



# Product Review

## Auscap Long Short Australian Equities Fund

ISSUE DATE 02-10-2018

### About this Review

ASSET CLASS REVIEWED	AUSTRALIAN EQUITIES
SECTOR REVIEWED	AUSTRALIAN LONG SHORT
SUB SECTOR REVIEWED	VARIABLE BETA
TOTAL FUNDS RATED	8

### About this Fund

ASIC RG240 CLASSIFIED	YES
FUND REVIEWED	AUSCAP LONG SHORT AUSTRALIAN EQUITIES FUND
APIR CODE	ASX0001AU
PDS OBJECTIVE	THE FUND AIMS TO GENERATE STRONG ABSOLUTE RETURNS IN EXCESS OF THE BENCHMARK, THE RESERVE BANK OF AUSTRALIA CASH RATE.
INTERNAL OBJECTIVE	10-15% P.A. ABSOLUTE RETURNS AT THE INDIVIDUAL STOCK LEVEL (NET) OVER FIVE YEARS
STATED RISK OBJECTIVE	TO AVOID PERIODS OF SIGNIFICANT NEGATIVE PERFORMANCE
DISTRIBUTION FREQUENCY	ANNUALLY
FUND SIZE	\$650M
FUND INCEPTION	01-12-2012
MANAGEMENT COSTS	1.5375% P.A. (EXC. EXPENSE RECOVERY)
PERFORMANCE FEE	15.375% (OF OUT-PERFORMANCE OVER THE BENCHMARK)
RESPONSIBLE ENTITY	AUSCAP ASSET MANAGEMENT LIMITED

### About the Fund Manager

FUND MANAGER	AUSCAP ASSET MANAGEMENT LIMITED
OWNERSHIP	WHOLLY-OWNED BY INVESTMENT STAFF
ASSETS MANAGED IN THIS SECTOR	\$650M (AUGUST 2018)
YEARS MANAGING THIS ASSET CLASS	5

### Investment Team

PORTFOLIO MANAGER	MATTHEW PARKER, TIM CARLETON
INVESTMENT TEAM SIZE	3
INVESTMENT TEAM TURNOVER	NIL
STRUCTURE / LOCATION	CENTRALISED, SYDNEY

### Investment process

BENCHMARK	RBA CASH RATE
STYLE	VALUE
RISK MANAGEMENT TARGET	CAPITAL PRESERVATION
TYPICAL STOCK NUMBERS	20-30 LONG AND 5-15 SHORT
MARKET CAPITALISATION BIAS	LARGE-TO-MID
STOCK LIMITS	MAX. 20% ABSOLUTE (LONG AND SHORT)
SECTOR LIMITS	NIL
MAXIMUM NET MARKET EXPOSURE	150%
MAXIMUM GROSS EXPOSURE	400% (200% GROSS LONG, 200% GROSS SHORT)
CASH RANGE	0-100%

### Fund rating history

OCTOBER 2018	RECOMMENDED
JUNE 2017	RECOMMENDED

### What this Rating means

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

### Strengths

- Experienced co-portfolio management team with a sound understanding of long-short investing.
- Repeatable and robust investment process with a strong link between 'bottom-up' stock ideas and the portfolio construction process.
- Sound risk management focus at a portfolio level and when managing 'short' positions.
- Attractive 'boutique' investment culture with strong alignment of interests.

### Weaknesses

- High key person risk with co-Portfolio Managers.
- Relatively unconstrained risk management framework from a stock, sector and gross market exposure point of view.
- The performance fee hurdle rate of simply beating the RBA cash rate is well below the internal total return objectives of the Fund.
- Loosely defined internal total return objective at the Fund level.

### Fund Risk Characteristics

	LOW	MODERATE	HIGH
BUSINESS SUSTAINABILITY RISK			●
CAPITAL VOLATILITY			●
LEVERAGE RISK		●	
SECURITY LIQUIDITY RISK		●	
SECURITY CONCENTRATION RISK			●
REDEMPTION RISK		●	

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

### BIometrics

#### Aggregated risks

	1	2	3	4	5	6	7
STD RISK MEASURE						●	

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

	LOW	MODERATE	HIGH
RISK TO INCOME		●	

We strongly recommend that potential investors read the product disclosure statement or investment statement. Lonsec Research Pty Ltd ABN 11 151 658 561 AFSL. No. 421445. This information must be read in conjunction with the warning, disclaimer and disclosure at the end of this document. This report supersedes all prior reports.

ANALYST: JAMES KIRK | APPROVED BY: ADRIAN HOE

# Auscap Long Short Australian Equities Fund

ISSUE DATE 02-10-2018

## Features and benefits

	LOW	MODERATE	HIGH
COMPLEXITY			●
ESG AWARENESS		●	

## 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 Auscap Long Short Australian Equities Fund ('the Fund') is a long biased, long/short capability that employs a value investment style. The Fund has an absolute return focus while typically demonstrating below market beta exposure on a net basis. The Fund has a high conviction approach with a typical long portfolio of 20 to 30 stocks and a short portfolio of 5 to 15 positions. Short positions are more actively managed although 'stop losses' are not used. Auscap Asset Management (Auscap or 'the Manager') is both the Investment Manager and the Responsible Entity ('RE') for the Fund.
- The investment objective of the Fund is to strongly outperform the RBA's Cash Rate over an investment cycle (five years). While the Fund does not have an overall target, the Manager seeks to deliver an absolute return of 10-15% p.a. at a stock level. Auscap's aim for the Fund is to both preserve capital and to have a lower correlation to the Australian equities market. Portfolio turnover is moderate relative to the peer group at around 100-200% p.a.
- At the core of the Manager's investment philosophy is the belief that markets are not always efficient, with participants frequently both over-reacting and under-reacting to changing circumstances. This can lead to a divergence between the share price and a company's intrinsic valuation, providing mispricing opportunities for skilled investors to exploit. The Manager aims to exploit such mispricings by buying shares in 'good' companies when these have been over-sold and shorting 'poor' companies when these trade considerably above fair value. In effect, this means that over time the Fund will go long lower beta stocks and short higher beta stocks. The Manager considers this to be important for risk mitigation.
- Lonsec expects the Fund's performance to be predominantly driven by stock selection and the resulting sector positions rather than market conditions that are favorable to its investment style. Lonsec believes that stock research and portfolio construction are the critical factors influencing the Fund's performance outcomes. The Manager's focus on quality and also capital preservation is likely to lead to the Fund outperforming in 'down' markets. Conversely, Lonsec expects that the Fund will under-perform in the later stages of 'bullish' market conditions.
- Lonsec notes that the Manager can be net long or net short depending on the requirements of the investment strategy being deployed at the time. The

Fund has broad predefined portfolio risk limits, with the Manager having the flexibility to raise the gross portfolio limit to a maximum of 200% gross long and 200% gross short and the net equity exposure to 150%. Lonsec notes that the Fund will typically be run in a more conservative manner than these limits suggest and has on average had a net exposure, including on a beta adjusted basis, below 100%. However, the net exposure has been above 100% and below 50% over the life-time of the Fund. The Manager has also shown a similar willingness to dial up or down the gross exposure; however the Fund has not been net short. In terms of leverage, Lonsec notes that it can both amplify gains but also amplify losses and investors must consider this possibility.

- The Fund is at the higher end of the Lonsec peer group in terms of fees, with a Management Fee of 1.5375% p.a. and an estimated expense recovery of 0.11% p.a. leading to a combined Management Cost estimate of 1.6475% p.a. The Fund also attracts a performance fee of 15.375% p.a. of the out-performance above the RBA cash rate, adjusted for management fees.
- During the financial year ended 30 June 2017, the net transaction costs for the Fund were estimated at 0.20% of the NAV of the Fund. Net transaction costs are costs incurred in managing the Fund (including explicit and implicit costs of buying and selling assets, the cost of hedging/protection strategies and/or when there are applications or redemptions of fund units by investors) that are not covered by the buy/sell spread. The Fund's buy/sell spread is 0.40% (round-trip). These costs are reflected in the unit price of the Fund and are borne by investors, but they are not paid to the Responsible Entity or the Manager. Please refer to the Fund's PDS for further details.
- Lonsec is a supporter of performance fee structures as long as these are structured appropriately. With respect to the Fund's performance fee structure, Lonsec is pleased to observe a high water mark without any reset period. However, Lonsec notes that the hurdle rate of simply outperforming the RBA cash rate (net of fees) is towards the lower end, especially when compared with the Fund's internal total return targets. Lonsec highlights that this fee structure could lead to investors incurring a high Indirect Cost Ratio in the event of strong Fund performance. However, a benefit of such a structure is that investors will not incur a performance fee in periods of significant market draw-downs.
- Lonsec considers it important to highlight that the Fund only offers investors **monthly rather than daily liquidity**. The Manager does however offer a daily liquid version of the same strategy in a separate standalone fund.

## Using this Fund

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

ANALYST: JAMES KIRK | APPROVED BY: ADRIAN HOE

## Auscap Long Short Australian Equities Fund

ISSUE DATE 02-10-2018

- The Fund is subject to equity market risks and movements (both positive and negative) in the prices of the underlying securities in the portfolio. Investors should therefore be aware of, and comfortable with, the potential for the Fund to experience periods of negative returns which may result in capital losses being incurred on their investment. As such, the Fund will generally sit within the growth component of a diversified investment portfolio.
- As a 'long/short' equity product, Lonsec considers the Fund to be suitable for blending with other Australian equities strategies.
- Advisors should consult the Lonsec Risk Profile Review and/or the Lonsec Risk Profile Definition document(s) on guidance for appropriate asset allocations to Australian equities within a diversified portfolio. Lonsec believes that investment allocations to Australian equities are appropriate for investors with a time horizon of at least five years.
- The Fund can utilise a broad range of strategies including short selling and adjusting the Fund's gross and net equity position to implement its strategy. The use of shorting and the adjustment of gross and net equity levels are undertaken for performance enhancement, risk mitigation and hedging purposes. Lonsec recommends that investors consider all the additional risks associated with short positions (including the potential for significant losses) prior to investing.

### 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

- Auscap launched a daily liquid unit class of their flagship strategy in March 2018.
- Auscap expanded the team in July 2018 via the recruitment of Investment Analyst, William Mumford. Mumford has four years of experience in the financial services industry. Mumford's most recent role was an Investment Banking Analyst at Macquarie Capital. Mumford is expected to assist the team explore a broader spectrum of opportunities.
- Rohan Purdy was hired as a Senior Lawyer to the firm. Additionally, Head of Legal and Compliance, Louisa Blackwood was appointed to the Compliance Committee in place of co-portfolio manager, Tim Carleton.
- The Manager was the beneficiary of material inflows over the past year, growing from \$386m to \$650m of AUM (inclusive of performance gains).

### Lonsec Opinion of this Fund

#### People and resources

- Matthew Parker and Tim Carleton co-founded Auscap in 2012 and are the key investors for the Fund. Lonsec highlights that collectively they have over 30 years of combined experience. Of the two, Parker has the longer industry track record of over twenty years. Carleton is experienced in his own right with over a decade of experience. Both previously worked at Goldman Sachs on its proprietary trading desk for three and four years respectively, implementing similar Australian equities long/short strategies. Prior to this, Parker worked for eight years at Merrill Lynch on its proprietary trading desk. Before joining Goldman Sachs in 2007, Carleton worked at Macquarie Bank within the Investment Banking Group. Lonsec regards both Parker and Carleton to be quality and experienced investors with a solid understanding of the requirements of long/short investing.
- Lonsec notes that Carleton and Parker act as the co-Portfolio Managers ('co-PMs') of the Fund as well as being executives and Board members of the firm. Lonsec observes the relationship between the two investors as being a net positive for the Fund and highlights the diversity of their backgrounds and significant co-tenure. Lonsec notes the diversity of backgrounds of the Co-PMs is explicitly highlighted by their respective approaches to stock analysis. Lonsec notes that Carleton tends to focus on financial statements to analyse a company focussing on management's past allocation of capital. Parker tends to focus on a company's operating environment and taps into the market nous of the broker network to determine what is driving a stock in the short-term from a 'market psychology' aspect. Lonsec considers the differences in approaches to be relatively complementary that have a track record of success.
- Nonetheless, Lonsec cautions that such dual portfolio manager structures can diminish individual accountability to an extent. However, in the Auscap context, Lonsec notes a mitigating factor being the extensive co-tenure of the co-PMs both at Auscap and Goldman Sachs before this.
- Lonsec considers the investment team to be small but adequately sized to implement the investment process having until recently, managed the Fund with two resources since Auscap's inception. Somewhat unusually for a 'boutique' at such an earlier stage of its corporate life-cycle, Auscap has a strong suite of non-investment related executives which provide support for the co-PMs. This includes in-sourced distribution and compliance teams led by Lee Hopperton and Louisa Blackwood respectively. There are also internal operational and administrative resources under the lead of Head of Operations Sarah Lappan. Lonsec considers the benefit of such internal support mechanisms to be that it frees up the time of the co-PMs to focus on investment-related tasks. Lonsec notes that the Fund has also outsourced certain tasks, with Link Fund Solutions (formerly White Outsourcing) having been appointed to provide administration, trade reconciliation and unit pricing services. Citi acts as the Fund's prime broker and custodian.

ANALYST: JAMES KIRK | APPROVED BY: ADRIAN HOE

## Auscap Long Short Australian Equities Fund

ISSUE DATE 02-10-2018

- Lonsec highlights that the Manager made further steps to strengthen its non-investment related support for the firm over the most recent year, most notably through the appointment of Rohan Purdy as a Senior Lawyer. Purdy's appointment brings the total number of support staff to twelve. Lonsec views the Manager's willingness to invest in its business positively.
- Lonsec highlights that the co-PMs were the only members of the investment team to manage the Fund since Auscap's inception. Lonsec is encouraged by the Manager's initiative to broaden the investment team via the hire of William Mumford. The expansion of Manager's resources should allow the Manager to explore a broader spread of stocks and opportunities. Lonsec highlights that small teams are also not unusual for similar niche strategies albeit the team lacking the resourcing of some larger peers and this is likely to curtail the breadth of the research process.
- Lonsec considers the remuneration of the co-PMs to be highly aligned with the Fund's investors. In particular, Parker and Carleton are both significant equity owners of Auscap and hence going forward will each receive a substantial share in all dividends paid. This serves as a direct link to fund performance via the Manager's ability to earn performance fees. Lonsec also highlights that the co-PMs are significantly co-invested in the Fund.
- Lonsec believes key person risk ('KPR') is very high and centered on Parker and Carleton given their decision-making responsibilities while being integral resources for the investment team. Lonsec also highlights their key executive role for the firm. Lonsec considers there to be some strong mitigating factors to its assessment, including the role both played in founding the firm, their strong commitment to the Fund's investment philosophy and the equity ownership. Nonetheless, Lonsec would carefully assess its rating of the Fund were either to leave the firm.
- Lonsec notes that both Carleton and Parker sit on Auscap's Board of Directors ('the Board'). The Board is rounded out by non-executive director Phillip Carleton. Lonsec notes that the Auscap Board lacks independent directors. However, Lonsec considers that the Fund has adequate independent oversight in the form of the Auscap Compliance Committee ('the Committee'). The Committee has three members, two of which have been designated as being independent (Richard Stokes and Lindy Tallis). The Committee is rounded out by Blackwood. Lonsec is pleased to see that Carleton recently stepped off the Committee, removing direct conflicts from Lonsec's perspective. The Committee meets at least quarterly to review all aspects of the Fund and its operations. That said, should any issues be identified by the Committee, then these will be reported through to the Board for remediation which Carleton and Parker are members of.

### Research and portfolio construction

- Lonsec considers Auscap's investment process to be robust and repeatable. The Manager seeks to invest in what it believes to be attractive total return opportunities, be these 'good' companies trading at below its assessment of intrinsic value or a 'poor' companies trading considerably above intrinsic value. The Manager identifies such companies by 'bottom-up' fundamental analysis.
- The initial step in the research process is idea generation. Ideas are principally sourced via the screening of the Manager's universe using a series of financially-based metrics. These metrics include the forecast earnings yield, anticipated earnings growth, Price-to-Earnings ratios, Price-to-Cashflow ratios, EV/EBIT multiples, dividend yields and Price to Net Tangible Assets. Lonsec highlights that this screening process allows what is a small investment team to focus its fundamental research effort on a more focused and attractively priced opportunity set.
- Using a combination of both qualitative and quantitative methods, the companies identified for in-depth evaluation are then assessed against the Fund's investment criteria. This 'bottom-up' research is considered by Lonsec to be thorough and insightful albeit the qualitative component appearing to lack structure. It also provides the Manager with high conviction investment opportunities on both the long and the short-side that are clearly articulated. In terms of 'bottom-up' research, this involves an extensive company visitation program, in-depth discussions with industry participants and 'sell side' analysts and the evaluation of relevant macroeconomic and historical company data. This is complemented by the co-PMs leveraging of their deep industry relationships, which Lonsec believes to be a relative strength of the Manager. Nonetheless, Lonsec considers the research process to adopt a reasonably flexible approach with stock research varying according to the stock under analysis.
- The Manager has a flexible approach to stock valuations, and a variety of methodologies can be used. This flexibility allows the Manager to target its valuation approach to different company or industry dynamics. Lonsec notes flexibility to be a differentiating feature versus some peers that have a more static approach, e.g. only using DCF techniques.
- The Manager uses fundamental factors, indicators of market sentiment and 'investor psychology' when constructing the portfolio. The Manager's conviction in a particular stock is a major factor when position sizes are calculated. Stock liquidity and technical analysis are then assessed before a final weight is set. Lonsec notes that both co-PMs must agree on a stock and its weight before it can be added to the portfolio.
- Lonsec considers the portfolio to be constructed in a very high conviction manner while also being reasonably dynamic in its net exposure positioning. Over the past two years, the top 10 long positions held by the Fund has averaged 65% of the Fund's gross exposure with the Manager regularly concentrated in a handful of sectors or thematics. In terms of net exposure, Lonsec considers the Fund to have a reasonably dynamic approach, having exhibited three distinct peak and troughs over the past three years, with peaks ranging from

ANALYST: JAMES KIRK | APPROVED BY: ADRIAN HOE

P 4-9



## Auscap Long Short Australian Equities Fund

ISSUE DATE 02-10-2018

135-115% net exposure while troughs ranged from 35-70% in each case. Lonsec highlights that the Fund deploys capital opportunistically depending on the opportunity set and therefore the net exposure is an outcome of the Manager's bottom-up view of the opportunity set. Lonsec notes a key difference to its closest peers is the Fund's net equity exposure is achieved by fundamental stock positioning rather than via SPI futures. Lonsec is supportive of this approach albeit potentially slower to adjust the net equity positioning of the portfolio while also elevating stock turnover.

- While Lonsec acknowledges the Fund has a reported weighted average duration of long positions held within the portfolio of over two years, Lonsec considers this figure to be skewed by a core group of long-held positions, many of which feature in the portfolio's top 10 holdings. Lonsec highlights that the Manager has the tendency to be highly active in its buying and selling of stocks outside of its core positions. Additionally, short positions tend to be short in duration. Lonsec considers there to be an element of disconnect between the Fund's long-term and short-term positioning alongside dynamism in topping and tailing of stock positions based on its read on sentiment within the market. Lonsec will seek to gain greater conviction in the Manager's high conviction, yet highly active portfolio approach in future reviews.
- Lonsec notes that 'sell discipline' is a feature of the portfolio construction approach for the Manager. Positions can be reduced or exited if the original investment thesis breaks down, the share price trades above (long) or below (short) its intrinsic value or there are poor technical indicators. Lonsec also notes that short positions are more actively managed than similar long positions which is a clear demonstration that the Manager is aware of the risks of 'shorting'.

### Risk management

- The Manager's risk management is a combination of fundamental analysis and close supervision. In particular, Lonsec notes that risk management has largely been embedded in the investment process via the Manager's detailed 'bottom up' stock research process that focuses on the quality of management, balance sheet strength and liquidity of individual stocks. This is augmented by the Manager's quality focus leading to it typically buying lower beta stocks and shorting higher beta stocks.
- The Manager does not apply stop-loss limits on single stock positions on either the long or the short side. While Lonsec notes the benefit of stop loss rules given the higher conviction approach, pleasingly the co-PMs have successfully managed this risk by adopting a more conservative approach to leverage. The Manager has fairly broad maximum net and gross exposure limits for the Fund of 150% and 400% (200% gross long and 200% gross short) respectively. However, Lonsec has reviewed the Fund's positioning over time and notes that in practice the Manager typically positions the Fund well within these limits.
- The Manager has minimal mandated limits on the portfolio in terms of 'soft' stock limits, with these being tiered to account for stock size and liquidity.

There are no sector limits in place. Lonsec notes that this approach is in keeping with the Manager's 'high conviction' philosophy and also its view that the Australian market is already naturally concentrated in banks and miners. While Lonsec understands the reasoning for such a relatively unconstrained approach, investors should be aware of the extent of idiosyncratic stock risk that an investment in the Fund entails.

- Lonsec notes that the Manager compensates for this by monitoring daily aggregate stock, sector and single name exposures within the portfolio. The Fund's Compliance Committee also undertakes a quarterly review of the Fund's operations and compliance framework which is delivered to the Auscap Board.

### Funds Under Management (FUM)

- The Manager currently has \$650m in FUM across this capability. At current levels, Lonsec does not have any immediate concerns regarding the Manager's capacity. The Manager has stated a capacity of \$2b for the capability. Lonsec notes however that this figure is based on when the Manager estimates the capability could start to suffer capacity-related performance issues. The Manager intends to monitor the Fund's capacity closely and would close the Fund if they believe size is materially affecting performance even if this were to occur before the expected capacity limit has been reached.
- Given the importance of capacity discipline to this sector, Lonsec would prefer the Manager to conduct or externally commission a formal capacity review with robust analysis to support the Manager's capacity estimate for the capability. Lonsec also considers capacity management to be critical in justifying the high management fee and the performance fee structure in this product.
- There are positives and negatives to low or high levels of FUM; however, on balance Lonsec believes managers with smaller FUM to be better placed to add value. Larger fund managers typically have better access to key decision makers and may gain better execution pricing and preferential access to IPOs and secondary offerings. However, on the negative side, managing a large pool of money means that a larger manager may confront liquidity issues and is likely to be less nimble in the market as it takes longer for a position to be established or sold down.
- Nonetheless Lonsec gains comfort that the Manager is reasonably aligned with investors to appropriately manage the capacity of the capability. This is evident via the co-PM's equity in the firm which is strongly dependent on performance fees alongside their co-investment in the strategy.

### Performance

- Lonsec notes that the Fund has an inception date of 1 December 2012. Hence it still does not have a track record of performance spanning a full investment cycle. Lonsec notes that the Fund has an absolute return focus and seeks to deliver absolute returns of 10-15% at a stock level over the long-term (defined as greater than five years).
- Lonsec is pleased to observe that the Fund continues to build on an impressive track record, having met its

ANALYST: JAMES KIRK | APPROVED BY: ADRIAN HOE

# Auscap Long Short Australian Equities Fund

ISSUE DATE 02-10-2018

total return expectations as an aggregate Fund over the past five years. As at 31 August 2018, the Fund has delivered a strong total return of 18.0% p.a. (after fees) over five years. These returns are in excess of the upper band of its total return expectations.

- The Fund has also delivered a strong Sharpe Ratio of 1.5 over the five-year period, emphasising that the Manager has delivered such returns with 'at market' volatility; the Fund's standard deviation for this period was 10.6% p.a. Lonsec notes that the Fund's performance over this period was also above the peer median total return of 8.7% p.a. (after fees) and Sharpe Ratio of 0.7.
- Lonsec notes that the strong total return was delivered over a period where the Fund's net exposure averaged below 100% and ranged from a high of 135% versus a low of 35%. Hence the returns were largely as a result of stock and sector selection rather than continual use of leverage.
- Lonsec notes that performance for the Fund has been somewhat softer in the short-term. Over the past two years the Fund has delivered a total return of 4.9% p.a. versus 7.1% p.a. for the peer median to 31 August 2018. Over the past 12-months however, the Fund has produced a total return of 10.6% (after fees) which is more in-line with its internal objective. Over the past year stock selection in Consumer Staples and Industrials positively contributed to the portfolio alongside the Fund's allocation to the Real Estate sector. The portfolio was adversely impacted by the Fund's short positions in the Information Technology and Financials sector as well stock specific positions in Consumer Staples and the Financials sector.
- Lonsec notes that the Fund's return profile is reasonably in-line with the Manager's stated focus on capital preservation. While the Fund has an Outperformance Ratio of 57% over the five-year assessment period, this is skewed to 'down market' outperformance (approximately 75%). Lonsec also highlights that the Fund has a worst draw-down of -7.6% and a time-to-recovery of 3 months, a better outcome versus the peer median. That said, Lonsec notes that the Fund's outperformance characteristics are more neutral over the past two years while the Fund's standard deviation was also higher than the peer median (10.6% vs. 9.2%).

## Overall

- Lonsec maintained the Fund's 'Recommended' rating following the most recent review. Lonsec has a high regard for Auscap's co-portfolio managers, Tim Carleton and Matthew Parker. In particular, Lonsec highlights their solid industry track records, extensive co-tenure and understanding of the risks of long/short investing. Lonsec considers Auscap to have an attractive 'boutique' investment culture which provides investors with high conviction stock picking with a focus on downside protection.
- Detracting from Lonsec's conviction is the relatively unconstrained risk management process from a stock, sector and gross exposure perspective. The investment team is relatively small and hence the research process lacks breadth compared to most peers. Additionally, Lonsec considers the fee load to be high, particularly given the stated capacity of the capability.

## People and Resources

### Corporate overview

Auscap Asset Management is a boutique fund manager that was established in 2012 by its two founding principles, Matthew Parker and Tim Carleton. Parker and Carleton hold 100% of the equity. The Manager is a specialist long/short manager and Auscap also acts as its own RE. The Manager has current FUM of \$650m.

### Size and experience

NAME	POSITION	EXPERIENCE INDUSTRY / FIRM
MATTHEW PARKER	PORTFOLIO MANAGER	20 / 5
TIM CARLETON	PORTFOLIO MANAGER	13 / 5
WILLIAM MUMFORD	INVESTMENT ANALYST	4 / <1

### Overview

Tim Carleton and Matthew Parker acts as the co-Portfolio Managers of the Fund and must agree on all portfolio decisions. Both are also analysts for the Fund in addition to Investment Analyst, William Mumford. Given the smaller team size, Auscap do use 'sell side' brokers but attribute only 10% of the value-add to this channel.

Parker has 20 years experience in the financial services industry. From 2008 to 2011 he was an Executive Director at Goldman Sachs where he was responsible for managing an Australian equities long/short portfolio using proprietary funds. Between 1999 and 2007 he was a Director at Merrill Lynch Australia responsible for managing proprietary capital. Prior to this, he worked at Bankers Trust.

Carleton has 13 years experience in the financial services industry. From 2007 to 2011 he was an Executive Director at Goldman Sachs where he was also responsible for managing an Australian equities long/short portfolio using proprietary funds. Prior to 2007 he worked at Macquarie Bank within its Investment Banking Group.

Mumford has four years of experience in the financial services industry. Mumford was an Investment Banking Analyst at Macquarie Capital from 2016-2018. Mumford has a Bachelor of Commerce from the University of New South Wales, majoring in Accounting and Finance.

### Remuneration

Carleton and Parker hold all the equity in Auscap and receive their remuneration from being the business owners.

## Research Approach

### Overview

RESEARCH PHILOSOPHY	VALUE
NO. STOCKS IN UNIVERSE	2150
NO. STOCKS FULLY MODELLED / RESEARCHED	100
RESEARCH INPUTS	INDUSTRY DATA, COMPANY MEETINGS AND SITE VISITS, COMPANY FINANCIALS, INDUSTRY PUBLICATIONS, EXTERNAL RESEARCH REPORTS AND VALUATION WORK
BROKER RESEARCH	TO HELP BUILD MODELS AND ESTABLISH MARKET CONSENSUS VIEW
VALUATION OVERVIEW	PRICE TO CF, PE, EV/EBIT, DIVIDEND YIELD & P/NTA.

ANALYST: JAMES KIRK | APPROVED BY: ADRIAN HOE

# Auscap Long Short Australian Equities Fund

ISSUE DATE 02-10-2018

## Identify value opportunities

The Manager seeks to identify investment opportunities through an evaluation of stocks within its universe using valuation metrics such as Price to Cashflow, PER, EV/EBIT multiples, Dividend Yields & Price/NTA multiples.

## Testing data against investment criteria

The Manager then assesses all opportunities identified against its specified investment criteria using both quantitative and qualitative analysis.

- Quantitative analysis includes historic financials, balance sheet strength, growth drivers; and
- Qualitative analysis includes company management, industry, simplicity of business model, nature of goods and services, anecdotal evidence & sensitivity analysis.

## 'Top-down' factors

While Auscap has traditionally adopted a more 'bottom-up' approach to investing, understanding 'top-down' factors influencing industry valuations is utilised in co-operation with 'bottom up' analysis. The Manager allocates 70% of analysis time to 'bottom-up' factors, 15% to 'top-down' and 15% to technical analysis.

## Portfolio Construction

### Overview

FUND BENCHMARK	RBA CASH RATE
INTERNAL RETURN OBJECTIVE	10-15% ABSOLUTE RETURN AT A STOCK LEVEL
INTERNAL RISK OBJECTIVE	TO AVOID PERIODS OF SIGNIFICANT NEGATIVE PERFORMANCE
PORTFOLIO DECISIONS	CO-PORTFOLIO MANAGERS
STOCK SELECTION	'BOTTOM UP'
TOP-DOWN INFLUENCE	INPUT IN THE RESEARCH PROCESS
TYPICAL NUMBER OF HOLDINGS	25-45 (LONG & SHORT)
MARKET CAPITALISATION BIAS	LARGE-TO-MID
EXPECTED PORTFOLIO TURNOVER	100-200% P.A.

Portfolio construction is driven from the Manager's conviction in a stock. The co-PMs must agree on a stock before it can be added to the portfolio for both long and short positions. The final portfolio relies heavily on the Manager's fundamental bottom-up evaluation of companies but broader economic conditions are considered as well.

The co-PMs will also consider the liquidity of individual stock positions and aggregate portfolio exposures when determining the final portfolio weights.

The Manager uses technical analysis to improve its entry into, and exit out of, stock positions. Such analysis is only used to manage entry, exit and risk around positions. Stocks are never entered into for technical reasons.

## Risk Management

### Risk limits

SEPARATE RISK MONITORING	YES
STOCK LIMITS	MAX. 'SOFT' LIMIT OF 20% OF NAV (LONG AND SHORT); TIERED TO ACCOUNT FOR SIZE AND LIQUIDITY
SECTOR LIMITS	NONE
NET EXPOSURE LIMITS	150%
GROSS EXPOSURE LIMITS	400% (200% GROSS LONG AND 200% GROSS SHORT)
PORTFOLIO BETA	NOT TARGETED
CASH LIMITS	0-100%
DERIVATIVES	EXCHANGE-TRADED DERIVATIVES (TYPICALLY FUTURES AND OPTIONS) PERMITTED BUT ARE RARELY USED

The Fund implements three mandate limits, being a broad 'soft' single security limit of 20% of NAV (long or short) and 'hard' net and gross exposure limits of 150% and 400% respectively. The stock limits are tiered to account for size and liquidity. There are no sector limits in place. The Fund is permitted to go 100% cash, although this is not typically used.

### Risk monitoring

Risk is primarily managed at the stock and portfolio level. At the stock level, risks are examined via the Manager's fundamental analysis. The Fund also uses quantitative tools to manage risk, including beta adjusted exposure, sector exposure, VAR and scenario analysis.

The Compliance Committee is responsible for monitoring the RE's compliance with the Fund's Constitution and compliance framework. It has a majority of independent members.

### Risks

**The Fund carries a number of standard 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

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

#### Derivatives

The Manager has scope to implement various derivative strategies with the objective of mitigating equity market risks and also to gain exposure to assets and markets. The Fund can invest in derivatives, such as options, futures and swaps and equivalent cash settled instruments, for hedging and non-hedging purposes. However, the Fund does not typically use derivatives and would expect to do so very rarely.

#### Leverage risk

The Fund is permitted to 'short sell' stocks (i.e. borrow and sell a stock it does not own) as well as enter into cash borrowings. The Fund's maximum gross equity market exposure is 400%, being 200% gross long and 200% gross short.

ANALYST: JAMES KIRK | APPROVED BY: ADRIAN HOE

# Auscap Long Short Australian Equities Fund

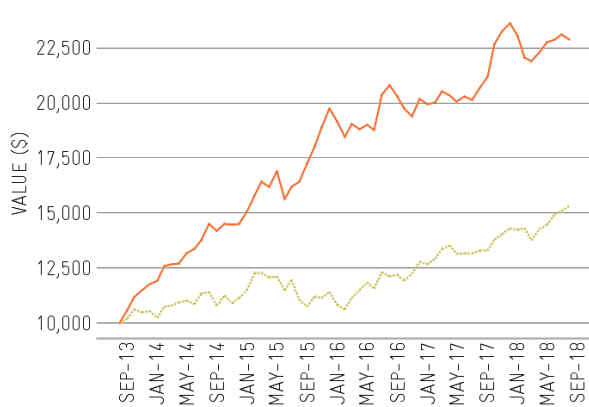
## Quantitative Performance Analysis - annualised after-fee % returns (at 31-8-2018)

### Performance metrics

	1 YR		2 YR		3 YR		5 YR	
	FUND	PEER MEDIAN	FUND	PEER MEDIAN	FUND	PEER MEDIAN	FUND	PEER MEDIAN
PERFORMANCE (% PA)	10.57	10.56	4.83	7.14	11.63	8.22	17.99	8.66
STANDARD DEVIATION (% PA)	9.88	9.15	8.76	8.05	10.44	9.92	10.55	9.42
EXCESS RETURN (% PA)	-4.88	-5.15	-7.62	-5.25	0.11	-3.25	9.08	-0.28
OUTPERFORMANCE RATIO (% PA)	41.67	41.67	33.33	41.67	44.44	44.44	55.00	51.67
WORST DRAWDOWN (%)	-7.22	-5.02	-7.22	-7.22	-7.22	-7.87	-7.55	-9.82
TIME TO RECOVERY (MTHS)	NR	NR	NR	NR	NR	7	3	7
SHARPE RATIO	0.88	1.14	0.35	0.94	0.93	0.65	1.50	0.65
INFORMATION RATIO	-0.56	-0.89	-1.02	-0.94	0.01	-0.40	0.91	-0.03
TRACKING ERROR (% PA)	8.67	7.73	7.46	7.46	9.50	8.13	9.99	8.30

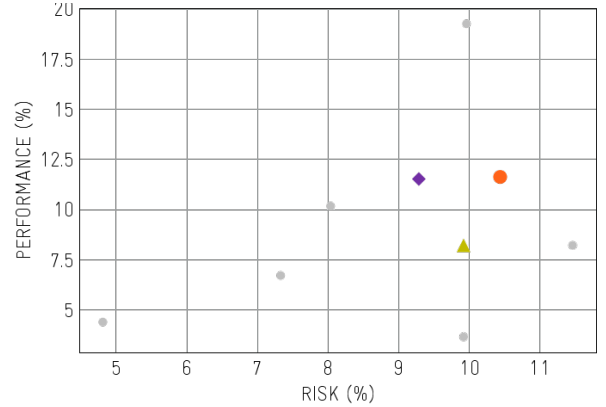
FUND: AUSCAP LONG SHORT AUSTRALIAN EQUITIES FUND  
 LONSEC PEER GROUP: AUSTRALIAN EQUITIES - AUSTRALIAN LONG SHORT - VARIABLE BETA  
 BENCHMARK USED: S&P/ASX 300 TR INDEX AUD  
 CASH BENCHMARK: BLOOMBERG AUSBOND BANK BILL INDEX AUD  
 TIME TO RECOVERY: NR - NOT RECOVERED, DASH - NO DRAWDOWN DURING PERIOD

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



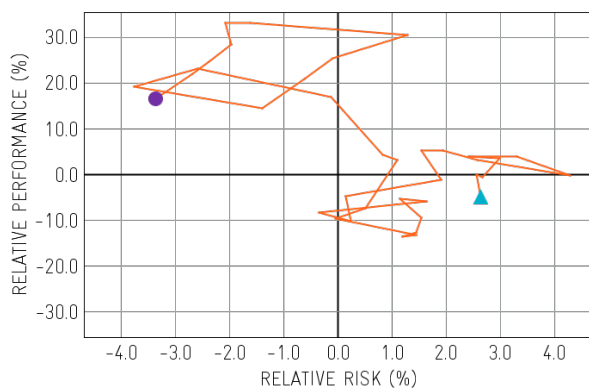
— AUSCAP LONG SHORT AUSTRALIAN EQUITIES FUND  
 - - - S&P/ASX 300 TR INDEX AUD

### Risk-return chart over three years



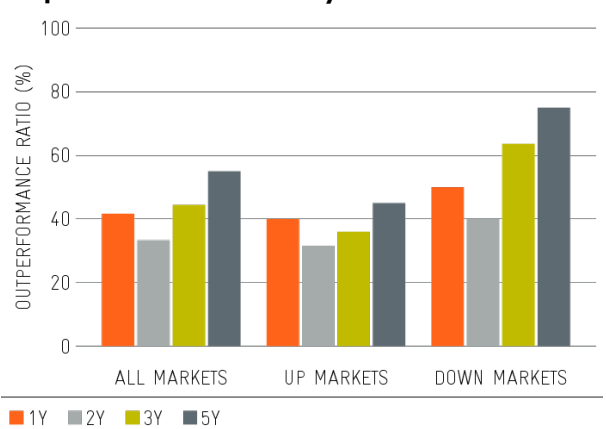
● AUSCAP LONG SHORT AUSTRALIAN EQUITIES FUND  
 ◆ S&P/ASX 300 TR INDEX AUD  
 ▲ PEER MEDIAN  
 ● PEERS

### Snail trail



● START (08-2015) ▲ END (08-2018)

### Outperformance consistency



■ 1Y ■ 2Y ■ 3Y ■ 5Y



## Auscap Long Short Australian Equities Fund

### Glossary

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

### About Lonsec

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.

### LONGSEC STRONGLY RECOMMENDS THIS DOCUMENT BE READ IN CONJUNCTION WITH THE RELEVANT PRODUCT DISCLOSURE STATEMENT

**IMPORTANT NOTICE:** This document is published by Lonsec Research Pty Ltd ABN 11 151 658 561, AFSL No. 421445 (Lonsec). Please read the following before making any investment decision about any financial product mentioned in this document.

**Disclosure at the date of publication:** Lonsec receives a fee from the fund manager or financial product issuer(s) for researching the financial product(s) set out in this document, using objective criteria. Lonsec may also receive a fee from the fund manager or financial product issuer(s) for subscribing to research content and other Lonsec services. Lonsec’s fee is not linked to the rating(s) outcome. Lonsec does not hold the financial product(s) referred to in this document. Lonsec’s representatives and/or their associates may hold the financial product(s) referred to in this document, but details of these holdings are not known to the Analyst(s). **Disclosure of Investment Consulting services:** Lonsec receives fees for providing investment consulting advice to clients, which includes model portfolios, approved product lists and other financial advice and may receive fees from this fund manager or financial product issuer for providing investment consulting services. The investment consulting services are carried out under separate arrangements and processes to the research process adopted for the review of this financial product. For an explanation of the process by which Lonsec manages conflicts of interest please refer to the Conflicts of Interest Policy which is found at: <http://www.lonsec.com.au/asp/IndexedDocs/general/LonsecResearchConflictsOfInterestPolicy.pdf> **Warnings:** Past performance is not a reliable indicator of future performance. Any express or implied rating or advice presented in this document is limited to “General Advice” (as defined in the Corporations Act 2001(Cth)) and based solely on consideration of the investment merits of the financial product(s) alone, without taking into account the investment objectives, financial situation and particular needs (‘financial circumstances’) of any particular person. It does not constitute a recommendation to purchase, redeem or sell the relevant financial product(s). Before making an investment decision based on the rating(s) or advice, the reader must consider whether it is personally appropriate in light of his or her financial circumstances, or should seek financial advice on its appropriateness. If our advice relates to the acquisition or possible acquisition of particular financial product(s), the reader should obtain and consider the Product Disclosure Statement for each financial product before making any decision about whether to acquire a financial product. Lonsec’s research process relies upon the participation of the fund manager or financial product issuer(s). Should the fund manager or financial product issuer(s) no longer be an active participant in Lonsec’s research process, Lonsec reserves the right to withdraw the document at any time and discontinue future coverage of the financial product(s). The rating in this publication relates to the financial product outlined in the publication which may have related financial products or be associated with other financial products and platforms. The rating may only be applied to the financial product outlined in this publication at first instance and whether it applies to related or associated financial products and platforms should be investigated by your financial adviser before you make an investment decision in relation to the related or associated financial products and platforms. You should be aware that the mandate, fees, underlying investments, the issuers of the related and associated financial products and platforms may be different from the financial product specified in this publication. You should satisfy yourself that the related and associated financial products and platforms meet your financial circumstances, needs and objectives before making an investment decision. **Disclaimer:** This document is for the exclusive use of the person to whom it is provided by Lonsec and must not be used or relied upon by any other person. No representation, warranty or undertaking is given or made in relation to the accuracy or completeness of the information presented in this document, which is drawn from public information not verified by Lonsec. Financial conclusions, ratings and advice are reasonably held at the time of completion but subject to change without notice. Lonsec assumes no obligation to update this document following publication. Except for any liability which cannot be excluded, Lonsec, its directors, officers, employees and agents disclaim all liability for any error or inaccuracy in, misstatement or omission from, this document or any loss or damage suffered by the reader or any other person as a consequence of relying upon it.

Copyright ©2018 Lonsec Research Pty Ltd (ABN 11 151 658 561, AFSL No. 421445) (Lonsec). This report is subject to copyright of Lonsec. Except for the temporary copy held in a computer’s cache and a single permanent copy for your personal reference or other than as permitted under the Copyright Act 1968 (Cth), no part of this report may, in any form or by any means (electronic, mechanical, micro-copying, photocopying, recording or otherwise), be reproduced, stored or transmitted without the prior written permission of Lonsec. This report may also contain third party supplied material that is subject to copyright. Any such material is the intellectual property of that third party or its content providers. The same restrictions applying above to Lonsec copyrighted material, applies to such third party content.