

360 Capital Industrial Fund (Notice of Meetings)

Meeting Proposals

This Lonsec report refers to the two following Notices of Meeting & Explanatory Memorandum in relation to the 360 Capital Industrial Fund (360 CIF or 'the Fund').

Unit-holder Meetings

	Meeting 1 360 Capital RE	Meeting 2 Requisitioning Members
Proxies Date	12 Sept 2012 (10am)	13 Sept 2012 (5 pm)
Meeting Date	14 Sept 2012 (10am)	17 Sept 2012 (10am)
Meeting Venue	Level 15 1 Bligh St Sydney	Oaks on Collins 480 Collins St Melbourne
Main Purpose	Special Resolution to list the Fund on the ASX and amend the Constitution	Extraordinary Resolutions to remove 360 Capital RE Ltd as RE and replace with Denison Funds Management Ltd

Meeting 1 called by **360 Capital RE Ltd** (360 Capital or 'the Manager') is to give Unit-holders (or Members)

- (a) **a say in relation to whether or not the Fund is listed on the Australian Securities Exchange** (even though the Constitutional amendments in 2009 under a previous RE enabled the Fund to be listed without Member approval).
- (b) an opportunity to **formally adopt amendments made to the Constitution** in 2009 and beyond.

However, Meeting 2 called by the **Requisitioning Members** is effectively more important as it will determine if 360 Capital RE Ltd is retained or replaced as RE by Denison Funds Management Ltd (Denison).

Should the resolutions at the second meeting succeed in being passed, Denison has stated that:

- 1) the listing of the Fund is unlikely to proceed in the near-term and
- 2) any Constitutional amendments will be re-examined.

Primarily, the votes come down to which Manager's proposals are in line with a Member's preferences.

Each Unit-holder may have different needs and objectives and should consult with their Financial Advisor in order to make the decision that is in their best interests.

Lonsec has sought further information from both managers and confine our comments to the **main issues**, with Lonsec's focus on the preservation of value for Unit-holders and not liquidity at any cost.

Lonsec Conclusion & Recommendation

Meeting 1

Lonsec recommends the Unit-holders **vote in favour** of the Special Resolution to list the Fund on the ASX and amend the Constitution.

Firstly, this simply gives the RE the ability to proceed to listing at an appropriate time in the future.

Secondly, the amendments to the Constitution are sensible and positive changes with respect to (i) removing the Exit Mechanism (ii) reducing or removing fees and (iii) allowing more flexible issue prices when raising capital as a listed entity.

"The New Constitution will only incorporate the May 2012 amendments in relation to the 360 Note Issue if and to the extent those amendments are determined by the Court to be effective." (360 Capital NoM p.10).

Meeting 2

Lonsec recommends that Unit-holders **vote against** the Extraordinary Resolutions to remove 360 Capital RE Ltd as responsible entity of the 360 CIF and to be replaced by Denison.

360 Capital

1. has managed the Fund with the best interests of Unit-holders in mind, while trying to strike a balance between providing liquidity for Unit-holders that want to exit the Fund in the near-term and adding value for Unit-holders that want to remain in the Fund over the medium to long term.
2. has stabilised the Fund's debt position, lowered costs and resumed distribution payments.
3. has a well qualified and experienced team with a focus on income producing property assets.
4. has an alignment of interests with other Unit-holders via an on-going holding in the Fund.

Denison (the alternative RE/Manager)

1. is not, at this stage, offering a more certain liquidity opportunity in the near-term for all Unit-holders (with that liquidity dependent upon a parent company, while the Fund remains unlisted).
2. is not likely to be a significantly better or worse property manager than the incumbent.
3. has not made a clear intention to acquire and maintain an equity stake in the Fund.

4. is more orientated towards opportunity/development type funds (and parent Forum Partners Inv. M'ment LLC has a debt focus).

Lonsec Comments

While Lonsec's recommendation is to retain 360 Capital as the RE, the management of the Fund would be enhanced by the following:

- Equity issues should be offered equally to all Unit-holders.
- Expert Reports (especially those paid for by Unit-holders) should be in a form suitable for distribution to all Unit-holders.

- Proposed changes to the Constitution should be put to a Unit-holder vote.
- Court actions where the RE has a financial interest in the Fund, should be paid for by the RE, not the Fund.

The **ASX listing** will likely lead to a reduction in near-term Unit price below current NTA. However, providing an Exit Mechanism now to Unit-holders would likely result in a fire-sale of assets and a further reduction in value for Unit-holders including those not currently seeking an exit. Once listed, Unit-holders have the choice to time the sale of their Units. Prices received will depend upon market determined values when sold.

Summary of Main Proposals

	360 Capital	Denison
ASX Listing	Immediately apply to ASX to list the Fund	Remain as an unlisted Fund. Possibly list the Fund at some point in the future, but not in near-term.
Exit Mechanism	Remove as part of the Special Resolution to amend Constitution	Remove and extend the Fund as an unlisted entity for at least another 3 years.
Liquidity	Via an ASX listing	For hardship cases only near-term. No definite liquidity for all Unit-holders.
Fees & Expenses		
Accrued Fees	Waive \$7.1m only if Fund lists	Waive \$7.1m fees
Unlisted - Acquisition Fee	Remove	Reduce from 5% to 1%-2%
Unlisted - Annual M'ment Fee	Maintain at 6% of revenue	Reduce from 6% to 5.5% (0.70% assets)
Unlisted – Leasing Fee	Remove	Remove
Unlisted – Exit Mechanism Fee	Remove	Remove
Listed – Annual M'ment Fee	0.65% of gross assets	0.70% of gross assets
Expenses		Reduce by \$0.2m
Investor Communication	Estab. Investor Advisory Committee	Estab. Investor Advisory Committee
Cost of NoM & Meeting	Fund to pay	Denison to pay
Court Case	Continue Appeal (Fund to pay costs)	Discontinue Appeal
Management Experience	Experienced with Institutions & retail Property focus on income producing assets	Experienced with 'retail'/ high net worth Property focus on opportunity/ development funds
Financial Backing	Capital injection by Australian non-property specialist investor Net assets \$50m	Recently acquired by large international property debt investor Net Assets \$??m
Alignment of Interest	Effectively 11.1% (13.7% after C/Note conversion) interest in 360CIF	No present holding in 360CIF. No clear intention to acquire equity
Convertible Notes	Interest rate 10-12%	Look at alternative financing

360 Capital RE Ltd

360 Capital acquired the Becton Funds Management business and took over the management of the Becton Industrial Fund (subsequently renamed) in December 2010.

As part of its review, 360 Capital intended to consider all options available to the Fund going forward. The main achievements include:

- Consolidated three debt facilities into a single **new three year finance facility on improved terms** provided by the main existing banker NAB.
- Signalled that the Fund's high **gearing** of 60% LVR (although in compliance with its debt covenant 62.5%) should be reduced.
- **Distributions** were recommenced in the June 2011 quarter at 4.0c (annualised) and recently increased to 4.5c.
- Continued the **divestment of non-core assets** which had begun under the previous manager (four older assets sold and seven more identified).
- **Meetings with Unit-holders** were conducted in four capital cities in April 2011 to communicate the strategic review.
- In May 2012, the Manager made an **institutional placement of 67.5m redeemable unsecured Convertible Notes** at \$0.40 (a discount to NTA of \$0.57). About \$22m of the \$27m raised was sourced from associates of 360 Capital Group.
- These funds together with additional debt of \$60m was used to acquire **four properties** with a value of \$80.4m (plus costs of \$7.0m). 360 Capital's intention has been to acquire new properties that will improve the overall quality and investment profile of the portfolio, in readiness for an intended ASX listing.
- The Manager had proposed the acquisition of a further five properties, valued at \$46.5m (plus costs) but these were subject to a further **Retail Convertible Note capital raising** (at \$0.40 to existing and new investors to raise up to \$40m) which has been deferred.

360 Capital has improved the Fund's portfolio by:

- re-leasing >130,000 sqm of space over 18 tenancies (40% of portfolio's lettable area)
- increasing the Weighted Average Lease Expiry from 3.2 to 4.9 years.
- raising occupancy from 91.4% (Sep 2010) to 98% (June 2012).

Simultaneously, the on-going rationalisation of non-core properties will enable a reduction in gearing in line with the bank **LVR covenant** step-down schedule (from <65% to <50%) over the next two years.

In Lonsec's view this is in keeping with the Refinancing section of the Strategy Review *"As part of this initiative, management will implement an investment strategy designed to place a cap on the Fund's debt levels to a maximum of 55 per cent"*.

The **Capital Raising** part of the Strategy Review also stated that *"the Fund may undertake a small capital raising with the proceeds used to retire a portion of the Fund's borrowings to reduce the loan to value ratio to below 55 per cent"... "If a capital raising is undertaken, it will be on an entitlement basis so that all Unitholders have the right to participate in the raising thereby not diluting their proportionate ownership of the Fund."*

An initial attempt to raise capital (mainly via institutions and a small allocation to Unit-holders) did not proceed.

The more recent Convertible Note issue involved an initial Institutional placement to Unit-holders and a Retail Offer. Unit-holders could have taken up more than their entitlement (as 360 Capital's entitlement would be available having already participated in the placement). Overall, a dilution of Other Unit-holders from 81% to 75% would have occurred, with 360 Capital increasing its interest from 19% to 25%.

"Over the longer term, 360 Capital intends to maintain an economic interest of approximately 15-20% in the Fund." Mostly via the 360 Diversified Fund's

The reason stated by 360 Capital to raise monies this way, was that they could not issue ordinary securities at a discount to NTA and capital could not be raised unless there was a sufficiently attractive income return offered (10%+). The Convertible Notes offered this avenue.

However, in Lonsec's view equal voting rights should not attach to these type of debt securities, until they are converted into ordinary equity. Furthermore, the implications of the Convertible Note issue was not clearly communicated to Unit-holders by 360 Capital.

360 Capital has a focus on:

- Co-investment stakes
- Australian income producing property (not development activities)
- Commercial real estate (not residential)

Management Personnel & Capability

360 Capital Profile

360 Capital Group	
Established	2006
Ownership	Tony Pitt & AMB Holdings (Angela Bennett) \$30m investment since May 2011
Net Assets	\$50m
FUM	\$900m across 11 funds
Staff	17 people
360 Capital RE Ltd	
Assets	>\$8m; and Compliant with NTA requirements

The **360 Capital Board** comprises three Independent Directors and one Executive Director.

Chairman **Andrew Moffatt** has experience in equity capital markets and corporate advisory.

David Van Aanholt is also Chairman of the Investment Committee for the Fund and brings over 20 years of experience in industrial property (ex CEO Asia Pacific for Goodman Group).

John Ballhausen (also a member of the Investment Committee) founded Rimcorp an industrial focussed funds management business with assets under management of \$100m (est. 2002; sold 2008). Prior to this he was Chief Investment Officer at HIH Insurance with responsibility for \$3b in funds (equities, fixed interest, property).

Tony Pitt (Managing Director) was the Fund Manager at JF Meridian Trust/Mirvac REIT from 2003-2006. During this period assets under management grew from \$492m to \$1.1b and the share price increased 24% from \$1.12 to \$1.39 (Feb 2002 – Dec 2006). Tony also has an interest in and was appointed to the board of Trafalgar Corporate (ASX: TGP). Since acquiring a 10% stake in Feb 2009 (now 25%) the share price has increased from \$0.33 to \$0.67 (and returned \$0.66 per share to investors).

Tony was a founding director of 360 Capital Group and since acquiring Becton Funds Management Ltd in December 2010, has presided over asset disposals of \$250m and refinancing of \$0.5b in debt.

The **team of executives** is relatively young with varying experience in property and funds management ranging from eight years to in excess of 20 years.

Individual fund performance figures under 360 Capital are attached in Appendix 1 and shows a return to positive total returns (except the Industrial Fund) in the latest period.

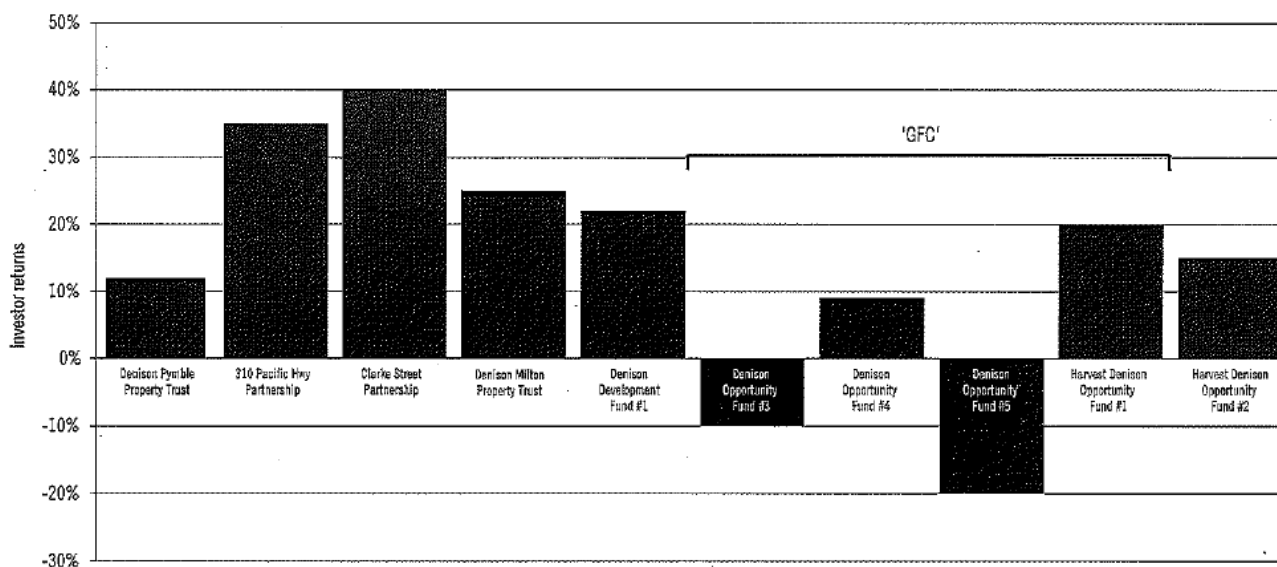
Appendix 1 – 360 Capital Funds Performance

Fund and Trust Half Year 2012 financial performance

Fund / Trust As at 31 December 2011	Dec 2011 Net Tangible Assets (NTA) per Unit ² (\$)	FY2012 Distribution Forecast (cents per Unit)	Total return ¹					Loan to Value Ratio (LVR) ⁴ (%)
			6 months to 31 Dec-11 (%)	1 Year p.a. (%)	3 Years ³ p.a. (%)	5 Years ³ p.a. (%)	Since Inception ³ p.a. (%)	
360 Capital Diversified Property Fund	0.29	1.60	3.4	(10.0)	(28.0)	(9.9)	(8.1)	52.7 ⁵
360 Capital Industrial Fund	0.57	4.00	(3.4)	3.2	(16.0)	(2.4)	2.3	60.0 ⁶
360 Capital Office Fund	(0.19)	–	0.0	(100.0)	(58.8)	(16.4)	(9.9)	118.9 ⁶
360 Capital Retail Fund	0.17	–	6.9	(12.9)	(40.7)	(13.3)	(6.7)	71.8 ⁶
360 Capital Canberra Trust	1.01	8.50	4.9	(5.8)	(0.2)	5.9	7.6	61.5
360 Capital Subiaco Square Shopping Centre Property Trust	1.57	8.00	2.5	27.8	1.7	12.5	8.8	50.6
360 Capital 441 Murray Street Property Trust ⁷	3.28	25.00	4.3	20.2	2.6	12.4	16.6	36.2
360 Capital Havelock House Property Trust	1.25	9.40	9.9	(12.4)	(3.8)	7.5	8.0	63.8
360 Capital 111 St George's Terrace Property Trust	3.52	26.00	20.1	7.3	4.2	13.8	15.6	48.0
360 Capital Developments Income Fund	0.78	–	62.5	(46.0)	(14.5)	(12.6)	0.8	33.9
360 Capital Development Fund No. 1	0.01	–	NA	NA	NA	NA	NA	NA
Total / weighted average								

- 1 The average Total Annual Returns reflect the combined return from income and capital growth (or decline).
- 2 As per individual Fund or Trust 2012 Half Year Financial Statements.
- 3 Over a given period ending 30 June 2011.
- 4 Please see individual Fund or Trust reports.
- 5 Look-through basis to underlying investment portfolio.
- 6 Calculated in accordance with the loan facility agreements on a combined basis.
- 7 Formerly 360 Capital Transport Building Property Trust.

Appendix 2 – Denison Completed Funds Performance (excluding Viento funds)



Denison Funds Management Ltd

Summary of Proposals

1. Not list the Fund on the ASX in the near-term
2. Reduce management fees
 - waive \$7.1m accrued fees
 - remove Exit Mechanism Fee permanently
 - lower annual management to approx 0.70% assets
 - review fee policy
3. Reduce operational costs (\$0.2m)
4. Appoint Investor Advisory Committee
5. Not raise capital at a discount
6. Establish a Liquidity Facility for Members with special consideration
7. Seek Members approval to extend the Fund for at least three years and a future liquidity event.
8. Full portfolio assessment (asset disposals if necessary)
9. Appropriate debt structuring and provide more favourable loan terms, with gearing circa 55%

Denison/Forum Profile

Denison Funds Management Ltd (Denison Aust P/L)	
Established	2002
Ownership	Forum Asian Realty Income III
Net Assets	Forum invested \$23m
FUM - Completed	Acq. & disposal >\$300m assets
Current	\$150m in 4 funds (13 assets)
Staff	7
Forum Partners Inv. M'tment LLC	
Established	2002
Ownership	3 founding partners & staff
Net Assets	n.a.
FUM	\$US5.5b
Staff	60 (10 offices globally)

Denison has a focus on managing direct real estate investments to generate superior returns within acceptable risks (opportunity or value-add funds).

Forum has a focus on real estate debt solutions and partners with large pension funds. It provides private equity, restructuring capital and market expertise to small and mid sized real estate companies.

Denison Funds Management Personnel

The Board comprises:

Andrew Faulk (Forum's Australia country head). Previous roles include Head of Structured and Institutional Real Estate at St George Bank with responsibility for a A\$3.5b asset portfolio. He has also practiced law with Clayton Utz in Sydney and accountancy with PricewaterhouseCoopers.

Ben Burney has 20 years' experience as a finance lawyer, specialising in property and funds management. He has practiced with Ashurst and DLA in London and is currently a partner and head of banking and finance with Sparke Helmore in Sydney.

Matthew Burrows Director & CEO

Matthew has 21 years experience in various aspects of commercial property at Raine & Horne, Jones Lang LaSalle, Perpetual Trustees and Hortons (Aust) P/L. His prior roles have involved commercial property management, commercial leasing and sales, property valuation, consultancy and trustee services.

Compliance Committee

Brendan Howell (Independent Compliance Committee Member). He currently sits on two company boards, one as the Chairman as well as being the chairman of one compliance committee and responsible manager for another entity. Brendan has previously held a variety of board-related positions for a number of Australian companies.

Robert Bishop (Independent Compliance Committee Member) has thirty years of experience in corporate finance and stock market floats, firstly in the law at Linklaters & Paines in London then at Allen, Allen & Hemsley in Sydney and as a stockbroker and investment banker at Ord Minnett Corporate Finance in Sydney and then Robert Fleming in London. Since 1998, Robert has run his own Sydney-based corporate finance business, First Capital Markets.

The **executive team** is relatively small with property industry experience ranging from eight years to 20+ years. Lonsec has to date not met any Forum executives as the acquisition was only completed in early 2012.

Denison's track record of **initiated and completed funds** is shown in Appendix 2. It shows that eight out of ten funds have recorded positive returns ranging from 10% to 40% pa Internal Rate of Return. Two funds have recorded negative returns.

Denison Opportunity Fund No.3 – a JV with AMP purchased at the start of the GFC and sold at cost.

Denison Opportunity Fund No.5 – a JV with Valad purchased for \$34m and sold for \$17m.

Denison recently acquired four poorly performed **Viento** funds (previously WRF Securities).

Property Portfolio

The Fund currently has a portfolio comprising 24 industrial properties spread over five Australian states. The following table sets out anticipated changes to the Fund's property portfolio as a result an on-going rationalisation of non-core properties.

360 Capital - Proposed Changes to Portfolio

	No Props	Value ¹
Existing	20	264.4
Walker Additional	4	80.4
Current	24	344.8
Heads of Agreement	(5)	(43.8)
Marketing Campaign	(3)	(30.2)
	19	267.1

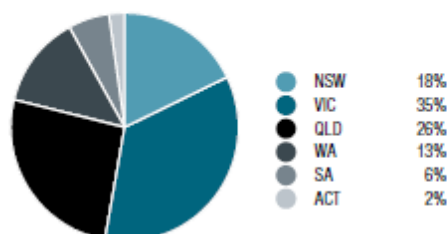
(Note 1: Book value excluding acquisition or sale costs)

Fund Property Position + Additional Portfolio

	Existing	Walker Additional	Total
No. Props	20	4	24
Value (\$m)	264.4	80.4	344.4
NLA (m2)	311,994	58,291	370,285
Cap. Rate	9.33%	8.60%	9.16%
Occupancy (area)	98%	100%	98.1%
WALE (income)	3.9yrs	9.6yrs	4.9yrs

The following graphs and tables show the approximate geographic spread and top tenants of the Fund (prior to the sale of two small properties in June 2012).

Geographic diversification (by income) as at 29 February 2012³



Top 10 tenants of the Fund as at 29 February 2012

Tenant	Gross income (\$m)	% of Gross income
1 The Reject Shop	3.0	7.5
2 Australian Pharmaceutical Industries (API)	3.0	7.4
3 Visy Industries	2.5	6.1
4 Hugo Boss Australia Pty Ltd	2.3	5.6
5 Post Logistics Australasia ⁴	2.1	5.1
6 Kent Transport Industries Pty Limited	1.5	3.8
7 Tyremax Pty Ltd	1.3	3.3
8 GM Holden	1.2	3.0
9 AWH Pty Ltd	1.2	2.9
10 CTI Freight Systems Pty Ltd	1.2	2.9
Top 10 total	19.4	47.6

(Source: 360 Capital Industrial Fund Prospectus & PDS)

Financial Position

The Fund's gearing position and net tangible asset (NTA) per unit is shown in the following table. Post listing assumes the conversion of existing Convertible Notes and the waiving of the \$7.1m fees. However, NTA/unit has reduced from \$0.57 prior to the acquisition of the Walker additional portfolio and recent sale of two small properties. If the Notes are not converted, then NTA/unit would be \$0.55.

Gearing and Net Asset Backing (Unaudited)

	Previous	30 June 2012	Pro Forma Post Listing
No. Props	22	24	24
Prop Value (1)	273.4	344.8	344.8
Total Assets	278.2	356.4	356.4
Debt	162.4	220.0	220.0
Cash	3.7	9.6	9.6
Net Assets	103.3	92.2	125.3
No. Ord Units	180.6	180.6	248.1
NTA/unit	\$0.57	\$0.51	\$0.50
LVR(2)	59.4%	63.8%	63.8%

(Note 1: Including capitalised acquisition costs)

(Note 2: Bank debt / Property Values including capitalised costs)

Bank Debt and Covenants

The Fund's bank debt will consist of a new two tranche facility with National Australia Bank:

Facility	Maturity	Amount
Tranche 1	30 Nov 2012	\$20m
Tranche 2	Earlier of 31 Dec 2015 or 3 yrs from Fund listing	\$240m
Drawn	Current	\$220.0m
	Fixed (@ 5.0% + margin)	\$155.0m

Bank Covenants

Date	LVR	ICR
Current	<65%	>1.6x
31 Dec 2012	<60%	
30 June 2013	<55%	
31 March 2014	<50%	>1.6x

Future Gearing Position

Given the mandated reduction in bank LVR gearing covenant down to 50%, the Fund will have to continue with an on-going rationalisation programme of non-core assets.

	Current	Post Asset Sales Under Heads of Agreement	Post Asset Sales under Marketing Campaign
Prop Value	344.8	301.0	270.8
Debt (1)	220.0	177.6	148.1
Bank LVR	63.8%	59.0%	54.7%

(Note 1: Net proceeds after selling costs applied to debt)

Convertible Notes

The Convertible Notes interest coupons are:

Coupon	Period
12.0%	Date of issue <u>until listing of Fund</u> (if any) or maturity
10.0%	<u>Following Fund listing</u> , where Note-holder does not convert into Units, until extended maturity date
16.0%	<u>If Issuer fails to satisfy listing conditions, from 17 Dec 2012</u> until maturity date or Fund listing. (Listing conditions includes used reasonable endeavours to procure listing of the Fund and not dependent on passing of special resolution).

About \$22m (55m) of the \$27m (67.5m) Notes issued went to the following 360 Capital associated entities:

- Group associated with AMB Holdings: 25m (37%)
- 360 Capital Diversified Prop. Fund: 23.7m (35%)
- 360 Capital Group: 6.3m (9.3%)

Ordinary Units

Ordinary Unit-holdings held by 360 Capital Diversified Property Fund is about 34m units (18.8%). Collectively, 360 Capital accounts for 35.8% of total capital (assuming Notes were converted).

Lonsec Expected Valuation – Peer Analysis

A-REIT Peer Group Comparison

Mid (Range)	Small	Large	360 Ind.
P/E (x)	11 (11 to 13)	12.5 (11 to 14)	
Yield (%)	8.0 (7.5 to 9.0)	6.5 (6.2 to 8.4)	10 to 11
Price/NTA (%)	-2 (-20% to +10)	-2 (-16 to +49)	-15 to -20
Gearing (%)	20 to 50	20 to 40	55 to 65

Lonsec has examined the following sample of the Fund's closest A-REIT peers (Small: Growthpoint; BWP Trust; Challenger Diversified) as well as other major A-REITs (Large: Goodman; Centro Retail; Charter Hall Retail; C'wealth Office; CFS Retail).

Based on this analysis, Lonsec's estimates that 360 Capital Industrial Fund (given its higher gearing and relatively small size), if it lists on the ASX could trade within the following investment metrics.

- a distribution yield of 10%-11%
- a discount to NTA of 15%-20%
- a price/earnings ratio of 7x – 8x

The Fund is estimated to have a pro-forma:

- NTA/unit of \$0.50
- Earnings of 6.1c per Unit
- Distribution of 4.5c per Unit

Est. Fund Unit Price Listed on ASX

	Range	Mid
Yield 10-11%	41c – 45c	43c
Price/NTA Disc -15 to -20%	40c – 43c	41c
P/E 7-8x	43c – 49c	46c

The above analysis equates to a price trading range on the ASX of 40c to 50c, with a mid-point of 45c.

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Date Released: 11 September 2012

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