31 MARCH 2023

AUSTRALIAN MID CAP FUND – CLASS B

PARADICE
INVESTMENT MANAGEMENT

PERFORMANCE NET (%)	1 MONTH	3 MONTH	1 YEAR	3 YEAR	5 YEAR	SI* P.A.
Australian Mid Cap Fund – Class B	-3.09	0.61	-8.57	17.06	6.07	7.09
Mid Cap Composite Benchmark[1]	-1.97	0.58	-6.66	19.43	7.45	8.28
Excess Return	-1.12	0.03	-1.91	-2.37	-1.38	-1.19
						*Since Inception date (SI) – 15 May 2017

Past performance of the Fund is not a reliable indicator of future performance. The value of an investment in the Fund may rise or fall. Returns are not guaranteed by any person. Fund returns are calculated before tax, after ongoing management costs and any accrued performance fees, and assumes the reinvestment of distributions. Returns greater than 1 year are annualised.

INVESTMENT OBJECTIVE

The Fund aims to outperform the Mid Cap Composite Benchmark[1] of 70% of the S&P/ASX Mid Cap 50 Total Return Index and 30% of the S&P/ASX Small Ordinaries Total Return Index over a three to five year period (after management costs and before tax).

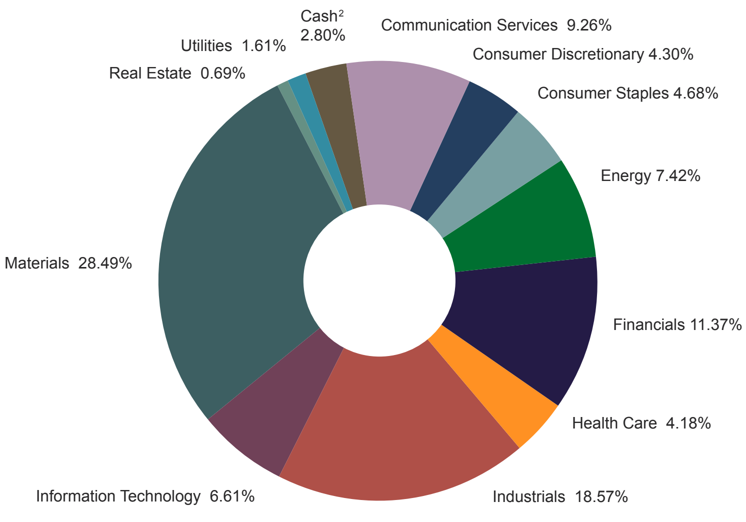
LEAD PORTFOLIO MANAGER

John Lake & Matthew Riordan

FUND OVERVIEW

The highly experienced team have a focus on downside protection and aim to generate strong, long term risk-adjusted returns.

SECTOR ALLOCATION



KEY DETAILS	
Number of Holdings	51
Portfolio Dividend Yield	2.79%
Fund Size (AUD)	$78M

TOP 10 POSITIONS	WEIGHT %
Carsales.Com Ltd.	4.77
ALS Ltd.	4.43
Ampol Ltd.	3.95
Orica Ltd.	3.91
Wisetech Global Ltd.	3.75
OZ Minerals Ltd.	3.49
Steadfast Group Ltd.	3.48
Qube Holdings Ltd.	2.88
IDP Education Ltd.	2.79
Iluka Resources Ltd.	2.64

FUND DETAILS	
APIR Code	ETL8772AU
Distribution Frequency	Semi-Annually
Management Fee	1.10% p.a.
Performance Fee	15% p.a.
Buy Sell Spread	+/- 0.25%
Minimum Investment	$20,000
Stock Range	Typically 40–60
Cash Range	0–10%

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Performance in AUD unless otherwise noted.

MARKET REVIEW

The Australian market seemed reasonably subdued during the quarter with the S&P/ASX 200 Total Return Index finishing up 3.46% and the Mid Cap Composite Benchmark finishing up 0.58%. These relatively modest moves disguised significant intra-month volatility that could basically be broken down into three discrete periods. The market rallied strongly in January on the belief that inflation was firmly under control and that there was the prospect of rate cuts later in the year. It then came back in February as it became clear that whilst falling, inflation remains "stickier" than hoped and the World Central Banks continue to demonstrate a commitment to controlling inflation and hence holding rates higher for longer. February also coincided with a reasonably weak reporting season (discussed below). March then saw an emerging banking crisis with 3 banks collapsing in the US, the most prominent being Silicon Valley Bank ("SVB"), and in Europe Credit Suisse ("CS") finally succumbed after years of lurching from crisis to crisis. The regulators and industry showed their increasing expertise at dealing with crises with SVB having its deposit base underwritten and CS being pushed into a rapid fire merger with UBS (with associated guarantees). Interestingly the market staged a strong recovery at the end of March.

The equity market moves coincided with similarly dramatic moves in fixed interest markets. The US 10 year bond yield started the quarter at 3.74%, then fell to 3.37% in January as optimism on inflation emerged. This bounced to 4.06% in March as Central Banks continued to demonstrate their resolve then fell to 3.47% at quarters end with the banking sector concerns. Australian 10 year bond yields exhibited even greater volatility in the period. Against this backdrop Central Banks continued to raise rates albeit at reduced increments with both the Federal Reserve and the RBA taking two 25bp increases at consecutive meetings in the quarter. There is an expectation that, in general, Central Banks are getting closer to a pause, but the question then becomes how long will rates be held at elevated levels and what economic damage may this cause?

The moves in equities during the quarter from a sector point of view were somewhat surprising. The US performance was actually quite narrowly focussed and dominated by Technology (especially mega caps) and Consumer Discretionary (which was the best performing sector in the ASX 200). This was reflected in the modest return of the Dow Jones Industrial Average (up 0.38% in USD) relative to the S&P 500 Total Return Index (up 7.50% in USD) and NASDAQ Composite Total Return Index (up 17.05% in USD). The performance of these sectors suggest that the market is capitalising the benefit of lower rates but ignoring the fact that the move in rates is partly due the banking sector woes and that we are yet to see the full impact of higher rates on the consumer. Other sectors that did well in Australia included more defensive sectors such as Communication Services and Consumer Staples.

The Materials sector also did relatively well during the period although not to the same extent as in the December Quarter. The reopening of China continued to provide support for many commodities such as iron ore (up 8.95% in USD) and copper (up 6.5% in USD). There has been some mixed feedback on the strength of the reopening of China but we remain constructive. There are also continuing signs that the change in Government is seeing relations with Australia "thaw" with increasing visits by politicians at both a State and Federal level. Commodity price moves were a lot more mixed during this quarter with spodumene and lithium carbonate prices falling 23.3% (in USD) and 55.8% (in USD) respectively after a very strong run with signs of overstocking taking place in various parts of the supply chain. Energy was also weak with Brent oil down 7.15% (in USD) and Newcastle Coal falling 56.1% (in USD) following on from gas price weakness in Europe after a mild winter saved the day. At the time of writing OPEC has looked to address the price weakness in oil by announcing production cuts. Gold prices have continued their general incline that started in November as the banking crisis, rising recession expectations and more gold purchases from central banks underpinned demand. Gold finished the quarter up another 9.9% and is now at record high levels in AUD. Interestingly gold equities have lagged this price move.

The March quarter also incorporated the reporting season for the 6 months ended 31 December 2022. We considered this to be a relatively "traditional" reporting season where results mattered with strong results being rewarded and poor results being punished. Overall it was a relatively weak reporting season and whilst revenue outperformed expectations on price increases to offset inflation we saw broadly negative EPS revisions with 32% downgrades vs 18% upgrades.

In our view, other notable trends in the quarter were:

- Supply chain impacts are starting to normalise.
- Inflationary impacts are beginning to move from the goods and materials side to the wages side with staff shortages persisting.
- Significant interest rate increases are starting to flow through the P&L side but despite this we did see capital management from companies like Ampol and a2 Milk.
- Consumer Discretionary stocks continued to deliver solid earnings results but we saw weakening sales performances from NZ operations (where they are ahead in the interest rate cycle) and sales for the start of CY23 from Consumer Durables retailers have started to weaken in line with housing.
- We are also seeing the advertising cycle start to weaken.

PERFORMANCE

The Paradice Australian Mid Cap Fund (the Fund) delivered a positive return for the quarter of 0.61%, which was 0.03% above the Mid Cap Composite Benchmark. The main contributors to this from a sector point of view was being underweight real estate and energy partially offset by an overweight in consumer staples.

Fund performance was largely driven by stock selection with moves here being heavily influenced by reporting season. The fund had a solid reporting season (the second strongest performance on a relative basis since its inception) driven by a combination of owning stocks with resilient earnings and avoiding a number of stocks that delivered disappointing results.

Positives

Domino's Pizza (DMP) – Underweight

Weak result and walked away from guidance. This came after an equity raising in December.

Orora (ORA) – Overweight

Strong profit result. The company had drifted ahead of reporting season over unfounded fears of weakness in the US operations.

AMP (AMP) – Underweight

Poor profit result across all divisions.

Sandfire (SFR) – Overweight

Strength in the copper price during the period. Following Oz Minerals' takeover by BHP, SFR is now the largest standalone copper producer on the ASX.

Ampol (ALD) – Overweight

Solid result saw a rebound from the previous quarter's weakness.

Negatives

Liontown Resources (LTR) – Underweight

Rallied despite weakness in the underlying commodity as the company notified the market late in the quarter of an approach by USA listed Albemarle.

Challenger (CGF) – Overweight

Despite a solid profit result the company was marked down over concerns of a flow on effect from the banking crisis.

a2 Milk (ALD) – Overweight

Dragged down by a profit downgrade by Synlait, who manufactures infant formula on their behalf.

Lynas (LYC) – Overweight

Concerns over a "production gap" due to a delay in the new Kalgoorlie plant and Telsa's comments on utilising less rare earths in

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their vehicles.

Spark New Zealand (SPK) – Overweight

Surprisingly poor profit result driven by wage inflation.

PORTFOLIO CHANGES

Purchases

Aurizon Holdings (AUB)

Share price underperformance following a weaker, weather impacted result provided an opportunity to purchase into an otherwise resilient stock.

REA Group (REA)

The recently subdued share price on concerns over lower property prices and transactions has provided an opportunity to increase our weighting in this very high quality company.

AUB Group (AUB)

This insurance broking and agency company has a strong earnings outlook on the back of ongoing premium increases and the recent acquisition of Tysers.

De Grey Mining (DEG)

Emerging gold miner developing a tier one resource in the Pilbara.

Carsales.Com (CAR)

Increased our holding following a strong result and participated in the equity raising to fund the purchase of a majority stake in Webmotors (Brazil).

Sales

Spark New Zealand (SPK)

Surprisingly poor profit result driven by wage inflation.

Whitehaven Coal (WHC)

Coal price came back in line with other energy pricing following a mild European Winter.

Charter Hall (CHC)

Concerns over property valuations and sector inflows.

Challenger (CGF)

Reduced our active weight as a risk precaution as we await to see if there are any residual impacts from the banking crisis.

Bank of Queensland (BOQ)

Concerns over competition on both the asset and liability side of the balance sheet.

ENVIRONMENTAL, SOCIAL, GOVERNANCE ISSUES (ESG)

Since taking government in 2022 the Labor Party has sought to deliver on the climate agenda it took to the Federal Election, the cornerstone of which has been a commitment to reform the safeguard mechanism. The Government published its initial proposed changes to the Coalition-era policy in January before consulting with business and other stakeholders. As the Coalition ruled out supporting the required legislation through Parliament, it became apparent that Labor would instead need the Greens support which initially cast some doubt on whether a deal could be struck given the Greens stance on new fossil fuel projects. This was despite the proposed changes being broadly supported by business and investors.

After weeks of negotiations, in late March it was announced that Labor had ensured the Greens support in return for a number of concessions to the plan. While exact detail remains to be published, it is clear that the deal will now require higher hurdles that current and new heavy emitting facilities covered under the mechanism must pass. The deal also has ensured greater funding to support harder-to-abate sectors such as steel to decarbonise, while limiting public funds being directed to coal and gas projects.

We have commenced a number of discussions with companies which operate safeguard facilities and will need to comply with the mandated emissions reductions out to 2030, whether these are achieved through operational efficiencies or in part by carbon offsets. While we wait for the publication of the more detailed Amendment Rules, we are testing companies' early understanding of potential costs to their business to upgrade infrastructure, invest in new decarbonisation initiatives or secure carbon credits. For any company which will need to initially rely on credits to comply, we are seeking to understand how it is managing this cost which we see as likely to increase over time.

ENGAGEMENT

During the quarter, we undertook a total of 25 engagements in which we explicitly discussed ESG matters with 21 companies relevant to the strategy. Of these, 84% were held at either board or executive level. The engagements covered a range of issues and most meetings discussed multiple ESG matters. In this period, the most commonly discussed topics were climate transition, human capital management and environmental management.

One company of focus during the quarter was JB Hi-Fi Ltd (JBH). We held a dedicated meeting on modern slavery with JBH's key ethical sourcing manager. We wished to better understand two reported concerns found at suppliers and understand progress made on corrective actions. We also sought to gain clarity on how JBH operates its grievance mechanisms and supports access to the factory workers of its suppliers. As a comparatively small customer, JBH has limited influence but we were pleased to see how the company leverages other avenues, such as the Responsible Business Alliance, to mitigate risks within shared supply chains.

OUTLOOK

While global inflation has fallen from its recent peak it still remains very "sticky" and elevated versus targeted levels. We believe that Central Banks have learned the lessons from the past about prematurely reducing interest rates in an inflationary cycle and hence are likely to keep them elevated for longer despite what the market might wish for. Wage increases are also likely to see pressure remain on inflation, particularly in Australia. Further, any economic developments that did lead to a sudden reduction in rates would undoubtedly not be good for corporate earnings and hence equities. In the meantime the ongoing strength of the economy has surprised us given the pace and level of rate increases but given the lagged impact of rate rises we do feel that we are entering into a more difficult economic environment.

Against this backdrop we anticipate a more trying earnings environment for the coming 6 months. We note that a number of companies that delivered poor H1 FY23 results in February either maintained guidance or predicted an improving earnings profile in the second half. Our experience tells us that this will be difficult to achieve and in many cases could prove to be wishful thinking. We continue to maintain a bias towards companies that have resilient earnings and/or are exposed to strong thematics such as infrastructure spend. That being said we are conscious that cyclical underperformance can provide attractive entry points to otherwise high quality stocks.

At the time of writing the banking crisis seems to have subsided but we are wary that, as we saw in the GFC, these issues can unexpectedly flare up again in different areas and geographies. Regardless of what happens we feel that a combination of issues arising from the crisis and more difficult economic circumstances will see credit become more difficult to obtain and more expensive.

We will continue to watch the reopening of China closely with the first Paradice staff member due to visit post Covid in the coming weeks. In the meantime we remain constructive on Chinese demand. Energy prices in Europe and globally remain a key area of focus for the team given its broader implications across many different sectors.