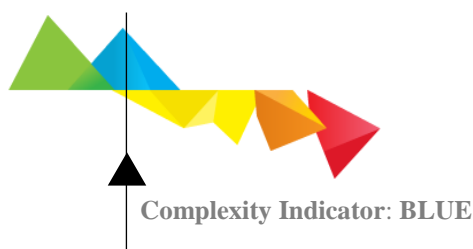


A<sup>+</sup>

	Key Credit Strengths	Key Risk Factors
<p><b>Analyst</b> Renee Corcoran (03) 8080 6684 renee.corcoran@australiaratings.com</p> <p><b>Credit Rating</b></p> <ul style="list-style-type: none"> <li>Class A units - 'A+'</li> <li>Class B units - 'A+'</li> </ul> <p>'A+' The Fund has a strong degree of protection against loss from credit risk</p> <p><b>Product Complexity Indicator</b> 'BLUE' A relatively simple financial product</p> <p><b>APIR Codes</b></p> <ul style="list-style-type: none"> <li>STL0027AU – direct units</li> <li>STL0044AU – platform units</li> </ul>	<ul style="list-style-type: none"> <li>A significant proportion of assets are held in cash, term deposits and securities of a high degree of credit quality.</li> <li>Low volatility risk due to short interest rate duration of portfolio.</li> <li>Conservative investment management style.</li> <li>Benefits from being part of the wider Bendigo and Adelaide Group, including in areas such as risk and compliance, IT and distribution.</li> <li>Experienced fixed income portfolio managers who have demonstrated continued solid performance in actively managing the Fund</li> <li>Demonstrated achievement of stated investment returns to investors.</li> <li>Strengthened and consistent portfolio credit quality over time</li> </ul>	<ul style="list-style-type: none"> <li>The creditworthiness of units in the Fund reflects the credit quality of underlying assets.</li> <li>Any future dislocation in credit markets where bond prices fall may adversely impact unit value.</li> <li>Increased geopolitical uncertainties in the macro-environment may adversely affect the market and the Fund.</li> <li>In exceptional market conditions or if redemptions materially exceed applications, requests for redemption of principal may be delayed until assets of the Fund can be liquidated.</li> </ul>

## Rating Review

The rating of Sandhurst Strategic Income Fund's ("the Fund's") units was reviewed in April 2017 and upgraded to 'A+' from 'A'. The one notch upgrade confirms the strong level of creditworthiness of the Fund; the historical performance of the Fund; and the solid performance of the investment management team in managing the Fund. The Product Complexity Indicator of the Fund was confirmed as BLUE.

Since our review in April 2016, the portfolio management team has continued to actively and conservatively manage the portfolio. In view of the uncertain market climate, the investment philosophy has continued to focus on strengthening credit quality and liquidity. As such, over the last 12 months, there has been more weight on investing in more liquid and higher quality assets.

## Credit Rating

An investment in the Fund represents a purchase of units in a registered managed investment scheme. The Class A and Class B units have been upgraded to 'A+' and reflect the legal form of the Fund and the weighted average credit quality of the assets that are acquired for the benefit of all unit holders ("investors").

Daily redemption is offered to Class B unit holders and weekly redemption is offered to Class A unit holders. In certain circumstances the constitution of the Fund allows the Responsible Entity to suspend or refuse withdrawals from the Fund. The upgraded rating of 'A+' reflects that the Fund has a strong degree of protection against loss from credit risk and the one notch upgrade indicates that the underlying credit quality of the portfolio is stronger than when Australia Ratings first rated it. The Fund's assets are of a credit quality that supports its ability to meet redemption requests in accordance to the terms as set out in the Fund's latest product disclosure statement (PDS) dated 30 January 2017.

Any future material change in the weighted average credit quality of the Fund's assets is likely to cause a change in the credit rating of the Fund's units.

The Fund has a low degree of risk to changes in interest rates as it holds a majority of its assets in the form of floating rate notes that reset in line with changes to market interest rates. The Fund is exposed to credit risk, interest rate risk, and duration risk through its investment in term deposits and other fixed income securities that are denominated in Australian dollars. This risk is managed by restricting investment to those bonds rated investment grade or better. The comprehensive investment selection and monitoring

processes that assess these risks on macro and micro perspectives also contribute to the overall portfolio risk management.

An investment in units in the Fund is not covered by the Financial Claims Scheme, which only applies to deposits up to \$250,000 in institutions regulated by the Australian Prudential Regulatory Authority.

### Product Complexity Indicator

A Product Complexity Indicator (“PCI”) of BLUE is assigned to the Fund’s units. This indicates that an investment in the Fund represents a relatively simple financial investment. The BLUE designation is intended to highlight that in certain unexpected circumstances the Fund can defer redemption requests to manage its liquidity in adverse market conditions.

Daily redemption is offered to Class B unit holders and weekly redemption is offered to Class A unit holders. In certain exceptional circumstances, the constitution of the Fund allows the Responsible Entity to suspend or refuse withdrawals from the Fund.

### Summary of the Fund

There have been no changes to the key entities since the last review, or since its inception.

Fund	Sandhurst Strategic Income Fund
Responsible Entity	Sandhurst Trustees Ltd
Investment Manager	Sandhurst Trustees Ltd
Custodian	Sandhurst Trustees Ltd
Fund Administrator	Sandhurst Trustees Ltd
Fund Bank Account	Bendigo and Adelaide Bank Ltd
Fund Auditor	Ernst & Young
Financial Year End	30 June

The Fund is a unit trust established by a constitution dated 27 May 2011. The Fund is a managed investment scheme and is registered with the Australian Securities and Investment Commission (“ASIC”). It is a fully distributing unit trust that distributes all capital and income on a pre-tax basis to unit holders.

The Fund was launched in July 2011 and as at 31 March 2017 had in excess of \$82 million in funds under management. The underlying portfolio is actively managed by

the Investment Manager, who must strictly follow investment parameters within the Investment Policy.

Sandhurst Trustees Limited (“Sandhurst”) is the Responsible Entity of the Fund and the Investment Manager. Sandhurst has a very long history in providing trustee services and providing a suite of common and managed investment funds to its clients. Sandhurst is a wholly-owned subsidiary of the Bendigo and Adelaide Bank and is part of the Bendigo Wealth division. Sandhurst also acts as the Investment Manager of the Fund.

The Fund seeks to provide investors with a regular income stream by investing in a high quality diversified portfolio of term deposits and fixed income securities that have a lower susceptibility to change in market value due to changes in interest rates.

Monies invested in the Fund are pooled and used to purchase eligible assets on behalf of all investors in the Fund. The Fund will make a distribution to investors at the end of each quarter based on the distributable income of the Fund.

Sandhurst also provides administration and registry services to the Fund.

### Investment Objective

The Fund’s objective is to earn a return greater than the Bloomberg AusBond Bank Bill Index after management costs and ordinary costs of the Fund as apportioned to the Class A and Class B units. The Bloomberg AusBond Bank Bill Index is an index of interbank interest rates in the institutional banking market. It is typically above the Reserve Bank’s Official Cash Rate.

The Fund is managed according to an Investment Policy. Since our last review, the Investment Policy was updated and approved in January 2017. No material changes occurred in this update, but rather credit rating parameters were made clearer.

The Fund has a focused investment approach of investing only in Australian dollar (“AUD”) denominated term deposits and floating rate income securities. The Fund aims to minimise interest rate risk and has typically exhibited a short duration of between 0.2 – 0.4, meaning it has a lower level of exposure to a change in asset values due to changes in interest rates.

### Key Fund Terms and Conditions

The Fund accepts daily applications and withdrawal requests. Requests for withdrawal of Class A units are processed

weekly on a Wednesday. Withdrawal requests relating to Class B units reflect the terms of the particular platform operator.

The Fund aims to generate returns that are in excess of its benchmark - the AusBond Bank Bill Index (after the fees of the Fund). The minimum management costs paid by the investors are:

- Class A units                    0.79% p.a.
- Class B units                    0.45% p.a.

The Fund makes distributions to investors on a quarterly basis based on the performance of the Fund as at 30 September, 31 December, 31 March and 30 June.

### Investment Manager

The investment manager, Sandhurst, has a long history acting as a manager of pooled investment products including common funds and managed investment schemes. The Board of Sandhurst comprises three independent directors Jenny Dawson, Ian Mainsbridge and Tony Robinson as well as two executive directors - Bruce Speirs and Richard Baker. No change to the Board has occurred since our review last year.

Sandhurst’s Funds Management team acts as the Investment Manager of the Fund. The Investment Manager is a team of highly experienced investment professionals who actively manage and monitor the Fund on a daily, weekly, quarterly and annual basis. Since the last review, the senior members of the team remain the same and are as follows:

**Thadeus McCrindle** (Head of Investments): Thadeus leads a team of four who are directly responsible for the investment and relative value considerations of the Fund. Thadeus’ experience includes over twelve years with Sandhurst managing fixed income, cash and credit funds and a leadership role overseeing multi-asset portfolios, superannuation strategy and estates and charitable trust portfolio management. Prior to that, Thadeus spent five years with J.P. Morgan in a quantitative analytical role overseeing listed and unlisted assets, and derivatives.

**Roger Coats** (Portfolio Manager): Roger is responsible for overseeing the Fund on a day to day basis and has been in this role since 2014. Roger is an experienced finance and investment executive and his past roles include senior positions with Merrill Lynch, ABN AMRO, Hambros and BNP Paribas in Australia and London.

**Kosta Jaric** (Analyst): Kosta has been with the Bank working in technical, analytical and modelling roles for over 10 years (including 3 with the Fund’s investment team) and currently

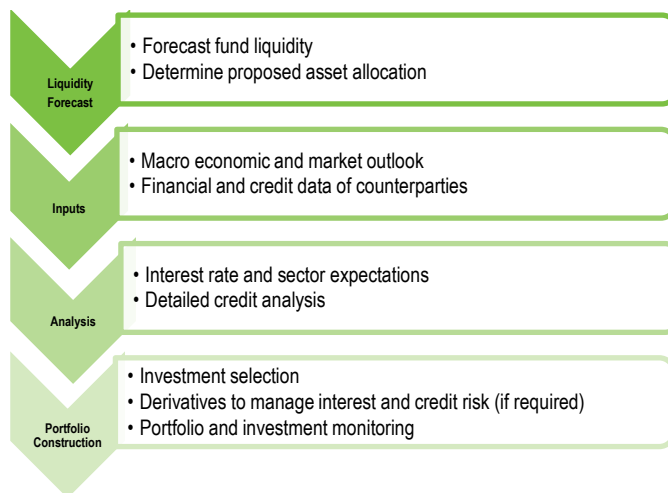
allocates 90% of his time to the Fund. His main responsibility is leading the analytical work including financial analysis, modelling, valuation, and the analytical work related to RMBS and structured transactions.

The Fund is also supported by the financial analysis skill and experience of Tim Lovell (Senior Analyst), and Mallory Trovato (Junior Investment Analyst). Mallory is responsible for assisting Kosta in his analytical work.

The Sandhurst Funds Management and Corporate Investments Investment Committee (“the Investment Committee”) meets quarterly to review performance and compliance with Fund objectives. The Investment Committee is chaired by Jennifer Dawson. Other members, who are all senior members within the Bank, include Richard Morice (Head of Strategy), Justin Hoare (Head of Products), and Paul Rohan (General Manager). The Investment Committee is currently seeking a replacement member for Julie Mackay who resigned in December.

### Investment Process

The Investment Policy governs the assets that the Fund can purchase or retain. A four step investment process is followed to assess the suitability of assets in the Fund.



The Fund’s investment process includes accumulating relevant economic, market and company specific financial and credit data. The second step is to form views on the outlook of credit markets and complete a detailed credit analysis of the counterparty or issuer of the fixed income security. More complex investments such as RMBS ones benefit from detailed bottom up and pool-wide approaches. The final step is to assess what impact the assets have on

the overall risk and reward of the Fund's asset portfolio. This includes decisions on the use of derivatives to manage interest rate and credit risk. The Investment Manager maintains ongoing weekly monitoring of the credit quality of the portfolio.

Australia Ratings' opinion is that the Investment Managers' investment process is robust and benefits from the experienced management team. The investment approach is conservative, technical and highly analytical.

### Asset Quality

The Fund's Investment Policy was amended and approved by the Board of Sandhurst in January 2017. Since our review last year, there have been no material changes to the policy which governs the permitted investments and exposure limits of the Fund. Changes that occurred were non-material and were for clarification purposes.

Permitted Investments include:

- government bonds or bills;
- semi-government bonds;
- government agency and municipality bonds;
- corporate bonds including covered bonds;
- asset-backed securities;
- mortgages and loans;
- hybrid securities;
- deposits with licensed ADIs;
- bank bills and negotiable certificate of deposits (NCDs);
- debentures issued by ADIs;
- commercial paper;
- other debt securities; and
- managed investment schemes that invest as above.

The Fund is governed by the following exposure limits, which have not changed since our review last year:

Table 1- Investment Target Exposure Limits

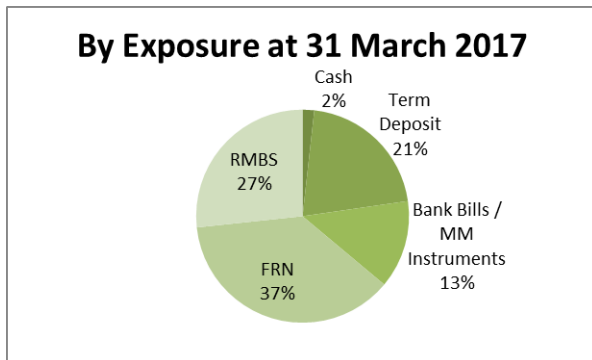
	Exposure	Max	Min
Primary	Bank bills & money market securities	100%	20%
	Australia Sovereign	80%	0%
	Semi-government and supra-nationals	60%	0%
	Corporate bonds and FRNs	60%	0%
	Asset-backed securities	40%	0%
Secondary	Hybrids and other	10%	0%
	Primary securities	100%	90%
	Secondary securities	10%	0%

The Fund can only invest in investment grade assets but is allowed to hold up to 10% in sub-investment grade and unrated assets in the event of a downgrade of a particular security. Derivatives can be used to manage interest rate risk, credit risk, foreign currency risk and duration risk. The Fund's Investment Policy does not allow the Fund to use gearing and it is not permitted to use derivatives in a way that generates leveraged returns. As there were no fixed rate investments, the Fund did not have any derivative exposures from hedging as at 31 March 2017.

As at 31 March 2017, the Fund had assets totalling \$82.1 million which is slightly lower than the \$88 million outstanding from our review last year. Management's expectations are that the focus on the retail distribution efforts will provide opportunities for increasing the Fund size in the near term future.

The overall exposure mix remains diverse and in line with the investment policy. The composition of the Fund has changed over the last 12 months, in line with the Investment Manager's overall strategy to preserve liquidity and credit quality to weather potential market uncertainties. As such, a greater emphasis has been placed on shorter term, more liquid securities. While cash investments decreased from 4% in June 2016 to 2% at the end of March 2017, short term money market instruments and bank bills increased from 8% to 13% during this same period. Term deposits now account for 21% of the total exposure and floating rate notes (FRNs) now account for 37% of the total exposure (from 41% in June 2016). Chart 1 illustrates the Fund's asset categories.

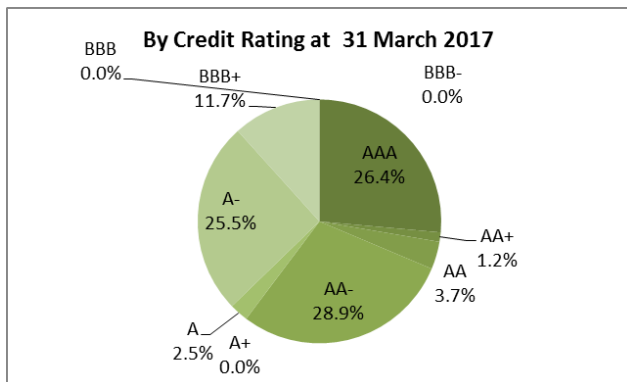
Chart 1 - Asset Composition as at 31 March 2017



Source: Sandhurst Strategic Income Fund

As at 31 March 2017, 88% of the portfolio was rated A- and above. During the last 12 months since our last review, the weighted average credit rating has strengthened from an A+ to AA-. The creditworthiness of the Fund's assets is illustrated in Chart 2 below.

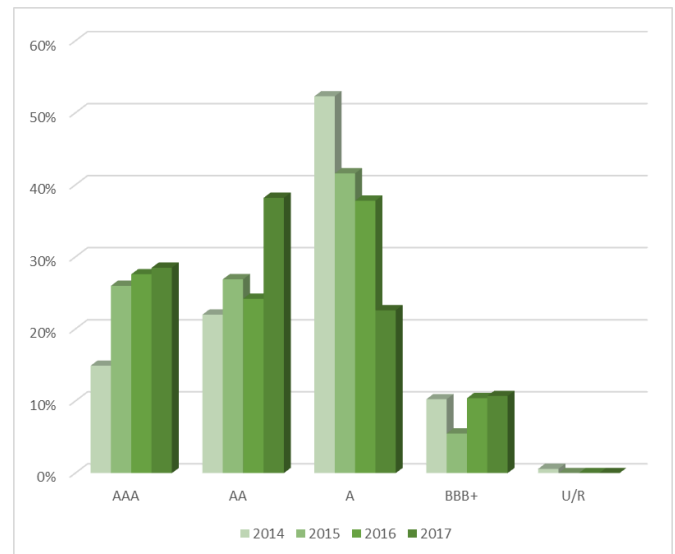
Chart 2 – Creditworthiness of the Fund's assets



Source: Sandhurst Strategic Income Fund

The consistent strengthening of the underlying credit quality of the portfolio is a main driver behind Australia Rating's credit rating upgrade of the Fund. Chart 3 provides a snapshot of the credit rating weightings of the underlying portfolio from 2014 through to 2017.

Chart 3: Portfolio breakdown by credit rating 2014 – 2017:



Source: Sandhurst Strategic Income Fund

### Liquidity

The Fund aims to maintain a minimum level of liquid assets to meet redemptions. The Fund has a target to hold cash and highly liquid securities equal to at least 11% of the Fund's assets with a minimum of at least 5%. 1-Day Liquid assets are designated to include:

- cash deposits;
- maturing investments (term to maturity < 2 days);
- bank bills, NCDs; and
- government bonds.

The Investment Policy stipulates the Fund must observe the liquidity parameters set out in Table 2.



Table 2 – Liquidity Management Parameters

	Target	Min
one day liquidity	11%	5%
one week liquidity	26%	
one month liquidity	45%	30%

Liquidity management plays an important role in order to meet redemption patterns.

### Risk Management

Sandhurst plays a number of roles in the management and administration of the Fund and its assets e.g. responsible entity, custodian, investment manager and registrar. The multiple roles are subject to a wider Sandhurst and Bendigo and Adelaide Bank risk management and compliance framework.

Sandhurst, as the Responsible Entity, has the primary responsibility to monitor compliance by the investment manager with the Fund's product disclosure statement (PDS) and Investment Policy.

The compliance of the Fund with its Constitution and Investment Policy is overseen by the Sandhurst Audit, Risk and Compliance Committee which is responsible for overseeing and monitoring the scheme's compliance with risk management frameworks (including regulatory compliance obligations). It is comprised of three non-executive directors of the Sandhurst Board. The committee also provides oversight of the treatment of all risk events (including regulatory breaches), including over escalation and rectification decisions. All events relating to amounts over \$5,000 are reported to the Bendigo and Adelaide Bank operational risk department.

Unit prices are calculated on a daily basis by Sandhurst's Operations and Support team. Daily redemption is offered to Class B unit holders and weekly redemption is offered to Class A unit holders. The Fund's assets are held by Sandhurst's custodial division on behalf of the Fund's investors.

Sandhurst as the Responsible Entity is covered under a Professional Indemnity and Financial Institutions Bond of up to \$100 million (any one loss and aggregate) for the Bendigo and Adelaide Bank Group.

### Financial Risk Profile

While the Fund is not guaranteed by Sandhurst or Bendigo and Adelaide, it does benefit from the organisational infrastructure of the Bendigo and Adelaide Bank Group, the 6<sup>th</sup> largest regulated bank in Australia with over \$68.6 billion of assets (fiscal year end 2016).

### Surveillance of the Rating

Australia Ratings will receive periodic reports of the Fund's investment portfolio to monitor the credit quality of the Fund's assets and the rating assigned to the units of the Fund.

### Contact Details

#### Australia Ratings

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