Construction and Methodology

Russell Australia High Dividend Index Series

v1.6

Contents

Section 1

Introduction

1.0 Introduction

1.1 Russell Australia High Dividend Index

1.1.1 The Russell Australia High Dividend Index ("RAHDI") is an equity index comprised of blue chip Australian companies that have historically paid above average dividends, including Franking Credits. The Index includes large cap companies and is built using an objective, transparent and market-driven construction.

1.2 The Russell Australia High Dividend Index Series does not take account of ESG factors in its design.

1.3 Available currencies

1.3.1 The base currency of the benchmark is AUD. Index values may also be published in other currencies.

1.4 Price and Total Return indices are calculated.

1.0 FTSE Russell

1.4.1 FTSE Russell is a trading name of FTSE International Limited, Frank Russell Company, FTSE Global Debt Capital Markets Limited (and its subsidiaries FTSE Global Debt Capital Markets Inc. and FTSE Fixed Income Europe Limited), FTSE Fixed Income LLC and The Yield Book Inc.

1.4.2 FTSE Russell hereby notifies users of the index series that it is possible that circumstances, including external events beyond the control of FTSE Russell, may necessitate changes to, or the cessation of, the index series and therefore, any financial contracts or other financial instruments that reference the index series or investment funds which use the index series to measure their performance should be able to withstand, or otherwise address the possibility of changes to, or cessation of, the index.

1.4.3 Index users who choose to follow this index series or to buy products that claim to follow this index series should assess the merits of the index's rules-based methodology and take independent investment advice before investing their own or client funds. No liability whether as a result of negligence or otherwise is accepted by FTSE Russell for any losses, damages, claims and expenses suffered by any person as a result of:

- any reliance on these Construction and Methodology, and/or
- any inaccuracies in these Construction and Methodology, and/or
- any non-application or misapplication of the policies or procedures described in these Construction and Methodology, and/or
- any inaccuracies in the compilation of the index or any constituent data.

Section 2

Management Responsibilities

2.0 Management Responsibilities

2.1 FTSE International Limited (FTSE)

2.1.1 FTSE is the benchmark administrator of the index series.[1]

2.1.2 FTSE Russell is responsible for the daily calculation, production and operation of the index series and will:

- maintain records of the index weightings of all constituents;
- make changes to the constituents and their weightings in accordance with the Methodology;
- carry out the periodic index reviews of the index series and apply the changes resulting from the reviews as required by the Methodology;
- publish changes to the constituent weightings resulting from their ongoing maintenance and the periodic reviews;
- disseminate the indices.

2.2 Amendments to the Methodology

2.2.1 This Methodology shall be subject to regular review (at least once a year) by FTSE Russell to ensure that they best reflect the aims of the index. Any proposals for significant amendments to this Methodology will be subject to consultation with FTSE Russell advisory committees and other stakeholders if appropriate. The feedback from these consultations will be considered by the FTSE Russell Index Governance Board before approval is granted.

2.2.2 As provided for in the Statement of Principles for FTSE Russell Equity Indices, where FTSE Russell determines that the Methodology is silent or does not specifically and unambiguously apply to the subject matter of any decision, any decision shall be based as far as practical on the Statement of Principles. After making any such determination, FTSE Russell shall advise the market of its decision at the earliest opportunity. Any such treatment will not be considered as an exception or change to the

[1] FTSE is not the benchmark administrator of the Index Series as the term administrator is defined in the IOSCO Principles for Financial Benchmarks and] Regulation (EU) 2016/1011 of the European Parliament and of the Council of 8 June 2016 on indices used as benchmarks in financial instruments and financial contracts or to measure the performance of investment funds (the European Benchmark Regulation) and The Benchmarks (Amendment and Transitional Provision) (EU Exit) Regulations 2019 (the UK Benchmark Regulation).

Methodology, or to set a precedent for future action, but FTSE Russell will consider whether the Rules should subsequently be updated to provide greater clarity.

Section 3

FTSE Russell Index Policies

3.0 FTSE Russell Index Policies

These Ground Rules should be read in conjunction with the following policy documents which can be accessed using the links below:

3.1 Statement of Principles for FTSE Russell Equity Indices

3.1.1 Indices need to keep abreast of changing markets and the Russell Index Methodologies cannot anticipate every eventuality. Where the Methodology does not fully cover a specific event or development, FTSE Russell will determine the appropriate treatment by reference to the Statement of Principles which summarizes the ethos underlying FTSE Russell's approach to index construction. The Statement of Principles is reviewed annually and any changes proposed by FTSE Russell are presented to the FTSE Russell Policy Advisory Board for discussion before approval by the FTSE Russell Index Governance Board.

The Statement of Principles can be accessed using the following link: Statement_of_Principles.pdf

3.2 Corporate Actions and Events Guide

3.2.1 Full details of changes to constituent companies due to corporate actions and events can be accessed in the Corporate Actions and Events Guide using the following link:

Corporate_Actions_and_Events_Guide.pdf

3.3 Queries, Complaints and Appeals

3.3.1 A constituent or prospective constituent company (or professional advisor acting on behalf of the company), a national organization or a group of no fewer than ten users of the Indices from different organizations acting in their professional capacity may appeal against decisions taken by FTSE Russell.

FTSE Russell's complaints procedure can be accessed using the following link:

Benchmark_Determination_Complaints_Handling_Policy.pdf

FTSE Russell's Appeal Process can be accessed using the following link:

Appeals_Against_Decisions.pdf

3.4 Recalculation Policy and Guidelines

3.4.1 Where an inaccuracy is identified, FTSE Russell will follow the steps set out in the FTSE Russell Index Recalculation Guidelines when determining whether an index or index series should be recalculated and/or associated data products reissued. Users of the Russell Australia High Dividend Index Series will be notified through appropriate media.

For further information refer to the FTSE Russell Recalculation Policy and Guidelines document which is available from the FTSE Russell website using the link below or by contacting info@ftserussell.com.

Recalculation_Policy_and_Guidelines_Equity_Indices.pdf

3.5 Index Policy for Trading Halts and Market Closures

3.5.1 Guidance for the treatment of index changes in the event of trading halts or market closures can be found using the following link:

Index_Policy_for_Trading_Halts_and_Market_Closures.pdf

3.6 Index Policy in the Event Clients are Unable to Trade a Market or a Security

3.6.1 Details of FTSE Russell's treatment can be accessed using the following link:

Index_Policy_in_the_Event_Clients_are_Unable_to_Trade_a_Market_or_a_Security.pdf

3.7 Policy for Benchmark Methodology Changes

3.7.1 Details of FTSE Russell's policy for making benchmark methodology changes can be accessed using the following link:

Policy_for_Benchmark_Methodology_Changes.pdf

3.8 FTSE Russell Governance Framework

3.8.1 To oversee its indices, FTSE Russell employs a governance framework that encompasses product, service and technology governance. The framework incorporates the London Stock Exchange Group's three lines of defence risk management framework and is designed to meet the requirements of the IOSCO Principles for Financial Benchmarks[2], the European benchmark regulation[3] and the UK benchmark regulation[4]. The FTSE Russell Governance Framework can be accessed using the following link:

FTSE_Russell_Governance_Framework.pdf

[2] IOSCO Principles for Financial Benchmarks Final Report, FR07/13 July 2013

[3] Regulation (EU) 2016/1011 of the European Parliament and of the Council of 8 June 2016 on indices used as benchmarks in financial instruments and financial contracts or to measure the performance of investment funds

[4] The Benchmarks (Amendment and Transitional Provision) (EU Exit) Regulations 2019

Section 4

Index Construction

4.0 Eligible Securities

4.1.1 Russell Australia High Dividend Index starts with the members of the FTSE Australia 100 Index, including infrastructure stocks and excluding foreign ownership limits. The index is then reduced down to those securities which meet the requirements to be considered high dividend paying companies.

4.1.2 Starting with the review universe, each security is given a Composite Yield Score. The Stock Weight of each security is then calculated by adding capitalization weight to the Composite Yield score multiplied by 2.5% as per the formula below.

Stock Weight = Capitalization Weight + (Composite Yield Core x 2.5%)

Therefore securities with positive Composite Yield Scores will see an increase in their Stock Weight compared to their Capitalization Weight and vice versa for those with negative Composite Yield Scores.

4.1.3 The Composite Yield Score is the combined score from the underlying factors.

4.2 Determining index membership

4.2.1 The top 50 companies by stock weight (as defined under Eligible Securities) are selected for the Russell Australia High Dividend Index and the resulting portfolio weights are then scaled to sum to one. This methodology allows the focus to remain on the largest capitalization companies with the highest Composite Yield Scores.

Section 5

Dividend Criteria

5.0 Dividend Criteria

5.1.1 The methodology not only targets high dividends, but is also built to include better quality dividends. To capture the quality of the underlying dividends the methodology focuses on penalizing those companies that have paid sporadic dividends and also those companies whose dividends have been falling or are likely to fall in the future based on certain factors such as Forecast Dividend and Forecast Dividend Growth. Multiple factors at varying weights are used to capture the relative importance of high forecasted dividends, consistency of dividends and trajectory of dividend growth (both future and historical). The factors used in the model are not equally weighted; rather weighted by their relative importance with the greatest emphasis on future dividend potential and equal emphasis on historical yields, dividend growth (including trailing and forecasted growth) and EPS variability.

5.2 Franking credits

5.2.1 For Australian investors, dividends are often worth more than the cash payments received. This is because a company can also distribute franking credits for any company tax it has paid. Dividends carry franking credits that entitle shareholders to a tax offset or a reduction in the amount of tax to be paid. Dividends received by investors can range from 100% franked to completely unfranked.

5.2.2 The effect dividend imputation has on individual shareholders depends mainly on two things – the individual shareholder's taxable income, and how much tax the company paid before it distributed a dividend. In some cases, a shareholder can actually pay less tax after receiving dividend income than would have been payable without it.

5.3 Grossed up dividend calculation

For example, a company declares a 10 cent fully franked dividend (taxed at 30%).

10c /70% x 30% = franking credit per share

= 4.28 cents per share

If the current share price was $2.50 the returns would be as follows:

Dividend yield = 10 cents/$2.50 = 4%

Grossed up = (10 cents + 4.28 cents)/$2.50 = 5.71%

5.4 Franking credits at different tax rates

Tax rates	10%	30%	40%	46.5%
Dividend	$700	$700	$700	$700
Grossed Up Dividend	$1,000	$1,000	$1,000	$1,000
Gross Tax Payable	$100	$300	$400	$465
Franking Credit Rebate	$300	$300	$300	$300
Net Tax Payable	Refund $200	$0	$100	$165

5.5 The 45-day rule

5.5.1 The 45-day rule aims to eliminate franking credit trading where franking benefits are received by someone other than the true economic owner of the underlying shares. The rule requires resident taxpayers to hold shares for at least 45 days to be eligible to receive franking benefits from dividends paid on shares. Furthermore, even if the shares are held for at least 45 days, the franking credit is denied if the resident taxpayer has eliminated 70% or more of the ownership risk through other financial transactions during that period. Hence, the rule also specifies a 30% minimum level of ownership risk.

5.6 Index treatment of franking credits

5.6.1 All dividends considered in the model have been grossed up and assume that the shares have been held for the full 45 days.

5.7 Composite yield score

5.7.1 The Russell Australia High Dividend Index targets not only companies that pay high dividends but also companies that pay high "quality" dividends as measured by the Composite Yield Score. The Composite Yield Score model weighs the following five factors:

1. 3-year Average Forecast Dividend,
2. 5-year Average Trailing Dividend,
3. 3-year Forecast Dividend Growth,
4. 3-year trailing dividend growth, and
5. 5-year standard deviation of annual Earnings per Share.

These factors were selected as proxies for selecting stocks with high forecasted dividends, consistent dividends and a positive dividend growth trajectory.

5.7.2 The Composite Yield Score Model is focused primarily on penalizing those companies that pay sporadic dividends and also those companies whose dividends have been falling or are likely to fall in the future. By identifying better "quality" and higher growing dividends, the Composite Yield Score Model is designed to avoid one-time dividend payments and also looks to reduce future turnover.

The factors used in the model are not equally weighted; rather the factors are weighted by their relative importance in achieving the desired outcome.

The methodology for calculating these factors are outlined below.

5.8 3 year average forecast dividend

5.8.1 This is computed as the average of consensus analysts' median predicted dividends for the current fiscal year 1, 2 and 3 divided by the most recent price. Three year forecasted dividends are utilized to avoid companies that are unlikely pay out dividends consistently in the future, which will help to reduce future turnover.

It is calculated as follows:

$$\frac{\frac{1}{3}(Div_{FY1}+Div_{FY2}+Div_{FY3}}{P_t}$$

Where:
Div_{FY} = Forecasted dividend per share (grossed up) in Fiscal Year.
P_t = Current Price

5.9 5 year average trailing dividend

5.9.1 This is computed as the average dividend yield over the previous five fiscal years. Trailing dividends are utilized to provide an indication of a company's ability to pay dividends in the future.

Five year trailing dividend yields are utilized to avoid companies that are unlikely pay out dividends consistently in the future, which will help to reduce future turnover.

It is calculated as follows:

Dividends Per Share-Five Year Average
Market Price-Five Year Average Close

5.10 3 year forecast dividend growth

5.10.1 This is computed as the growth in grossed up dividends per share from fiscal year one to fiscal year three. The inclusion of this factor helps to identify the trajectory of the three year average forecasted dividend yield.

It is calculated as follows:

$$\frac{(Div_{FY3} - Div_{FY1})}{Div_{FY1}}$$

Where:
DivFY = Forecasted dividend per share (grossed up) in Fiscal Year.

5.11 3 year trailing dividend growth

5.11.1 This is computed as the growth in grossed up dividends per share over the past 3 years. The inclusion of this factor helps to identify the trailing trajectory of the average dividend yield.

It is calculated as follows:

$$\frac{(Div_{FY0} - Div_{FY-2})}{Div_{FY-2}}$$

Where:

Div_{FY} = Dividend per share (grossed up) in Fiscal Year.

5.12 5 year standard deviation of annual EPS

5.12.1 This is computed as the standard deviation of annual EPS (fiscal year) over the trailing 5 years. This measure is included to help avoid value traps and identify companies with less cyclical earnings patterns.

5.13 Factor scoring

5.13.1 In measuring a company's exposure to a particular factor we have used standardized scores. Standardized scores, or normalization, allow each company's factors to be converted to a common scale which can be easily interpreted and comparable.

Using the Forecasted Dividend Yield as an example, we calculate the difference between observed company's Forecasted Dividend Yield and the universe's weighted average Forecasted Dividend Yield and then divide the difference by the universe's Forecasted Dividend Yield standard deviation.

5.14 Forecasted dividend yield standardized score

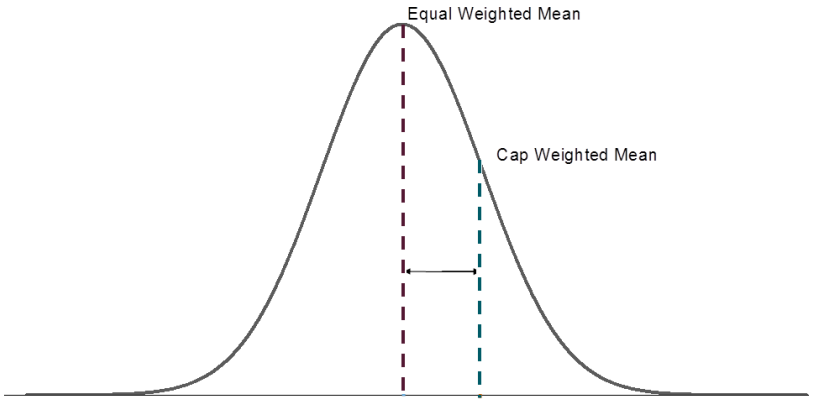
$$Z_{\text{FcstDivYie Id}_i} = \frac{\text{FcstDivYie Id}_i - \mu}{\sigma_{\text{FcstDiYield}}}$$

5.14.1 The use of standardized scores provides a simple measure of how many "standard deviations" an observation is away from the expected value; in this case the expected value is the capitalization weighted mean yield of the universe. For the Forecasted Dividend Yield, using a universe capitalization weighted mean of 5.5%, with a universe standard deviation of 2.8%, a company with a forecasted dividend yield 2.7% would produce a standardized score of -1. In other words, this company's dividend yield is one standard deviation below the universe average or alternatively is in the bottom quintile (16th percentile) of the universe.

5.15 Calculating the universe mean and standard deviation

5.15.1 The Z-scores are calculated using a capitalization weighted universe mean and an equally weighted universe standard deviation.

5.15.2 The capitalization weighted mean is used because it is the objective that we are trying to beat (i.e. greater dividend yield than the market). We try to illustrate this in the bell chart below where we have plotted the equal weighted mean (blue line) and assumed a capitalization weighted mean (orange line). The deviation we are concerned with, and want to capture, is the deviation away from the capitalization weighted mean.



5.15.3 The equal weighting on the standard deviations is used to better capture the underlying range of the variables and to reduce the dominance of large capitalization stocks determining the range size (see Adams, Lin and Ross 2002).[5]

[5] Securities with larger weights will impact the market value-weighted mean and deviate only moderately from that mean. A market value-weighted standard deviation would give large weights to large capitalization stocks and produce very small standard deviations and very large Z-scores. Using

Capitalization Weighted Mean

$$\mu_{factor} = \sum w_i Factor_i$$

Equal Weighted Standard Deviation

$$\sigma_{Factor} = \sqrt{\frac{(Factor_i - \mu_{Factor})^2}{n}}$$

5.16 Extreme values

5.16.1 At certain points we can have situations where an extreme value on a factor can arise (we define extreme value as +/- 2 standard deviations). When these values arise it suggests that there is an issue with the data or that potentially (most likely) the market is discounting the stock due to some other factor that is not captured in the model. For the index where we identify a stock has a particular factor score greater than +/- 2 standard deviations we set the Composite Yield Score to zero. The effect of setting the Composite Yield Score to zero is that the stocks weight in the final index will be determined by its market capitalization only.

5.16.2 Once a Composite Factor Yield Score is calculated for all stocks in the starting universe, these scores are then standardized using Z-Scores which provide a common scale which can be easily interpreted and used for comparison purposes among different stocks.

an equal weighted standard deviation in the Z-score calculation reduces the impact of large cap stocks on the standardization process and results in greater normality of the Z-scores.

Section 6

Periodic Review of Constituents

6.0 Periodic Review of Constituents

6.1 Semi-annual reconstitution

6.1.1 The index is reconstituted semi-annually using data as of the last business day in February and August.

6.1.2 The rebalanced index is implemented on the first business day in April and October.

These rebalance periods have been chosen to also coincide with the Australian company reporting season so that the reconstitution incorporates the latest analyst estimates.

Section 7

Corporate Actions and Events

7.0 Corporate Actions and Events

7.1 Full details of changes to constituent companies due to corporate actions and events can be accessed in the Corporate Actions and Events Guide for Non Market Cap Weighted Indices using the following link:
Corporate_Actions_and_Events_Guide_for_Non_Market_Cap_Weighted_Indices.pdf

A Corporate 'Action' is an action on shareholders with a prescribed ex date. The share price will be subject to an adjustment on the ex date. The index will be adjusted in line with the ex date.

These include the following:

- Capital Repayments
- Rights Issues/Entitlement Offers
- Stock Conversion
- Splits (sub-division) / Reverse splits (consolidation)
- Scrip issues (Capitalisation or Bonus Issue)

A Corporate 'Event' is a reaction to company news (event) that may impact the index depending on the index rules. For example, a company announces a strategic shareholder is offering to sell their shares (secondary share offer) – this could result in a free float weighting change in the index. Where an index adjustment is required FTSE Russell will provide notice advising of the timing of the change.

7.2 **Suspension of Dealing**

Suspension of Dealing rules can be found within the Corporate Actions and Events Guide for Non Market Cap Weighted Indices.

7.3 **Takeovers, Mergers and Demergers**

The treatment of takeovers, mergers and demergers can be found within the Corporate Actions and Events Guide for Non Market Cap Weighted Indices.

For more information about our indices, please visit ftserussell.com.