ISSUE DATE 05-09-2023

Lonsec

5 Highly Recommended

Product Review
Pengana Emerging Companies Fund

About this Review

ASSET CLASS REVIEWED	AUSTRALIAN EQUITIES
SECTOR REVIEWED	AUSTRALIAN SMALL CAP
SUB SECTOR REVIEWED	CORE / STYLE NEUTRAL
TOTAL FUNDS RATED	23

About this Fund

ASIC RG240 CLASSIFIED	NO
FUND REVIEWED	PENGANA EMERGING COMPANIES FUND
APIR CODE	PER0270AU
PDS OBJECTIVE	TO OBTAIN RETURNS GREATER THAN THE S&P/ASX SMALL ORDINARIES ACCUMULATION INDEX OVER ROLLING THREE YEAR PERIODS AFTER FEES.
INTERNAL OBJECTIVE	TO OUTPERFORM THE BENCHMARK BY 5% P.A. AFTER FEES OVER ROLLING THREE-YEAR PERIODS
STATED RISK OBJECTIVE	TRACKING ERROR NOT SPECIFICALLY TARGETED HOWEVER EXPECTED TO BE IN THE RANGE OF 6-9% P.A.
DISTRIBUTION FREQUENCY	SEMI-ANNUALLY
FUND SIZE	$671M (JULY 2023)
FUND INCEPTION	NOVEMBER 2004
ANNUAL FEES AND COSTS (PDS)	2.1% P.A.
PERFORMANCE FEE	20.5% (OF FUND RETURN ABOVE INDEX, WITH HIGH WATER MARK)
RESPONSIBLE ENTITY	PENGANA CAPITAL LIMITED

About the Fund Manager

FUND MANAGER	PENGANA CAPITAL LIMITED
OWNERSHIP	50% PENGANA HOLDINGS, 25% STEVE BLACK & 25% ED PRENDERGAST
ASSETS MANAGED IN THIS SECTOR	$671M (JULY 2023)
YEARS MANAGING THIS ASSET CLASS	18

Investment Team

PORTFOLIO MANAGER	STEVE BLACK, ED PRENDERGAST
INVESTMENT TEAM SIZE	2
INVESTMENT TEAM TURNOVER	NIL
STRUCTURE / LOCATION	CO-PORTFOLIO MANAGER / SYDNEY

Investment process

STYLE	STYLE NEUTRAL
BENCHMARK	S&P/ASX SMALL ORDINARIES ACCUMULATION INDEX
TYPICAL STOCK NUMBERS	50-70
TYPICAL CAPITALISATION BIAS	SMALL CAP
KEY PORTFOLIO LIMITS	STOCK: INDEX +7%; SECTOR: ABSOLUTE 20%
MAX. OF ISSUED CAPITAL OF ANY ONE STOCK	10%
MAX. CASH LIMIT	10%
MIN. MARKET CAPITALISATION	$25M
CAPACITY	$800M

Fund rating history

SEPTEMBER 2023	HIGHLY RECOMMENDED
OCTOBER 2022	HIGHLY RECOMMENDED
SEPTEMBER 2021	HIGHLY RECOMMENDED

What this Rating means

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

Strengths

- The Fund's Co-Portfolio Managers, Ed Prendergast and Steve Black, are highly experienced, having built a strong pedigree in Australian small cap investing.
- The investment approach of the Fund is long-standing, with a strong track record over multiple market cycles.
- The Manager has shown a strong commitment to capacity management.

Weaknesses

- The Fund's total fee load is at the upper end of the peer group.
- The Fund is approaching its stated capacity target.
- High Key Person Risk in both Portfolio Managers.

Fund Risk Characteristics

	LOW		MODERATE		HIGH
BUSINESS SUSTAINABILITY RISK			●		
CAPITAL VOLATILITY					●
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 7 equates to a Risk Label of 'Very High' and an estimated number of negative annual returns over any 20 year period of 6 or greater. 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			●		

ANALYST: MATTHEW TURNBULL | APPROVED BY: ROBBIE LEW

Pengana Emerging Companies Fund

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 Emerging Companies Fund ('the Fund') is an actively managed, bottom-up, long only Australian equities product. The portfolio is typically holding between 50-70 stocks. The Fund's internal performance objective is to outperform the S&P/ASX Small Ordinaries Accumulation Index ('the Index') by 5% p.a. (net of fees) over rolling three-year periods.
- The Fund's investment approach that Lonsec would broadly characterise as a 'style neutral' investment style. Pengana Capital ('the Manager') focuses heavily on stocks which it considers to be 'under-researched' in the small and micro-cap market, believing that limited broker coverage in the smaller end of the market leads to greater pricing inefficiencies existing relative to the large cap market.
- The Manager places an emphasis on identifying the quality factors exhibited by companies. This assessment is then overlaid with valuation measurements. The Manager's investment philosophy has not changed since the inception of the Fund in 2004. Investors should note that the Manager's philosophy leads to the exclusion of resources and mining, A-REITs and biotech stocks from the Fund's investable universe. The emphasis on quality also means the Fund is likely to outperform peers in 'down' markets but that it may underperform in 'up' markets.
- The Fund is managed in a reasonably active fashion (with ex ante tracking error not being a key risk measure) and the portfolio is generally well diversified. Lonsec believes that diversification is particularly important in the small cap sector, given the level of risk associated with many individual small companies, although it is also worth noting that diversification comes at the cost of reducing the weight to a Manager's best ideas.
- The Fund's PDS dated 15 September 2022, has disclosed Annual Fees and Costs (AFC) totalling 2.104% p.a., comprising (1) management fees and costs of 1.334% p.a., (2) a performance fee of 0.66% p.a., and (3) net transaction costs of 0.11% p.a. In line with RG97, some fees and costs have been estimated by the issuer on a reasonable basis, and the actual fees and costs may vary to these estimates.
- The Fund's performance fee of 20.5% is payable where the performance of the Fund exceeds the S&P/ASX Small Ordinaries Accumulation Index plus 1.334% p.a. (the performance hurdle). The performance fee is calculated and accrued daily, and paid semi-annually from the Fund. Performance fees are subject to a high water mark with no reset periods (if the cumulative accrued performance fee amount is negative for any performance fee period, the Fund will need to make up this underperformance in future periods before a performance fee is payable).
- The Fund also charges buy/sell spreads set at 0.20% upon entry and 0.20% upon exit. These spreads are subject to change, most notably during periods of market volatility, and can be sourced from the Manager's website.

Using this Fund

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

- Lonsec notes that the Manager has produced a Target Market Determination ('TMD'), which forms part of the Responsible Entity's Design and Distribution Obligations for the Fund. Lonsec has collected the TMD that has been provided by the Manager and notes that this should be referred to for further details on the Target Market Summary, Description of Target Market and Review Triggers.
- Small cap funds invest in a market that is less liquid and more volatile than the large cap Australian equity market. This Fund should be used to complement large cap exposure in clients' portfolios, rather than replace it, with up to one-fifth of the Australian equities component of a portfolio typically being invested in small caps depending on client risk preferences. Lonsec's model portfolio asset allocation is limited to 'Growth' and 'High Growth' risk profiles.
- The Fund is subject to equity market risk and movements (both positive and negative) in the share prices of the underlying securities in the portfolio. Investors should therefore be aware that the Fund may experience periods of negative returns and that there is a risk of potential 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.

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.

Changes Since Previous Lonsec Review

- There have been no material changes to the investment process or team since the previous review.

Lonsec Opinion of this Fund

People and resources

- Lonsec considers the two-person investment team of Steve Black and Ed Prendergast to be one of the most highly experienced in its Australian equities small cap peer group. The pair have built a proven track record and strong reputation in small cap investing, with both having been co-Portfolio Managers of the Fund since its inception in November 2004. Lonsec is pleased to observe the partnership continues to function successfully.
- Whilst noting the excellent experience of the investment team, the team size of two is smaller than the peer group average. Moreover, given the 'boutique' nature of the Manager, the investment

team does not have access to the range of in-house resources generally enjoyed by larger, institutional peers (such as quantitative resources or dedicated dealers). While this is considered to be a disadvantage to some extent, Lonsec notes the partnerships in place with Pengana Capital (marketing and infrastructure support) and BNP Paribas (back office functions) allow the team to focus on research and portfolio management rather than non-investment functions, a luxury not always afforded to other boutique investment teams.

- On 1st June 2017, Pengana Holdings Pty Ltd merged its business with Hunter Hall International Limited (Hunter Hall). 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, Pengana Capital Group. Lonsec is pleased to observe that the corporate merger has had no impact on the investment team.
- Lonsec considers the alignment of interests between the investment team, Pengana and end investors to be strong. The boutique structure in place whereby the portfolio managers and Pengana each own 50% of the business, allowing for performance fees earned to be passed through to equity-holders in the form of higher dividends. The alignment with end investors is further supported by the co-investment into the Fund by both Black and Prendergast.
- Lonsec considers key person risk ('KPR') in Black and Prendergast to be high. The current co-Portfolio Manager structure has a natural lower level of KPR compared to structures reliant on one lead Portfolio Manager, a structure adopted by some small cap teams. KPR is further mitigated by the equity stake held in the business by Black and Prendergast and the performance fee structure. However, the departure of either Black or Prendergast would result in Lonsec reassessing the current rating. Lonsec notes that at present, there is no succession plan in place. Whilst the team remain fully committed to the strategy, Lonsec will look for an articulation of a succession plan at future reviews.

Research and portfolio construction

- Given the nature of the Manager's investment approach, a significant proportion of the research effort involves contact with company management. Lonsec considers the volume of company contact undertaken by the team to be a relative attraction of the Fund, believing that the ability to assess the quality of management and their ability to deliver on their respective business strategies to be a crucial element of small cap investing. Lonsec observes the broader research effort to be predominantly 'bottom-up' in nature, with company-specific and financial analysis conducted to generate sufficient levels of conviction relevant to valuation targets.
- Fundamental company analysis focuses on assessing the predictability and visibility of earnings with close examination of qualitative factors that are expected to affect profit drivers. Discounted Cash Flow ('DCF') is the primary valuation methodology used to derive a company's intrinsic value with consideration of additional valuation metrics where necessary. Whilst Lonsec considers the Manager's research process to be in-line with comparable peers, albeit somewhat less structured. This is a reflection of the investment team's approach, preferring to remain nimble to account for the idiosyncrasies present at this end of the market capitalisation spectrum. Lonsec is comforted in this aspect by the Manager's long term and successful track record of applying the process to small cap investing.
- A key driver of weighting considerations within portfolio construction is the upside to assessed valuation derived from DCF modelling in conjunction with the Quantitative Scoring Matrix ('QSM'), a qualitative assessment of company traits that are difficult to accurately incorporate into valuation models. The QSM encompasses factors such as valuation confidence, history of cash flow delivery and stock liquidity amongst others.
- Black and Prendergast as co-Portfolio Managers are equally accountable for portfolio construction which is driven by their judgement and skills rather than a specific set of rules. All decisions involving more than a 0.5% change in portfolio weight must be agreed upon by both Portfolio Managers. Lonsec notes the portfolio construction process is highly intuitive, any concerns about the less structured investment process are outweighed by the co-Portfolio Managers extensive co-tenure working together and their experience in small caps investment management. Stocks are typically included in the portfolio based on a three-year view. Sell decisions are driven by positions either reaching their target price, a change in fundamental view of the stock or relatively more attractive companies being available.
- While Lonsec considers the portfolio to be actively managed, Lonsec highlights that a small portion (typically 8-10%) of the portfolio are stocks held to hedge against the portfolio diverging too far from the Benchmark. This risk mitigation policy has been in place for the last 13 years and is considered by Lonsec to be a pragmatic way of managing benchmark risk.

ESG Integration

- Lonsec's ESG integration assessment considers how rigorous, robust and structured the ESG process for the Fund is as well as how well it integrates into the overall investment process and the Manager's overall policy and reporting framework. The assessment is not intended to assess the underlying holdings of the Fund's portfolio or the Manager's adherence to any form of impact, green / sustainable or ethical standards.
- At the corporate level, Lonsec views Pengana's overall ESG policy framework and disclosure as lagging peers. The Manager has an articulated commitment to their integration of ESG within their investment process with evidence of a policy framework and improved public positioning. The ESG policy is publicly available and remains rather generic compared to peers. Pleasingly the policy lightly touches on the engagement framework, however no reporting on engagement outcomes is publicly available. While the Manager does not provide any details on their proxy voting policy, voting records for certain funds are publicly available.
- The Manager has indicated that their Responsible Investment style is 'ESG Integration' and as such

they take Environmental, Social and Governance factors into consideration when assessing investment opportunities. With a primary ESG style of 'Risk or Value' Managers will determine inclusion based on the balance of overall risk (including ESG risk) and potential return. As a result, this approach may mean that lower quality ESG companies may be included if the return potential is sufficient, and this may conflict with some client's perception of what a strong ESG process would deliver.

- Within the management of this specific Fund, Lonsec notes:
  - The Manager has a very limited range of external data providers with limited structured data collection evident. The Manager relies on collecting its own ESG data through company meetings and web sites. Lonsec believes that this is less robust than peers.
  - There are clear signs of robust ESG elements as a core component of the Manager's research process. While research is undertaken in a structured manner, it provides less measurable outputs than in some leading Managers. Research storage and calibration is not as strong as in leading Managers.
  - There are clear links from the Manager's research to the stock selection process through the Manager's incorporation of ESG factors in their price targets. This adjustment is applied on using a standardised model enhancing appropriate calibration of ESG incorporation.
  - While there is monitoring of ESG characteristics of the portfolio across several ESG and sustainability dimensions, this plays no clear role in overall portfolio construction. The Manager targets the ESG score of the portfolio based on the Manager's own proprietary ESG scores.
  - While engagement is a component of the Manager's approach, it is managed in a less structured manner than with some leading peers. There is no structured system for prioritising engagements, tracking outcomes or for measuring success.
  - Compliance monitoring of ESG factors is deemed adequate, however overall transparency provided to investors is lagging. Pleasingly, voting on the Fund is directed by the Fund's Portfolio Managers directly.

Risk management

- Risk management is inherently built into the Manager's focus on investing in 'quality' companies. The Fund also has 'hard' stock limits in place with regards to the stock and sector limits and these exposures are monitored daily. The above mentioned benchmark-risk portion of the portfolio is an additional tool that is utilised to calibrate risk levels.
- Lonsec notes the Fund has greater levels of diversification compared to small-cap peers and the Manager has consistently demonstrated a strong sell discipline, both of which reflect the strong risk management culture of the investment team. Lonsec notes that beyond the mandated risk and exposure limits, risk-control decisions can be largely qualitative and subjective in nature, guided by the portfolio managers' experience and judgement.
- Lonsec considers the Manager to have adequate risk management parameters and tools in place to sufficiently monitor portfolio risks such as stock and sector exposures. In addition to compliance checks undertaken by Pengana Capital, risk management is augmented via weekly exception reporting conducted by BNP Paribas.

Capacity Management

- The Manager currently manages $671m in Australian small caps as at July 2023. Lonsec notes the Manager is currently accepting 'new' investors into the Fund due to a decrease in FUM since the previous review. The Fund had been 'soft' closed for many years as the Manager actively manages flows to keep it comfortable within capacity limits. Lonsec is pleased that the Manager has historically demonstrated strong capacity discipline.
- Lonsec's view is that managing high levels of FUM is more difficult, as it reduces the ability to trade in and out of less liquid stock positions without market impact. In addition to disadvantages with trading, large FUM may also result in a number of substantial shareholder positions. These occur when a shareholder's position is greater than 5% of a total company's shares. For substantial holdings, shareholders must quickly notify the market of any trading activity in the stock.
- The investment team has been more proactive than many of its peers in managing the capacity of the Fund, showing an impressive awareness of the negative performance implications that can result from managing large amounts of FUM in the small cap sector. This approach has been partly driven by Black's prior portfolio management experience where he was responsible for managing a small cap fund with a high level of FUM. The Manager has set a capacity limit for the strategy at 0.5% of the market capitalisation of the S&P/ASX Small Ordinaries Accumulation Index.

Fees and costs

- Lonsec considers the total fee load for the Fund (AFC of 2.104% p.a.) to be amongst the highest in the peer group, impacted in part by the Fund's disclosed performance fee cost of 0.80% p.a. Lonsec also notes that the hurdle for the performance fee is low relative to its performance target, there is no cap on the level of performance fees paid and that the Manager can accrue a performance fee where fund performance is negative, although it cannot be paid. While cognisant of the overall fee load, Lonsec sees this as justified to a degree due to the Manager's strong capacity management discipline.
- The buy/sell spread is set at +/-0.20%, and the net transaction costs disclosed under the RG97 reporting regime are 0.11% p.a. The net transaction costs of 0.11% p.a. implies the Fund's buy/sell spread is too narrow and this will be a watchpoint going forward.

Product

- The Fund is a small companies equity strategy that invests across a relatively diversified portfolio of Australian stocks. Lonsec does not consider it to be operationally challenging to implement. Additionally, the Manager employs high quality 'tier 1' service

Pengana Emerging Companies Fund

providers. However, Lonsec notes that the Fund uses a related party Responsible Entity ('RE') which may lead to conflicts which need to be managed. Lonsec notes this RE relationship has been stable since the inception of the Fund and there have been no issues with any service providers for the Fund since last review.

Performance

- The Fund's internal performance objective is to outperform the Index by 5% p.a. (after fees) over rolling three-year periods. The following performance commentary is quoted on an after fee basis for the period ending 31 July 2023.
- Over three year period, the Fund generated an absolute return of 11.7% p.a., outperforming the Benchmark and peer group median by 5.8% p.a. and 1.4% p.a., respectively. As a result of the solid outperformance, the Fund generated superior risk-adjusted returns to the peer group median (as measured by the Sharpe and Information Ratios) over the three year timeframe. Pleasingly, the Fund has met the internal performance objective.
- The Fund returned 4.1% in absolute terms over the most recent 12-month period, to outperform the Benchmark by 3.4%. The Fund did however underperform the peer group median by 3.2%. Over this period, key contributors to performance were positions in Technology One, AUB Group and IVE Group, while key detractors were positions in City Chic Collective, Aussie Broadband and Healius.
- A notable feature of the Fund is its resilient 'down' market outperformance over long market cycles except during broad-based market drawdowns. A function of the Manager's focus on quality and management competence, the Fund has outperformed in 65% of 'down' markets over the ten-year period ended 31 July 2023.

Overall

- Lonsec has maintained the Fund's **'Highly Recommended'** rating at its latest review. Lonsec continues to hold in high regard the co-Portfolio Managers, Steve Black and Ed Prendergast, who it considers to be two highly qualified investors with a strong pedigree in small cap investing. The pair have built a strong track record having managed the Fund through multiple market cycles since 2004. Additionally, the boutique structure of the Fund offers strong alignment with investors.
- Lonsec notes that the Fund is approaching its capacity limit. Having said that, Lonsec is also pleased to observe the Manager's continued discipline with regards to managing capacity. Furthermore, the Fund's total fee load is at the upper end of the peer group.

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 1st June 2017, Pengana merged its business with Hunter Hall International Limited (Hunter Hall).

The merger was effected by Hunter Hall acquiring all the shares in Pengana in return for the issuance of approximately 74.1 million Hunter Hall shares to Pengana shareholders. Following the merger, Hunter Hall shareholders own approximately 27% and Pengana shareholders own approximately 73% of the issued equity of Hunter Hall, comprising approximately 101.5 million shares post transaction. On completion of the merger Hunter Hall was renamed Pengana Capital Group Limited (Pengana).

As a combined funds management business, Pengana manages approximately $3bn in FUM, as at July 2023, across global and Australian equity strategies. Pengana employs over 50 staff including approximately 17 investment professionals across offices in Sydney and Melbourne. The directors and staff currently own circa 41% of the business. 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.

Size and experience

NAME	POSITION	EXPERIENCE INDUSTRY / FIRM
STEVE BLACK	PORTFOLIO MANAGER	27 / 18
ED PRENDERGAST	PORTFOLIO MANAGER	29 / 18

Pengana employs a flat team structure with Black and Prendergast equally responsible for managing the portfolio. From Lonsec's observations there is a very collegiate environment at Pengana with the two team members working closely in all aspects of the research and portfolio construction process. Back office and administration functions have been outsourced to BNP Paribas and Pengana Capital is responsible for marketing.

Prior to joining Pengana, Black spent ten years at Goldman Sachs JBWere firstly as a small caps analyst then eight years as portfolio manager of the Emerging Leaders Fund. Under the management of Black, the Goldman Sachs JB Were Emerging Leaders Fund had a sustained period of strong performance.

Prior to joining Pengana with Black, Prendergast spent 11 years as a broker predominately at ABN AMRO and Citigroup. During his time at Citigroup, Prendergast was well regarded, including being the BRW industry survey's number one rated small cap analyst in 2003 and 2004 (a survey of industry participants, including peers).

Pengana Emerging Companies Fund

Remuneration / alignment of interests

The Manager is entitled to a performance fee of 20.5% for after-fee returns above the Index. As Black and Prendergast are each significant stakeholders in the business; the performance fee serves to further align their interests with investors by incentivising them to outperform the Index and recoup any underperformance. In addition, both Black and Prendergast are co-invested in the Fund further aiding their alignment of interests with end investors.

Research Approach

Overview

INVESTMENT STYLE	STYLE NEUTRAL
NO. OF STOCKS IN UNIVERSE	800
INVESTMENT UNIVERSE	AUSTRALIAN AND NEW ZEALAND COMPANIES LISTED OUTSIDE THE S&P/ASX50.
NO. OF STOCKS FULLY MODELED	~300 UP TO DATE LIVE MODELS
KEY SCREENS	MIN MARKET CAP $25M – EXCLUDE BIOTECH, A-REITS & RESOURCE COMPANIES
TOP-DOWN	0%
BOTTOM-UP	100%
QUALITATIVE ANALYSIS	MANAGEMENT QUALITY
RESEARCH INPUTS	EXTENSIVE COMPANY CONTACT – INDUSTRY-BASED FEEDBACK VIA UNLISTED COMPANIES
USE OF BROKER RESEARCH	PRIMARILY USED TO ASSESS ALTERNATIVE ASSUMPTIONS AND VALUATIONS MADE BY THE INVESTMENT COMMUNITY
VALUATION APPROACH - PRIMARY	DCF
VALUATION APPROACH – SECONDARY	P/E RATIO, EV/EBITDA RATIO, DIVIDEND YIELD

The research process is not overly structured and is designed to be flexible to account for the vagaries of the small capitalisation universe and each company's specific idiosyncrasies. Company views are determined by fundamental research inputs and a valuation (primarily DCF). The valuation process will also include a mix of factors where necessary including, one-year forecast price earnings (P/E) multiples, one-year forecast Enterprise Value / Earnings before Interest Tax and Amortisation (EV/EBITA) multiples, dividend yield, market capitalisation.

All invested stocks are modelled with consideration for cash flows, profit & loss and balance sheet strength to assist in determining individual company valuations and price targets.

Portfolio Construction

Overview

FUND BENCHMARK	S&P/ASX SMALL ORDINARIES ACCUMULATION INDEX
RETURN OBJECTIVE (INTERNAL)	TO OUTPERFORM THE INDEX BY 5% P.A. OVER ROLLING THREE YEAR PERIODS
RISK OBJECTIVE (INTERNAL)	TRACKING ERROR 6-9% P.A.
PORTFOLIO DECISIONS	CO PORTFOLIO MANAGERS
STOCK SELECTION	BOTTOM UP
TOP-DOWN INFLUENCE	INPUT ONLY
TYPICAL NUMBER OF HOLDINGS	50-70
MARKET CAPITALISATION BIAS	SMALL CAP
EXPECTED PORTFOLIO TURNOVER	40-60%
OBSERVED ACTIVE SHARE	>80%
% OF PORTFOLIO IN TOP 10 HOLDINGS	39.2% (JUNE 2023)

Portfolio construction is conducted jointly by Black and Prendergast with the objective to build a highly diversified portfolio of 'best ideas'. Stock weights are primarily driven by the upside to assessed valuation as well as a Qualitative Scoring Matrix ('QSM'). The QSM accounts for qualitative inputs which are difficult to incorporate within the valuation model. In building the final portfolio, the co-portfolio manager's will use their best judgement in considering both the valuation output and recommended QSM weight for each stock. Other considerations at this stage include ensuring an appropriate level of diversification within the final portfolio, maintaining stock and total portfolio liquidity and overall risk management.

Accountability for the portfolio lies equally with both Black and Prendergast. Individual attribution analysis is not undertaken for each of the Portfolio Manager's in-part due to the collaborative portfolio construction process and veto rights each has on any position. All decisions involving more than a 0.5% weight change in a stock in the portfolio must be agreed upon between the two of them.

Stocks are typically included in the portfolio based on a three-year view. Sell decisions are driven by positions either reaching their target price, a change in fundamental view of the stock or relatively more attractive companies being available. Pengana will not sell down a position singularly based on falling share prices, but such price changes may provoke reassessment of the company's fundamentals which may result in the position being subsequently removed.

Risk Management

Risk limits

SEPARATE RISK MONITORING TEAM	YES
MAX. OF PORTFOLIO IN ANY ONE STOCK	INDEX +7%
MAX. OF PORTFOLIO IN ANY ONE SECTOR	20%
MAX. OF ISSUED CAPITAL OF ANY ONE STOCK	10%
MAX. CASH LIMIT	10%
MINIMUM MARKET CAPITALISATION	$25M

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There are broad upfront portfolio limits in place around individual stocks and sectors. While not targeted, the Fund will also typically demonstrate a Tracking Error of 6-9% over time which is largely in-line with peers. Unlike some peers, cash cannot exceed 10% of net asset value and the Fund is likely to be mostly fully invested over time.

Risk monitoring

Given the focus on valuation and the exclusion of higher risk companies (such as biotechs and resources), risk management is part of the research and stock selection process. Portfolio risks are managed at the portfolio construction stage via a series of risk limits.

The Fund's custodian, BNP Paribas, provides weekly exception reporting, which acts as a separate compliance resource.

In addition, the Manager uses the Bloomberg PORT and MAS tools to monitor factors such as cross-correlation between stocks, tracking error and marginal risk contribution at the individual security and portfolio level on a monthly basis. Also the Manager has implemented FactSet, giving the team full attribution capabilities at the stock, sector and portfolio levels, as well as a suite of risk-factor analytical tools.

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.

Liquidity risk

Investments that trade less or are smaller in nature can be more difficult or more costly to buy, or to sell, than more liquid or larger investments. It may not be possible to sell or otherwise dispose of illiquid securities both at the price and within a time period deemed desirable by the Investment Manager.

Derivatives risk

The Manager has scope to implement various derivative strategies with the objective of mitigating equity market risks. Lonsec notes that derivatives have never been used to-date and will generally be restricted to using futures as a method of investing residual cash balances. Derivatives cannot be used to leverage the Fund.

Lonsec

Pengana Emerging Companies Fund

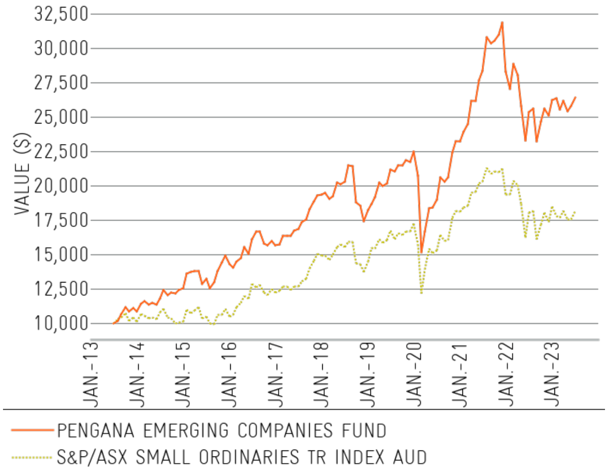
Quantitative Performance Analysis - annualised after-fee % returns (at 31-7-2023)

Performance metrics

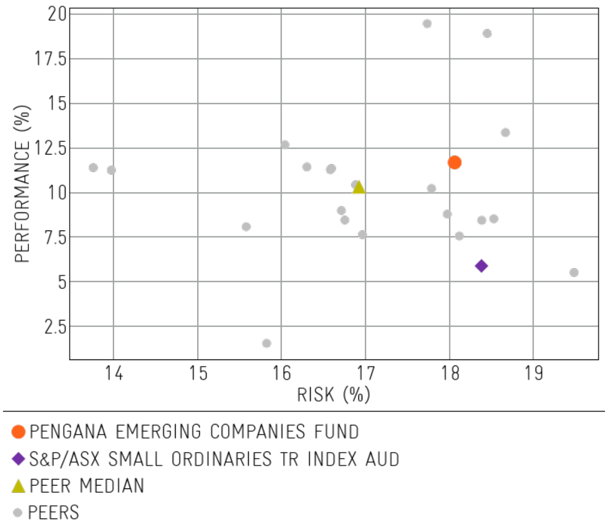
	1 YR		3 YR		5 YR		10 YR	
	FUND	PEER MEDIAN	FUND	PEER MEDIAN	FUND	PEER MEDIAN	FUND	PEER MEDIAN
PERFORMANCE (% PA)	4.14	7.30	11.68	10.33	5.45	5.92	10.22	9.43
STANDARD DEVIATION (% PA)	14.62	14.76	18.06	16.92	21.61	20.74	17.08	17.07
EXCESS RETURN (% PA)	3.38	6.54	5.79	4.44	2.27	2.74	4.03	3.25
OUTPERFORMANCE RATIO (% PA)	50.00	58.33	61.11	58.33	55.00	56.67	55.00	57.50
WORST DRAWDOWN (%)	-9.28	-9.04	-27.13	-23.89	-32.58	-29.06	-32.58	-29.21
TIME TO RECOVERY (MTHS)	4	2	NR	NR	9	7	9	8
SHARPE RATIO	0.07	0.29	0.58	0.53	0.20	0.21	0.50	0.43
INFORMATION RATIO	0.53	1.07	0.89	0.77	0.32	0.45	0.61	0.58
TRACKING ERROR (% PA)	6.42	6.42	6.52	6.14	6.99	5.86	6.59	5.70

PRODUCT: PENGANA EMERGING COMPANIES FUND
LONSEC PEER GROUP: AUSTRALIAN EQUITIES - AUSTRALIAN SMALL CAP - CORE / STYLE NEUTRAL
PRODUCT BENCHMARK: S&P/ASX SMALL ORDINARIES TR INDEX AUD
CASH BENCHMARK: BLOOMBERG AUSBOND BANK BILL INDEX AUD
TIME TO RECOVERY: NR - NOT RECOVERED, DASH - NO DRAWDOWN DURING PERIOD

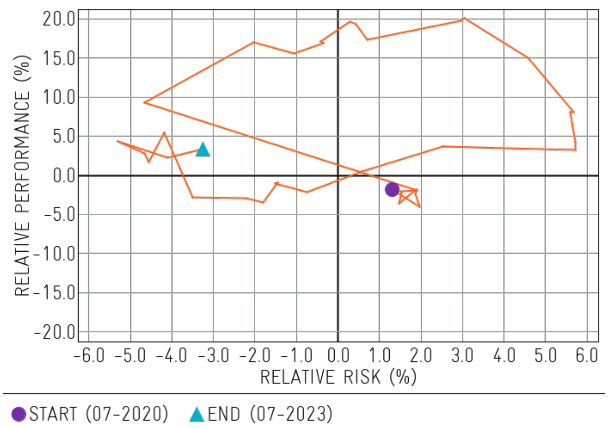
Growth of $10,000 over 10 years



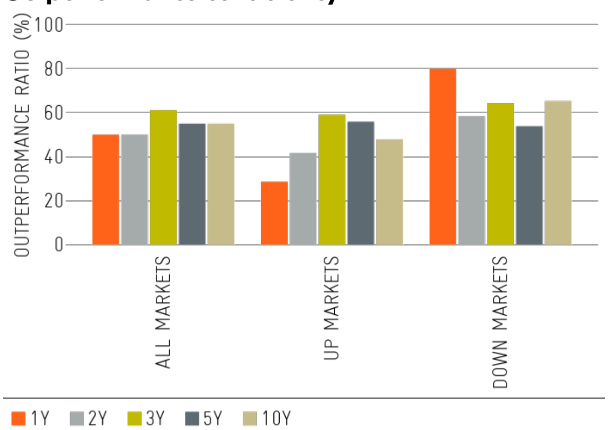
Risk-return chart over three years



Snail trail



Outperformance consistency



ANALYST: MATTHEW TURNBULL | APPROVED BY: ROBBIE LEW

Pengana Emerging Companies 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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