PENGANA
CAPITAL

PENGANA EMERGING COMPANIES FUND

Environmental, Social, and Governance (ESG) policy

We have managed the Pengana Emerging Companies Fund since 2004, with a strict and consistent process around risk controls and valuation disciplines. We have also used a number of ethical overlays which we formalise in this document in order to provide our investors with more information about our approach to non-financial criteria.

Our process includes a Qualitative Scoring Matrix which seeks formalise our assessment of factors such as management, history of delivery to targets and more recently, ESG factors. It is clear to us that companies with a strong focus on strong environmental, social, and governance practises prove to be the best long-term investments.

Below we break out the detail in our application of these qualitative factors in our assessment of potential investments. This should be read in conjunction with Pengana Capital Group's ESG policy. Pengana Capital is a signatory to the UN Principals for Responsible Investment (PRI), and a member of the Responsible Investment Association of Australia (RIAA).

Environmental impact

We favour investments which have a neutral to positive impact on the environment and avoid heavy polluters.

We do not invest in mining companies and have limited exposure to companies which provide services to this sector. We believe coal to be the most problematic commodity given its contribution to harmful emissions, and hence avoid service companies with an over exposure this sector. We also limit the total exposure in the portfolio to mining services stocks at 20%. We do not invest in fossil fuel energy generation.

Certain industries such as alternative waste management and renewable energy are favourably screened. Waste disposal to landfill is a major contributor to greenhouse gas hence recycling and landfill diversion is a priority. We seek renewable energy investments where the returns are predictable, and valuations allow for capital appreciation. This sector is heavily reliant on government incentive schemes, which can be unpredictable hence this needs to be factored into valuation parameters.

More generally, our discounted cash flow valuation methodology will naturally favour companies with low capital needs. Such industries tend to have low carbon footprints given the lack of assets such as factories and other carbon intensive infrastructure required to generate operating cash flow. White collar industries such as software, financials, services businesses etc feature heavily in our portfolio due to their low capital needs.

Social impact

We exclude certain industries which contribute to poor social outcomes, often with downstream health impacts. Tobacco manufacture, weapons, irresponsible lending, problem gambling etc are screened out. Our regular and intensive management meetings are often the best format to understanding the social impact of each company.

We strongly believe companies which provide debt finance to disadvantaged citizens at unreasonably high interest rates are problematic and have avoided this sector. This predatory lending often creates entrenched disadvantage. Gaming companies, which prey on problem gaming (e.g. pokie machines) are excluded, however those skewed to “leisure” gaming (e.g. lotto tickets) fall within our accepted level of social impact.

For retailers we look to identify companies which source product from factories which provide safe, remunerated conditions for their workers. Safety is also critical in the assessment of the culture of the company, especially in industries such as mining services, construction etc hence we closely monitor safety outcomes for such companies.

Certain industries such as healthcare, education, aged care, and childcare have positive social attributes to which we are favourably disposed.

Governance

The small cap sector is typically the home of entrepreneurial companies with founders retaining large shareholdings. It is therefore critical that such parties exercise their control without harming the interests of minority shareholders. This does not mean we exclude companies with large founder shareholdings (in fact it is more often a positive as it shows strong alignment of interests), however we strongly discount those companies where such shareholders are seen to place their interests above any other shareholders.

We believe management teams and boardrooms should reflect diversity in gender and background on the basis that such diversity creates a broad source and balance of idea generation and oversight.

The fund managers have been in small cap investing for over 25 years each, and firmly believe the judgement on governance is one which needs to be assessed on a case by case basis. Imputing quantitative measurements is not practical hence experience is paramount in assessing such factors.

We are not an activist fund

Importantly, our assessment of the merits of each investment applying ESG principals is the result of our own qualitative work. Where appropriate we source third party information - for example retailers sourcing product from the developing world are often rated by independent groups. However, we do not outsource our voting intentions to third party advisors. We would rather use our direct contact with management teams to form and express a view on the company’s capabilities and strategies.

We vote our shares in instances where we believe our voice is important in avoiding poor outcomes, however we are not an activist shareholder. We would not seek to invest in a flawed company in the hope of forcing change at board level to achieve an outcome. We would equally not invest in a company with poor ESG principals in the hope of agitating for change.