is close to full employment with the unemployment rate for June down to 4.37%. Headline and underlying inflation however, has weakened with a sharp fall in mobile phone operator prices detracting 0.3% thanks to a price war in the industry. The weakening also extended to housing, health care, transport, and apparel.

The Federal Reserve (Fed) raised the cash rate again in June to 1.25% and announced that it is likely to start reducing the size of its balance sheet “relatively soon”. The Fed believes temporary factors are weighing on inflation and that the economy is already past the level of unemployment that should generate wage inflation. Markets are sceptical and are only discounting one, or possibly two more rate hikes to the end of 2018.

In June, the Fed also approved plans from the 34 largest US banks to use extra capital for stock buybacks, dividends and other purposes after all banks passed the first round of annual stress tests.

Closer to home, growth of 1.7% for the first quarter of 2017 was weaker than had been expected, while extremely high level of debt and low wages growth are undermining consumer confidence. A slowdown in property prices looks to be finally materialising, helped by APRA’s 30% cap on interest only loans combined with the step up in capital controls in China.

In June, Standard & Poor’s (S&P) downgraded the credit ratings of 23 Australian financial institutions and increased Australia's "economic risk" score from 3 to 4 citing economic imbalances, specifically rising property prices and high household debt. The big 4 banks, were spared because of their government guarantee status.

Household debt, at over 190% of disposable incomes, is amongst the highest in the developed world. The Reserve Bank governor Philip Lowe remains uneasy over household borrowing levels. His main concern is not so much the actual level of debt, which he argues is held by wealthier households, but what would happen to consumers in the event of a shock.

On a more positive note, the unemployment rate fell to a four-year low of 5.5% in June. This is now just 0.5 of a percentage point above the Reserve Bank’s "full employment" target. The actual composition of employment also improved with an increase in full time employees and a fall in those working part time.

In global equity markets, there has been a rotation away from the cyclicals, which benefitted from the Trump reflation trade, with flows back toward the high-quality dividend payers. This combined with higher interest rates meant financials were amongst the strongest performers in the quarter. Technology stocks also rallied, reflecting strong liquidity and a preference for stocks which can increase earnings. Also, as tends to be the case in rising markets, small and mid-cap companies outperformed large caps.

The domestic equity market lost ground in the second quarter, retracing some of the 15.9% delivered over the nine months to March 31, 2017. Drivers of the weakness were varied, including a consolidation of commodity prices and resources earnings, the surprise imposition of a Major Bank Levy by the Government, as well as weakness across domestic consumer-facing industrials.

Portfolio Review

During the quarter, the Portfolio outperformed its benchmark by 0.81%. Performance for the 2017 Financial Year was 11.73%, outperforming the benchmark by 2.61%. Several changes were implemented during the quarter. Investa Office Fund (IOF), Myer Holdings (MYR) and Fairfax (FXJ) were added to the portfolio at 5% weightings, whilst Tatts Group (TTS) and Flight Centre (FLT) were sold. We also had two takeovers completed during the quarter with Cover-More (CVO) and Duet Group (DUE) exiting the portfolio.

Myer (MYR) is an iconic Australian department store group with a network of 67 stores across Australia. It offers premium-quality exclusive-branded apparel, cosmetics, home ware and general merchandise. Whilst the retail environment remains challenging Myer has begun its turnaround plan and is investing in its top-tier stores and brands. The company is now in a strong financial position with minimal debt. Back in March, long time retail investor Solomon Lew recently purchased an 11% stake in the company through Premier Investments (PMV) for $1.15 per share. The share price pulled back for weeks following the purchase and we entered in at well under $1.00. We believe MYR has now fallen into attractive value territory for either international suitors or perhaps even presenting as another buying opportunity for Premier.

Investa Office Fund (IOF) was also added at a 5% weighting. IOF owns a mostly A-grade Australian office portfolio with secure medium-term earnings, underpinned by relatively long average leases and fixed annual rental increases on the majority of leases. Financial leverage is conservative and the distribution policy is sustainable, retaining sufficient cash flow to fund leasing incentives and maintenance capital expenditure. Cromwell Property Group (CMW) built up a 10% stake in IOF back in April 2016, offering a bid of $4.45 per share in November 2016 and further increasing the bid to $4.85 cash. CMW are currently undertaking due diligence and with IOF shares trading at a significant discount to the bid price we established our position. After previously exiting our position in Fairfax Media (FXJ) towards the end of March off the back of spinning out its Domain business, we decided to re-enter. Post the demerger announcement, FXJ received two indicative takeover offers from private equity firms. Although both firms walked away from their offers we still see room for corporate activity with the Domain spinoff still progressing.

Over the quarter we exited our positions in both Tatts Group (TTS) and Flight Centre (FLT). After months of deliberation, the Australian Competition Tribunal approved the deal between Tabcorp (TAH) and TTS, on the condition that TAH sells its Odyssey Gaming business in Queensland. The tribunal is satisfied the merger will result in substantial public benefits. TAH has offered 0.8 Tabcorp shares plus 42.5 cents cash for each TTS share, a $4.21 all cash offer from the Macquarie consortium was rejected by TTS management, in favour of the TAH offer.

With the likelihood of the consortium coming back with another offer looking unlikely, we decided to exit our position and take the money off the table. With regards to FLT, following a re-affirmation of earnings forecasts in May the share price rallied close to 30 per cent, taking the valuation to around 19x current year earnings. While we still believe the company offers potential for corporate activity, given the strong net cash position and dominant market position in Australia, the recent significant increase in valuation is likely in our view to dampen enthusiasm for corporate activity. Together with the weak outlook for discretionary spending and structural changes in the industry we decided to exit our position following the strong rally. We may look to re-establish our position should the valuation become more appealing at some point.

As at 30 June 2016 the portfolio held 15.5% cash to be deployed as opportunities present.

As organic earnings growth grinds slowly higher over the medium term, our view is that corporate activity will become increasingly prevalent. As always, we favour stocks we are happy to hold even in the absence of a takeover.

Outlook

Valuations across most asset classes are now at relatively elevated levels. Government bond yields have never been lower while corporates and governments have taken on more debt. However, growth in global economies is improving and we expect the recovery to take longer than in previous cycles given the severity of the last recession.

This supports the case for further strength in equity markets. Additionally, with the next moves from central banks involving tightening rather than easing in monetary policy, it seems too early for investors to go underweight equities and overweight fixed income.

Despite the central bank tightening, global liquidity should remain supportive. Policy rates in Japan and the eurozone are set to remain in negative territory throughout 2018. Meanwhile, central bank asset purchases, while slowing, will continue in the Eurozone throughout 2018 and even longer in Japan as it is still some way off hitting its inflation target of 2%.

There is the risk though, that any slowdown in response to Central Bank tightening could be the

cause of a pull-back in equity markets, given the support that monetary stimulus has given equity markets over the past few years. Higher equity market valuations and low volatility also raises the question as to whether investors are too complacent. The US VIX index (a widely used measure of market volatility, often referred to as the "investor fear gauge.") moved to its lowest level in over twenty years at the end of June. Expectations are that volatility will pick up in the second half of 2017.

Looking ahead for the domestic economy, many of the drivers that have supported the economy since the GFC appear to have largely run their course. That is, uninterrupted growth in China, high commodity prices, monetary support from the RBA (which cut rates from 7.25% to 1.5%) and an increase in household debt (as a % of GDP) to levels amongst the highest in the world.

That said, activity should be supported in the near term by global growth, the continuation of low interest rates and a potentially lower AUD. The drag on growth from the mining sector appears to be moderating and while we expect growth will slow in China over the coming months as authorities attempt to rein in credit, we believe authorities will do this in a manageable way. Fiscal spend in China should also continue to support growth, and subsequent demand for Australian exports. Trump talks about spending $1 trillion on infrastructure over ten years while China plans to spend double that between 2016 and 2020.

Finally, we expect the RBA to leave rates unchanged for the remainder of 2017 with the competing forces of a stubbornly high AUD supporting the case for a cut and strong house price growth putting pressure on the Bank to raise rates. Markets are now pricing in the possibility of a rate hike by April of next year at 50% and a full hike priced in for 2018.