PENGANA CAPITAL GROUP

MONTHLY REPORT
AUGUST 2023

PENGANA AUSTRALIAN EQUITIES FUND

DESCRIPTION

The Pengana Australian Equities Fund aims to enhance and preserve investor wealth over a 5- year period via a concentrated core portfolio of principally Australian listed securities. The Fund uses fundamental research to evaluate investments capable of generating the target return over the medium term. Essentially, we are in the business of seeking to preserve capital and make money – we are not in the business of trying to beat the market. We remain focused on acquiring and holding investments that offer predictable, sustainable and well-stewarded after-tax cash earnings yields in excess of 6% that will grow to double digit levels as a percentage of our original entry price in five years. We believe that building a well-diversified portfolio of these “gifts that keep on giving” represents a meaningful way to create and preserve financial independence for our co-investors.

STATISTICAL DATA

VOLATILITY[3]	NUMBER OF STOCKS	BETA[4]	MAXIMUM DRAW DOWN
11.4%	24	0.63	-23.1%

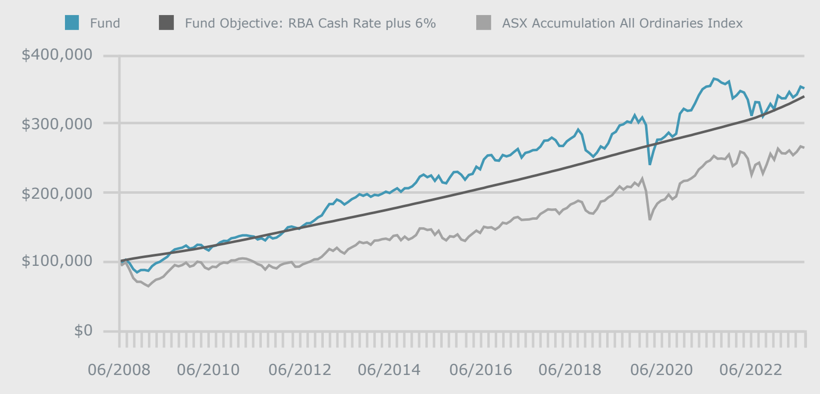
PERFORMANCE TABLE

NET PERFORMANCE FOR PERIODS ENDING 31 Aug 2023[1]

	1 MTH	1 YEAR	3 YEARS P.A.	5 YEARS P.A.	10 YEARS P.A.	SINCE INCEPTION P.A.
Australian Equities Fund	-0.7%	6.2%	7.0%	3.8%	6.3%	8.6%
Fund Objective: RBA Cash Rate plus 6%	0.8%	9.3%	7.3%	7.2%	7.5%	8.4%
ASX Accumulation All Ordinaries Index	-0.7%	8.9%	10.6%	7.2%	8.2%	6.6%

PERFORMANCE CHART

NET PERFORMANCE SINCE INCEPTION[2]



TOP HOLDINGS (ALPHABETICALLY)

BHP Group Ltd	Materials
CSL Ltd	Health Care
Evolution Mining Ltd	Materials
Medibank Pvt Ltd	Financials
National Australia Bank Ltd	Financials
nib holdings Ltd/Australia	Financials
ResMed	Health Care
SG Fleet Group Ltd	Industrials
Telstra Group Ltd	Communication Services
Woolworths Group Ltd	Consumer Staples

SECTOR BREAKDOWN

Consumer Discretionary	10.7%
Consumer Staples	6.8%
Financials	29%
Health Care	14.7%
Industrials	4.2%
Materials	12.2%
Real Estate	1.3%
Communication Services	6.1%
Utilities	3.3%
Options	0.2%
Cash	11.4%

CAPITALISATION BREAKDOWN

ASX 1-50	52.7%
ASX 51-100	13.5%
ASX 101-300	9.8%
All Ordinaries	5.7%
Non ASX	6.8%
Derivatives	0.2%
Cash	11.4%

CUSTOM SECTOR BREAKDOWN

Defensive	44.4%
Financials	24.2%
Consumer Discretionary	10.1%
Resources	9.7%
Options	0.2%
Cash	11.4%

QUALITY RETAILERS SHINE IN A TOUGH ENVIRONMENT

COMMENTARY

The Fund generated a -0.7% return in August. By way of comparison, the Australian stock market declined by -0.7%, whilst the (annual) return of the RBA cash rate plus 6% equated to approximately +0.8% for the month. Calendar year to date, the Fund has achieved a return of +9.4%, which compares favourably to our benchmark return of +6.4% over the same period, and the Australian stock market at +7.0%. We are pleased that a portfolio of defensive, hard assets continues to deliver a healthy, positive real return in varying market conditions.

The key message that we took away from this corporate earnings season was that whilst the outlook for corporate revenues is likely more resilient than first thought, ongoing inflation continues to provide upward pressure on the cost of doing business. We are pleased to be able to report that for the majority of our holdings, we received a positive validation of our respective investment theses. Standout performers included our discretionary retail holdings **Accent Group** and **Super Retail Group**. **Resmed** was a notable detractor in the period, offsetting what was otherwise a strong period for the Fund.

As in previous months, the period end performance figure belied the underlying volatility experienced during the month, with the ASX down as much as -3.5% at its low point. The catalyst for a recovery this month was the July CPI print which came in below expectations, and better than expected retail sales data from both official ABS statistics and corporate commentary. Amidst all of the noise, it was a relatively 'normal' corporate reporting season, with the number of beats/in-line/misses broadly balanced. This was an improvement from February, where elevated levels of forecast risk post-Covid resulted in a far greater number of 'misses'. That said, outlook statements on balance disappointed, with a resilient revenue environment more than offset by ongoing inflation in the cost of doing business, in particular around the wage inflation and rising financing cost lines. Overall corporate earnings forecasts for FY24 declined by around 3% during the month.

We view corporate earnings season as an important validation event for our longer term investment theses across the portfolio – more so than a period to extract short term performance in any given year. We are pleased to report that for the vast majority of our holdings, we believe we received that affirmative validation – be it in reported financial performance, operational milestones achieved, and discussions with management during numerous meetings over the month. Standouts during the period were our holdings in discretionary retail such as **Accent Group** and **Super Retail Group**, both of which reported earnings ahead of expectations for FY23, as well as trading updates considerably more resilient than the market was expecting. Importantly for our investment thesis, both companies are demonstrably better businesses now than they were pre-Covid. Other positive validations came from **James Hardie Industries**, **Medibank**, and **SG Fleet**, whilst **CSL** was able to provide more clarity around the trajectory of gross margins, which had concerned investors in the preceding months.

Resmed was a material detractor for the Fund during the period, offsetting what would otherwise have been a month of solid outperformance. Share price weakness in August for Resmed was driven by two primary factors. Firstly, strong top line momentum, including record quarterly US device sales, failed to translate into commensurate profit growth, with a previously guided recovery in gross margins deferred, and elevated operating costs. Relative to our investment thesis, the top line momentum validated our expectations for strong industry growth, compounded by market share gains for RMD as a major competitor is absent with product recalls. We can reconcile the GM evolution with product mix during the period, and the elevated costs associated with, amongst other things, securing the additional market share during the period. On this basis, our medium term cash flow projections remain largely unchanged. The second factor relates to the approval of a drug (GLP-1 RA) for the treatment of obesity, which is recognised as a significant contributor to sleep apnoea. We believe the threat this poses to Resmed's potential target market has been over estimated due to a number of factors including the cost of treatment, various side effects, and significant weight regain following withdrawal from the drug. Given what we view as solid underlying fundamentals and an over reaction to GLP-1, we added to our RMD holdings on the weakness during the month.

Other detractors during the month included **Credit Corp**, despite solid momentum in the US and domestic Consumer Lending, which continues to experience subdued growth in the core domestic debt ledger business, and **Telstra** where solid underlying performance from the key mobile division was offset by disappointment from management's decision not to monetise the recently separated infrastructure arm of the business. We believe Telstra management presented a sound argument to retain 100% ownership, however, recognise a subset of the investor base that was invested for that event alone transitioning its way out of the register. With the core elements of our investment thesis validated, we remain positive and have more recently added to our position at these more attractive levels.

The key message that we took away from this corporate earnings season was that whilst the outlook for corporate revenues is likely more resilient than first thought (think soft landing as opposed to cliff), ongoing inflation continues to provide upward pressure on the cost of doing business, particularly around wage inflation. The result is a likely continuation of domestic inflation above the target range, in turn providing limited scope for interest rate cuts for the foreseeable future. We continue to position the portfolio with this in mind, ensuring exposure to business models with pricing power and low levels of price elasticity (to combat inflation) as well as those who benefit from an elevated rate environment. From a valuation perspective, this environment typically favours portfolios whose valuation is predominately focused on current earnings and cash flows (such as this Fund), as opposed to those whose valuation is more dependent on future earnings and cash flows. Our cash balance remains healthy and ready to deploy should future opportunities present.

We remain as focused as ever on our primary objectives of capital preservation and generating a reasonable real return for our investors. We continue to believe this is best served by a disciplined approach and consistent investment methodology. A variety of good businesses run by honest and competent management teams at the right price will create a well-diversified portfolio of ever-growing cash earnings streams.

FEATURES

APIR CODE	PCL0005AU
REDEMPTION PRICE	A$ 1.7746
FEES *	Management Fee: 1.025% Performance Fee: 10.25%
MINIMUM INITIAL INVESTMENT	A$10,000
FUM AT MONTH END	A$ 661.4m
STRATEGY INCEPTION DATE	1 July 2008
BENCHMARK	The RBA Cash Rate Target plus Australian equity risk premium.

FUND MANAGERS

Rhett Kessler
CIO and Senior Fund Manager

Anton du Preez
Deputy CIO and Fund Manager

1. Net performance figures are shown after all fees and expenses, and assume reinvestment of distributions. The benchmark of cash rate plus 6% p.a. is included in the chart as it relates to the Fund's investment objective and performance fee. The Fund may invest up to 100% of its assets in equity securities. The greater risk of investing in equities is reflected in the addition of a margin above the cash rate. No allowance has been made for buy/sell spreads. Please refer to the PDS for information regarding risks. Past performance is not a reliable indicator of future performance, the value of investments can go up and down.
2. Inception 1st July 2008.
3. Annualised standard deviation since inception.
4. Relative to ASX All Ordinaries Index. Using daily returns.

*(including GST, net of RITC) of the increase in net asset value subject to the RBA Cash Rate & High Water Mark. For further information regarding fees please see the PDS available on our website.

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PENGANA CAPITAL LIMITED

ABN 30 103 800 568

AFSL 226566

CLIENT SERVICE

T: +61 2 8524 9900

F: +61 2 8524 9901

E: clientservice@pengana.com

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PENGANA.COM