Cromwell Phoenix Property Securities Fund

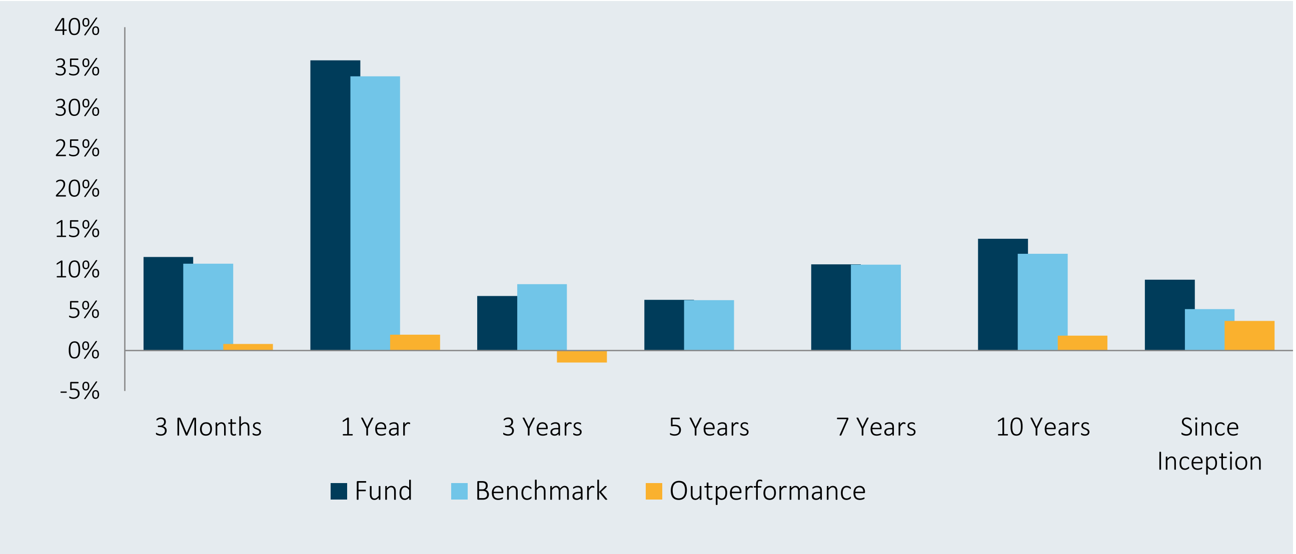
June 2021 Quarterly

The **Cromwell Phoenix Property Securities Fund** invests in a benchmark unaware manner. The Phoenix Investment Team uses its fundamental and proprietary research to actively manage the fund with a focus on maximising total return.

Performance to 30th June 2021

	3 Months	1 Year	3 Years	5 Years	7 Years	10 Years	Since Inception (16 Apr 2008)
Fund*	11.59%	35.91%	6.74%	6.26%	10.67%	13.83%	8.77%
Benchmark **	10.74%	33.91%	8.23%	6.25%	10.63%	11.98%	5.12%
Outperformance	0.84%	2.00%	-1.48%	0.02%	0.04%	1.85%	3.65%

*Performance figures for the Cromwell Phoenix Property Securities Fund are shown net of fees
** S&P/ASX 300 A-REIT Accumulation Index



Contributors and Detractors to Portfolio Performance

	Outperformed	Underperformed
Overweight	APN Property Group Charter Hall Group	Lendlease Group Sydney Airport
Underweight	Goodman Group	Scentre Group

Market Commentary

The S&P/ASX 300 A-REIT Accumulation Index powered higher over the quarter, adding 10.7%. Property stocks outperformed broader Australian equities, despite the S&P/ASX 300 Accumulation Index also delivering a solid 8.5% gain.

Property fund managers were the key outperformers over the quarter, with elevated corporate activity in the sector supporting returns. Leading the way, APN Property Group (APD) finished the quarter 69.2% higher after Dexus (DXS) announced a proposed acquisition of APD at a significant premium to its prior share price. For more on APD and the transaction, see the feature article in this document. Elsewhere, Centuria Capital Group (CNI) completed its takeover of Primewest (previously PWG). The deal was well received, with CNI rallying 14.3%. Large capitalisation fund managers were also outperformers, given strong growth in funds under management without the need to undertake large corporate transactions. Charter Hall Group (CHC) powered ahead 22.0% whilst Goodman Group (GMG) picked up 17.7%.

Despite a mix of COVID-19 related restrictions in place around Australia, office property owners were broadly outperformers, as strong demand for direct exposure to Australian offices supported prices and thereby book values of properties. Mirvac Group (MGR) rose 18.8%, whilst Centuria Office REIT (COF) and Dexus (DXS) gained 18.4% and 11.8% respectively. Growthpoint Properties Australia (GOZ) lifted sharply in the June quarter, adding 20.2% after reporting like-for-like valuation gains of 7.7%.

Retail property owners were the major underperformers over the quarter, with the future rental levels and capital expenditure still very much uncertain. Large capitalisation mall owners were weakest, with Vicinity Centres (VCX) and Scentre Group (SCG) giving up 2.7% and 2.8% respectively. Valuations for neighbourhood shopping centres remained resilient over the period, with Shopping Centres Australasia's (SCP) like-for-like valuations up 9.5%. Similarly, Charter Hall Retail REIT (CQR) reported revaluations at 30 June 2021 were 4.1% higher than previous values. Despite this positive news, SCP added 3.1% and CQR lifted 2.3%, both underperforming the broader property index.

Despite ongoing strong residential housing prices, residential property developers underperformed property markets in the June quarter. Stockland (SGP) still managed to rise 9.0% as its projects are likely to be key beneficiaries of recent housing strength. Perth-based developers Peet Limited (PPC) and Finbar Group (FRI) lagged. PPC added 4.3%, whilst FRI gained a lesser 1.8%. Bucking the trend, Divine Limited (DVN) received a takeover bid from its major shareholder CIMIC Group Limited (CIM) and rose 74.1% as a result.

Performance Commentary

Charter Hall Group (CHC) ▲ 22.0%

The portfolio holds an overweight position in CHC. Its outperformance added value from an absolute and relative perspective over the quarter.

Phoenix has often discussed the leverage property fund managers have to asset valuations. As fund managers charge fees as a percentage of assets under management, asset valuation increases are likely to represent very high margin revenue growth. This has been the case for CHC, which provided an update regarding its funds under management in June. Valuation growth across CHC's funds was 8.3% over the last 12 months. Furthermore, total funds under management increased by $12 billion over the course of the 2021 financial year, representing 28% growth. A number of market participants with public forecasts expected that CHC would only reach this level of funds under management in the 2023 financial year.

Demand for property funds management product continues to be strong. Ongoing low interest rates and relatively higher property yields are likely to continue to attract investment moving forward. CHC has the benefit of being able to attract capital from institutional and retail investors as well as the listed market through its listed real estate investment trusts. CHC is also reasonably diversified across asset classes, including industrial, office, retail, social infrastructure and long weighted average lease expiry (WALE) property. This multifaceted approach should also support funds under management growth into the medium to long term.

Sydney Airport (SYD) ▼ 6.5%

The portfolio holds an overweight position in SYD. Its underperformance detracted value from an absolute and relative perspective in the June quarter.

SYD owns Sydney Airport through a concession to operate the airport until 2097. It is likely that SYD is being held back by short term considerations, despite its very long asset life. Recently announced restrictions in Sydney linked to the suppression of COVID-19 will have a detrimental impact on SYD in the near term. Despite this, SYD's profitability is most substantively linked to international travel. Australia's delayed COVID-19 vaccine rollout, along with the related closure of international borders is more detrimental to SYD's recovery, than short term, local restrictions. However, while recent news has been disappointing, with 76 years remaining on its concession, the impact to SYD's valuation is relatively marginal.

At its Annual General Meeting held in May, SYD highlighted the strong liquidity it holds to meet any further delays or capital requirements. This includes $2 billion of equity raised in August 2020 and additional debt raised through the recent period. As at 30 April 2021, SYD had $2.9 billion of liquidity and a well structured debt profile with an average maturity in 2026.

SYD also generates non-aeronautical revenue, which was slowly recovering, prior to recent restrictions. 54% of its retail stores were trading, with 80% of those based in its domestic terminal open. Domestic demand for parking was at 84% of levels seen in 2019, partially supported by a preference for the use of private vehicles over public transport. Hotel occupancy also reached 41%, up from 17% achieved in the second half of 2020. Separately, SYD released traffic numbers for April 2021, with domestic passengers falling 34.8% when compared with 2019. Unsurprisingly international passenger traffic remained minimal.

APN Property Group – A Return to Glory

APN Property Group announced it had entered into a scheme implementation deed with Dexus (DXS) in May 2021, by which DXS would acquire 100% of APD for 91.5 cents per security. This price represents a 50.0% premium to APD's closing share price on the day prior to the announcement and a 65.8% premium to the volume weighted average price over the 3 months prior. This represents an attractive price for APD's security holders, including Phoenix, which has been a shareholder in APD since May 2013 and has been a significant shareholder in the company for many years. The story of how APD reached this point however started well before that.

From Little Things

In 1984, APD's current Chairman, Chris Aylward, joined the Grollo Group and went on to become a founding director in Grocon Pty Ltd. During his time at Grocon, the Melbourne company completed city defining projects such as the city's premier office building, 101 Collins St and the Crown Casino complex. In 1996, Aylward and Bruno Grollo contributed $760,000 to start APN Property Group, then a developer focused on much smaller projects, their first being the development of a private hospital in Frankston in Melbourne's Southeast.


101 Collins St, Developed by Grocon

In 1998, current director Howard Brenchley joined APD and established APN Funds Management Limited. The current APD business can trace its roots to formation of this business, with some of the funds created by Brenchley existing to this day, including the APN Property for Income Fund. APN's "property for income" investment philosophy proved popular with investors and as a result, a funds management business of substance was built.

In just less than a decade after its genesis, APN Property Group listed on the ASX, with the 2005 listing valuing the company at approximately $116 million. Much of the money raised was returned to APD's founders, an impressive return on the small sum of capital initially put into the business. Despite this, Aylward maintained a large stake in the business and would retain oversight of the business until this day.

Rise and Fall and an Opportunity

Around the time of its listing, APD announced a joint venture strategy, offering European listed and unlisted property funds to investors. For a period of time the business grew substantially, attracting a client list that would be the envy of fund managers across Australia. European funds included the APN Champion Retail Fund, which invested in Greek Carrefour supermarkets, the APN Euro Property Fund, and the once-listed APN European Retail Property Group. APD's assets under management grew to a peak of $4.8 billion in 2007 and saw its share price increase from $1.00 at listing to $2.60 less than two years later.

The Global Financial Crisis (GFC) was particularly punishing for APD and the funds it managed. Performance in its European related funds was extremely poor and the company was forced to take significant impairments in its European investments. The lack of leverage at the APD head stock level ensured the company would survive, however the damage was well and truly done. Its share price eventually dropped to $0.10 per share. After the GFC, a decision was made to exit the European business and refocus on Australian domestic property offerings. By the end of 2012 assets under management had fallen to $1.6 billion.

Carrefour Supermarket, Nea Moudania, Greece

Rebuilding on Strong Foundations

Phoenix is commonly attracted to companies that have been through challenging times, as they often present compelling investment opportunities, with many investors distracted by recent history. In May 2013, Phoenix established a position in APD at a price of $0.20 per share. At the time, after stripping out cash and co-investments, this valued the funds management business at only 0.1% of assets under management. While the near term earnings outlook appeared to be subdued, Phoenix believed APN enjoyed a strong reputation among investors and financial planners and that there was substantial value in its retail distribution franchise, which had been cultivated over decades.

APD's key offerings, the APN AREIT Fund and then-listed Generation Healthcare had strong investment performance and Phoenix believed a relatively low interest rate environment would be supportive to growing assets under management. Furthermore, the cost structure of the business had been realigned so any increase in funds under management would flow through to shareholders at a very high incremental margin.

At the time succession planning was also taking place, with current CEO Tim Slattery taking on an Executive Director role in 2014, with Chris Aylward slowly relinquishing day-to-day management duties held whilst he was Executive Chairman. Slattery has proven to be a strong leader with an ability to support product development, whilst also protecting investors of both APD and APD's externally managed funds.

Creating Valuable Franchises

Across Phoenix's holding period, APD has predominantly offered three types of products; unlisted funds investing in listed REITs, direct property funds and listed property funds. Whilst the REIT funds and direct property funds have ticked along solidly, the listed property funds have been APD's shining lights. The first success was Generation Healthcare. APD purchased its management company from ING for $4 million in 2011. Within 5 years Generation had outperformed the property index by over 14%, grown assets and received an acquisition offer from Canadian investor, Norwest Healthcare Properties. The offer included a payment of $35.6 million to APD for the management company (13.3% of assets under management) and a significant premium for its stake in the fund. Upon the acquisition's completion, a $0.10 fully-franked dividend was paid to APD investors.

Other listed funds include APN Industria REIT (ADI), listed in 2013, sourcing assets from an Australand wholesale fund. ADI has grown assets from $378 million to almost $1 billion today. Another successful listed fund, the APN Convenience Retail Fund (AQR) was formed from a combination of direct funds, APN Property Plus Portfolio and Convenience Retail Reit No. 2 and has now amassed a portfolio of over $650 million in convenience retail property. Both ADI and AQR have produced strong returns for investors, are run by highly capable management teams and have established strong platforms for future growth.

A Deal That Makes Sense

In Phoenix’s opinion, the listed market has not reflected the true value of the APD funds management platform for a long time. Despite steady growth, high incremental margins and a number of valuable franchises, APD’s funds management business was being valued at approximately 1.1% of assets under management in the months prior to the DXS acquisition announcement. The other key component that may not have been considered by some, is the company’s aforementioned strong standing amongst retail investors and financial planners. DXS has publicly stated that it is looking to grow its funds management business. It already has a strong franchise amongst institutional customers, as demonstrated by its recent transaction taking control of the AMP Capital Diversified Property Fund. A retail funds management business takes a long time to build when starting from scratch. APD is a business with a 25-year track record in Australia. DXS appears to have seen the value in this, as demonstrated by the hefty premium its offer represents. This value along with synergies in APD’s other businesses could make this a positive deal for both DXS and APD shareholders.

There is no mistaking that this deal represents a great result for APD shareholders. On its initial $0.20 per share investment, Phoenix has received much more than its capital outlay in fully-franked dividends alone, not to mention a share price return of more than 3.5x. This result is a credit to Aylward, Slattery and all those that have stewarded APD to this point. Phoenix and investors in the Cromwell Phoenix Property Securities Fund should be thankful to the APN team for the fantastic outcome and we wish them all the best in the future.

Westrac Newcastle, Source: ADI 1H21 Presentation

Market Outlook

Since the onset of COVID-19, the listed property sector has been amongst the most volatile core asset classes both domestically and globally. The 35.1% fall of the S&P/ASX 300 Property Accumulation Index in March 2020 was followed by a swift recovery, with the sector closing the June 21 quarter just under 5% off its pre-COVID highs.

Such extreme volatility can partly be explained by the uncertain impacts of the crisis, where a once very forecastable sector had suffered from the withdrawal of earnings guidance, expected cuts to contracted rents in support of tenants and a renewed focus on balance sheets and the cost and availability of debt. In many cases, a strong recovery is now priced into securities, however this varies significantly across the sector.

In times of stress, one's true character is often revealed. In recent times this has been true across the companies under Phoenix's coverage. Some chose to protect the interests of themselves and other insiders, whilst others clearly demonstrated their shareholder and broader stakeholder focus, even if it increased the risk to themselves. This period has reinforced Phoenix's strong emphasis on governance and alignment of interests.

Phoenix does remain cognisant of the structural changes occurring in the retail sector with the growing penetration of online sales and the greater importance of experiential offering inside malls. Recent events will likely accelerate these changes. Furthermore, in the short term, discretionary retail sales are likely to be driven by government stimulus and may be highly varied across retailers and dependent upon social distancing restrictions. These issues are well understood and the trajectory to a new "normal" is only now beginning to reveal itself. These factors explain why retail stocks have been the most volatile of all property sub-sectors.

As COVID-19 passes, and earnings become more forecastable again, the market will be able to refocus on a resilient sector which is currently supported by low bond yields. February's reporting season once again demonstrated the resilience of earnings generated by property securities and the upcoming August results are likely to continue to be supportive in most sub-sectors.

Phoenix has for some time discussed the risk of inflation, given the enormous fiscal stimulus and extreme monetary policy setting that we now live with. In very recent times, commentators and bond markets have begun to acknowledge the presence of such a risk. Historically, real assets such as property and infrastructure have performed well during inflationary periods.

Portfolio Detail

Top 10 Holdings (In Alphabetical Order)
APN Property Group Centuria Capital Group Charter Hall Group Dexus GPT Group Growthpoint Properties Australia Lendlease Group Mirvac Group Sunland Group Vicinity Centres

	Fund
Cash	3.0%
ASX 300 A-REITS	71.7%
Other ASX Listed Securities	25.3%

	Fund	Benchmark
Office	24.8%	19.9%
Retail	24.9%	32.5%
Industrial	18.9%	39.0%
Infrastructure	4.8%	0.0%
Other	23.6%	8.6%
Cash	3.0%	0.0%
Total	**100.0%**	**100.0%**