



# Product Review

## Pengana Australian Equities Fund

ISSUE DATE 11-10-2021

### About this Review

ASSET CLASS REVIEWED	AUSTRALIAN EQUITIES
SECTOR REVIEWED	AUSTRALIAN LARGE CAP
SUB SECTOR REVIEWED	ABSOLUTE RETURN
TOTAL FUNDS RATED	5

### About this Fund

ASIC RG240 CLASSIFIED	NO
FUND REVIEWED	PENGANA AUSTRALIAN EQUITIES FUND
APIR CODE	PCL0005AU
PDS OBJECTIVE	TO ACHIEVE OVER THE MEDIUM TO LONG TERM AN INVESTMENT RETURN IN EXCESS OF THE RBA CASH RATE PLUS A MARGIN TO COMPENSATE INVESTORS FOR THE EXTRA RISK ASSOCIATED WITH INVESTING IN AUSTRALIAN EQUITIES
INTERNAL OBJECTIVE	RBA CASH RATE PLUS 6% (NET OF FEES) OVER 3-5 YEARS
STATED RISK OBJECTIVE	LESS VOLATILITY THAN THE S&P/ASX ALL ORDINARIES INDEX
DISTRIBUTION FREQUENCY	SEMI-ANNUALLY
FUND SIZE	\$973M (JULY 2021)
FUND INCEPTION	01-07-2008
MANAGEMENT COSTS	1.076% P.A. (INCL. EXPENSES)
PERFORMANCE FEE	10.25% (OF PERFORMANCE ABOVE RBA CASH RATE PLUS 6% P.A. SUBJECT TO HWM)
RESPONSIBLE ENTITY	PENGANA CAPITAL LIMITED

### About the Fund Manager

FUND MANAGER	PENGANA CAPITAL
OWNERSHIP	PENGANA CAPITAL GROUP LIMITED (ASX: PCG)
ASSETS MANAGED IN THIS SECTOR	\$973M (JULY 2021)
YEARS MANAGING THIS ASSET CLASS	13

### Investment Team

PORTFOLIO MANAGER	RHETT KESSLER
INVESTMENT TEAM SIZE	5
INVESTMENT TEAM TURNOVER	LOW
STRUCTURE / LOCATION	ANALYSTS/SYDNEY

### Investment process

STYLE	CORE
BENCHMARK	RBA CASH RATE PLUS 6%
TYPICAL STOCK NUMBERS	20-40
TYPICAL CAPITALISATION BIAS	ALL-CAP (MID TO SMALL BIAS)
STOCK POSITION LIMITS	10% ON ACQUISITION, 15% AT MARKET
SECTOR POSITION LIMITS	UNCONSTRAINED
CASH LIMIT	MAXIMUM 100% (TYPICALLY 20%)
GLOBAL EQUITIES LIMIT	MAXIMUM 20%
DERIVATIVES USE	YES

### Fund rating history

OCTOBER 2021	RECOMMENDED
JULY 2020	RECOMMENDED
AUGUST 2019	RECOMMENDED

### What this Rating means

The 'Recommended' rating indicates that Lonsec has strong conviction the financial product can generate risk adjusted returns in line with relevant objectives. The financial product is considered an appropriate entry point to this asset class or strategy.

### Strengths

- Logical Australian Equity strategy targeting total returns, with a focus on drawdown risk mitigation.
- Chief Investment Officer/Senior Portfolio Manager Rhett Kessler is a highly experienced absolute return portfolio manager.
- Long-term track record of absolute returns and downside protection.

### Weaknesses

- The total fee load is relatively high, even with a hurdle on which performance fees can be earned.
- The Fund is managed by a relatively small investment team, albeit noting the targeted research approach.
- Very high key person risk in Kessler as CIO and lead Portfolio Manager.

### Fund Risk Characteristics

	LOW	MODERATE	HIGH
BUSINESS SUSTAINABILITY RISK		●	
CAPITAL VOLATILITY			●
FOREIGN CURRENCY RISK	●		
SECURITY CONCENTRATION RISK			●
SECURITY LIQUIDITY RISK		●	

Risk categories are based on Lonsec's qualitative opinion of the risks inherent in the financial product's asset class and the risks relative to other financial products in the relevant Lonsec sector universe.

### BIometrics

#### Aggregated risks

	1	2	3	4	5	6	7
STD RISK MEASURE						●	

A Standard Risk Measure score of 6 equates to a Risk Label of 'High' and an estimated number of negative annual returns over any 20 year period of 4 to less than 6. This is a measure of expected frequency (not magnitude) of capital losses, calculated in accordance with ASFA/FSC guidelines.

	LOW	MODERATE	HIGH
RISK TO INCOME		●	

### Features and benefits

	LOW	MODERATE	HIGH
COMPLEXITY			●
ESG	●		

We strongly recommend that potential investors read the product disclosure statement Lonsec Research Pty Ltd ABN 11 151 658 561 • AFSL No. 421 445 • This information must be read in conjunction with the warning, disclaimer, and disclosure at the end of this document. This report supersedes all prior reports.

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## Fee profile

	LOW	MODERATE	HIGH
FEES VS. UNIVERSE			●
FEES VS. ASSET CLASS			●
FEES VS. SUB-SECTOR			●

Fee Biometrics are a function of expected total fee as a percentage of expected total return.

## What is this Fund?

- The Pengana Australian Equities Fund ('the Fund') is a benchmark unaware, concentrated long only strategy of typically 20-40 stocks with a focus on achieving absolute returns and preserving capital. The Fund utilises a bottom-up fundamental research approach to invest in listed Australian securities that can generate a sustainable cash earnings yield with a margin of safety. The Fund aims to exceed the RBA Cash Rate plus 6% (net of fees) over rolling three to five-year periods.
- Pengana Capital Group ('the Manager' or 'Pengana') can invest up to 20% of the Fund (in aggregate) in non-Australian listed stocks, listed Australian hybrids, securities in exchange traded funds, listed bonds and derivatives. The Fund can also hold high levels of cash in the absence of attractive investment opportunities. The exposure will be consistently net long, with a neutral position of 80% long and 20% cash.
- The Fund aims to enhance and preserve investor's wealth over a five-year period. Its investment objective is to achieve an investment return, over the medium to long term, including capital appreciation, dividends and interest, in excess of the risk free rate (RBA Cash Rate target) plus a margin to compensate investors for the extra risk associated with investing in Australian equities (also known as the 'equity risk premium'). The Manager believes an appropriate equity risk premium is 6-7% p.a., which currently translates to an internal absolute return target of 7-8% p.a. over five years. The Manager also seeks a volatility of return less than that of the Australian Equity market.
- Lonsec expects the Fund's performance to be largely driven by its active stock positions and the Fund's allocation to cash, determined via bottom-up research and the Portfolio Manager's qualitative judgement. Investors should note that generally the Fund has a lower level of market exposure compared to more traditional long-only Australian Equity funds.
- The Fund is permitted to invest up to 20% of the portfolio in global equities. The Fund has not invested overseas to a significant extent to date and will actively manage any currency hedging overlay based on views around the Australian dollar.
- The Fund's track record indicates that its outperformance ratio is heavily skewed towards outperformance in declining markets, which is in line with its absolute return style and focus on capital preservation. In contrast, the Fund may underperform the broader market index during bullish economic conditions. Portfolio turnover has been low historically (i.e. less than 30% p.a.).
- The Fund charges a 1.076% p.a. Management Cost (including a management fee of 1.025% p.a., capped expense recovery fee of 0.04% p.a. and estimated

indirect costs of 0.011% p.a.) and a Performance Fee of 10.25% subject to several conditions. The conditions for payment of the Performance Fee are as follows: the Fund return must exceed the RBA Cash Rate plus 6% accumulated from the previous high water mark; the Performance Fee cannot reduce the Fund's net return below the RBA Cash Rate plus 6% for the period; and finally the Fund's Net Asset Value (NAV) must be equal to or above the high water mark. There is no performance reset hurdle in place. The total fee load places the Fund at the upper end of the broader Australian Equity peer group.

- According to the PDS dated 1 December 2020, the estimated performance fee was 0.656% p.a. of NAV (including GST) for the prior financial year. For the financial year ending 30 June 2020, the net transactional and operational costs were reportedly covered in full by the buy/sell spread. Net transaction costs are costs incurred in managing the fund (including explicit and implicit costs of buying and selling assets, the cost of hedging/protection strategies and/or when there are applications or redemptions of fund units by investors) that are not covered by the buy/sell spread. Buy/sell spreads are subject to change depending on market conditions. Refer to the Manager for current buy/sell spreads.

## Using this Fund

**This is General Advice only and should be read in conjunction with the Disclaimer, Disclosure and Warning on the final page.**

- The Fund is subject to equity market risks and movements (both positive and negative) in the prices of the underlying securities in the portfolio. Potential investors should therefore be aware of, and comfortable with, the potential for the Fund to experience periods of negative absolute returns, which may result in capital losses being incurred on their investment. Lonsec recommends that equity investments are suitable for investors with an investment time horizon of at least five years.
- The Fund is nevertheless managed with the aim of generating positive absolute returns and has the flexibility to vary the portfolio's asset allocation (i.e. global equities, hybrids, debt, derivatives and cash), which can introduce additional risks to investors. It is also expected that the Fund's performance may have a lower correlation to equity market indices than more traditional benchmark aware, long only Australian equity products. Lonsec considers it suitable for blending with other Australian equities strategies including core, value and growth style funds, small cap or benchmark aware products.

## Suggested Lonsec risk profile suitability

SECURE	DEFENSIVE	CONSERVATIVE	BALANCED	GROWTH	HIGH GROWTH
		●	●	●	●

For guidance on appropriate asset allocations and risk profiles, refer to the latest Lonsec Strategic Asset Allocation Review and Risk Profile Definitions on our website.

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### Changes Since Previous Lonsec Review

- The Pengana Australian Equities Income Fund was closed on 30 October 2020. This fund was managed by Mark Christensen and Chris Tan, who held dual roles as Portfolio Manager/Analyst. With the fund's closure Christensen and Tan are continuing in their roles as Analysts focused solely on the Pengana Australian Equities Fund.
- David Glasser joined the team as an Intern Analyst on January 2021 and was promoted to Investment Analyst in September 2021. His primary role will be to support the broader team.
- There has been no significant changes to the Manager and the Fund's processes since Lonsec's previous review.

### Lonsec Opinion of this Fund

#### People and resources

- Pengana Capital Group is a listed equities manager (ASX: PCG) founded in 2003 and based in Sydney. The Manager has over \$4.2bn in funds under management and operates a number of boutique investment teams across global equities, Australian equities and alternatives. On 9 March 2017 Hunter Hall International Limited ('Hunter Hall') proposed to merge with Pengana Holdings Pty Ltd, which was approved 1 June 2017. Hunter Hall acquired the outstanding shares of Pengana Holdings Pty Ltd in exchange for the issuance of approximately 74.1m Hunter Hall shares to be allotted to shareholders to form Pengana Capital Group. As part of this allotment, key personnel within the Pengana business were granted shares under a loan share plan in the now listed combined entity. This included portfolio managers Kessler and Anton du Preez of the Pengana Australian Equities team.
- Kessler is the Chief Investment Officer and Senior Portfolio Manager who is ultimately responsible for the Fund. Kessler has over 26 years of investment experience, including eight years at IAG Asset Management ('IAGAM'), where he held roles including Head of Research and Portfolio Manager for the IAGAM Absolute Return Fund. Kessler is the founding principal of the strategy having launched the strategy at Pengana in October 2007. Lonsec regards Kessler's investment experience and overall investment capability highly, considering him to be a quality investment professional with suitable experience in absolute return style investing.
- The investment team of five is relatively small in the context of the Manager's broad investment universe. That said, Lonsec notes the targeted research approach and concentrated, low turnover investment style allows the Manager to operate with a lower headcount than many of its peers. Additionally, Lonsec notes that the Manager looks opportunistically for investments and does not try to cover the entire universe in the way that a core-styled benchmark aware fund manager would. Pleasingly, Lonsec notes the recent addition of an Investment Analyst from the Fund's intern program and will continue to keenly monitor the resourcing of the investment team.
- Kessler is chiefly supported by Deputy CIO and Portfolio Manager du Preez, who joined Kessler at

Pengana in February 2009. du Preez has extensive portfolio management experience, having managed Australian, South African and Global Equity strategies in a value and market neutral style over a career spanning over 29 years prior to joining Pengana. Lonsec considers du Preez to be a highly capable and experienced investment professional who has formed an extensive and successful track record working alongside Kessler.

- The team has two experienced and high quality analysts in Chris Tan and Mark Christensen and have recently added an additional investment analyst via the Fund's intern program. Collectively, Lonsec considers the investment team to be suitably experienced and skilled.
- Pengana and the Fund's management team (Kessler and du Preez) share in the profits generated by their business unit in a 45/55 proportion, which helps promote the alignment of interests between Pengana and the investment staff. The alignment with end investors is further supported by the performance fee structure and the material investment in the Fund by Kessler. Lonsec is pleased to note that this arrangement remains unchanged since the merger between Hunter Hall and Pengana. Additionally, Lonsec is pleased with the additional retention efforts undertaken under the merger with key investment staff (Kessler and du Preez) granted shares of Pengana under a loan share plan with a five-year escrow period. Going forward, it is also understood that equity participation in some form may be broadened to include Tan and Christensen contingent on certain milestones being reached.
- There is a very high level of key person risk with Kessler due to the small team size, his decision making responsibilities within the investment team, and his central role in developing the investment process used by the Fund. This risk is lessened by Kessler's profit share agreement, share holding plan, his significant co-investment in the Fund, and the appointment of du Preez as his backup.

#### Research and portfolio construction

- The Manager has a conservative approach to investing and prefers companies with predictable after-tax cash flows with pricing power and resilient business models. The Manager will screen out stocks that are unable to generate an after-tax cash earnings yield of 6-8% p.a. with sustainable growth in the medium term. Stocks that have a short history, such as start-up companies are typically filtered out. The Manager tends to avoid companies with overly complex corporate structures and financially engineered entities. Lonsec believes this approach to be prudent and aligned with the Manager's philosophy of conservatism and capital preservation.
- Investment ideas are generated mainly through internal research and also from broker contacts. The Manager forms a qualitative view on each stock, which involves an assessment of management competence, business model resilience and industry structure. Company visits and discussions with company management, suppliers, and competitors are an important part of this process. Access to external research is considered a valuable resource in supplementing idea generation and understanding

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industries. Lonsec notes the lower level of research expertise in the Metals and Mining sectors but does not consider this to be a significant disadvantage, given the portfolio has a bias away from these sectors. Lonsec also believes the Manager's qualitative research to be detailed but somewhat lacking in breadth.

- Quantitative assessment includes a valuation component using a combination of proprietary and broker-sourced models. Internal models integrate cash flow, balance sheet and earnings analysis with the primary focus of determining the quantum and certainty of cash flows and determining a stock's return to shareholders within operating and financial leverage parameters. Lonsec believes this to be logical and consistently applied.
- The research process has a clear focus on downside risk and market exposure via the Manager's tactical cash allocations and derivative positions. Specifically, the Fund can hold up to 100% in cash if no suitable investment opportunities can be found that meet the Fund's investment criteria. Over the last three years, cash levels have ranged between 2-21% and averaging 11%. Lonsec notes that the Manager's cash allocation decision is driven by its bottom-up research, which differs from a number of its peers that may overlay macroeconomic views or other top-down considerations. Lonsec notes Kessler's input is critical to the Fund's tactical asset allocation.
- Lonsec considers the Fund's portfolio construction process to be relatively subjective and unconstrained in comparison to peers, allowing the Manager significant autonomy. Instead of price targets or stock rankings, position sizes are determined according to level of conviction, relative risk/reward profiles and market liquidity. As such, there is more art than science involved. However, Lonsec notes that the Manager has historically demonstrated a conservative approach to portfolio construction and has used its wide investment mandate predominantly to hedge or reduce portfolio risk. Having said that, the Fund has a reasonable allocation to mid/small cap stocks and concentrated sectors, which can increase overall risk levels. Over the longer term, Lonsec is reassured by the Manager's general adherence to its investment philosophy and Kessler's common sense approach to investing.
- Lonsec is mindful of the cash drag from the Fund consistently being less than fully invested and believes it is inefficient from a total portfolio construction and overall fee point of view. Since the Fund's inception cash weighting has fluctuated between 5-49%, with an average cash weight of 20-25%. That said, the cash allocation over the last three years has been trending downwards. Lonsec views positively the reduction in the Fund's cash level in line with the increased availability of bottom-up investment opportunities.
- While Lonsec considers the investment approach to be well-defined, the Fund's positions in fleet operators (e.g. SG Fleet) and financing companies (e.g. Credit Corp) is considered a deviation from the Fund's quality, defensible positioning. Additionally in Lonsec's view, position sizing in some cases appears to be discordant with the associated risks and the Fund's focus on capital preservation. Disappointingly,

these positions were among the biggest detractors to the Fund's performance during both the market drawdowns of 2018 and 2020. Lonsec will continue to monitor the Manager's propensity to own less liquid, lower quality stocks and will observe for greater adherence to the long-held investment philosophy in future reviews in order to maintain its conviction.

### ESG integration

- Whilst the Manager has articulated a commitment to the integration of ESG within their investment process, Lonsec observes little evidence in their public positioning and notes that ESG policies are accessible on the firm's website. Overall, Lonsec views the strength of this commitment to be behind peers in this sector.
- The degree of commitment to overall ESG factors within the Manager's ESG policy framework is adequate albeit disclosure of policies pertaining to voting and engagement are not easily accessible on the firm's website. This contrasts with industry norms.
- ESG factors are considered in the Manager's investment process to the extent that these factors may impact the performance of an investment over time. Furthermore, elements of ESG are visible within the valuation processes. On a peer relative basis, Lonsec considers the overall level of ESG integration within this Fund to be low to moderate.

### Risk management

- The Fund is run in a benchmark unaware fashion and does not have any formal tracking error constraints in keeping with the Fund's absolute return style. The Fund is also able to invest up to 100% in cash with the asset allocation decision intrinsically tied to stock valuations.
- Lonsec considers much of the Fund's risk management process to be within its bottom-up stock research process. In particular, the Manager seeks to invest in companies with defensive characteristics. The identification of such companies is largely the result of the detailed bottom-up assessment of quality and value. The Manager may also buy derivative protection (typically index puts) around events it deems as a potential catalyst for a drawdown event. The manager considers current market conditions are appropriate for a heightened level of protection. The Fund holds ASX 200 puts, as and when necessary.
- Portfolio positions are monitored daily to ensure the Fund adheres to portfolio constraints as well as monitoring liquidity and counterparty risk.
- Lonsec notes that the Manager's risk management process and systems are not as sophisticated as some of its peers. The risk management framework is broadly based on qualitative judgement and can be subjective in nature. Thematic exposures can be material given the Fund's low turnover, concentrated style. That said, risk is almost entirely managed in an absolute sense and Lonsec believes the systems used are adequate for monitoring portfolio risk.

### Capacity management

- As of 31 July 2021, the strategy was approximately \$973m in size. Lonsec notes the strategy has been the beneficiary of a material level of inflows in prior years. Subsequently, Pengana has informally soft

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closed the strategy, whereby attempting to limit FUM inflows to existing clients only.

- Pengana have stated that the strategy's theoretical maximum capacity is 0.5% of the free float adjusted market capitalisation of the small and mid-cap market. However, Kessler has indicated that he would be more comfortable managing around \$1bn, which is more conservative than the funds stated estimate capacity. Lonsec notes that the team is now actively managing 97% of this theoretical maximum capacity indicated by Kessler.
- Whilst there are positives and negatives to low or high levels of FUM, on balance (and all other factors being equal) Lonsec believes managers with smaller FUM are better placed to add value. As such, Lonsec believes that the Manager has the potential to confront liquidity issues and is less nimble in the market (as it takes a longer period of time for a position to be established or sold down) than peers with smaller FUM. This is particularly pertinent in times of market volatility as experienced in the recent calendar year.
- That said, Lonsec has a level of comfort that the Manager can effectively manage the strategy at current lower levels of FUM due to the flexibility of the mandate (ability to hold 100% cash, invest 20% offshore, all-cap nature of the portfolio), relatively conservative initial capacity estimate compared to peers and strong alignment/co-investment of interests with investors. The portfolio turnover of the strategy is also typically fairly low at below 30% p.a. Notwithstanding, Pengana will need to carefully manage the firmness of their capacity stance going forward for Lonsec to maintain conviction in their capacity management. The strategy's capacity will continue to be a key focus in future reviews to ensure that liquidity constraints are not detrimental to performance.

### Performance

- The Fund has comfortably achieved its internal performance target (RBA Cash Rate plus 6% p.a.) over all periods assessed, delivering an average outperformance of 1.3% p.a. above its internal performance target (all figures net of fees to 31 July 2021). Relative to the market returns (as measured by the S&P/ASX 300 Index) the Fund has generated an alpha of 0.7% p.a. over the ten-year period with similar risk levels. However, the Fund's performance have trailed the market in over the other periods assessed.
- Historically, the Fund's conservatism has resulted in lower volatility and drawdowns than the broader market. Notably, the Fund has outperformed in almost 80% of down markets since the Fund's inception. In contrast, the Fund has only outperformed in around 30% of up markets over the corresponding period. In recent years, however, the Fund has exhibited risk levels closer to the market, which has resulted in stronger correlations to equity markets.
- The Fund has tracked at a much higher level of volatility than its long term average since Q3 2018. Lonsec has noted that in recent market drawdown events the Fund had provided lower than expected capital preservation and higher than

expected correlation to equity markets. That said, Lonsec highlights that the recent Covid-19 induced drawdowns were non-financial in nature, and the Fund's experiences in prior drawdowns have been more instructive. Pleasingly in strong market conditions, the Fund returned 26.2% over the one-year period, outperforming the peer median of 1.9% but trailing the broader market by 3%.

### Overall

- Lonsec has maintained the Fund's rating as **'Recommended'**. Lonsec's rating is based on its high regard for Rhett Kessler as Portfolio Manager and the intuitive investment philosophy and process behind the strategy, which has a long track record of producing absolute return outcomes for investors. That said, the Fund has suffered from weaker performance more recently with instances of higher risk stock selection and general risk-return dynamics somewhat deviating from the Manager's long-held conservative investment philosophy. Lonsec will continue to monitor performance outcomes to maintain its current level of conviction in the Fund.

## People and Resources

### Corporate overview

The Fund was formerly managed by Pengana Holdings Pty. Ltd., the owner of Pengana Capital Limited, which was jointly owned by Pengana Staff, Directors and other minority interests (50.1%) and nabInvest (a wholly owned subsidiary of National Australia Bank, 49.9%).

On 9 March 2017, Hunter Hall International Limited proposed to merge with Pengana Holdings Pty Ltd, which was approved 1 June 2017. Hunter Hall acquired the outstanding shares of Pengana Holdings Pty Ltd in exchange for the issuance of approximately 74.1m Hunter Hall shares to be allotted to shareholders to form Pengana Capital Group.

As a combined funds management business, Pengana managed over \$4.2bn in FUM across global and Australian Equity strategies.

Pengana employs over 40 staff including approximately 20 investment professionals across offices in Sydney, Melbourne, and Singapore. The investment team responsible for this Fund is based in Sydney.

All of Pengana's underlying managers are boutique in nature with profit sharing arrangements in place with the responsible portfolio management teams and Pengana. Additionally, key members of the team are aligned to the headline business via the allotment of shares under a loan share plan, which have a five year escrow period from the date of the merger.

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## Size and experience

NAME	POSITION	EXPERIENCE INDUSTRY / FIRM
RHETT KESSLER	CIO/SENIOR PORTFOLIO MANAGER	26 / 13
ANTON DU PREEZ	DEPUTY CIO/PORTFOLIO MANAGER	29 / 12
MARK CHRISTENSEN	INVESTMENT ANALYST	21 / 7
CHRIS TAN	INVESTMENT ANALYST	27 / 5
DAVID GLASSER	INVESTMENT ANALYST	5 / <1
STEPHANIE DORAN*	TRADER	6 / 6

\* On maternity leave. Trading to be managed by Kessler and du Preez with support from Glasser.

**Rhett Kessler** (Chief Investment Officer & Senior Portfolio Manager) joined Pengana in October 2007. He was previously at IAG Asset Management ('IAGAM') for eight years. In addition to his role as Head of Research at IAGAM, he played an active role as a Joint Portfolio Manager for various wholesale funds totalling \$3.3bn. In 2005, he successfully launched and ran the IAGAM Absolute Return Fund. Prior to this he was a rated media analyst for UBS Australia for two years. Before emigrating from South Africa in 1996, Kessler successfully managed wholesale and retail equity portfolios as Deputy General Manager of Investment for Liberty Asset Management. Kessler holds bachelors degrees in Commerce and Accounting from the University of Witwatersrand, is a Chartered Accountant (SA) and a Chartered Financial Analyst.

**Anton du Preez** (Deputy CIO and Portfolio Manager) joined Pengana Capital in February 2009. Prior to this Du Preez was with Rand Merchant Bank ('RMB') for five years. In this role he managed a value proprietary fund in Australia for two years, and before that a similar RMB fund in South Africa. Before joining RMB, Du Preez was a Co-Principal of a market neutral hedge fund based in Cape Town, South Africa. Previously, he was a Director and Fund Manager at PSG Asset Management responsible for managing a global equity fund, which achieved top quartile performance on a consistent basis. Du Preez was a rated sell-side analyst with ABN Amro covering industrial and consumer sectors. Du Preez holds bachelors and honours degrees in Commerce and Accounting from the University of Stellenbosch and Pretoria, is a Chartered Accountant (South African and Canadian) and a Chartered Financial Analyst. Du Preez is also qualified as a Chartered Management Accountant (UK).

**Mark Christensen** (Investment Analyst) joined Pengana in October 2013 as an Investment Analyst within the Australian Equity team. Previously, Christensen was a research analyst at Morgan Stanley with experience covering Australian Consumer and Gaming equity out of Sydney and European Consumer Staples out of London across seven years. Prior to Morgan Stanley, Christensen was a chartered accountant at PricewaterhouseCoopers for five years.

**Chris Tan** (Investment Analyst) joined Pengana in September 2015 as an Investment Analyst within the Australian Equity team. Tan's most recent role was running the Manikay Partners Asia Pacific office. His prior career spans investment banking, trading and investing with senior roles at UBS and Deutsche Bank.

## Remuneration / Alignment of interests

Analysts receive a mixture of fixed and variable remuneration, which includes a competitive base salary and discretionary bonus. The variable component is based on a combination of qualitative and quantitative factors. The qualitative component involves an assessment of idea generation, research capability, and overall contribution to the business. The quantitative assessment focuses on the ability of analysts to identify stocks with sustainable earnings yield in the medium term. A profit sharing arrangement is in place between the investment team (Kessler and du Preez) and Pengana Capital Group in relation to the earnings of the Australian Equity business unit. Additionally, Kessler and du Preez are the only members of the team that were granted shares of the headline Pengana Capital Group as part of the merger.

## Research Approach

### Overview

RESEARCH PHILOSOPHY	BOTTOM-UP SEEKING QUALITY COMPANIES AT REASONABLE PRICES WITH A FOCUS ON CAPITAL PRESERVATION
INVESTMENT STYLE	QUALITY/VALUE
NO. OF STOCKS IN UNIVERSE	GREATER THAN 300
NO. OF STOCKS ACTIVELY RESEARCHED	80-180
KEY SCREENS	AFTER-TAX CASH EARNINGS YIELD OF 6-8% P.A.

The key inputs into the research process include company management, suppliers, customers, competitors (both listed and unlisted), broker research, investment banks and industry specialists. Broker research is an important input with regards to idea generation, understanding industries and facilitating meetings with company management.

The key areas of focus and the aims of the research process include:

- Management Competence: With a clear preference for companies with strong management and a track record of integrity.
- Business Model Resilience: Is business model transparent and predictable?
- Industry Structure: How much market power does company wield?
- After-tax Earnings Yield: Quantum and predictability of future earnings.

### Valuation

The primary valuation approach is after-tax cash earnings yield targets. A company's after tax cash earnings yield is calculated by taking the profit (EBITDA) and subtracting the working capital, maintenance capital expenditure, interest and tax to determine an earnings figure, which is divided by the size of the company. The after tax cash earnings yield is required to be at least 6% p.a. with reasonable certainty to grow to 10% plus yield within five years. This measurement of value tends to look for companies for which earnings are predictable and therefore are akin to an increasing annuity. Intrinsic value is also inferred from a number of other financial metrics such as price-to-earnings, return on equity and profit margins.

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## Portfolio Construction

### Overview

FUND BENCHMARK	RBA CASH RATE PLUS 6% P.A.
RETURN OBJECTIVE (INTERNAL)	SAME AS ABOVE
RISK OBJECTIVE (INTERNAL)	VOLATILITY OF RETURN LESS THAN THE AUSTRALIAN EQUITY MARKET
PORTFOLIO APPROACH	BENCHMARK UNAWARE
PORTFOLIO DECISIONS	ULTIMATE RESPONSIBILITY WITH CIO
STOCK SELECTION	BOTTOM-UP
TOP-DOWN INFLUENCE	5%
MARKET CAPITALISATION BIAS	ALL-CAP
TYPICAL NUMBER OF HOLDINGS	20-40
EXPECTED PORTFOLIO TURNOVER	APPROXIMATELY 30% P.A.
% OF PORTFOLIO IN TOP 10 HOLDINGS	47.4% (JULY 2021)

As the portfolio manager, Kessler is ultimately responsible for management of the Fund. Rather than strict valuation targets, position sizing is subjective and discretionary in nature. The portfolio is constructed in a benchmark unaware fashion where absolute positions are determined by the conviction, relative attractiveness, and market liquidity of the security. The Manager will tend to avoid being overly exposed to single factor risks, however sector concentration and market-capitalisation biases may result from the bottom-up process.

Buy decisions are based on the Manager's assessment of fundamental quality first, then its valuation. Other factors considered in the buy decision include non-fundamental factors such as appetite for risk, M&A, behavioural investing, and technical factors. A risk/reward assessment is undertaken no matter how compelling the valuation. Stocks may be sold if the Manager believes company fundamentals have changed or its potential for achieving cash earnings yield is compromised. Portfolio turnover has been low-moderate historically at circa 20-30% p.a.

The cash allocation decision is primarily driven by bottom-up valuation and the Fund will generally be more heavily invested in cash when few opportunities are presented. Nonetheless, the Fund has held an average cash buffer of approximately 20-25% since inception.

## Risk Management

### Risk limits

SEPARATE INVESTMENT RISK MONITORING	YES
STOCK	MAXIMUM 15% OF NAV (10% OF NAV AT ACQUISITION)
SECTOR	UNCONSTRAINED
TRACKING ERROR	8-12% P.A. (NOT TARGETED)
CASH	0-100% (TYPICALLY 20%)
GLOBAL EQUITIES	0-20%

The Manager views risk from an absolute return standpoint, rather than viewing risk as differences in performance against a market benchmark. As a benchmark unaware Manager, the Fund can take sizeable positions away from the benchmark, including material allocations into cash. The Fund may also use a number of derivative strategies in gaining and adjusting stock-specific positions or market exposure and as a means of managing the Fund's overall risk profile.

### Risk monitoring

Risk is primarily managed at the security level through the adherence to the investment process. The Portfolio's risk positions are monitored daily by Pengana's risk officer and Chief Investment Officer Nick Griffiths using a combination of Bloomberg and in-house risk management systems.

### Currency hedging

The Fund is permitted to invest up to 20% of the portfolio in global equities. Pengana will actively manage any currency hedging overlay based on its fundamental views around the Australian dollar.

## Risks

**An investment in the Fund carries a number of standard investment risks associated with investment markets. These include performance, liquidity, counterparty, market and tax risks. These and other risks are outlined in the PDS and should be read in full and understood by potential investors. Lonsec considers the following to be the major risks:**

### Equity market risk

Investments in equity markets are subject to numerous factors, which may have an impact on the performance of an investment (both positive and negative). Unexpected changes in economic, technological, structural, regulatory or political conditions can have an impact on the returns of all investments within a particular market.

### Derivatives risk

The Manager has scope to implement various derivative strategies with the objective of mitigating equity market or currency risks or gaining exposure to an investment. Lonsec does not expect this to be a widely adopted strategy. The Fund's net portfolio exposure will never be short overall and derivatives cannot be used to leverage the Fund.

ANALYST: JIMMY LUO | APPROVED BY: HONG HON

# Pengana Australian Equities Fund

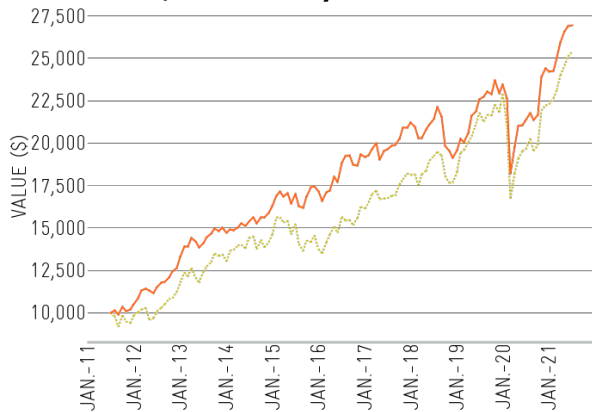
## Quantitative Performance Analysis - annualised after-fee % returns (at 31-7-2021)

### Performance metrics

	1 YR		3 YR		5 YR		10 YR	
	FUND	PEER MEDIAN	FUND	PEER MEDIAN	FUND	PEER MEDIAN	FUND	PEER MEDIAN
PERFORMANCE (% PA)	26.16	24.27	7.99	7.99	7.44	6.87	10.42	-
STANDARD DEVIATION (% PA)	10.60	9.79	16.74	12.85	13.61	11.63	11.25	-
EXCESS RETURN (% PA)	-2.97	8.69	-1.70	2.82	-2.70	1.00	0.66	-
OUTPERFORMANCE RATIO (% PA)	33.33	75.00	41.67	61.11	41.67	53.33	45.00	-
WORST DRAWDOWN (%)	-2.03	-2.22	-23.12	-16.96	-23.12	-19.34	-23.12	-
TIME TO RECOVERY (MTHS)	2	2	8	12	8	10	8	-
SHARPE RATIO	2.46	2.46	0.42	0.45	0.45	0.52	0.74	-
INFORMATION RATIO	-0.90	1.41	-0.30	0.40	-0.46	0.05	0.10	-
TRACKING ERROR (% PA)	3.30	6.04	5.73	5.93	5.89	5.38	6.66	-

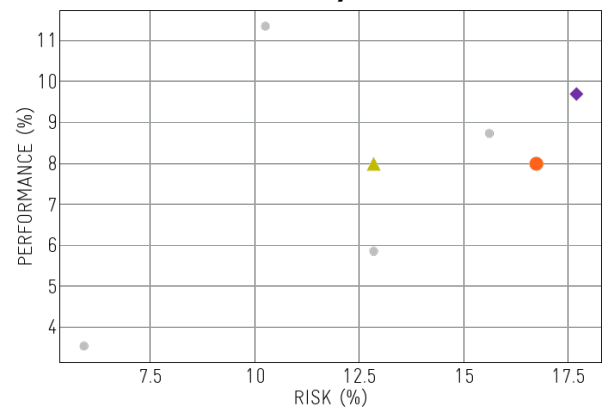
PRODUCT: PENGANA AUSTRALIAN EQUITIES FUND  
 LONSEC PEER GROUP: AUSTRALIAN EQUITIES - AUSTRALIAN LARGE CAP - ABSOLUTE RETURN  
 PRODUCT BENCHMARK: S&P/ASX 300 TR INDEX AUD  
 CASH BENCHMARK: BLOOMBERG AUSBOND BANK BILL INDEX AUD  
 TIME TO RECOVERY: NR - NOT RECOVERED, DASH - NO DRAWDOWN DURING PERIOD

### Growth of \$10,000 over 10 years



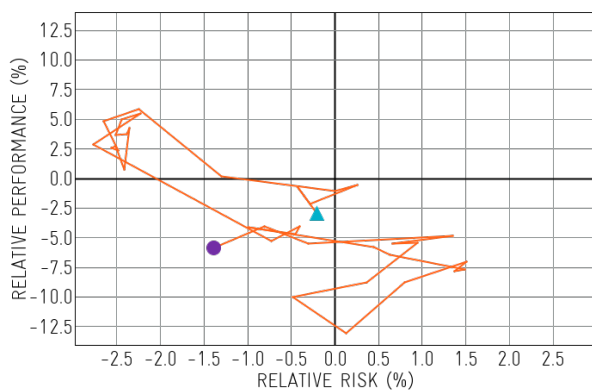
— PENGANA AUSTRALIAN EQUITIES FUND  
 ..... S&P/ASX 300 TR INDEX AUD

### Risk-return chart over three years



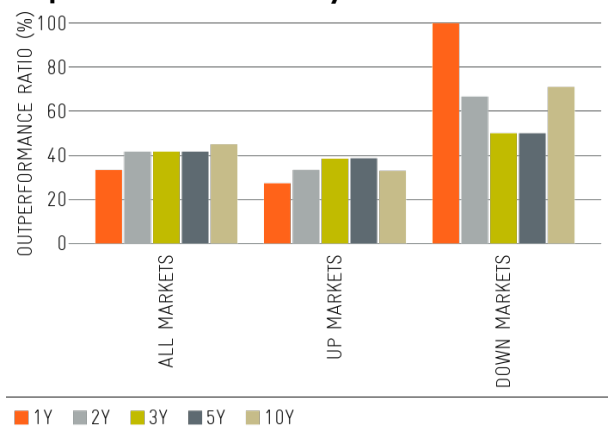
● PENGANA AUSTRALIAN EQUITIES FUND  
 ◆ S&P/ASX 300 TR INDEX AUD  
 ▲ PEER MEDIAN  
 ● PEERS

### Snail trail



● START (07-2018) ▲ END (07-2021)

### Outperformance consistency



■ 1Y ■ 2Y ■ 3Y ■ 5Y ■ 10Y



## Pengana Australian Equities Fund

### Glossary

**Total return** ‘Top line’ actual return, after fees  
**Excess return** Return in excess of the benchmark return  
**Standard deviation** Volatility of monthly Absolute Returns  
**Tracking error** Volatility of monthly Excess Returns against the benchmark (the Standard Deviation of monthly Excess Returns)  
**Sharpe ratio** Absolute reward for absolute risk taken (outperformance of the risk free return (Bank Bills) / Standard Deviation)  
**Information ratio** Relative reward for relative risk taken (Excess Returns / Tracking Error)  
**Worst drawdown** The worst cumulative loss (‘peak to trough’) experienced over the period assessed  
**Time to recovery** The number of months taken to recover the Worst Drawdown  
**Snail Trail** A trailing 12-month relative performance and relative risk measurement over the benchmark. The trail is generated using a 12-month rolling window over the specified period

### About Lonsec

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