PENGANA CAPITAL

MONTHLY REPORT
SEPTEMBER 2021

PENGANA HIGH CONVICTION PROPERTY SECURITIES FUND

DESCRIPTION

A Property Fund focussed on capital security, income yield, and sustainable growth.

The Fund believes each security has an underlying or intrinsic value and that securities become mispriced at times relative to their value and each other.

The Fund seeks to exploit such market inefficiencies by employing an active, value based investment style to capture the underlying cashflows generated from real estate assets and/or real estate businesses.

The Fund believes that responsible investing is important to generate long term sustainable returns. Incorporating ESG factors along-side financial measures provides a complete view of the risk/return characteristics of our property investments.

The Fund is benchmark unaware. All positions are high conviction and assessed on a risk-reward basis, resulting in a concentrated portfolio of 10-20 securities.

STATISTICAL DATA

VOLATILITY[3]	NUMBER OF STOCKS 17	BETA (USING DAILY RETURNS)[4]	MAXIMUM DRAW DOWN -15.8%

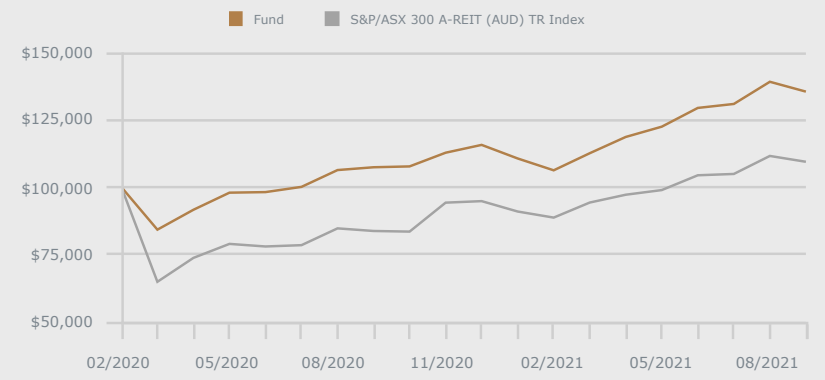
PERFORMANCE TABLE

NET PERFORMANCE FOR PERIODS ENDING 30 Sep 2021[1]

	1 MTH	1 YEAR	SINCE INCEPTION P.A.
High Conviction Property Securities Fund	-2.6%	26.2%	21.1%
S&P/ASX 300 A-REIT (AUD) TR Index	-1.9%	30.7%	5.8%

PERFORMANCE CHART

NET PERFORMANCE SINCE INCEPTION[2]



TOP HOLDINGS (ALPHABETICALLY)

Charter Hall Group	Real Estate
Goodman Group	Real Estate
GPT Group	Real Estate
Ingenia Communities Group	Real Estate
Mirvac Group Property Trust	Real Estate

SECTOR BREAKDOWN

Office REITs	3.9%
Retail REITs	7%
Diversified REITs	34%
Specialized REITs	7.5%
Industrial REITs	21.6%
Internet Services & Infrastructure	3.6%
Residential REITs	6.3%
Real Estate Development	9.1%
Cash	6.9%

THE END OF LOCKDOWNS

COMMENTARY

The AREIT sector retraced some of its gains from last month to finish down -1.9% for September. This was driven by the combination of a steepening yield curve, which created headwinds for the yield-sensitive real estate sector, and over $1 billion in equity issuance putting pressure on the more liquid names such as Goodman Group and Charter Hall Group. In comparison, the Fund returned -2.6%, underperforming the index by 0.7%.

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As we come out of lockdown, our focus turns to the two real estate sub-sectors which have been most affected, retail and office, and assessing how these sectors will perform post-COVID-19. By reference we are considering the experience of their global peers, given that developed global markets are ahead of Australia regarding vaccination rates and freedoms.

For large mall owners such as Scentre Group (SCG) and Vicinity Group (VCX), operational metrics have improved with both visitation and sales rebounding as soon as restrictions were eased. SCG reported that sales for the first half of 2021 were up 1% (ex-cinemas and travel operators) in 2019. Rental assistance declined materially to 5% of net operating income compared to 39% in the prior period. However, income is still down in the order of 10%-15% due to lower occupancy, lower ancillary income (car park and media), and negative leasing spreads of around -10%.

Looking to global peers, such as Hammerson in the UK and Simon Property Group in the U.S., their share price outperformed the market leading into the re-opening but lagged post opening. We attribute this to two factors:

1) Structural headwinds in online retailing continue to take market share from physical stores. We expect that as restrictions ease, online retailing will initially slow but pick up again as behavioural habits change, with consumers preferring the convenience and greater product choice of shopping online. In the U.S., online retailing is expected to make up 40%-50% of total sales by 2025, whilst in Australia, this is expected to increase to 20% from 11%.

2) As the economy re-opens, people are likely to spend on experiences like travel and leisure rather than buying more things (given that a lot of spending has been brought forward such as setting up home offices).

We remain underweight discretionary retail and prefer sub-regional malls such as SCA Property Group (SCP), which is leveraged to convenience and the "shop local" thematic.

For office, it is expected that demand will remain subdued as corporates continue to assess the impact of working from home (WFH) on their business.

Currently, consensus is emerging for a more flexible hybrid model with 1-2 days a week WFH on average across the entire market.

Will this translate to a 20-40% reduction in corporate demand for space? Here are some considerations;

Need for social distancing – a reversal of workspace density to accommodate social distancing Type of space required – more collaborative space such as meeting rooms to incorporate both digital and physical work Capacity utilization – companies would have to work out the number of desks for "peak" offices days, unless the company imposes a system of designated WFH days to limit peaks in demand, but that would be counterintuitive to flexibility.

Based on market surveys, major tenants will look to consolidate space and take the opportunity to upgrade towards prime space in the best locations, offering state-of-the-art facilities (air filtration, wellness, etc) and sustainability credentials. This will likely lead to increased obsolescence of older stock, which will need to be refurbished or converted to other use, such as residential.

Based on the last reporting season, valuations among office REITs were stable, supported by strong transactions despite deterioration in key operating metrics such as occupancy, rents, and incentives.

We remain positive on selective metro offices such as Irongate Group (IAP) due to better value ($600/sqm for an A grade office in Parramatta vs CBD of $1,200/sqm), higher exposure to government tenants and longer weighted average lease expiry (WALE) profiles.

As a high conviction manager, we are not tied to the index. Our investments are made based on long-term thematic drivers along with strong underlying cash flows, and backing management teams who are able to grow earnings through development and capital management. Currently, we have 30% of our exposure outside the index, particularly in the alternative sector, which provides us with both diversification and more sustainable earnings.

FEATURES

APIR CODE	PCL8246AU
REDEMPTION PRICE	A$ 1.3097
FEES *	Management Fee: 0.70% Performance Fee: 15%
MINIMUM INITIAL INVESTMENT	A$10,000
FUM AT MONTH END	A$ 11.08m
STRATEGY INCEPTION DATE	11 March 2020
BENCHMARK	S&P/ASX 300 A-REIT Total Return Index

FUND MANAGERS

Amy Pham
Portfolio Manager

Jade Ong
Investment Specialist

1. Net performance figures are shown after all fees and expenses, and assume reinvestment of distributions. The Fund incepted on March 11th 2020. Index performance calculations include a complete month's performance for March 2020. No allowance has been made for buy/sell spreads. Past performance is not a reliable indicator of future performance, the value of investments can go up and down.
2. Inception 11 March 2020.
3. Annualised standard deviation since inception.
4. Relative to S&P/ASX 300 A-REIT TotalReturn Index.

* For further information regarding fees please see the PDS available on our website.

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