Zenith Investment Partners

Highly Recommended
Recommended
Approved
Not Rated
Redeem

Product Assessment

Report data as at 31 May 2020
Rating issued on 09 Jun 2020

Auscap Long Short Australian Equities Fund

VIEWPOINT

The Fund, managed by Sydney-based Auscap Asset Management (Auscap), provides investors exposure to Australian equities, through a long/short, variable beta strategy. Zenith's conviction in the Fund is underpinned by the high calibre of the investment team and the attractiveness of the underlying investment philosophy and process, which we believe is prudent and robust. Whilst we are disappointed with Auscap's challenging performance in recent market conditions, we retain conviction in the Fund achieving its investment objectives over the long term.

Auscap was established in 2012 as a boutique, Australian equities focused long/short investment manager. Auscap is independently owned by founders Tim Carleton and Matthew Parker.

The investment team of five is led by Carleton and Parker, who collectively have over 37 years' industry experience. Prior to establishing the Fund, both Carleton and Parker worked at Goldman Sachs from 2008 to 2011 where they each managed an Australian equities long/short portfolio using proprietary funds. Zenith views the portfolio managers' prior working relationship as a positive for the Fund. In addition, Zenith believes Carleton and Parker are highly experienced and have a solid understanding of the Australian equities market.

The Fund is managed through a co-portfolio manager structure, with Carleton and Parker jointly responsible. The Fund is expected to be long-biased over the long term and is constructed through a benchmark unaware and bottom-up approach, strongly leveraging the stock selection process. For a stock to be included in the Fund, a consensus is needed between Carleton and Parker. Zenith believes Auscap's stock selection process is intuitively sound, drawing on the bottom-up stock selection experience of the investment team.

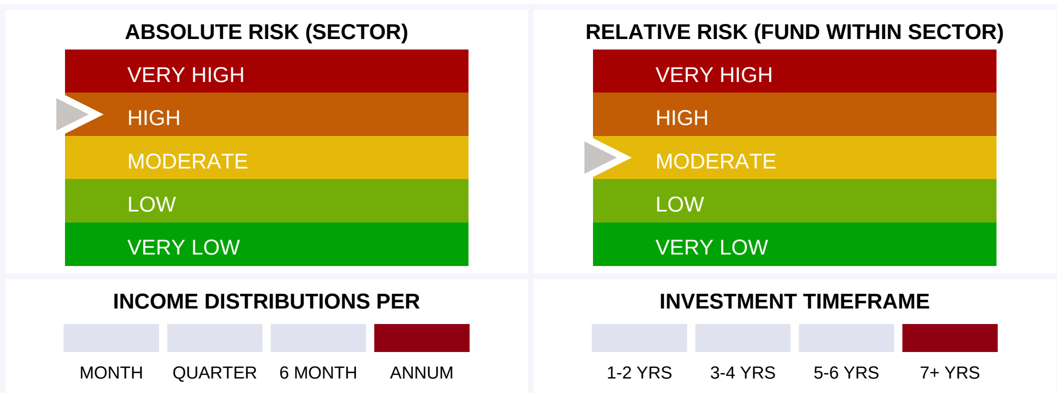
Portfolio weights are determined based on the conviction of Auscap's investment thesis and stock liquidity, with Carleton and Parker considering market dynamics to determine optimal entry and exit points. The portfolio managers are responsible for dealing, which Zenith believes allows for a better understanding of market forces and sentiment.

Unlike its long/short peers who dynamically adjust market exposures through derivatives, the Fund's aggregate gross long and short exposures are a function of the investment opportunity set. In addition, the Fund can hold cash (up to 100%) in the absence of compelling absolute return investment opportunities or for risk management purposes. Zenith is confident in Auscap's portfolio construction approach and believes the portfolio managers are well placed to utilise the Fund's flexible investment mandate to meet its investment objectives. However, Zenith notes that the Fund may exhibit a performance profile that is significantly different from that of peers and its benchmark. As such, investors should be aware there is significant reliance on the judgment and skill of Carleton and Parker.

Effective 31 March 2020, Auscap announced amendments to the Fund's fee structure, which includes a temporary management cost reduction to 1.025% p.a. and the waiver of performance fees until all unitholders have experienced a positive return. Once all unitholders have been made whole, Auscap will introduce dual hurdles (S&P/ASX All Ordinaries Index and the RBA Cash Rate) for its performance fee. Whilst Zenith believes these changes are beneficial to investors, we note that business risk has increased as a result. Zenith will continue to monitor business stability going forward.

FUND FACTS

- Generally holds between 25 and 45 stocks (20 to 30 long positions and 5 to 15 short positions)
- Net exposure generally ranging between 50% and 130%
- Expected portfolio turnover between approximately 100% p.a. and 200% p.a.
- Monthly liquid with one-month redemption notice period (daily liquid class, APIR: ASX6124AU)



APIR Code
ASX0001AU

Asset / Sub-Asset Class
Australian Shares
Long Short

Investment Style
Variable Beta

Investment Objective
To achieve absolute returns of 10% p.a. to 15% p.a. (before fees) over the long term, with an overarching philosophy of capital preservation.

Zenith Assigned Benchmark
S&P/ASX 300 (Accum)

Net Returns (% p.a.)

	5 yrs	3 yrs	1 yr
Fund	-1.37	-7.66	-26.44
Benchmark	4.35	4.48	-6.52
Median	4.39	4.43	-5.27

Income (% p.a.)

	Income	Total
FY to 30 Jun 2019	3.79	-9.17
FY to 30 Jun 2018	1.74	12.72
FY to 30 Jun 2017	5.29	7.98

Fees (% p.a., Incl. GST)
Management Cost: 1.54%
Performance Fee: 15.375% over RBA cash rate

APPLICATIONS OF INVESTMENT

SECTOR CHARACTERISTICS

The Zenith "Australian Shares – Long Short" sector consists of long/short funds investing across the market cap spectrum of the Australian equity market. These funds can short sell equities and/or SPI futures to capture excess return opportunities and manage risk. Over the long term, Zenith expects quality long/short funds to outperform the S&P/ASX 300 Accumulation Index given a manager's ability to generate excess returns from short selling.

Each long/short manager uses vastly different investment processes. Some managers are fundamentally driven, others use quantitative tools, and others have trading style biases. Funds in this sector employ active extension or variable beta investment styles. Active extension funds can be used in place of a traditional long-only fund where the investor wishes to increase the "activeness" of their fund allocations in equities. That is, the fund can build a higher conviction portfolio by shorting stocks that it thinks will underperform and use the proceeds to invest long in stocks that may outperform. Variable beta funds can be used by investors to reduce the market risk of investing with a long-only fund that must be close to fully invested. Variable beta funds can decrease their market exposures to protect against market falls (by increasing shorts or cash holdings). In general, investing in quality variable beta funds should provide investors "smoother" returns than simply investing in the index.

Zenith benchmarks all funds in this sector against the S&P/ASX 300 Accumulation Index. However, many managers in this category benchmark their funds against the S&P/ASX 200 Accumulation Index. Both indices are market-capitalisation weighted, resulting in companies with the largest market capitalisations receiving the heaviest weightings within the index. Over the longer term, Zenith believes there will be minimal difference between the return profiles of these indices.

The Australian share market, as represented by the S&P/ASX 300 Index, is highly concentrated and narrow. Technically, a company is considered large cap if it falls within the S&P/ASX 50 Index, with companies falling between the S&P/ASX 50 and S&P/ASX 100 considered mid cap. All stocks outside of the S&P/ASX 100 Index are considered small capitalisation stocks.

As at 31 May 2020, the Financials and Resources sectors combined represented a significant portion of the S&P/ASX 300 Accumulation Index, with the Financials sector accounting for approximately 27% of the Index, and Materials approximately 20%. The split between Industrials and Resources stocks was approximately 80%/20%. The top 10 stocks represented approximately 43% of the weighting of the Index, and the top 20 stocks represented over 57% of the Index.

PORTFOLIO APPLICATIONS

Investors should be aware that the Fund has monthly liquidity, whilst Auscap also applies a minimum of one month notice period for redemptions. Zenith notes that a daily liquid unit class of the Fund is available (APIR: ASX6124AU). However, investors can only access this investment option via select investment platforms.

In general, compared to most other asset classes, equities offer investors the opportunity for higher capital growth over the longer term with some income. However, this higher growth is also often associated with higher volatility. Therefore, it is recommended that investors adopt a longer time frame when investing in equities.

Investors should also be cognisant of the fact that the Australian equity market is relatively concentrated, with the Materials and Financials sectors dominating the market. The market also only represents approximately 1% of global equity markets (in terms of market capitalisation). Therefore, to mitigate this concentration risk it is highly recommended that investors diversify their investments across asset classes, both domestically and globally.

Unlike a traditional long-only Australian equities fund, Auscap employs a concentrated long/short investment strategy, which provides it with greater flexibility to meet its investment objectives over the long term. The short selling capability enables the Fund to profit from companies that are expected to fall in price or hedge against declines in the market and therefore, potentially offer a different return profile to most long-only Australian equity funds. As a result, the Fund will be exposed to higher levels of stock specific risk, and as such, performance may deviate from the benchmark and peers.

Zenith notes that Auscap has demonstrated extensive use of the flexibility within the mandate, with the net equity exposure of the Fund ranging between 45% and 135% since inception. Auscap has been more dynamic than peers in adjusting exposures materially over shorter discrete periods, subject to the availability of investment opportunities or for risk management considerations.

Zenith encourages investors to adopt a medium to longer-term investment timeframe of more than seven years when investing in this Fund. Investors should be aware that the Fund targets its return objective with leverage. The gross exposure (total long plus total short exposure) of the Fund has varied between 60% and 230% since inception. Zenith believes this is an important measure for investors to understand as it is indicative of the actual leverage in a portfolio, which may amplify losses should Auscap fail to deliver added value from both its long and short components (i.e. gross leverage of greater than 100% magnifies the level of success and failure).

While the Fund can be held as a standalone exposure to the Australian equities sector, Zenith believes the Fund should be blended with other style-neutral or growth-orientated Australian equities products to achieve a more diversified exposure to the asset class and has the potential to enhance the overall risk/return profile of a portfolio.

The Fund's portfolio turnover is expected to be between approximately 100% p.a. and 200% p.a., which Zenith considers to be high. Auscap was not able to provide any insight on the proportion of expected turnover attributed to the resizing of existing positions and that which is due to initiating and closing positions. Given this expected level of turnover, the majority of the Fund's returns are expected to be delivered via the realisation of capital gains in income distributions, rather than through capital appreciation in the unit price. In addition, realised capital gains are highly unlikely to be eligible for the capital gains tax discount, which can have a further negative impact on the after-tax outcomes for high tax rate paying investors. As such, holding all else equal, the Fund may be more appealing to investors who are nil/low tax rate payers or high marginal tax rate payers who invest through tax-effective vehicles such as a superannuation fund.

RISKS OF THE INVESTMENT

SECTOR RISKS

Funds within the "Australian Long Short" sector are exposed to the following broad risks:

BUY/SELL SPREAD INCREASES: Global markets are experiencing significant volatility due to the COVID-19 situation. As a result, the cost of transacting has risen significantly. In addition, funds employing currency hedging have also been impacted with an increase in foreign exchange transaction costs.

In response to this, many managers have been frequently adjusting the buy/sell spreads for many funds, often daily. In some cases, the adjustments have been material. Zenith encourages all advisers/investors to reconfirm the buy/sell spread on each fund prior to making any investment decision and prior to issuing trade instructions. As markets stabilise, Zenith expects spreads to revert to historical levels, however, this may take several months.

MARKET & ECONOMIC RISK: A risk to the performance of funds in the sector is a sustained downturn across the Australian share market. In addition, changes in economic, social, technological or political conditions, as well as market sentiment could also lead to negative fund performance. This risk can be significantly reduced by investors adhering to the Fund's prescribed investment timeframe.

SPECIFIC SECURITY RISK: This is the risk associated with an individual security. The price of shares in a company may be affected by unexpected changes in that company's operations such as changes in management or the loss of a significant customer.

LIQUIDITY RISK: This is the risk that a security or asset cannot be traded quickly enough, due to insufficient trading volumes in the market. When trading volumes are low, buyers/sellers can significantly impact the price of a security when attempting to quickly enter/exit a material position.

STYLE BIAS RISK: Australian equity managers will either employ a Growth, Value or Neutral (combination of Value & Growth) styled approach to investing. Each style is conducive to certain market conditions i.e. Growth should outperform Value in an upward trending market and vice versa in a downward trending market. As with Market Risk, investors should adhere to the fund's investment timeframe to avoid short-term market movements and style impact.

CAPACITY RISK: High levels of funds under management (FUM) can present additional challenges to an Australian equity manager, as high FUM has the potential to hamper the manager's ability to trade efficiently and/or be forced to disclose substantial shareholdings to the market (most common in smaller companies).

SHORT RISK: Australian long/short funds have the ability to borrow securities and sell them on market (i.e. shorting). Given that such securities will need to be returned to the lender eventually, the short seller may be required to re-purchase the securities on market at a higher price, thereby incurring a loss. Such losses can potentially be unlimited given that there is no theoretical limit on how much the price of a security can rise.

REGULATORY RISK: The ASIC Regulatory Guide 97 'Disclosing Fees and Costs in PDSs and Periodic Statements' came into effect on 1 October 2017 and seeks to establish a common framework for disclosing fees with respect to registered managed investment schemes issued to retail investors.

In January 2019, ASIC released a Consultative Paper (CP), seeking feedback with respect to proposed changes to the existing fee and cost disclosure regime. The consultation period ends in April 2019, following which, ASIC will collate feedback and structure final recommendations, notifying of an intended implementation period.

In its current form, RG97 is not expected to impact the actual costs (or net returns) on existing investments. Rather, the guide is focused on providing increased transparency with respect to the costs of management. Given this, it is feasible that under RG97, investors become more sensitive to the costs charged and seek lower cost alternatives, potentially leading to fund outflows.

FUND RISKS

Zenith has identified the following key risks of the Fund. Although Zenith believes the risks noted are all significant, we have listed them in order of importance. In addition, we have not intended to highlight all possible risks.

KEY PERSON RISK: Auscap is subject to a relatively high level of key person risk. Zenith views Tim Carleton and Matthew Parker as being critical to the management of the Fund. A departure of either would trigger an immediate review of our rating on the Fund, however, Zenith acknowledges the material equity ownership of Carleton and Parker in the business and we believe that this mitigates the risk of a departure, at least in the medium-term.

BUSINESS RISK: Business risk is generally higher for boutique firms; however, as is the case with Auscap, it is reduced substantially once profitability is reached. The firm's level of funds under management (FUM) is approximately $A 264 million, as at 31 May 2020. Although the firm is currently profitable and holds significant working capital, we note that there has been a material decline in FUM from a peak of approximately $A 637 million (as at 30 September 2018). Zenith will continue to monitor business stability going forward.

CONCENTRATION RISK: The Fund holds a concentrated portfolio of stocks (typically 25 to 45 including shorts). Investors should be aware that this may result in higher levels of stock specific risk and as such, performance can deviate from the benchmark and peers.

TEAM FOCUS RISK: In addition to the Fund, Auscap's investment team of five also manages the Auscap Global Equities Fund. As such, Zenith believes that the investment team's research focus has the potential to be diluted.

CAPACITY RISK: Excessive levels of FUM can inhibit a manager's ability to trade portfolio positions effectively and may, therefore, limit outperformance potential. Whilst Zenith does not consider capacity to be a current issue, given strategy FUM of approximately $A 258 million as at 31 May 2020, Zenith will continue to monitor this risk closely.

LEVERAGE RISK: The Fund has the ability to short sell stocks and use the proceeds to increase its long exposure to stocks. This increases an investor's exposure to Auscap's stock specific decisions and can magnify returns and losses. The maximum gross exposure, namely the sum of the Fund's long and short exposures, is limited to 400% of the value of the Fund's net assets.

DERIVATIVE RISK: The Fund can use derivatives such as options and futures and these investment securities can be volatile, speculative, illiquid and leveraged. The use of derivatives is limited to hedging purposes with index/stock puts used to hedge physical stock positions, whilst futures are used to adjust the market exposure of the portfolio. However, the Fund can only use exchange traded derivatives and cannot use them to leverage up the Fund.

ACCESSIBILITY RISK: The Fund offers investors monthly liquidity. Zenith notes that this is inconsistent with peers and would prefer more favourable liquidity terms given that a large portion of the investments in the Fund and their historical return generation are predominately from trading in a relatively liquid segment of the Australian equity market (S&P/ASX 200). In addition, Auscap also applies a one-month minimum notice period for redemptions.

Zenith notes that a daily liquid unit class of the Fund is available (APIR: ASX6124AU). However, investors can only access this investment option via select investment platforms.

COUNTERPARTY RISK: The Fund's custody and counterparty contracts are subject to potential default risk. In particular, the Fund is exposed to counterparty risk with its Prime Broker, Citigroup Global Markets Limited (CGML). Assets of the Fund are required to be transferred to CGML when borrowing stock for short selling. Assets up to the required collateral amount are held on CGML's balance sheet and are not segregated from other CGML assets.

Should CGML become insolvent, there is a risk that the assets posted by the Fund may not be recoverable.

QUALITATIVE DUE DILIGENCE

ORGANISATION

Based in Sydney, Auscap Asset Management (Auscap) was established in 2012 as a boutique Australian equities focused long/short investment manager. In November 2019, Auscap expanded its product suite by launching the Auscap Global Equities Fund.

Auscap is independently owned by its founders, with Tim Carleton and Matthew Parker holding 100% of Auscap's equity.

As at 31 May 2020, Auscap had approximately $A 264 million in firmwide funds under management (FUM). As at the same date, Auscap managed approximately $A 258 million in its Australian long/short strategy.

Although the firm is currently profitable and holds significant working capital, we note that profitability has been negatively impacted by a significant reduction in FUM. Zenith will continue to monitor business stability going forward.

INVESTMENT PERSONNEL

Name	Title	Tenure
Tim Carleton	Portfolio Manager	7 Yr(s)
Matthew Parker	Portfolio Manager	7 Yr(s)

The investment team of five is led by Carleton and Parker, who collectively have over 37 years' industry experience. Prior to establishing the Fund, both Carleton and Parker worked at Goldman Sachs from 2008 to 2011 where they each managed an Australian equities long/short portfolio using proprietary funds. Zenith views the portfolio managers' prior working relationship as a positive for the Fund.

Zenith believes Carleton and Parker have complementary skill sets and focus areas. For example, Carleton typically begins his company research through analysing financial statements, while Parker will start by determining the broader consensus views on the company.

Having founded the strategy together in 2012, Carleton and Parker have maintained the initial co-portfolio manager structure since inception. Carleton and Parker share all responsibilities and do not allocate workload along sector or industry lines. Furthermore, there is no performance attribution between the two, ensuring the management of the Fund is cohesive and constructive.

Over the past three years, Auscap has added three analysts, Gavin Rogers, William Mumford and Naveen Patney, with its investment team now comprising five individuals. With over 25 years' investment experience, Rogers is based in Melbourne and predominantly acts as a sounding board for Carleton and Parker. Zenith notes that Rogers previously worked with Carleton and Parker at Goldman Sachs. Mumford and Patney provide analytical support for the portfolio managers, allowing them to focus on the key investment issues. Zenith views the recent expansion of the team positively.

Given Carleton and Parker are co-owners of the business, Zenith believes the ownership structure of Auscap aligns the interests of the investment team to the performance of the Fund and the overall success of the business.

Overall, Zenith believes Carleton and Parker are highly experienced and have a solid understanding of the Australian equities market.

INVESTMENT OBJECTIVE, PHILOSOPHY AND PROCESS

The Fund aims to achieve absolute returns of 10% p.a. to 15% p.a. (before fees) over the long term. Auscap maintains an equal focus on meeting its performance and capital preservation objectives. Zenith notes that Auscap is conservative and measured in its investment approach, which we believe is conducive for the management of an absolute return/variable beta strategy.

Auscap believes that markets are efficient in the long term, however due to behavioural biases and the time required for information to be disseminated and fully analysed, inefficiencies can occur in the shorter term. These inefficiencies result in the deviation of stock valuations from their intrinsic value. Auscap attempts to exploit these inefficiencies through the use of a concentrated, long/short strategy that is driven primarily by fundamental analysis.

Auscap adopts a value style approach to investing, whilst seeking to identify stocks with attractive quality attributes. Zenith is pleased to with Auscap's discipline in applying its value style process through a range of market conditions.

SECURITY SELECTION

The Fund's investable universe is all Australian listed equities, however Auscap will tend to focus predominantly on stocks within the S&P/ASX 200 Index.

The stock selection process begins with the identification of attractively priced potential investment opportunities. Auscap screens the universe on the following metrics:

- Forecast earnings yield
- Anticipated earnings growth
- Price to earnings ratio (P/E)
- Price to cash flow ratio (P/CF)
- Enterprise value to earnings before interest and tax ratio (EV/EBIT)
- Dividend yield
- Price to net tangible assets (P/NTA)

In addition to the quantitative screen, Auscap also considers opportunities from a variety of sources such as:

- Industry data
- Company meetings and site visits
- Discussions with management
- Discussions with sector & stock analysts
- Review of external research reports and valuation work

Once an investment opportunity is identified, it is subject to both quantitative and qualitative analysis. The portfolio managers rely on internal fundamental research, which includes financial analysis and a company visitation program.

Quantitative analysis includes an assessment of the following metrics:

- Historic cash flow generation and conversion
- Current strength of balance sheet (Debt/EBIT, Interest coverage ratio and Debt to market capitalisation)
- Return on invested capital (ROIC)
- Return on assets (ROA)
- Return on equity (ROE)
- Historic, near-term and sustainable revenue and earnings growth
- Historical profitability
- Sector and stock revenue growth drivers
- Volatility of revenues, earnings and cash flow

Qualitative analysis involves the assessment of the following factors:

- Quality and strength of management
- Industry feedback and perception
- Simplicity of the business model
- The nature of the goods and services offered
- Investigative and anecdotal evidence
- Testing of the investment thesis against similar and contrary opinions

In addition, Auscap also has access to numerous brokers for external investment research reports, broker research reports and corporate access.

More specifically for short selling opportunities, Auscap seeks the following characteristics:

- Poor cash flow
- A weak balance sheet
- Declining earnings and/or cash flows
- Complex business models
- Questionable accounting practices
- Poor cash flow conversion (as a percentage of reported profits)
- Undisciplined, inexperienced or poor management
- A market capitalisation that significantly exceeds a reasonable estimate of fair value
- Market sentiment, investor psychology and technical indicators that suggest downside price risk

Overall, Zenith believes Auscap's stock selection process is intuitively sound, drawing on the bottom-up stock selection experience of the investment team.

PORTFOLIO CONSTRUCTION

Given the co-portfolio manager structure, Carleton and Parker are jointly responsible for portfolio construction. For a stock to be included in the Fund, a consensus is needed between Carleton and Parker.

The Fund is expected to retain a long bias over the longer term and is constructed through a benchmark unaware and bottom-up approach, which strongly leverages the stock selection process.

The Fund is relatively concentrated and will typically hold between 25 and 45 stocks, both long and short combined. More specifically, there will generally be 20 to 30 long positions and 5 to 15 short positions.

Portfolio weights are determined based on the conviction of Auscap's investment thesis and stock liquidity. Long positions have typically ranged between 0.5% and 8%, whilst short positions have typically ranged between -0.2% and -2.5%.

Carleton and Parker will consider investor psychology and market sentiment to determine optimal entry and exit points. Individual positions will be exited when one of the following occurs:

- The investment thesis becomes invalidated by new data, changing circumstances and/or a change in Auscap's view
- The position trades above (for long positions) or below (for short positions) Auscap's view of intrinsic value
- Poor technical indicators suggest a continued deterioration in the share price is probable, without an appropriate justification for continued investment

The portfolio managers are responsible for dealing, which Zenith believes allows for a better understanding of market forces and sentiment. Portfolio turnover is expected to be high at approximately 100% p.a. to 200% p.a.

Unlike its long/short peers who dynamically adjust market exposures through derivatives, the Fund's aggregate gross long and short exposures are a function of the investment opportunity set. In addition, the Fund can hold cash (up to 100%) in the absence of compelling absolute return investment opportunities or for risk management purposes.

Zenith is confident in Auscap's portfolio construction approach and believes the portfolio managers are well placed to utilise the Fund's flexible investment mandate to meet its investment objectives.

RISK MANAGEMENT

Portfolio Constraints	Description
Number of Stocks - Long	20 to 30 (Soft limit)
Number of Stocks - Short	5 to 15 (Soft limit)
Net Exposure (%)	-150% to 150% (Typically 50% to 130%)
Gross Exposure (%)	max: 400%
Long Exposure (%)	max: 200% (Typically 90% to 140%)
Short Exposure (%)	max: 200% (Typically 20% to 40%)
Cash (%)	max: 100%
ESG Constraints - Excluded Sectors	N/A

The Fund is managed within the above listed risk management constraints. Whilst broad, Zenith believes these risk limits provide the Fund with sufficient flexibility to achieve its investment objective, whilst maintaining a disciplined approach to investing.

At the individual security level, Zenith believes that risk management is well incorporated in the detailed fundamental research process undertaken by Auscap.

The gross and net equity exposures of the portfolio are dependent on the investment opportunity set and subject to the portfolio limits. Zenith believes the gross and net equity exposure constraints are appropriate given the strategy and objective.

Zenith notes that there are no industry, sector or market capitalisation exposure limits, which can potentially lead to high levels of concentration in certain sectors.

Given the asymmetric risk profile of short sold positions, Auscap manages these positions more actively than their long counterparts. Short sold positions will typically be smaller than corresponding long positions. Greater consideration is given to liquidity and high levels of short interest, with short positions typically in companies with market capitalisations of greater than $A 1 billion. Short positions will typically constitute 20% to 40% of the Fund.

Zenith is comfortable with Auscap's risk management process and in particular notes the conservative and disciplined approach undertaken by the portfolio managers. However, investors should be aware there is significant reliance on the judgement and skill of Carleton and Parker.

Environmental, Social & Governance (ESG)

While the portfolio has no specific exclusions as outlined in the table above, Auscap incorporates ESG considerations into its research effort. The identification of ESG issues can be reflected in a company's quality assessment and/or valuation, which if deemed to be significant, can preclude the company from potential investment. Zenith believes that this qualitative analysis of a company’s operations is crucial on a forward basis, given that a company's performance with regards to ESG considerations is increasingly being reflected in the company's share price. Overall, Zenith is comfortable with Auscap's approach to ESG.

ADMINISTRATION AND OPERATIONS

The Fund has no redemption fees or gates.

The Fund provides monthly liquidity with a one month redemption notice period. Zenith notes that a daily liquid unit class of the Fund is available (APIR: ASX6124AU). However, investors can only access this investment option via platforms.

Operations

The Auscap Compliance & Risk Management Policies set out Auscap’s approach to risk management and capture Auscap’s legal, regulatory and commercial obligations.

In conjunction with launching a retail version of the Fund in 2016, the Compliance Committee now comprises a majority of independent members whereas previously it was a subcommittee of the Auscap Board. This committee is ultimately responsible for the ongoing monitoring of compliance, audit, and risk management functions.

Service Providers

The Fund has appointed the following independent service providers:

Prime Broker

Citigroup Global Markets Limited

Administrator

Link Fund Solutions Pty Ltd

Custodian

Citigroup Global Markets Limited

Auditors

Ernst & Young

Legal

Norton Rose Fulbright

Pricing

The Fund’s holdings are liquid Australian stocks that trade on the ASX. The portfolio is linked to live prices and runs live each trading day. The Fund Net Asset Value (NAV) is calculated by the administrator.

Transparency

Auscap has provided Zenith with the documentation that we have requested and we are comfortable with the level of transparency that Auscap has provided.

Disaster recovery

Auscap has a detailed business continuity and disaster recovery plan. Auscap has a disaster recovery office located away from the city with separate computers and internet access. Files are stored on a network drive located in a secure temperature controlled room onsite. The files are backed up daily to the Cloud (which is secure and accessible remotely) and weekly to an external hard drive stored offsite. Key staff reconvene at the external disaster recovery office, download the company files and resume operations remotely.

Personal trading

Personal dealing is permitted but before trading the trader must receive prior approval and disclose all trade details to the Executive Directors. All employees must sign a Securities Trading Declaration on commencement at Auscap.

Compliance

Auscap maintains a detailed Operations & Compliance Manual in addition to a Compliance Plan that has been lodged with ASIC.

In terms of monitoring regulatory changes or other compliance developments Auscap employs an in-house legal and compliance capability, whilst they also utilise the services of external legal and compliance services.

The Principals of Auscap do not have any other active business interests. There are no outstanding legal, criminal, civil or regulatory proceedings against Auscap or the investment principals.

Personal dealing is permitted but before trading the trader must disclose all the details of the trade to the Executive Directors. All employees must sign a Securities Trading Declaration on commencement at Auscap.

INVESTMENT FEES

The Sector average management cost (in the table below) is based on the average management cost of all flagship Australian Shares - Long Short funds surveyed by Zenith.

The Fund charges a management cost of 1.5375% p.a. and a performance fee of 15.375%. The performance fee is payable on performance exceeding that of the S&P/ASX All Ordinaries Accumulation Index, subject to the performance also exceeding the return of the RBA Cash Rate and requiring all prior underperformance to be recouped. It is calculated monthly and paid semi-annually.

Effective 31 March 2020, Auscap announced amendments to the Fund's fee structure, which includes a temporary management cost reduction to 1.025% p.a. and the waiver of performance fees until all unitholders have experienced a positive return. Whilst Zenith believes these changes are beneficial to investors, we note that business risk has increased as a result. Zenith will continue to monitor business stability going forward.

Zenith notes that Auscap's 2020 implementation of a dual hurdle, brings it in line with best practice.

When assessing the Fund on its prevailing fee structure, Zenith believes the Fund is expensive, relative to peers, given its stated objectives. In addition, we believe that investors have not been sufficiently compensated by way of risk-adjusted performance given the fees paid over the past three years (ending 30 June 2019).

There is also a buy/sell spread of 0.2% charged on Fund entry and exit, which is in place to protect existing investors from applications and redemptions, with any excess proceeds retained in the Fund.

(The fees mentioned above are reflective of the flagship version only, fees may differ when the product is accessed through an alternate investment vehicle such as a platform.)

Fees Type	Fund	Sector Average (Wholesale Funds)
Management Cost	1.54% p.a.	1.15% p.a.
	Description	
Performance Fee	15.375% over RBA cash rate	
	Buy Spread	Sell Spread
Buy / Sell Spread	0.20%	0.20%

PERFORMANCE ANALYSIS

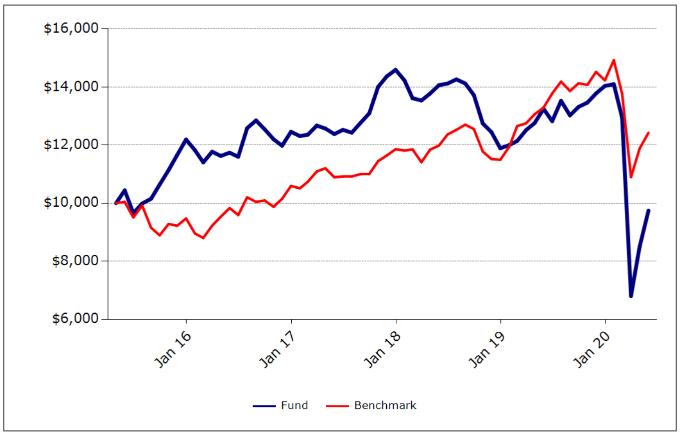
Report data: 31 May 2020, product inception: Dec 2012

Monthly Performance History (%, net of fees)

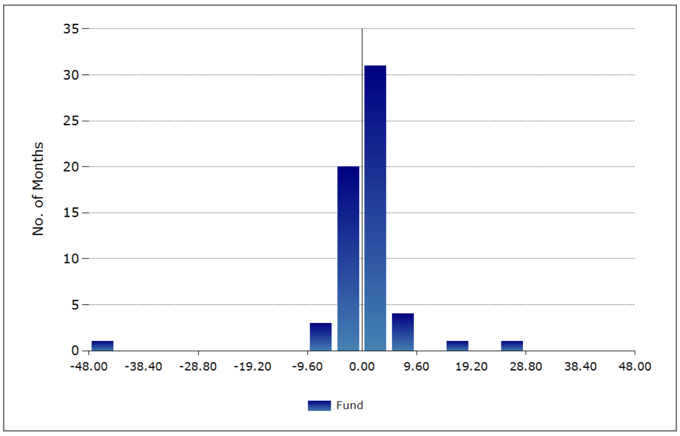
	JAN	FEB	MAR	APR	MAY	JUN	JUL	AUG	SEP	OCT	NOV	DEC	FUND YTD	BENCHMARK YTD
2020	0.42	-8.17	-47.44	24.96	14.63								-30.58	-12.67
2019	0.92	1.19	3.08	1.96	3.82	-3.21	5.46	-3.70	2.24	1.13	2.32	1.89	18.06	23.78
2018	-2.50	-4.31	-0.56	1.75	2.11	0.39	1.02	-0.99	-2.85	-7.09	-2.33	-4.49	-18.51	-3.07
2017	-1.20	0.42	2.52	-0.81	-1.52	1.18	-0.77	2.75	2.53	6.96	2.58	1.56	17.11	11.95
2016	-3.01	-3.54	3.22	-1.24	0.96	-1.19	8.48	2.13	-2.37	-2.72	-1.83	4.00	2.20	11.80

Benchmark: S&P/ASX 300 (Accum)

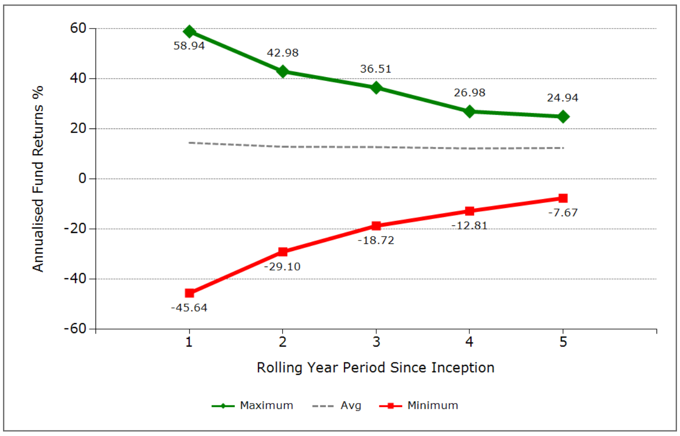
Growth of $10,000



Monthly Histogram



Minimum and Maximum Returns (% p.a.)



ABSOLUTE PERFORMANCE ANALYSIS

Return	Incpt.	5 yr	3 yr	1 yr
Fund (% p.a.)	10.12	-1.37	-7.66	-26.44
Benchmark (% p.a.)	7.79	4.35	4.48	-6.52
Median (% p.a.)	9.24	4.39	4.43	-5.27
Ranking within Sector	**Incpt.**	**5 yr**	**3 yr**	**1 yr**
Fund Ranking	4 / 14	17 / 18	22 / 22	23 / 23
Quartile	1st	4th	4th	4th
Standard Deviation	**Incpt.**	**5 yr**	**3 yr**	**1 yr**
Fund (% p.a.)	23.46	27.41	33.89	56.71
Benchmark (% p.a.)	13.99	15.15	16.62	25.78
Median (% p.a.)	15.45	15.44	17.43	25.93
Downside Deviation	**Incpt.**	**5 yr**	**3 yr**	**1 yr**
Fund (% p.a.)	17.92	21.60	27.29	44.89
Benchmark (% p.a.)	9.48	10.99	12.91	20.28
Median (% p.a.)	9.55	10.90	12.83	19.76
Risk/Return	**Incpt.**	**5 yr**	**3 yr**	**1 yr**
Sharpe Ratio - Fund	0.34	-0.11	-0.27	-0.48
Sortino Ratio - Fund	0.45	-0.15	-0.34	-0.61

All commentary is as at 31 May 2020.

The Fund aims to achieve absolute returns of 10% p.a. to 15% p.a. (before fees) over the long term. Auscap maintains an equal focus on meeting its performance objectives and capital preservation.

Whilst the Fund has achieved its performance objective since inception, it has been unable to do so over the most recent one, three and five-year periods.

The Fund has achieved its returns with a level of volatility, as measured by Standard Deviation, that is marginally higher than that of the S&P/ASX 300 Accumulation Index since inception.

On a risk-adjusted basis, the Fund has also achieved strong Sharpe and Sortino Ratios since inception, thus investors have been generally rewarded for the risk inherent in the Fund.

RELATIVE PERFORMANCE ANALYSIS

Alpha Statistics	Incpt.	5 yr	3 yr	1 yr
Excess Return (% p.a.)	2.33	-5.72	-12.14	-19.92
% Monthly Excess (All Mkts)	51.11	41.67	41.67	50.00
% Monthly Excess (Up Mkts)	44.83	39.47	48.00	57.14
% Monthly Excess (Down Mkts)	62.50	45.45	27.27	40.00
Beta Statistics	**Incpt.**	**5 yr**	**3 yr**	**1 yr**
Beta	1.25	1.45	1.80	2.05
R-Squared	0.56	0.64	0.78	0.87
Tracking Error (% p.a.)	16.03	17.75	20.70	33.96
Correlation	0.75	0.80	0.88	0.93
Risk/Return	**Incpt.**	**5 yr**	**3 yr**	**1 yr**
Information Ratio	0.15	-0.32	-0.59	-0.59

All commentary is as at 31 May 2020.

Zenith seeks to identify funds that can outperform their index in greater than 50% of months in all market conditions, as we believe this represents a persistence of manager skill. Whilst the Fund has achieved this outcome since inception, it has been unable to do so over the most recent one, three and five-year periods.

Since inception, the Fund has tended to produce greater outperformance consistency in declining markets which Zenith believes demonstrates Auscap's focus on capital preservation. Disappointingly, this has not been the case in recent market conditions.

The Fund has produced strong excess returns relative to the benchmark and the cash rate since inception.

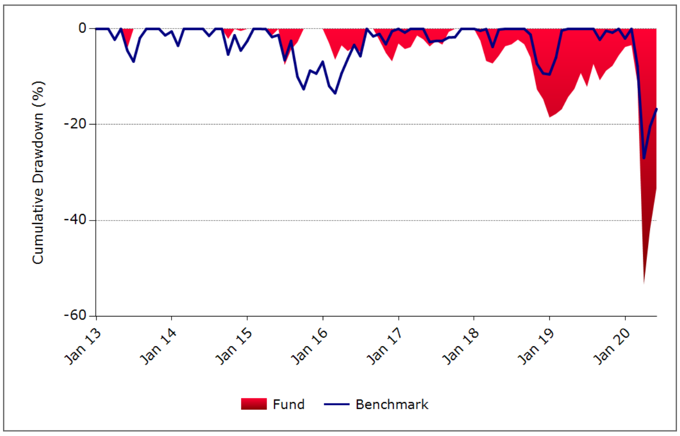
The Fund's Tracking Error has remained high, which is consistent with the Fund's absolute return and benchmark unaware mandate.

DRAWDOWN ANALYSIS

Drawdown analysis assesses the relative riskiness of a Fund versus the benchmark, in reference to capital preservation. The maximum Drawdown is recorded as the percentage decline in the value of a portfolio from peak to trough (before a new peak is achieved). All Drawdown analysis is calculated commencing from the inception date of the Fund in question, and Drawdown analysis for the Fund and benchmark(s) are calculated independently. That is, the largest drawdown for the Fund and benchmark(s) will not always refer to the same time period.

Drawdown Analysis	Fund	Benchmark
Max Drawdown (%)	-53.37	-26.97
Months in Max Drawdown	27	2
Months to Recover	-	-

Worst Drawdowns	Fund	Benchmark
1	-53.37	-26.97
2	-7.55	-13.46
3	-6.77	-9.51
4	-6.44	-6.83
5	-4.05	-5.37



All commentary is as at 31 May 2020.

Whilst the Fund has historically demonstrated an ability to preserve capital during periods of market stress, Zenith notes this level of capital preservation has not been as prevalent when assessing the Fund's more recent performance. As such, Zenith remains disappointed with Auscap's inability to preserve capital in recent market conditions.

INCOME/GROWTH ANALYSIS

Income / Growth Returns	Income	Growth	Total
FY to 30 Jun 2019	3.79%	-12.96%	-9.17%
FY to 30 Jun 2018	1.74%	10.98%	12.72%
FY to 30 Jun 2017	5.29%	2.69%	7.98%
FY to 30 Jun 2016	16.38%	3.75%	20.13%
FY to 30 Jun 2015	3.14%	13.67%	16.81%
FY to 30 Jun 2014	34.25%	11.76%	46.01%
FY to 30 Jun 2013	6.83%	12.89%	19.72%

The Fund does not target specific income levels.

Where applicable, distributions are paid annually. Zenith would prefer a more frequent distribution profile to alleviate potential issues involved with large distributions at 30 June.

The Fund’s portfolio turnover is expected to be between approximately 100% p.a. and 200% p.a., which Zenith considers to be high. Auscap was not able to provide any insight on the proportion of expected turnover attributed to the resizing of existing positions and that which is due to initiating and closing positions. Given this expected level of turnover, the majority of the Fund's returns are expected to be delivered via the realisation of capital gains in income distributions, rather than through capital appreciation in the unit price. In addition, realised capital gains are highly unlikely to be eligible for the capital gains tax discount, which can have a further negative impact on the after-tax outcomes for high tax rate paying investors. As such, holding all else equal, the Fund may be more appealing to investors who are nil/low tax rate payers or high marginal tax rate payers who invest through tax-effective vehicles such as a superannuation fund.

REPORT CERTIFICATION

Date of issue: 9 Jun 2020

Role	Analyst	Title
Author	Jock Allen	Investment Analyst
Sector Lead	Jacob Smart	Senior Investment Analyst
Authoriser	Bronwen Moncrieff	Head of Research

ANALYST DISCLOSURE

As at the time this report was issued, the Analyst, report Authoriser and/ or the Sector Lead holds interests in either the product, the product issuer or a relevant related party. The Analyst/Authoriser/Sector Lead certifies that the extent of the holding is non-material in nature and has been undertaken in accordance with Zenith's Trading Policy and RG79.149(c).

RATING HISTORY

As At	Rating
9 Jun 2020	Recommended
12 Jun 2019	Recommended
14 Jun 2018	Recommended
31 May 2017	Recommended
21 Jun 2016	Recommended
25 Jun 2015	Not Rated - Screened Out

Last 5 years only displayed. Longer histories available on request.

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Zenith has charged Auscap Asset Management a fee to produce this report.