Lonsec

Recommended

Product Review
Pengana Private Equity Trust

About this Review

ASSET CLASS REVIEWED	ALTERNATIVES
SECTOR REVIEWED	GROWTH ALTERNATIVES (HIGH)
SUB SECTOR REVIEWED	PRIVATE EQUITY
TOTAL COMPANIES RATED	7

About this Trust

ASIC RG240 CLASSIFIED	YES
LIT REVIEWED	PENGANA PRIVATE EQUITY TRUST
ASX CODE	PE1
PDS OBJECTIVE	TO GENERATE, OVER AN INVESTMENT HORIZON OF AT LEAST 10 YEARS, ATTRACTIVE RETURNS AND CAPITAL GROWTH THROUGH A SELECTIVE AND DIVERSIFIED APPROACH TO PRIVATE MARKETS, INCLUDING PRIVATE EQUITY, PRIVATE CREDIT, AND OTHER OPPORTUNISTIC INVESTMENTS
INTERNAL OBJECTIVE	8% TO 14% P.A. NET OF FEES OVER AN INVESTMENT HORIZON OF AT LEAST 10 YEARS.
DISTRIBUTION POLICY	SEMI-ANNUALLY
MANAGEMENT COSTS	1.25% P.A.
PERFORMANCE FEE	20% (8% P.A. HURDLE RATE NET OF RE/MANAGEMENT FEES)
RESPONSIBLE ENTITY	PENGANA CAPITAL LIMITED

Market data

MARKET CAPITALISATION	$292M
UNITS ON ISSUE	239M
UNIT PRICE (24-9-2020)	$1.22
52 WEEK HIGH/LOW UNIT PRICE	$1.69 / $0.99
NAV (31-8-2020)	$1.20
52 WEEK HIGH/LOW NAV	$1.35 / $1.19
UNIT PRICE PREM/(DISC) TO NAV	1.34%

About the Fund Manager

FUND MANAGER	GROSVENOR CAPITAL MANAGEMENT, L.P.
OWNERSHIP	PRIVATELY-OWNED (PENDING LISTING ON THE NASDAQ)
ASSETS MANAGED IN THIS SECTOR	US$33.0BN (JUNE 2020)
YEARS MANAGING THIS ASSET CLASS	21

Investment Team

PORTFOLIO MANAGER	FRED POLLOCK
INVESTMENT TEAM SIZE	48
STRUCTURE / LOCATION	COMMITTEE/GLOBAL

Investment process

PERMITTED INVESTMENTS	PRIVATE EQUITY, PRIVATE CREDIT, OPPORTUNISTIC INVESTMENTS AND CASH
MARKET CAPITALISATION BIAS	MIDDLE MARKET
LEVERAGE	UP TO 25% AT FUND LEVEL & IN UNDERLYING FUNDS

Trust rating history

SEPTEMBER 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.

Scope of this rating

- Lonsec has used its Managed Funds research process in forming an opinion on this Listed Investment Trust's (LIT or Trust) ability to meet its stated investment objectives. The extent of any 'point-in-time' divergence between PE1's unit price and its underlying Net Asset Value (NAV) per unit is not part of the ratings consideration.
- Lonsec does consider whether structural or management issues could potentially lead to a LIT trading at a significant discount to its NAV over an extended period of time without any recourse for unitholders. This aspect forms part of the wider qualitative and quantitative assessment that Lonsec undertakes when assessing the relative investment merits of a LIT.

Strengths

- Grosvenor has a strong track record in private markets spanning over 20 years and a highly qualified investment team applying a thorough and robust investment process.
- Being listed on the ASX provides investors with daily liquidity for an illiquid asset class.
- The Trust will be highly diversified across companies, industries and vintages once fully built out.

Weaknesses

- The dual layer of management and performance fees leads to a relatively high fee load compared to peers and very high in absolute terms.
- The portfolio is not expected to reach its target allocation until 2022-23 with a high cash balance initially, reducing the incentive to invest during this period, particularly given the high fees charged.
- The LIT may be highly correlated to the broader equity market and exhibit high volatility.
- Investing in co-mingled vehicles may reduce the portfolio constructions maneuverability and may lead to a lumpier NAV return profile.

ISSUE DATE 25-09-2020

ANALYST: MATTHEW O'NEILL | APPROVED BY: DARRELL CLARK

Pengana Private Equity Trust

Trust Risk Characteristics

	LOW	MODERATE	HIGH
BUSINESS SUSTAINABILITY RISK		●	
CAPITAL VOLATILITY			●
CREDIT RISK			●
FOREIGN CURRENCY EXPOSURE		● (moderate–high)	
INTEREST RATE RISK		●	
LEVERAGE RISK			●
REDEMPTION 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 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		●	

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 Trust?

- The Pengana Private Equity Trust ('the Trust' or ASX code: 'PE1') is a Listed Investment Trust ('LIT') trading on the ASX following its listing on 30 April 2019. Pengana Capital Limited has engaged Grosvenor Capital Management ('Grosvenor' or 'the Manager') as the investment manager of the Trust, which seeks to provide investors with a diversified set of exposures to private markets, including private equity, private credit, and other opportunistic investments. Investments are predominantly made through Grosvenor's co-mingled funds, although can be directly through vehicles managed by third-party investment managers. PE1 aims to achieve returns in the range of 8% to 14% p.a. net of fees over an investment horizon of at least 10 years.
- The Trust also targets a cash distribution yield equal to 4% p.a. (pro-rated on a non-compounded basis) of the Trust's NAV (excluding the total value of the Alignment Shares). The Trust's distributions are not franked. Pengana has also established a distribution reinvestment plan.
- The Trust's fees are 1.25% p.a. for the Responsible Entity and management fee and a 20% performance fee over a hurdle rate of 8% p.a. (net of Responsible Entity/management fees). Further, the Trust has more than one layer of management and performance fees. The Trust's investments including underlying Grosvenor funds are subject to both management and performance fees, and those underlying investments may also be subject to management and performance fees by the General Partner ('GP'). As per the PDS dated 11 February 2020, the fee disclosure for the Trust is as follows: management costs of 2.64% p.a. comprised of a management fee and Responsible Entity fee of 1.25% p.a. of NAV (in aggregate), estimated performance fees of 0.00% p.a., estimated secondaries management and carried interest fees of 0.17% p.a. and estimated indirect costs of 1.24% p.a.
- Further, as per the PDS date, the Responsible Entity has also estimated the transactional and operational costs of the Trust for the financial year ending 30 June 2020 (adjusted to reflect a 12-month period) will be 0.63% p.a. These costs are incurred in managing the Trust's assets including explicit and implicit costs of buying and selling assets, borrow costs and the cost of hedging/protection strategies. These costs are reflected in the NAV of the Trust and are borne by investors, but they are not paid to the Responsible Entity or the Manager. Refer to the PDS for further details on fees and costs.
- PE1's NAV is struck monthly in arrears. It should be noted that many of the underlying investments are valued quarterly. Third-party pricing information may not be available regarding a significant portion of investments in certain asset classes, and in some circumstances may rely on valuation models that Grosvenor has created in order to value the assets and calculate the account value. In these instances Grosvenor's valuations will be reviewed by a third-party firm (i.e. Duff & Phelps or Value Research Company) once a year on a rotational basis.
- The Trust has the capacity to employ leverage directly up to 25% of the Trust's NAV excluding short-term borrowing, deferred purchase price obligations (i.e. when a portion of the purchase price for an investment is paid after closing rather than up-front) and guarantees. Pengana have stated that this facility is only intended to be used to manage the timing of cashflows related to capital calls and distributions and that the modelling suggests that this facility may not be used. The Manager first requires approval from Pengana to apply leverage of more than 15%. The underlying funds will also employ leverage from time-to-time in a variety of ways and the 'look-through' level of gearing is expected to be moderate.
- The Trust also comprises Alignment Shares which were valued at 5% of the total subscription raised during the Trust's IPO. As at 31 August 2020 these compromise approximately 2.04% of the Trusts NAV. The Alignment Shares are convertible preference shares in Pengana Capital Group (PCG). The Alignment Shares rank above ordinary shares in the event of a wind-up of PCG. Approximately two years after the listing of PE1, the Responsible Entity intends to distribute the Alignment Shares to PE1 unitholders and they will automatically convert into ordinary shares in PCG.

Pengana Private Equity Trust

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Using this Trust

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

- As a predominately private markets fund (equity and debt assets), Lonsec considers this Fund should likely be funded from within either the global equity or alternative growth components of a diversified portfolio. The Trust is suitable for higher risk profile investors with investment time horizons of over five years.
- The Trust is subject to equity market risk and movements (positive and negative) in the prices of the underlying investments in the portfolio. As such, the Trust is likely to exhibit high volatility and moderate-to-high correlation to global equities. Investors should be aware that the Trust may experience periods of negative returns and that there is a risk of capital loss being incurred on their investment. Lonsec also notes that there is risk of the Trust trading to a discount to NAV given the complexity of the strategy and expected volatility.
- Lonsec notes that investing in private markets is not without additional risks, and investors' tolerance for alternative asset specific risks (such as those associated with the use of leverage, underlying illiquidity and estimated asset pricing) should also be considered.
- The Trust will also have investments in private credit. Private credit tends to have an intermediate or long-term liquidity profile. It offers potential for excess returns relative to traditional credit. The lack of correlation between private credit and traditional credit, along with the protection of covenants in the loan documents, may help to mitigate downside risk in a well-diversified portfolio.
- The Trust invests in assets that are largely denominated in non-A$ currencies. The Trust will generally be unhedged for foreign currency movements and therefore currency fluctuations may significantly impact the value of the Trust.
- PE1 may pay unfranked distributions from capital, particularly in the early years, which could lead to the unit price reducing equal to the portion of capital distributed. The distribution policy may exacerbate reductions in the capital base at times of negative capital returns, especially during market downturns and periods of heightened market volatility. Investors should also seek professional tax advice to further evaluate any implications from the distribution policy to their personal circumstances.

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

- On 13 March 2020 given the COVID-19 induced market volatility experienced in Q1-2020 Pengana announced to the ASX that the Trust's Secondary Offer had been withdrawn. The ASX was then notified on 11 June 2020 that the Trust would be undertaking a one-for-three non-renounceable Rights Issue at $1.25. Throughout July 2020 PE1 then raised approximately $93.5m through the Rights Issue (with part of the shortfall allocated to sophisticated investors), as well as having placed additional securities with sophisticated investors utilising part of the Trust's 15% placement capacity.
- As such, the Trust's NAV as at 31 August 2020 was approximately $288.4m and the Trust has progressed with its planned build-out since listing. That said, the current portfolio still comprises a significant portion of cash and cash like investments (65%) although close to half of this comprises capital commitments to existing investments. Over the period PE1 has made further commitments to the GCM Grosvenor Co-investment Opportunities Fund II, which closed in April 2020 with a final commitment size of US$540m, and the GCM Grosvenor Multi-Asset Class Fund II, which had its final funding round close in December 2019 with a commitment size of US$983m. Since inception PE1 has also now made commitments to eight primary funds and four secondary funds. While the secondary investments have been made directly, it is expected that Grosvenor will open initial funding rounds for a new co-mingled secondaries vehicle in Q4-2020 and it is expected that PE1 will seek to commit capital to this investment when possible.
- In January 2020 the Trust paid its first distribution of $0.025 per unit for the period ending 31 December 2019, the Trust has also since paid two distributions of $0.0125 per unit for the three-month periods ending 31 March 2020 and 30 June 2020. Going forward the Trust still intends to pay distributions on a semi-annual basis.
- From 1 July 2020 Pengana has flagged the intention to target a cash distribution yield equal to 4% p.a. payable semi-annually (pro-rated on a non-compounded basis) of the Trust's NAV (excluding the total value of the Alignment Shares). This was first communicated in the Trust's Product Disclosure Statement (PDS) as being an aspirational target post 1 July 2021.
- Over the 12-month period to 1 August 2020, across the investment team Grosvenor has had six departures and five additions at the Principal level and above. These include but are not limited to, Managing Director within the private equity team focused on the EMEA regions, Arnaud Lipkowicz, departed the Manager in March 2020 after 12 years at the firm. Lipkowicz was also a member of the private markets Investment Committee. Head of Infrastructure Vikram Bhaskar departed the Manager in November 2019, Bhaskar was also a member of the Investment Committee. As such, Brian Sullivan who leads the secondaries team has since joined the private markets Investment Committee and continues to be a member of the GCM Grosvenor Multi-Asset Class Fund II Investment Committee. Recent hires include:

- Managing Director, Kevin Nickelberry joined the co-investment team in April 2020.
- Executive Director, Ravi Mehta joined within the Strategic Investments Group in May 2019.
- Principal, Jason Kesner joined within the Strategic Investments Group predominantly focussed on illiquid credit investments in March 2020.
- Managing Director, Amy Wierenga, joined in May 2020 as Chief Risk Officer and is responsible for global risk strategy and oversight.

- On 3 August 2020 Grosvenor announced that it will become a public company through a merger with CF Finance Acquisition Corp. (NASDAQ: CFFA), a special purpose acquisition company sponsored by Cantor Fitzgerald. Grosvenor's existing senior management team will continue to lead the business and there is not expected to be any material changes to the equity holdings of the existing management and investment team. The deal is expected to close in Q4-2020.

Lonsec Opinion of this Trust

People and resources

- Established in 1971, Grosvenor has been investing in private markets since 1999 and currently has over US$56.2bn in assets under management across absolute return strategies, private equity, real estate and infrastructure. Grosvenor is headquartered in Chicago and has offices in New York, Los Angeles, London, Tokyo, Hong Kong and Seoul. The investment team across private equity, infrastructure, real estate and strategic investments totals 80 with the team loosely structured according to Primaries, Co-investments, Secondaries, and Opportunistic (which aims to provide some flexibility for tactical allocation shifts).
- Grosvenor announced in August 2020 the intention to become a public company, it is expected that the existing senior management team will continue to lead the business and there is not expected to be any material changes to the equity holdings of the existing management and investment team. Lonsec does not currently have any material concerns regarding the listing, although will seek to monitor these developments.
- The Trust's Investment Committee is responsible for all investment decisions related to the Trust. It includes Grosvenor's President Jonathan Levin (Chair), as well as Jason Metakis, Bradley Meyers, Brian Sullivan and Fred Pollock. Pollock is also the Trust's named Portfolio Manager and firm's Chief Investment Officer (CIO). Lonsec notes that the Investment Committee is well-experienced, with an average firm tenure of nine years and average investment experience of 20 years.
- In addition to being the Trust's Portfolio Manager and firm's CIO, Pollock also leads the Strategic Investments Group and is a member of the separate Private Markets and Absolute Return Strategies Investment Committees. Lonsec believes that these other roles help provide a broad perspective on global markets and are complimentary to his role as Portfolio Manager. Pollock has 16 years' investment experience, five of which gained at Grosvenor.
- While investment decisions are undertaken by the Trust's Investment Committee, all new investments also require the approval of Grosvenor's Operations Committee. Lonsec believes that this dual-approval structure to be best practice, although noting that it is reasonably common for private equity managers. The use of an Investment Committee also helps to reduce key person risk. The Operations Committee is also well-experienced, with an average firm tenure of 16 years and average investment experience of 24 years.
- Overall, Grosvenor's investment team is considered to be highly qualified, to have strong experience in investing in private markets and be well-resourced. The Private Equity Team comprises 48 professionals and executes private equity investments across primary funds, secondaries, and co-investments. In addition, Grosvenor has 58 investment professionals within absolute return strategies that focus on liquid, intermediate, and illiquid special situations credit strategies and a 12-member Strategic Investments Group led by Pollock, which sources, underwrites and structures opportunistic investments, primarily by executing direct investments and co-investments.
- Grosvenor also has a well-resourced 15-person Operational Due Diligence Team, who are members of the Finance and Legal Departments and are separate to the investment team. The Operational Due Diligence Team is responsible for separately reviewing investments and managers from a structuring and operations perspective firm-wide and includes members with legal, audit, tax, technology and securities experience.
- Grosvenor has in excess of 400 underlying investment manager relationships with commitments in over 940 underlying funds and over 249 active Co-investment opportunities. Lonsec considers Grosvenor's significant position in the private equity landscape provides several key advantages versus smaller peers. One such advantage is the ability to get continued access and preferred allocations into oversubscribed funds due to its existing relationships with General Partners (GPs). Grosvenor also has an active presence as an adviser to underlying managers, with Advisory Board seats on over 40% of its mid-market buy-out fund investments. Lonsec also notes that Grosvenor tends to be much more willing than competitors to invest in GPs based in second or third tier cities. Lonsec believes this is a potential advantage and also indicates the breadth of coverage of the Manager.
- Lonsec notes that the Manager and investment team are highly aligned to the performance of the programme in a variety of ways, including employees having invested over US$450m of capital alongside that of clients, incentive fees being linked to performance outcomes, annual bonuses being based on both individual performance and the success of the firm and numerous key members of Grosvenor's management team (including investment professionals) participating in a profit share of the firm. Overall, Lonsec believes the strength of the alignment to be a key positive for the Trust although largely in line with peers.

Research and portfolio construction

- The Trust seeks to invest in a range of private markets investments with the target allocation range for each being; primaries (15-30%), co-investments (15-30%), secondaries (15-30%), private credit (5-15%), opportunistic (10-25%) and cash/short duration public credit (2-10%). The Manager intends for the portfolio to be fully built-out after three to four years post inception, and to be highly diversified with exposure to in excess of 500 underlying companies.
- Overall, Lonsec believes Grosvenor's due diligence process for new investment opportunities is detailed and considered, leveraging the collective senior expertise of the investment team via well-resourced investment committees. Pleasingly, Lonsec highlights that the Manager is highly selective in terms of its investments which highlighted by the low rate of primary and co-investment opportunities which have been invested into historically (circa 6%). The investments in secondaries are also made fairly opportunistically.
- For primary investments, once sourced, it is then subject to an initial evaluation to assess its merits/suitability. Following this stage, a deal team is created to perform full due diligence to determine whether the opportunity is well-positioned to generate superior risk-adjusted returns. Primary investments are the backbone of the Manager's business; with Grosvenor deploying about US$1bn a year across 30 or so fund commitments. Primaries have the advantages of providing greater diversification and helping to create GP relationships although may suffer from the J-Curve effect, high fees and historically lower returns than co-investments. That said, given the Manager's scale they may at times be able to invest under preferred fee terms, though Lonsec would prefer to see stronger evidence of this.
- Secondaries exist largely due to institutions seeking to make adjustments to portfolio allocations and given that the buyers of are liquidity providers, they can usually be bought at a discount to NAV. Further, relative to primaries the advantages include J-Curve mitigation and a more positive cashflow/distribution profile and the ability to evaluate underlying companies. For secondary investments the team's key focus is whether they are priced appropriately and the team underwrites the funds on an asset-by-asset basis, modelling the financial performance and projecting the ultimate disposition of each asset. Lonsec notes that while the quality of the underlying GP is a consideration, the Manager will not necessarily screen out poor management teams and, rather, will factor this information into the price/discount to NAV. Lonsec believes this approach to be reasonably pragmatic, noting that it has been highly consistent in generating positive returns for the Manager since 2003.
- The opportunity to invest in co-Investments are made possible due to the Manager's established relationships with GPs and its investments into primary funds. Grosvenor usually execute co-Investments with sponsors in whose funds they have previously invested alongside. This allows the Manager to complete due diligence within a shortened timeframe (which is typically a requirement for deals to be completed). When performing due diligence on a co-investment opportunity, the deal team focuses heavily on the company's strategy and growth prospects, analysing the industry dynamics and comparable companies to better understand the competitiveness of the company. Although much like primaries there is a keen focus on the sponsor. Lonsec considers this approach to be logical and detailed.
- The key benefits of co-Investments are reduced fees, J-Curve mitigation and the ability to select opportunities. On the other hand, the main concern with co-Investments is that investors are being offered assets which are unwanted by the GPs. Historically the lower costs of co-Investments have resulted in higher returns than for primaries and secondaries, albeit with greater variability of return outcomes. In saying this, Lonsec also notes that the Manager has less experience in making co-Investments (as well as total dollars invested) than for primaries.
- While the Trust has the ability to invest in all sectors, the Manager has historically shied away from early stage/venture capital technology companies. Lonsec believes the highly selective nature of Grosvenor's process, the bias towards buyouts and the proposed level of diversification is reflective of the Manager's relatively conservative investment style. While these elements should help to reduce the overall investment risk of the portfolio, the trade off is the portfolio is likely to have lower growth potential. As an example, Lonsec does not believe the Trust is likely to benefit in any meaningful way from investing into exponential winners like Uber, as is the case for more aggressive private equity funds.
- The Manager will typically look to increase the portfolio weight towards growth sectors earlier in the economic cycle (such as IT, Industrials, Consumer Discretionary and Financials) and then transition towards defensive sectors or opportunistic investments late in the cycle or in recession (such as Healthcare, Special Situations and Distressed companies). That said, given the recent corona-virus led market volatility, the Manager's current outlook is rather cautious yet reasonably opportunistic. They have a bias towards GPs who have performed well through the cycle and for secondaries, the Manager has a current focus on notable discounts and shorter duration deals (2-3 years); where the distribution is expected to be higher than NAV. For co-Investments the preference is for companies that have notable tailwinds in the covid environment within the Technology and Healthcare space. The Manager believes this is a way to de-risk the initial portfolio and Lonsec considers this to be a sensible strategy given the current market environment.
- Given recent market volatility and the Manager's expectation of greater opportunities in the period ahead the portfolio is somewhat behind on its original investment plans although the portfolio is still expected to take three-to-four years from inception to be positioned in line with the long-term target ranges. Nevertheless, the portfolio continues to hold approximately 65% (31 August 2020) in cash and Lonsec believes that investors will need to be patient in waiting for any real uptick in NAV. The slow build-out of the portfolio partly reflects the Manager's

desire to create diversification across verticals and vintages.

- While being built-out, the Trust holds cash and may make investments into short duration public credit via underlying managers. This is designed to provide sufficient liquidity when capital is called by primary and co-mingled Grosvenor funds. That said, given the market volatility experienced in Q1-2020, the Manager decided to largely redeem all investments in short duration public credit, in favour for holding USD cash. Disappointingly during the quarter these investments suffered notable losses (in USD terms), although since inception the investments were roughly flat (in USD terms). Further, the significant USD cash investments currency fluctuations may significantly impact the value of the Trust as the portfolio seeks to be fully built-out.
- Further, given the sell-down of short duration public credit in favour of USD cash, this has reduced the dividend coverage ratio (i.e., the proportion of a distribution being paid out of realised gains rather than capital) in the near term. The Manager's modelling now estimates that by the end of 2021, after fee realised gains should be sufficient to cover all of the distribution payable each year. This is longer than originally intended and may lead to the unit price reducing equal to the portion of capital distributed.
- The Manager has also communicated that the Trust may invest back into short duration public credit at a later date. Whilst acknowledging the benefits of allocating to short duration public credit during the Trust's ramp-up phase, Lonsec believes the Trust's overall large cash balance detracts from the Trust's appeal given the fees charged albeit with limited private market asset exposure during this phase and to be inconsistent with the spirit of the strategy. Lonsec believes that this initial implementation/cash drag is one of the key drawbacks for investors.
- Although the Manager has the ability to position the initial portfolio according to market conditions, Lonsec notes that it will be highly illiquid once it is fully invested. As such, thereafter, there will be limited potential to re-position the Trust. While this is also the case for private market peers, Lonsec notes that the Trust's structure, whereby a significant portion of investments are accessed via co-mingled Grosvenor funds, means that for the Trust (relative to peers) there is potentially less opportunity to manoeuvre the portfolio on an investment by investment basis.
- Although Lonsec considers the Manager's approach to asset valuations to be in line with private markets standards, and is pleased to note that they are reviewed by a third party firm once a year on a rotational basis, the process is considered less tailored to an ever-green fund structure than the Lonsec rated private markets peer group. Given this is a daily liquid vehicle, and although the NAV is struck monthly (as opposed to the standard quarterly process of private markets) the Trust is still largely reliant on the underlying investments quarterly struck valuations. As such, the NAV may experience greater variability during end of quarter valuation periods, this will be most notable during volatile investment markets.
- Furthermore, at IPO PE1 was expected to be net cash positive by 2022-23 but given the disruption in the investment pipeline due to the increased market volatility in Q1-2020, the portfolio potentially will not be net cash positive until 31 March 2025. This may also mean that the Trust is more reliant on raising external capital to alter the portfolios asset allocation which reduces the Fund's maneuverability. Lonsec is overall disappointed by this outcome.

ESG integration

- The Manager has articulated a commitment to the integration of ESG with evidence of a policy framework and public positioning from a corporate standpoint. Although the Manager did not provide extensive details on engagement outcomes or policy, there was reasonable evidence of ESG integration within the investment process for the Fund which was somewhat greater than peers in this sector. Overall, on a peer relative basis, Lonsec considers the overall level of ESG integration within the Fund to be moderate.

Risk management

- As previously noted, all of the Trust's investment decisions require approval from both the Operations Committee and the Investment Committee. Lonsec believes this structure may help identify fraud and/or avoid other legal issues ahead of time.
- Risk is managed through deep analysis at the entry stage, both in terms of the investment capability and ensuring legal rights are preserved, given the Manager invests as a minority Limited Partner (LP) investor. As mentioned, the Manager will also look to gain Advisory Board seats where possible. In saying this, Lonsec highlights that the risks of private market investments are difficult to manage after the initial investment given their illiquidity.
- Maintaining portfolio liquidity is a key consideration in the early years, particularly with respect to being able to meet capital calls on primary investments. Lonsec notes that the Manager also does have some flexibility to borrow at the Trust level, however, this capability is generally intended to be used only for short-term cashflow requirements.
- The Manager is conscious of debt and what type of relationships managers have with lenders. The use of leverage varies between buyouts and special situations and the level of debt is considered on a 'bottom-up' basis rather than there being any overarching philosophy on the overall level of leverage.
- The portfolio is expected to be highly diversified once it has been fully built-out across companies, industries and vintages. Lonsec, however, notes that the Manager also has a strong North America focus, with over 70% of Primary deals and Co-Investments being made within the USA and 20% within Europe.

Fees

- The fees are 1.25% p.a. for the Responsible Entity/ management fee and a 20% performance fee over a hurdle rate of 8% p.a. (net of Responsible Entity/ management fees). At the underlying fund level the fees are estimated by the Manager as initially being:

a) Secondaries – a Management Fee of 1.00% p.a. plus an Incentive Fee of 10% over a Preferred Return of 8% p.a.
b) Co-investments – a Management Fee of 0.95% p.a. plus an Incentive Fee of 10% over a Preferred Return of 8% p.a.
c) Opportunistic – a Management Fee of 1.00% p.a. plus an Incentive Fee of 15% over a Preferred Return of 8% p.a.
d) Primaries – a Management Fee of 1.80% p.a. plus an Incentive Fee of 20% over a Preferred Return of 8% p.a.
e) Private Credit – a Management Fee of 0.85% p.a. plus an Incentive Fee of 17.5% over a Preferred Return of 7% p.a.
f) Short Duration Credit – a Management Fee of 0.45% p.a.

- Further, the Trust will also be subject to underlying GP fees on a fund by fund or investment by investment basis, these fees may vary and have the potential to be significant. These costs are reflected in the NAV of the Trust and are borne by investors, but they are not paid to the Manager.
- Lonsec considers the overall fee load, which includes more than one layer of management and performance fees, to be relatively high compared to peers and very high in absolute terms. Overall, this is a key negative of the Fund. Nevertheless, Lonsec notes that the economics of the venture are effectively that Pengana Capital will be only marginally above break-even over a 10-year period on management costs alone. Pengana Capital's investment is therefore heavily leveraged towards PE1 being able to generate high performance fees over this period. Lonsec also notes that given the initial pace in which capital is expected to be deployed, the Manager does not expect to be able to generate much in the way of performance fees until Year Four at the earliest.

Performance

- As PE1 was listed on the ASX on 30 April 2019 the Trust has a limited trading history and track record. While it has been a volatile period in global markets, the Trust has had a very volatile performance pattern. The Trust's discount/premium to NAV has varied from close to -30% to +30%. As such, the Trust's one year volatility to 31 August 2020 (as measured by standard deviation) was 29.7%. Lonsec views this level of share price volatility negatively noting this is a function of many factors, including but not limited to; the market capitalisation of the LIT, shareholder base, management fee, portfolio performance and dividend history. Notably, the majority of smaller LIT/LIC's have generally traded at a discount to their NAV although given the recent capital raise, PE1 has now grown in size, and Lonsec highlights that the Trust has largely traded at a premium since listing. Lonsec will seek to asses the Trust's trading performance as it gains a longer-term track record.
- Over the one year period to 31 August 2020 the Trust's share price return (including dividends) was -3.2%. While the Trust has reported its NAV per unit to 31 August 2020, the underlying investments are valued with a lag and therefore reflect a combination of 31 March 2020 and 30 June 2020 valuations. Over the one-year period to 31 August 2020 the NAV return (net of fees) of the Trust was -4.5%. During the second half of 2019 the portfolios short duration public credit positions largely added to returns, and as the Trust was only beginning to invest in private assets, these had a more muted performance impact. As credit spreads widened and the Trusts private markets investments updated their valuations, the short duration public credit and private markets assets detracted in Q1-2020. That said, the Trust's currency exposure to the USD led to a 7.6% net NAV return over the period as the AUD sold off heavily. That said, the AUD has since rallied significantly and the Fund's sizeable USD cash positioning has been the largest detractor over the five months to 31 August 2020, although as private market valuations were continuously updated in May and June 2020 (to reflect the underlying investments' 31 March 2020 valuations) these also somewhat detracted from the Trust's performance. Nevertheless, Lonsec will be keen to assess performance outcomes as the portfolio progresses towards its steady state build-out.
- Grosvenor has a track record investing in private markets lasting over 20 years. The Manager's long-run performance has been strong in primaries, secondaries and co-Investments, achieving strong double digit returns in all three strategies. The returns have been highest in co-Investments over the long-term, which in part reflects the lower fees. secondaries have been the best strategy from a risk versus return perspective, with only one secondary investment delivering lower returns than the initial outlay.

Overall

- Lonsec has maintained the Trust's '**Recommended**' rating following the most recent review. Lonsec considers the Grosvenor investment team to be experienced and well-resourced, applying a thorough and robust investment process. The firm has a good private market track record spanning over 20 years. PE1 being an ASX-listed vehicle provides daily liquidity for an illiquid asset class although liquidity of units is market-dependent. The Trust, however, is likely to be highly correlated to the broader equity markets and exhibit high volatility.
- That said, Lonsec notes that the portfolio composition is likely to be markedly different to the target allocation over the first three years with a material cash/short duration public credit exposure initially before diversifying across companies, industries and vintages once built-out. Further, during the Trust's ramp-up phase, Lonsec believes the large cash drag detracts from the Trust's appeal given the fees charged and limited private market assets exposure. Finally, Lonsec considers the overall fee load, which includes multiple management and performance fee layers, to be relatively high compared to peers and very high in absolute terms.

Pengana Private Equity Trust

People and Resources

Corporate overview

Pengana Capital Group ('Pengana') is a diversified funds management group with distinct investment strategies that aim to deliver superior long-term risk-adjusted returns to investors, with a focus on capital preservation. Pengana was founded in 2003 and is headquartered in Sydney, with smaller offices in Melbourne, Brisbane and Perth. Pengana manages over A$3.3bn (31 August 2020) in funds under management.

Grosvenor is an investment manager with (all figures as at 30 June 2020) US$56.2bn funds under management. The assets are invested across Absolute Return Strategies (US$23.2bn), Private Equity (US$20.7bn), Infrastructure (US$5.4bn), Real Estate (US$3.3bn) and Strategic Investments (US$3.5bn). Of the Private Equity assets managed, 90% are in customised portfolios, with just 10% in commingled vehicles.

Size and experience

NAME	POSITION	EXPERIENCE INDUSTRY / FIRM
JONATHAN LEVIN	PRESIDENT	17 / 9
JASON METAKIS	MANAGING DIRECTOR	21 / 10
BRADLEY MEYERS	MANAGING DIRECTOR	23 / 17
FREDERICK POLLOCK	CIO, MANAGING DIRECTOR & PORTFOLIO MANAGER	16 / 5
BRIAN SULLIVAN	MANAGING DIRECTOR	24 / 6

Grosvenor's investment team across private equity, real estate and infrastructure totals approximately 70 with the team loosely structured according to Primaries, Co-Investments, Secondaries, and Opportunistic (which includes special situations and aims to provide some flexibility for tactical allocation shifts).

Jonathan Levin is President and is responsible for the day-to-day management of the firm. Levin is Chair of Grosvenor's Global Investment Council and a member of the Investment Committees for Grosvenor's Private Markets, Absolute Return Strategies Seeding and the Strategic Investments Group. He holds an A.B. in Economics from Harvard College. Levin is a member of the Board of Directors of the Ann & Robert H. Lurie Children's Hospital of Chicago.

Jason Metakis is a member of the Grosvenor's Private Markets Investment Committee and serves on Grosvenor's Global Investment Council. He focuses on private equity Co-investments and direct investments and is responsible for deal sourcing, due diligence, and managing client relationships. Metakis received an A.B. with honours in Economics from Harvard College in 1999 and a Master of Business Administration from Harvard Business School in 2004.

Bradley Meyers is Head of Grosvenor's Portfolio Management, a member of the Grosvenor's Absolute Return Strategies Investment Committee, and serves on Grosvenor's Global Investment Council. Meyers is also a member of Grosvenor's Seeding and Special Opportunities Investment Committees. Meyers is responsible for overseeing certain portfolio management processes. Meyers received his Bachelor of Science in Accountancy from the University of Illinois at Urbana-Champaign in 1997 and his Master of Business Administration from the University of Chicago Booth School of Business, with a concentration in Finance, in 2003. Meyers is a Certified Public Accountant.

Frederick Pollock is the Chief Investment Officer of GCM, Head of the Strategic Investments Group (SIG), a member of Grosvenor's Private Markets and Absolute Return Strategies Investment Committees, Co-Head of Grosvenor's Research and serves on Grosvenor's Global Investment Council. He received his Bachelor of Science summa cum laude in Economics from the University of Nevada in 2001 and his Juris Doctor magna cum laude from Harvard Law School in 2004.

Brian Sullivan leads the secondaries practice and is focused on deal sourcing and executing secondary fund investments. He is also a member of the Grosvenor's Private Markets Investment Committee and serves on Grosvenor's Global Investment Council. He received his Bachelor of Science in Mechanical Engineering from the United States Naval Academy and his Master of Business Administration from the Wharton School at the University of Pennsylvania. Sullivan holds the CFA designation.

Remuneration & Alignment of Interests

The Manager and investment team are incentivised through a variety of means, including:

1. Employees investing over US$450m of capital into Grosvenor's funds;
2. Performance Fees;
3. Bonuses, which are based on individual employee performance and overall success of the firm; and
4. Numerous key members of the management team (including investment professionals) participate in the profits of the firm.

Research Approach

Overview

Grosvenor seeks to assess each GPs potential for value creation at different stages of the investment process (i.e., sourcing, due diligence, structuring, execution, monitoring, and exit) in an attempt to gain an in-depth understanding of the opportunities and risks associated with each investment.

Grosvenor's due diligence process for underlying funds utilises a 'bottom-up' approach involving multiple teams seeking to maximise efficiencies and ensure appropriate checks and balances in order to select and approve investments. All potential investments undergo an initial screening process to determine whether the transaction warrants additional analysis. If a decision is made to move forward, the deal team proceeds with due diligence and conducts detailed analysis of the key risks, merits and suitability of the proposed investment.

Grosvenor is an active investor across the spectrum of both market size and fund manager size. Grosvenor maintains an extensive network of relationships and is able to gain access to a range of private equity managers.

Grosvenor seeks investment exposure to middle market companies, which Grosvenor believes are generally more attractive because they represent a larger set of opportunities, lower entry valuations, and more conservative capital structures. In addition, middle market investments can offer fund managers more opportunity for organic value creation and increased exit opportunities, resulting in the potential for higher returns.

Primaries

Key assessment criteria for primary investments:

1. Top quartile performers with repeatable strategies.
2. The skill and composition of the GP's team. (This process includes off-list reference checks).
3. The value creating initiatives that the team have previously made.
4. The Manager generally prefers mid-market managers, as they allow LPs more time (typically several weeks) to do their due diligence than larger GPs.
5. In terms of analysis of prior performance, there is a focus on consistency.
6. The Manager is conscious of leverage and what type of lender relationships managers have. The target leverage varies between buyouts and special situations and debt is considered on a 'bottom-up' basis. There is no overarching philosophy on the level of leverage.
7. The Manager will typically look to use it scale and relationships to get access to allocations in oversubscribed funds.
8. The Manager will also look to get better fee terms of transactions (i.e. better than the typical 2% p.a. & 20% performance fee).

Secondaries

Key assessment criteria for secondary investments:

1. Does the Manager have an informational advantage because there are not too many competing buyers?
2. The level of discount to NAV.
3. Like for primaries, there is also a focus on middle market and special situations funds.
4. The Manager also likes niche sector opportunities.
5. The focus is on deal sizes of around $50m.
6. The Manager is most proactive in buying into Secondaries when the NAV is understated for purchases.
7. Grosvenor will tend to take control of an Advisory Board seat if the seller has one.
8. The underlying GP is a consideration, albeit, the quality of the investment team is then factored into the price/discount to NAV.

Co-investments

Co-investments are considered by the Manager on a case-by-case basis. Grosvenor has committed to 6% of co-investments opportunities to date. For Co-Investments, the Manager comes in as a minority investor but working with management team to drive value creation.

Generally, the Manager will hold co-investments for an average of 4-5 years. The Manager has the ability to exit on the same terms and at the same time as the sponsor, usually exiting through the sale of a company either through trade sale or an IPO (which is rare).

The Manager will also keep track of the deals they have let pass and this helps shape the future due diligence and possibly correct where they were too selective (i.e. where the deal was rejected but subsequently did well).

Private credit

Private credit investments include a wide variety of fixed income instruments that seek to capitalise on dislocations in credit markets and mispriced/ misunderstood credits. Primary strategies include: structured credit, distressed credit, mezzanine debt and direct lending as well as other niche strategies such as litigation finance.

Direct and opportunistic investments

The opportunistic investment strategies implemented in the Trust have the flexibility to invest across illiquid asset classes, strategies, sectors, regions and capital structure. The objective of these strategies is to invest in compelling risk-adjusted return opportunities across Grosvenor's global alternatives platform. Grosvenor generally seeks to deploy capital into the following scenarios:

1. Dislocations: opportunities in which macro and/or industry-level events combine with shifting market conditions to create what Grosvenor considers to be irrational securities pricing. Dislocations often represent opportunities to purchase high-quality cash flows at a discount to fundamental value.
2. Fundamental Thematic: including political transitions in an economy or major changes in an industry or sector.
3. Orphaned Assets: securities that are "in transition" for which there is no current investor demand but can be valued through fundamental analysis. The lack of competition to purchase these assets can provide attractive entry points.
4. Complex Situations: opportunities where many investors are unwilling or unable to conduct in-depth analysis or develop sufficient expertise.
5. Partnerships: partnerships with third-party managers and specialists to access attractive, difficult-to-replicate exposure and expertise. Grosvenor also invests in partnerships with external managers where additional scale and industry operating relationships enhance the value proposition.
6. Structured Transactions: opportunities to partner directly with companies as providers of financing, focusing on compelling risk/return profiles.

Portfolio Construction

Overview

The Trust invests in private markets through a combination of primaries, co-investments, secondaries, private credit and opportunistic investments. Grosvenor relies on a dual-track approval process for underlying fund investments that requires approval from both the Investment Committee and Operations Committee which both have the ability to veto an investment.

The Trust utilises strategies employed across Grosvenor's investment platform and seeks to provide diversification across underlying investment managers, vintages, geographies, sectors, and strategies. Grosvenor generally seeks to invest with underlying investment managers who have historically managed investment vehicles which have generated upper quartile returns, and whom Grosvenor believes have the potential to continue to do so due to strong deal sourcing capabilities, superior structuring and execution skills, and the ability to add value at an operating level.

Pengana Private Equity Trust

Grosvenor generally will focus on opportunities involving underlying managers (and/or management teams) with whom it has already invested or with whom it is otherwise familiar.

The portfolio construction process incorporates both 'top-down' and 'bottom-up' elements. As part of Grosvenor's portfolio construction process, Grosvenor conducts analysis of target industries, sectors and regions, including an analysis of the economic conditions, investment environment, and the state of the private equity markets. These 'top-down' analyses guide the team's sourcing, due diligence and portfolio construction decisions. This approach takes into consideration a number of factors, such as deal flow, team expertise, market conditions, long-term value creation opportunities, and risk mitigation.

The Trust may invest either directly or indirectly through investments in one or more of Grosvenor's funds or other underlying funds. The target allocation range for each strategy are primaries (15-30%), co-investments (15-30%), secondaries (15-30%), private credit (5-15%), opportunistic (10-25%) and cash/short duration public credit (2-10%). Ultimately, the Manager intends for the portfolio to be highly diversified with exposure to in excess of 500 underlying companies.

Risk Management

Risk limits

SEPARATE RISK MONITORING	YES
MAXIMUM COMMITMENT TO ANY SINGLE UNDERLYING FUND	20%
BORROWING POLICY	UP TO 25% AT FUND LEVEL & IN UNDERLYING FUNDS

As previously stated, all new investments in the Trust requires the approval of Grosvenor's Operations Committee. The Operations Committee includes: Paul Meister (Vice Chairman and Operations Committee Chair), Francis Idehen (Chief Operating Officer), Ivaldo Basso (Head of Operational Due Diligence), Lilly Faranakian (Global Chief Compliance Officer) and Burke Montgomery (General Counsel).

From an investment point of view, Grosvenor seeks to identify, evaluate and mitigate material risks of underlying funds prior to making a commitment by, among other things:

- Conducting due diligence and confirming facts about the manager – team, strategy, track record, benchmarking, fundraising status and legal terms.
- Understanding the manager's value add and differentiation relative to the market.
- Understanding the manager's competitive advantage and ability to generate returns over various market cycles.
- Assessing the manager's operational risks.
- Assessing the manager's organisational stability.
- Assessing strategy relative to market opportunity.
- Assessing competitive dynamics.
- Determining portfolio fit relative to strategy.

Risk monitoring

The risk monitoring process is undertaken by the Manager with oversight by Pengana.

Currency management

The Trust will generally be unhedged for currency movements. In certain limited circumstances, the Trust may engage in foreign exchange hedging transactions intended to reduce foreign exchange exposure, primarily to hedge capital calls or known commitments.

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.

Although liquidity is generally expected to exist in this secondary market on the ASX, there are no guarantees that an active trading market with sufficient liquidity will develop, or should it develop after listing, that such a secondary market will sustain a price representative of the NAV per Unit.

Risks Associated with Portfolio Companies

The companies in which the Trust or the underlying funds may invest may involve a high degree of business and financial risk. These companies may be in an early stage of development, may not have a proven operating history, may be operating at a loss or have significant variations in operating results, may be engaged in a rapidly changing business with products subject to a substantial risk of obsolescence, may require substantial additional capital to support their operations, to finance expansion or to maintain their competitive position, may have a high level of leverage, or may otherwise have a weak financial condition. In addition, these companies may face intense competition, including competition from companies with greater financial resources, more extensive development, manufacturing, marketing, and other capabilities, and a larger number of qualified managerial and technical personnel.

Moreover, during periods of difficult market conditions or slowdowns in a particular investment category, industry, or region, companies may experience decreased revenues, financial losses, difficulty in obtaining access to financing, and increased costs.

Lack of Portfolio Liquidity

The underlying funds are not expected to provide any voluntary liquidity to their investors and may, at any given time, hold significant amounts of securities and other assets issued by Portfolio Companies that are very thinly-traded, for which no market exists, or which are restricted as to their transferability.

Debt and Leverage Risk

The underlying funds will employ leverage from time to time in a variety of ways. The Trust may borrow directly or through an intermediate entity to fund investments, pay fees and expenses or to address the timing issues associated with the acquisition of investments and re-investment of proceeds. The use of leverage will magnify the potential gains and losses.

Currency Risk

Investments will predominantly be made in U.S. dollars (as well as multiple other foreign currencies),

Pengana Private Equity Trust

and if these currencies change in value relative to the Australian dollar (being the functional currency of the Trust) the value of these investments can change and accordingly can negatively affect the value of the Portfolio.

Portfolio Valuation

Valuations of the underlying investments are expected to involve uncertainties and discretionary determinations. Third-party pricing information may not be available regarding a significant portion of investments in certain asset classes, and in some circumstances may rely on valuation models that Grosvenor has created in order to value the assets and calculate the account value.

Credit risk

Credit risk refers to the risk that a party to a credit transaction fails to meet its obligations, such as defaulting on a mortgage, a mortgage-backed security, a hybrid security, a fixed interest security or a derivative contract. This creates an exposure to underlying borrowers and the financial condition of issuers of these securities.

Lonsec

Pengana Private Equity Trust

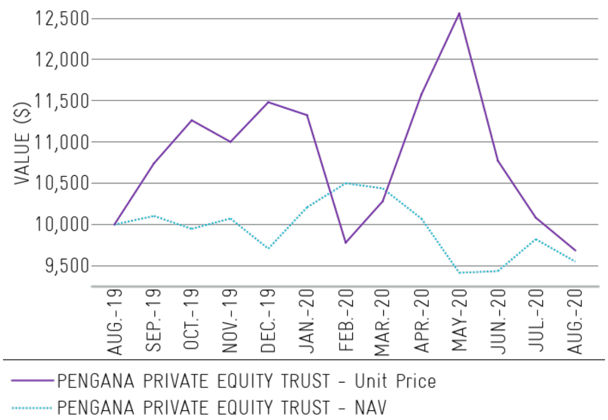
Quantitative Performance Analysis - annualised after-fee % returns (at 31-8-2020)

Performance metrics

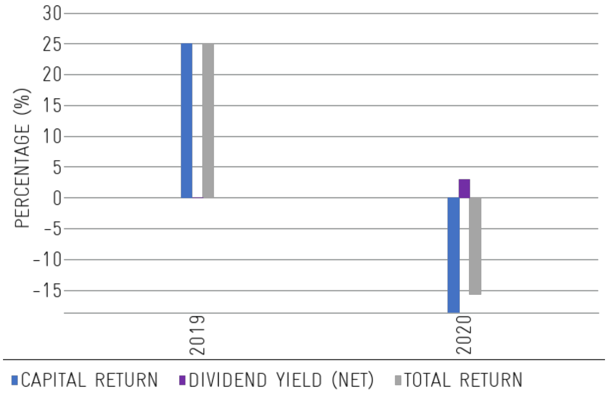
	3 MTH	6 MTH	9 MTH	12 MTH
TOTAL RETURN (% PA)	-22.91	-0.98	-11.96	-3.16
STANDARD DEVIATION (% PA) *	-	-	-	29.67
EXCESS RETURN (% PA)	-22.94	-1.16	-12.38	-3.82
WORST DRAWDOWN (%)	-22.91	-22.91	-22.91	-22.91
TIME TO RECOVERY (MTHS)	NR	NR	NR	NR
TRACKING ERROR (% PA) *	-	-	-	29.64

FUND: PENGANA PRIVATE EQUITY TRUST
BENCHMARK USED: BLOOMBERG AUSBOND BANK BILL INDEX AUD
* PERIODS LESS THAN 12 MONTHS ARE NOT CALCULATED
TIME TO RECOVERY: NR - NOT RECOVERED, DASH - NO DRAWDOWN DURING PERIOD

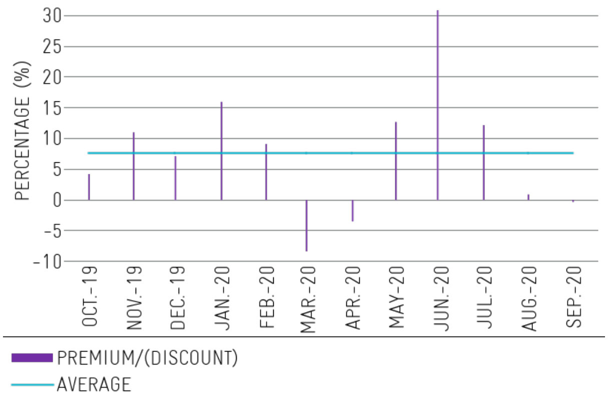
Growth of $10,000 over one year



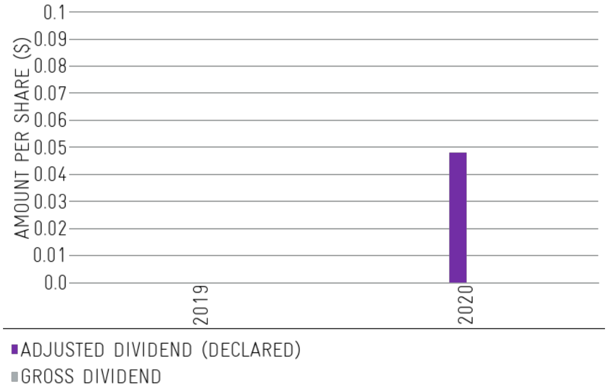
Calendar Year Returns over two years



Unit Price Premium/Discount to NAV over one year



Dividend Record over two years



ANALYST: MATTHEW O'NEILL | APPROVED BY: DARRELL CLARK

Lonsec

Pengana Private Equity Trust

Glossary

Click here for the glossary of terms.

About Lonsec

Lonsec Research Pty Ltd (Lonsec) is an investment research house with specialist areas of expertise, that was originally established in 1994 and the current entity was registered on 23 June 2011. From 1 July 2011, Lonsec became a fully owned subsidiary of Lonsec Fiscal Holdings Pty Ltd, a privately owned entity with a multi-brand strategy of providing leading financial services research and investment execution. Lonsec believes that professional financial advisers need informed opinions on the best investment strategies and financial products to provide real value for their clients. To meet this need, Lonsec has in place an experienced research team, which draws on a robust research process to undertake in-depth assessment of managed fund products.

Analyst Disclosure and Certification

Analyst remuneration is not linked to the research or rating outcome. Where financial products are mentioned, the Analyst(s) may hold the financial product(s) referred to in this document, but Lonsec considers such holdings not to be sufficiently material to compromise the rating or advice. Analyst holdings may change during the life of this document. The Analyst(s) certify that the views expressed in this document accurately reflect their personal, professional opinion about the matters and financial product(s) to which this document refers.