AUSTRALIAN

RESEARCH

INDEPENDENT INVESTMENT RESEARCH

360 Capital Active Value Equity Fund

May 2020

INDEPENDENT
INVESTMENT RESEARCH

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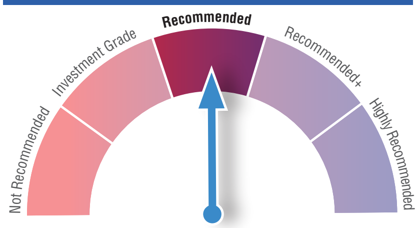
1) The research process has complete editorial independence from the company and this is included in the contract with the company;
2) Our analyst has independence from the firm's management, as in, management/ sales team cannot influence the research in any way;
3) Our research does not provide a recommendation, in that, we do not provide a "Buy, Sell or Hold" on any stocks. This is left to the Adviser who knows their client and the individual portfolio of the client.
4) Our research process for valuation is usually more conservative than what is adopted in Broking firms in general sense. Our firm has a conservative bias on assumptions provided by management as compared to Broking firms.
5) All research mandates are settled upfront so as to remove any influence on ultimate report conclusion;
6) All staff are not allowed to trade in any stock or accept stock options before, during and after (for a period of 6 weeks) the research process.

For more information regarding our services please refer to our website www.independentresearch.com.au.

360 Capital Active Value Equity Fund

Note: This report is based on information provided by the company as at May 2020

Rating



Report Analyst Details

IIR Analyst	Rodney Lay
LinkedIn Profile	https://www.linkedin.com/in/rodney-lay-71623715/

Key Investment Information

Name of Fund	360 Capital Active Value Equtiy Fund
Investment Manager	360 Capital Equity Management Pty Limited
Responsible Entity	360 Capital FM Limited
Investment Type	Stapled security made up of 2 registered schemes
Inception Date	16 March 2020
Fund Term	Open-ended Trust
Min Investment	$20,000
Target Total Returns	IIR in excess of 12% p.a.
NAV Valuation Policy	Monthly
Liquidity	Hard Lock Up first 18 months. Thereafter, liquidity will be provided with 3 months notice.
Distribution Policy	None first 18 months. Quarterly thereafter.
MER	None
Performance Fee	No Performance Fee (PF) < 6% p.a Fund Total Return (TR). 2% PF for Fund TR 6-8% p.a. 20% PF for Fund TR in > 8%

Fees Commentary

While the 'outperformance' fee structure may appear unusual to Australian investors, it is not uncommon for activist strategies. The intention is align and incentivise managers to execute and be rewarded by successful activist outcomes (alpha) rather than being rewarded by general movements in equity markets (beta).

Target Portfolio Characteristics

Number of Holidngs	10 to 20
Time to Target Portfolio	Circa 3 years
Target Mkt Cap Companies	$20m - $500m
Expected Hold Period	3 to 5 years
Permitted Leverage (not intended)	Up to 50% of GAV

The investment opinion in this report is current as at the date of publication. Investors and advisers should be aware that over time the circumstances of the issuer and/or product may change which may affect our investment opinion.

OVERVIEW

The 360 Capital Active Value Equity Fund ("the Fund") is a newly established stapled security made up of two registered managed schemes managed by 360 Capital Equity Management Pty Limited (the 'Manager'). The Fund will ultimately provide investors exposure to a relative concentrated portfolio of ASX-listed companies in which the Manager will seek to unlock capital value in its invested companies through an active, collaborative investment strategy. The Manager is prepared to drive value via M&A, corporate restructuring, recapitalisations and general activism to help build high caliber businesses. The Manager is led by Portfolio Manager (PM) Dennison Hambling, who was previously Chief Investment Officer at First Samuel Ltd, in addition to a proven leadership team with more than 20 years operating experience in funds management, banking and risk management. The portfolio will build over times as opportunities present, with the Manager targeting 10-20 companies that can: deliver >5%p.a. average NPAT growth, and have, or can achieve, >12.5% ROIC. The Fund is prepared to sell when prices reflect the opportunity set. Whilst ideally a long-term owner of quality businesses, the Investment Manager will sell businesses whose price embodies significantly all of the future opportunity set, or where the business is better owned by another party

INVESTOR SUITABILITY

Activism strategies, or which alternatively may be referred to as active equity or strategic equity strategies, offer arguably the purest form of active, alpha-seeking equities investment management. Investors must recognise, however, that such strategies have very idiosyncratic payoff profiles (exacerbated by high portfolio concentration) that aim to outperform equity markets over a multi-year investment horizon with typically very low correlation to the broader equities market. This characteristic is a naturally corollary of the nature of the investment strategy, whereby achieving the ultimate investment objective is very much a function of a fund manager's ability to execute on any given strategy to create value. Investors must be prepared to take a long term view in terms of the realisation of value (alpha) and, given the longer term time frame regarding the crystallisation of value, such strategies typically offer no liquidity during an initial investment period (18 months in the case of the Fund). Activism strategies are in many respects more akin to private equity, with what is typically a J-curve returns profile, yet where the underlying investments are potentially subject to as much beta 'risk' as a traditional value investment prior to the successful realisation of the activist strategy (should it be successful). That said, where there is a distinction is the upside versus private equity may not be as high yet on the flip side an activism manager is not paying a premium for control, with the possibility of a better entry price. The market timing / opportunity for activism is currently strong given recent and likely ongoing ructions in investment markets. Guiding equity recapitalisation, operational improvements, and M&A are a few such opportunities in the current environment. Activism strategies are however 'evergreen' strategies across a full market cycle, with the nature of the value add levers available to managers simply changing based on different market environments. Given the idiosyncratic and potentially lumpy nature of returns, IIR believes an investment in the Fund should represent a small part of an overall long-term equity allocation. It should be a strategic allocation, not just a technical market momentum related allocation. While long activist funds may be a viable solution for some, reduced liquidity, high tracking error, and increased fees can make them unsuitable for others.

RECOMMENDATION

Independent Investment Research (IIR) ascribes a "**RECOMMENDED**" rating to the 360 Capital Active Value Equity Fund. Being an effective activist investor is a rare talent, requiring the ability to identify prospective opportunities and effectively execute by working with management, boards,and a shareholder base. It is a strategy also characterised by high barriers to entry - the activist investor must ideally come with an established and strong reputation (ideally through a collaborative approach versus a confrontational approach). While the investment team is newly formed, the Portfolio Manager, Dennison Hambling, has runs on the board given his track record at First Samuel Ltd where he recorded +9.5% p.a. alpha based on a total return of 15.9% p.a. over a 10 year period in the dedicated activist sleeve of a broader mandate (14.2% p.a. over 10 years). Over time as FUM grows and assuming performance is true to style, IIR can definitely envisage the rating being raised one notch.

SWOT ANALYSIS

Strengths

- Dennison Hambling has a 20 year track record in investment management including 10 years in active value style investing. In relation to the prior activist strategy, the PM recorded material alpha and the 'shape' of performance was very much true to the activist style. The PM has recorded a successful hit rate on completed activist campaigns of 80% over the 10 year period of the prior strategy, well in excess of activist sector global averages.
- Being a successful activist investor is a rare talent. It requires particular skills and abilities, the bulk of professional investors do not have. It requires the ability to implement multiple strategies (being either or a combination of operational, financial, managerial, industry in nature), to persuasively explain why such strategies are in the best interest of the company, to win over key stakeholders, to know when to pivot to a more assertive engagement strategy and a determination to pursue the activist strategy which are generally long term in realisation time frame. Dennison's prior track record indicates he possesses these skills.
- A cooperative, collaborative approach to activist campaigns, as the PM invariably initially employs, has some distinct advantages over a more confrontational style. The headline and reputation risk of the latter style is something that a conservative investor would not necessarily want to be associated with, notwithstanding that some activist funds can generate strong returns and be effective at driving change in large corporations. Further, a cooperative approach often (but not invariably) leads to a shorter time line to creating value add versus a confrontational approach. A shorter time line implies a lesser use of resources for an investment manager and a superior internal rate of return (IRR) on an investment. Finally, collaborative engagement also appears more likely to achieve success than more assertive approaches, particularly outside the United States.
- The outperformance of "pure-play" activist funds has also led many traditional investment managers to adopt a more active stance with respect to their investments. Some have become "occasional activists". However, industry analyse reveals, not surprisingly, that experienced activists earn significantly higher returns than less experienced activists. They also find that companies targeted by experienced activists have significantly higher stock returns and modestly higher operating performance for up to three years after the activist engagement compared with those targeted by less experienced activists.
- The above highlights the fact that there are real barriers to entry to executing an effective activist equity strategy. It is not a skill that the bulk of fund managers have. Although activism is growing, it remains a strategy that few investment managers can pursue because there are significant barriers to entry. Activist managers need credibility to influence companies and benefit from support of other shareholders, and a critical mass of long-term capital to buy large stakes and engage successfully.
- The Fund intends to make investments into companies which are initially valued at $20m-$500m. IIR believes this is sensible, being a more prospective market cap segment. First, management teams in small and mid-cap companies are relatively inexperienced compared to large cap companies. They are generally less sophisticated in their capital allocation decisions and therefore tend to be more amenable to changes proposed by an activist investor. Second, a relatively smaller investment is required in small and mid cap companies to acquire a status of a significant minority shareholder (this is also a necessity for the Fund given FUM is starting from a low base). In other words, it is easier for an activist manager to garner support from other shareholders in small and mid-cap companies with a smaller, more concentrated shareholder base. Lastly, stock valuations can potentially show a significant improvement in small and mid-cap companies, which trade in a relatively inefficient sector of the market.

- The Manager is a value investor, as is almost invariably the case for activist investors, with a focus on companies that are inherently solid fundamental businesses (enabling value to be unlocked). By 'solid fundamental businesses' the PM also means that it has a defensive characteristic to its cash flows. As such, if the engagement is unsuccessful there is a far greater likelihood that the downside risk is mitigated.
- Activist managers often make two mistakes when structuring their funds, which encouragingly the Manager has not made. First, they are willing to take money from a broad range of investors. Many of these investors may be new to activist strategies, and may not fully appreciate the long-term nature of the strategy. Therefore, some of these investors may be inclined to redeem their investments upon experiencing short-term market volatility, as opposed to allowing the manager to execute his or her strategy and unlock value. Second, activist managers often rely on a long "lockup" period to deter investors from redeeming too early. Lockups may be part of the solution, but — they don't address how the activist will manage redemptions once the lockup expires. Activists must be able to assess the true liquidity of these strategies and structure redemption terms accordingly.
- The zero MER fee structure ensures fees are only paid on 1) invested capital and 2) the 'outperformance' performance fee structure appropriately incentivises the Manager and aligns its interests with shareholders.

Weaknesses

- More a risk than a weakness per se, the Fund will start with limited FUM of $10m. The ability to create a diversified portfolio and to effectively implement the strategy (which requires a degree of scale in which to exert influence at a target company level) can only be implemented with sufficient FUM. In the interim, the portfolio will be built progressively over time as FUM increases and opportunities present. Consequently, the portfolio may be very highly concentrated in the initial circa two years. That said, the Manager is relatively confident in achieving FUM of circa $100m by calendar year end and which enable sufficient portfolio diversification.
- Because of the longer-term nature of the investment thesis, activism often displays a J-Curve or initial period of flat to negative returns before the realization of operational objectives and financial metrics results in valuation improvements, similar to private equity. Investors must have long term investment horizon. This is more a feature of the activist strategy than a weakness per se.
- Key man risk is arguably the most significant of all investment strategies. Most well-known shareholder activists become recognisable figures to the market. If a "key man" leaves an organization, or is for whatever reason no longer involved in making key investment decisions (e.g. becomes incapacitated), there is the risk that the market will catch on and actively short the shares held by the activist's fund in expectation that the fund will be forced to liquidate because of the departure of this individual. Additionally, credibility is arguably more important than any other strategy given it is solely about being winning over support, generally by convincing and gaining support from key stakeholders. Dennison is incentivised via the payment of bonuses related to the outperformance fee achieved by the Fund.

Opportunities

- To the best of our knowledge, the Fund is one of a very few pure play activist strategies in Australia accessible to retail investors. The strategy is comparable to the Tanarra Capital Long Term Value Fund managed by John Wylie. Furthermore, market conditions are favourable for an activist strategy, with many quality companies now trading at distressed prices, and 'ripe' for active ownership.
- In a low returns, concentrated investing world the need for a strategic allocation to active (versus passive), long only investing has never been higher. Counter-intuitively the amount of capital now proportionately allocated and managed to 'active' long only investing has never been lower. Over the last few years, in an environment characterised by low interest rates, compressed risk premia and flushed with liquidity seeking yield and flowing into ETFs and passive funds, fundamental stock picking has not always been rewarded. The exceptional returns of the past eight years are unlikely to be repeated and there is a scarcity of 'easy beta' to be harvested.
- With such concentration, there exists much greater opportunity – and risk – for idiosyncratic or company-specific factors to drive an alpha outcome over the long term, as opposed to mere beta. But investors need to be clear that prior to achieving an activist

outcome (assuming it is indeed achieved) an activist strategy may well have just as much beta risk as a traditional value strategy. Over time, this is likely to be mitigated by way of diversification in the expected time line of activist engagement outcomes through multiple investments. Again, investors must adopt a long term investment horizon in order to both realise the raison d'etre of activist strategies, namely as a return enhancer and portfolio diversifier.

- Due to the idiosyncratic and event-driven nature of returns, the investment strategy has exhibited a very low correlation to the broader Australian equities market, presenting potential diversification benefits for investors. Furthermore, given the current opportunity set, and in particular recapitalisations, the Fund has the potential to be something of a hedge against existing long equities exposure for investors (for example, by having the ability to participate in a recapitalisation, the Fund has the potential to offset the dilution risk an investor has inherent in existing position in the same stock).
- Activism has one clear advantage over private equity buy-out funds. Specifically, activists get to build their position in the company with little to no fanfare, capturing a significant premium when news hits. Research shows this is less than the control premium mega buy-out funds typically pay, but given a choice a rationale investor would prefer to collect such a spread rather than pay it.

Threats

- Activist funds are typically highly concentrated with about 10-15 portfolio holdings. As such, they can be expected to have a (materially) higher degree of volatility relative to the broader market. Additionally, with so few holdings liquidity constraints in one or a few of a fund's positions can quickly become a liquidity problem for the fund's investors.
- Given most of the target companies are small and mid caps, liquidity can be come a material risk, both on the upside and downside. The liquidity risk may manifest in two ways. On the upside, it may lead to a significant degree of portfolio concentration, with an uncomfortable weighting to one stock if the manager is precluded from materially trimming its position (and further increasing what is already a high degree of portfolio concentration). On the downside, the liquidity risks are obvious but the overall performance impact on a fund would be greatly amplified where the particular stock had increased to a very significant weight prior to a share price fall (this is precisely what occurred in relation to the PM's past Emeco investment in the First Samuel Portfolio - refer to Performance Analytics section).
- While the Australian legal structure is supportive of an activist strategy, the counterbalance is that often there is an antipathy amongst Australian investors to sanction management. It can be argued that Australian investors often exhibit an unhealthy tolerance of under-performing management teams (although the Banking Royal Commission may have contributed to a shift in attitude).
- On a rolling 1- and 3-year basis of the manager's prior activist strategy, correlation and beta varied materially over time. Activist strategies are subject to near-term market correlation 'risk'. Activists are generally long-only investors, which may cause their returns to have a significant amount of near-term correlation with the equity markets. Over the long-term, however, active engagement should allow these strategies to deliver alpha by unlocking value embedded in the engaged companies, through strategic, operational or financial enhancements.
- The reputation of the Fund could be adversely impacted by a number of factors including failure to provide customers with the quality of service they expect, significant delays or cost overruns, disputes or litigation with third parties such as customers, contractors, employees, or suppliers or adverse media coverage.

PRODUCT OVERVIEW

The Fund aims to provide unitholders with income and capital returns from investing in a relatively concentrated (10-20 stocks), yet diverse portfolio by way of industry / sector exposure of listed and, to a lesser degree, unlisted equity assets. The target portfolio will be formed over time based on growing FUM and the availability of suitable investment opportunities. Investments will be implemented by way of an activist value investment strategy, with the Manager utilising a collaborative, constructivist approach (constructive activism) versus a confrontational approach.

Activist engagement tactics fall along a continuum between approaches that aim for collaboration with incumbent leadership of the target company (such as private meetings with management) and highly confrontational approaches (such as an immediate hostile takeover bid). A number of activist fund managers use the term "constructivism" to distinguish collaborative approaches from the aggressive tactics commonly associated with hedge fund "activism"

The Manager focuses primarily or wholly on constructivist tactics, and invariably does so in the initial part of a value add campaign. The activism style of Dennison Hambling has always been to take relatively long-term view of investments in target companies, aiming to work in cooperation with management over a period of years.

Integral to its activist approach, the Manager will be prepared to drive merger and acquisition activity, corporate restructuring, recapitalisation and provide strategic direction (where appropriate) to help drive operational change and build high quality and improved businesses, and/or to drive price re-valuations.

The Fund intends to make investments into companies which are initially valued at $20m-$500m. It is the Manager's view, and which IIR concurs with, that this area is prospective, partly due to the weight of investable funds in Australia having migrated to larger value businesses and become more passive in nature.

As is generally the case for activist strategies, investments are expected to be long to very long term in nature. Over the investment time horizon (3-5 years typically), it is expected that each investments will realise its potential "renovations" completed, or price re-rate for mispriced companies. These investments may then become core holdings if they are functioning well, and able to grow constantly and with high returns.

A focus of these core investments, and in fact any investment in the Fund, will be the exit of each investment. The exit/sale of an investment will be appropriate to each particular investment and designed to maximise the investment outcome over the Fund's 3 to 5 year investment horizon. This may be achieved by on-market sale, IPO, trade sale, takeover or other mechanisms. Where core holdings are assessed to be fully valued, the imperative to exit will be greater.

Dennison Hambling, PM, has over 20 years' experience in investment management and company analysis across Australasia and has significant experience originating and executing wide ranging transactions in the unlisted to mid-market space. Prior to the formation of the Manager and Fund, Dennison was the Chief Investment Officer at First Samuel Ltd for 12 years and prior to this worked at Cooper Investors, Goldman Sachs and NZ Funds Management.

In terms of structural aspects, the Fund has two distinctive characteristics, and which are broadly consistent with activist funds, namely liquidity and fee structure.

With respect to liquidity, there will be no liquidity for an initial 18 months (ending 30 September 2021). Thereafter, the Responsible Entity (RE) will endeavour to provide liquidity to all unitholders wishing to redeem all or some of their investment every three months and with a three month notice period. To provide liquidity, the RE may: sell Fund assets; raise new equity for the Fund; reconsider the gearing ratio of the Fund; or undertake a combination of these or other measures.

The liquidity structure, with a hard initial lockup period and subsequent restriction on redemption frequencies (for example every quarter end) and longer redemption notice periods, is common amongst activist funds. It is designed to 1) allow time to build capital and the portfolio, and 2) to better align the liquidity rights offered to investors with the liquidity of the long term investment time frame of the underlying assets.

Investors should also note that while it is the Manager's genuine intention to honour its liquidity provisions, the Fund's PDS stipulates the RE can exercise discretion regarding limiting liquidity. Restrictions could conceivably be in the form of Fund-level gates (which enable the RE to limit redemptions up to an agreed percentage of the Fund's NAV) and investor-level gates (which allow the RE to limit redemptions by each investor up to an agreed percentage of that investor's investment in the Fund in each redemption period). Additionally, the RE would also have the right to suspend redemptions in certain circumstances (which, in practice, would only exercised as a very last resort).

In IIR's view the ability to restrict redemptions is entirely appropriate given the nature of the strategy. Activist managers often make two mistakes when structuring their funds. First, they may be willing to take money from a broad range of investors. Many of these investors may be new to activist strategies, and may not fully appreciate the long-term nature of the strategy. Therefore, some of these investors may be inclined to redeem their investments upon experiencing short-term market volatility, as opposed to allowing the manager to execute his or her strategy and unlock value.

Second, activist managers often rely on a long "lockup" period to deter investors from redeeming too early. Lockups may be part of the solution, but — they don't address how the activist will manage redemptions once the lockup expires. Activists must be able to assess the true liquidity of these strategies and structure redemption terms accordingly.

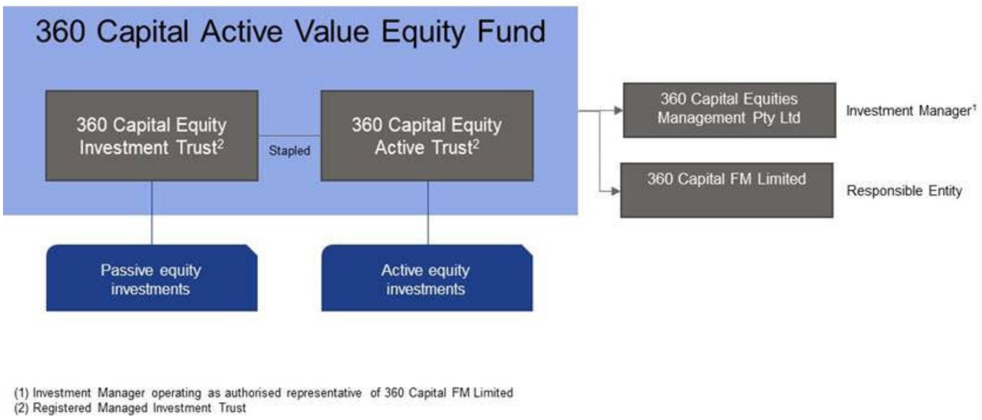
Regarding fees, the Manager has adopted an 'outperformance' fee model, with fees only derived from performance fees (there is no MER). The Performance Fee is based on: no fee until 6% p.a; to the extent that the Fund's total return is more than 6% but not more than 8%, the amount which if deducted from the Fund would reduce the Fund's total return to 6%; and then 20% of performance above 8% p.a. While this structure may appear unusual to Australian investors, it is not uncommon for activist strategies. The intention is align and incentivise managers to execute and be rewarded by successful activist outcomes (alpha) rather than being rewarded by general movements in equity markets (beta).

Fund Structure

The Fund will be two registered managed investment schemes (Trust) comprising a Passive trust, 360 Capital Equity Investment Trust ('360 CEIT'), and an Active trust, 360 Capital Equity Active Trust ('360 CEAT'), stapled together. The structure provides a more tax efficient outcome for investors. In IIR's experience, this stapled structure is a commonly utilised structure in investment vehicles that make a combination of investments purely for income and investments that provide a combination of income plus capital returns.

The Active trust provides CGT concessionary relief. The active trust will hold only those investments in which the Manager takes an equity stake and controlling operating position in any underlying investment.

Fund Structure



Source: Manager

360 CAPITAL GROUP

The Responsible Entity of the Fund is 360 Capital FM Limited. The Responsible Entity is a member of the 360 Capital Group. The 360 Capital Group is an ASX-listed (ASX: TGP), alternative asset investment and funds management group concentrating on strategic and active investment management of alternative assets. It was founded in 2006.

As at the date of this report, 360 Capital Group has a market capitalisation of approximately $264 million and manages listed and unlisted funds on behalf of investors, with approximately $600m in FUM. Approximately 33% of the 360 Capital Group is owned by staff and directors.

INVESTMENT TEAM

Dennison Hambling is the PM of the Fund, and has 20 years experience with an equity activism investment style. Prior to establishing the Fund, Dennison was Chief Investment Officer of First Samuel Limited for 12 years where he generated an annualised return of 14.2% p.a (post tax and fees) through a small and mid-cap activist portfolio over a 10 year period (4.7% p.a alpha compared to the All Ordinaries Accumulation Index, or 8.2% p.a versus the Small Ordinaries Accumulation Index) or 13.7% p.a (pre tax and fees). Prior to this Dennison was a portfolio manager at Cooper Investors Ltd (formerly ParadiceCooper Ltd).

Dennison is assisted by Fleur Graves (Senior Analyst), with the two representing the principal members of the investment strategy. Dennison and Fleur are also assisted by Will Riggall and Andrew Garside, who have come into the 360 Capital Group through the recent acquisition of Ralton Asset Management, as well as Johnathan Nguyen (Senior Analyst). Johnathan performs a subsidiary analyst role, being a ‘shared resource’ across the group.

And on top, two Board members in particular provide valuable assistance and input into the strategy, specifically Graham Lenzner and Stuart Jordan (both Non-executive Directors).

Graham has previously been on a number of boards (ostensibly for Dennison, albeit representing all shareholders) and in the sort of situations that the PM envisages happening going forward. As such, he has direct activist campaign experience in addition to considerable experience more broadly.

Stuart Jordan has been a life time fund manager. He provides input not only with respect to investment opportunities in the Fund but also more broadly with respect to discussing various issues. He provides complementary capacity for Dennison and Fleur to ensure they have the capacity to cover the work load and the right mix of the broad skill sets to manage various activist strategies. This is important as activist campaigns have a long tail time frame, i.e. a sustained work load.

In IIR’s view there are several characteristics necessary for the long-term success of an activist investor.

Firstly and most fundamentally, IIR views being a successful activist investor as requiring particular skills and abilities, the bulk of professional investors would not have. It requires the ability to implement multiple strategies, to persuasively explain why such strategies are in the best interest of the company, to win over key stakeholders, to know when to pivot to a more assertive engagement strategy and a determination to pursue the activist strategy which are generally long term in realisation time frame. Dennison’s prior track record indicates he possesses these skills.

The above highlights the fact that there are real barriers to entry to executing an effective activist equity strategy. It is not a skill that the bulk of fund managers have. Although activism is growing, it remains a strategy that few investment managers can pursue because there are significant barriers to entry. Activist managers need credibility to influence companies and benefit from support of other shareholders, and a critical mass of long-term capital to buy large stakes and engage successfully.

Furthermore, staying power to successfully navigate multi-year activism campaigns requires a stable investor base committed within longer lockup share classes. Again, this highlights that while activist portfolios largely comprise public equities, the activist’s approach to unlocking company value and long field of vision more closely resembles private equity strategies.

Second, as with any investment manager, shareholder activists must first be discerning investors. Of all active investment strategies, the activist strategy is the most active and the most alpha seeking, with market beta playing no overt role in the strategy over the long term. It is important that an activist manager be able to discern solid fundamental businesses, ideally with defensive characteristics, and which have some degree of valuation floor that is clearly definable. If an activist believes its “engagement” and changes will be the sole drivers of performance, the manager may run a significant risk of loss of capital.

Third, an activist investor must be able to recognize when it’s time to push harder and when it is time to walk away. When an active investment turns for the worse, the most common reaction of an activist manager is to push harder and throw more resources at the investment in order to turn it around. This is not, however, always the best strategy. Sometimes the best strategy is to cut losses and move on to another opportunity. On the flip side, it is also important that an activist manager have the right valuation discipline to sell investments that work out. Should a situation appreciate in value before the manager “gets active” for whatever reason, the manager should exit the position when valuation targets are met and not become active simply for the sake of being active. Dennison Hambling's track record indicates a perception to judge the above. That said, there has been mistakes. Importantly, the PM has learnt lessons from these unprofitable strategies. But of course, not even the best activist investor will get all campaigns right (in fact globally average success rates top out at 60% in the U.S. market).

Fourth, the successful activist should have the capability and willingness to take a company private, for three important reasons. One is the very powerful message communicated when a shareholder activist offers to tender for an entire company. This assists in winning the support of the rest of the shareholders since it creates economic value for the shareholders through the implied takeout premium, as well as by providing a vote of confidence that an activist is willing to own the entire company. The second reason is that idle promises will only work a few times. Indeed, the market will catch on very quickly if an activist manager is not willing to go through with the tender. Credibility is a very important part of this strategy. The third and final reason is that the goal of a shareholder activist is to get control of a company in order to implement change. The ultimate way to get more control is by owning an entire company in the private market. Furthermore, restructuring a company in the private market is theoretically much easier than restructuring in the public market, since an activist manager does not have to worry about public market scrutiny and a fluctuating stock price.

Finally, the outperformance of "pure-play" activist funds has also led many traditional investment managers to adopt a more active stance with respect to their investments. Some have become "occasional activists". However, industry analyse reveals, not surprisingly, that experienced activists (based on fund managers' prior experience of activism and the industry of companies targeted by the fund) earn significantly higher returns than less experienced activists. They also find that companies targeted by experienced activists have significantly higher stock returns and modestly higher operating performance for up to three years after the activist engagement compared with those targeted by less experienced activists.

The key members of the investment team are detailed below.

- **Dennison Hambling, Head of Equities.** Dennison has over 20 years' experience in the investment and funds management industry. Dennison is responsible for 360 Capital Group's Public and Private Equity Strategies. Dennison joined 360 Capital in 2019 having been Chief Investment Officer of First Samuel Limited for 12 years. Prior to this Dennison was a portfolio manager at Cooper Investors Ltd (formerly ParadiceCooper Ltd). Dennison started his investment career in New Zealand working with NZ Funds Management as an analyst working on an Australasian Equity Portfolio. Dennison has a Mcom (Hons) in Economics from the University of Auckland and is a CFA Charterholder. In his time with his prior employer Dennison delivered a +2.7% p.a. above market performance managing a mainstream equity portfolio, and a +13.7% p.a. return for the past 10 years in the small and mid-cap portfolio, well in excess of the relevant market returns, and with a more restricted style than that which will be applied in the 360 Capital Active Value Equity Fund..
- **Fleur Graves, Senior Analyst.** Fleur has over 12 years experience in the investment industry. Prior to joining 360 Capital this year, Fleur was an equities and investment analyst with First Samuel Limited. This encompassed analysis of industries and companies, and providing input and guidance into investment decisions. Fleur was also the Portfolio Manager for listed property/ infrastructure investments. Previously, Fleur worked in the aerospace industry, principally in Project Management roles. Fleur has a Bachelor of Engineering (Aerospace, Honours), Bachelor of Business (Business Administration), and Master's degrees in Commercial Law (Monash University) and International Business (University of Melbourne).
- **Jonathon Nguyen, Senior Analyst.** Jonathon joined 360 Capital as an Analyst in 2018 and is responsible for underwriting and analytics of Group investment initiatives. Prior to this, Jonathon was a Treasury Analyst (ALM) for a mutual bank, responsible for the liquidity/funding requirements and management of fixed income investments in the banking portfolio. He initially started his career as a Graduate at State Street Bank & Trust Co., working in the Global Markets Division. Jonathon holds a Bachelor of Commerce from the University of New South Wales.
- **Graham Lenzner, Non-executive Director.** Graham has had a career spanning four decades, with particular emphasis on funds management and financial markets. Graham was an Executive Director of the Armstrong Jones Group for 12 years, the last four years

as Joint Managing Director. Other previous roles include Finance and Deputy Managing Director of Aquila Steel, General Manager Finance and Investments of MMI Insurance Limited and Director Head of Equities with Schroder Darling Management Limited. Graham has served on the board of a number of public and private companies.

- **Stuart Jordan, Non-Executive Director.** Stuart's most recent role was founder and Managing Director of Discovery Asset Management, a boutique funds management business, specialising in small company investments. Prior to this he was with QIC as Head of the Australian Small Companies team. Stuart was also with Deutsche Asset Management (Australia) as Head of Australian Equities and was responsible for the flagship equities product, which was close to $6b in size. Previous roles included Portfolio Manager and Securities Analyst for State Authorities Superannuation Board and Securities Analyst for Industrial Equity Limited. His first role after graduating from university was Chartered Accountant. He is currently a board member of Channel Investment Management Limited and was a member of the Institute of Chartered Accountants and The Securities Institute of Australia for many years.
- **Tony Pitt, Executive Director.** Tony is a founding Director of 360 Capital Group and has worked in the property and property funds management industries for over 20 years. As Managing Director, Tony is responsible for the Group's investments, strategic direction and overall Group strategy. He has overseen the IPO on the ASX of three AREITs since 2012 as well as the creation of various unlisted funds, undertaken various corporate acquisitions and disposals, mergers and acquisitions and the ASX listing of 360 Capital Group. Tony has formerly held numerous senior roles and directorships at Mirvac Group, James Fielding Group and Paladin Australia. He also held positions at Jones Lang LaSalle and CB Richard Ellis.

Investment Team & Investment Committee Personnel

Name	Position	Ind. Exp. (yrs)
Dennison Hambling	Head of Equities	20
Fleur Graves	Senior Analyst	12
Jonathon Nguyen	Senior Analyst	6
Graham Lenzner	Non-executive Director	50
Stuart Jordan	Non-executive Director	35
Tony Pitt	Non-executive Director	>20

SHAREHOLDER ACTIVISM STRATEGIES

Shareholder activism strategies, or which alternatively may be more accurately described active equity or strategic equity strategies, offer arguably the purest form of active equities investment managements, and aim to outperform equity markets over a multi-year investment horizon and do so generally with particularly low correlation.

Activists serve as a primary catalyst for unlocking value within identified public companies through engagement with those companies' management teams and boards of directors. They are, in a sense, bringing the owner's voice closer to the decision making process. After an ideal candidate for shareholder activism is identified, the investment team proposes a course of action to company management.

The strategies, or levers for value creation, can be broadly divided into four sub-strategies:

• Operations - Cost reduction programs, revenue growth initiatives, productivity measurement, improved investor relations.

• Strategic Transactions – Merger, acquisitions, divestitures, joint ventures, private company sales (LBOs), public company sales.

• Capital Structure - Share buybacks, alternative security structures, debt refinancing, dividend policy, equity infusion.

• Management/Board - Recruitment of talent, strengthening incentives systems, direct board participation, governance or policy changes.

Risk Factors and Other Considerations

As with any strategy, activism has its own set of unique risk factors that investors should be aware of when considering an investment in the space. First, funds are typically concentrated and aggressive with about 8-15 core positions and 10-15 farm positions. They generally have a long bias, although some funds may hedge the overall market or a particular industry or sector using either index or basket shorts. Managers typically do not use position-level hedges. Nevertheless, activist funds can experience equity-like levels of volatility including significant drawdowns.

Second, the strategy invests with a longer investment horizon. Thus, even though these funds invest in publicly traded stocks, they tend to have longer lock ups, often in the one to three year range. Such longer locks are required to provide the activist manager with stable capital for making concentrated, longer-term investments.

Third, activist investors participating in hostile situations tend to frequent the news headlines. This may be a concern for certain types of investors.

Fourth, there is a lack of suitable benchmark for the strategy. HFRX (Hedge Fund Research's investable index series) has an Activist Index available but it does not represent an exhaustive list of managers. Since activist investors use a private equity approach, comparing such funds to an evergreen investable HFRX index is not ideal. Investors can overcome this shortcoming to a certain extent either by using a long-only equity index or assigning it a relevant asset class index, for example using a broad hedge fund index if the allocation is in the hedge fund category.

Fifth, Advisers recognise the potential of activist funds, but tend to warn about the dangers of investing in concentrated portfolios as well as other non-financial risks linked to these investments. The headline risk and reputation risk that is often associated with activist hedge funds is something that a conservative investor wouldn't necessarily want to be associated with, notwithstanding that some activist funds can generate strong returns and be effective at driving change in large corporations. It is worth noting, however, that there are different types of activist funds: there are the ones who employ aggressive tactics; others which have a softer shareholder engagement approach and there are those who are occasional activists.

INVESTMENT PROCESS

Philosophy

Activist engagement tactics fall along a continuum between approaches that aim for collaboration with incumbent leadership of the target company (such as private meetings with management) and highly confrontational approaches (such as an immediate hostile takeover bid). A number of activist fund managers use the term "constructivism" to distinguish collaborative approaches from the aggressive tactics commonly associated with hedge fund "activism"

The Manager focuses primarily or wholly on constructivist tactics, and invariably does so in the initial part of a value add campaign. The activism style of Dennison Hambling has always been to take relatively long-term view of investments in target companies, aiming to work in cooperation with management over a period of years.

From early on, Dennison Hambling has adopted an approach of making companies better and more competitive, which makes them more valuable and, as a consequence, is likely to generate a solid return for the activist strategy and other shareholders. As a practitioner of long only strategies, this has often involved joining boards of the companies, so as to drive incentives and have visibility of commitment and progress.

Over the years at an industry level there has been a trend towards more quiet activism. Activists have tended to become less hostile, less likely to publicise their engagement, and more likely to engage by getting onto company boards. In part, this may be a response to companies, who are more familiar with activism, and not taken by surprise when an activist comes on board. Furthermore, this approach has tended to gain ever more support from other stakeholders, both passive strategies and active equity managers, who themselves are more inclined to become more engaged as progress has become evident.

While the PM has invariably commenced an engagement with a constructionist approach, the is not to say there has not been cases were there has been a shift to a more assertive stance. This has typically occurred where satisfactory progress has not been made or there is a degree of intransigence from management / the board. In some such cases, this assertive stance has involved the removal of some or all of a management team where deemed in the best interest of all shareholders. The PM's philosophical view is he is there not so much as to 'hold the hand' of existing management / board, rather to hold the hand of the company.

The efficiency and timeliness of driving change is important. A cooperative approach often (but not invariably) leads to a shorter time line to creating value add versus a confrontational approach. A shorter time line implies a lesser use of resources for an investment manager and a superior internal rate of return (IRR) on an investment.

An activist investor must also be able to recognize when it's time to push harder and when it's time to walk away. When an active investment turns for the worse, the most common reaction of a shareholder activist is to fight harder and throw more resources at the investment in order to turn it around.

This is not, however, always the best strategy. Sometimes the best strategy is to cut losses and move on to another opportunity. On the flip side, it is also important that the activist have the right valuation discipline to sell investments that work out. Should a situation appreciate in value before the manager "gets active" for whatever reason, the manager should exit the position when his or her valuation targets are met and not become active simply for the sake of being active.

"Active" does not mean "Activist"

Typical Activist	360 Capital Active Value Equity Fund
Forced to rely on threats and aggressive use of public relations for influence	Ability to influence from the inside through board positions and/or nominations
Lack of downside protection due to limited skills to operate the company	Downside protection limited by the ability to be "hands on" as required
Financial/theoretical background	Extensive company and investment expertise
Trader mindset	Investor mindset

Investment Strategy

The tactics of the Manager, as the case for investor activism generally, falls within four broad groups: 1) operational improvements; 2) financial restructuring; 3) strategic direction; and, 4) corporate governance. These are not mutually exclusive, meaning that the Manager may pursue one or more of these tactics simultaneously. Most activists enter a position only after having established a clear playbook to unlock shareholder value, as well as steps to ensure such changes are implemented.

Operational Improvements

Activism campaigns targeting operational performance are probably the most complex, requiring industry expertise and, often, patience. This strategy requires more time to realise any value creation since implementing change, fixing any perceived faults in the business, and then capitalising on the investment all take time to achieve.

Activists pursuing this strategy focus on driving improved returns on capital for the targeted company. They can do this by seeking to rationalize cost structures or wring efficiencies out of working capital or capital spend. In response to the growing noise that activists make about returns on capital, companies increasingly focus on returns on capital, and the financial press has noticed.

Strategic Direction

The M&A strategy for activists is where they seek to put a targeted company into play, agitating for the sale or break up of the company. In some ways, this M&A strategy is one of the most appealing to activists, as it often allows them to quickly capture upside through a takeover premium, simply by kick-starting the sale or break-up process of a targeted company. Activists pursue M&A as a lever to realise high returns in a short period of time.

Activists focused on M&A tend to seek out sectors where they expect meaningful consolidation, or where consolidation is already underway. They may canvas financial sponsors or strategic acquirers prior to approaching the target to ensure sale-ability. If an outright sale is not viable, activists may otherwise seek to maximize value by agitating to break the company up altogether.

A successful activist should have the capability and willingness to take a company private, for three important reasons. One is the powerful message communicated when a shareholder activist offers to tender for an entire company. This will go a long way in winning the support of the rest of the shareholders since it creates economic value for the shareholders through the implied takeout premium, as well as by providing a vote of confidence that the activist is willing to own the entire company.

The second reason is that idle promises will only work a few times. Indeed, the market will catch on very quickly if the shareholder activist isn't willing to go through with the tender. Credibility is a very important part of this strategy.

The third reason is that the goal of a shareholder activist is to get control of a company in order to implement change. The ultimate way to get more control is by owning an entire company in the private market. Furthermore, restructuring a company in the private market is theoretically much easier than restructuring in the public market, since you don't have to worry about public market scrutiny and a fluctuating stock price.

Financial Restructuring

Financial restructuring, or effectively improving capital efficiency, may encompass proposing changes to reduce excess cash, increase or reduce leverage and/or deliver higher or lower payouts to shareholders (such as through increased / decreased dividends, special dividends or share repurchases), or suggesting that the company undertake (or refrain from undertaking) an equity issuance, debt restructuring or other recapitalisation.

The current market environment is clearly ripe for equity recapitalisations and debt restructuring. While it is not expected to be a material component of its execution approach, the Manager does have the ability to execute by way of a convertible note structure. This can provide distinct benefits over participating in an equity recapitalisation, namely providing greater downside protection while the potential for equity upside as well as not risk being crowded out by existing shareholder taking up all or a significant amount of the additional issued equity.

Corporate Governance

The fourth lever or strategy that activists typically deploy in seeking to unlock hidden value is corporate governance. Activists pursuing this strategy often seek to replace directors on the corporate board, via a proxy fight. This activist strategy is often a means to the end and is usually coupled with one of the other three strategies above.

In Australia, institutional shareholders enjoy enhanced access to boards and senior management. This is a privilege supported by shareholder rights, such as the annual two strikes say-on-pay vote or the ability to call a shareholder meeting pursuant to the Corporations Act. These are clear incentives for boards and management to seek engagement with shareholders around grievances to produce meaningful outcomes. In many offshore markets, public campaigning is often the only available option.

A trend to watch is the expected consolidation of Australia's superannuation industry given various inefficiencies in the sector. Superannuation investors are already some of the largest governance-conscious shareholders on ASX. Their growing scale, and capability to purchase larger blocks of shares, combined with the moral obligation to act as stewards of retirement savings, could over time tempt them towards more aggressive methods of corporate influence at larger Australian companies. In seeking better returns for their clients, pension funds in markets such as the US have for many years outsourced hundreds of millions of dollars of investment capital to hedge fund activists with a successful track record.

The implication is clear. Poorly governed companies are more likely to lose against a shareholder activist, and those companies that continue to take a proactive approach towards governance disclosure and engagement expectations are better positioned to withstand shareholder scrutiny. While it remains to be seen whether Australia will require the scale of public activist campaigning that is now characteristic of other offshore capital markets this dynamic can only be supportive of activist campaigns.

Activist Tactical Game Plan

Corporate Governance

- Ensure Skilled and committed board
- Management quality and focus
- Properly defined roles and incentives

Operational Improvements

- Cost effectiveness
- Asset utilisation
- Appropriate price /value equation

Strategic direction

- Acquisitions, dispositions and spin offs
- Ensure clear strategic direction
- Assess capital allocation framework

Financial Restructuring

- Debt restructurings
- Buy back program
- Dividends vs capital reinvestment

Source: Manager

Target Companies

The Fund is targeting investment into companies that can deliver greater than 5% p.a. net profit after tax (NPAT) growth, and have, or can achieve, greater than 12.5% return on invested capital (ROIC). These attributes are indicative only and are subject to change.

The Investment Manager believes these returns can be generated from businesses with consistent revenue and loyal customers, and where there is room for earnings growth that is not currently encompassed in the investment's price. This can occur for a number of reasons, including but not limited to: 1) underestimating the growth in the business; 2) lack of systems and process; 3) requirement for business transformation; 4) regulation or threat thereof; and 5) market fatigue which sees investors give up on "the story".

The Manager is of the view that by allowing a longer investment time frame and clear strategy, the Fund can more adequately assess and gain returns. By having a meaningful equity stake, this will enable influence within the investment companies to drive ultimate value appreciation.

The ultimate investment sphere is where there is perceived low value (reflected in a low price), with meaningful upside potential. This approach may do two things:

(1) make the Fund look contrarian and, at times, at odds with market norms, and

(2) lead to better returns as value is acknowledged for the investment companies, either by the market, or other private buyers.

Market Cycle Opportunities

Activist strategies represent a perennial strategy, have the ability to realise value through the full market cycle. However, the nature of opportunities and tactics employed typically vary at any given phase of a full market cycle.

I. Activism in a recessionary market environment

In a recessionary period, company operations generally come under intense scrutiny. Cost cutting is the general theme as management attempts to maintain margins. Amidst such conditions, operational and financial restructuring tactics are typically more appropriate relative to strategic turnarounds. Activist investors focused on streamlining operations and increasing margin efficiency find target company management to be more receptive during such a period.

II. Activism in an upward trending market environment

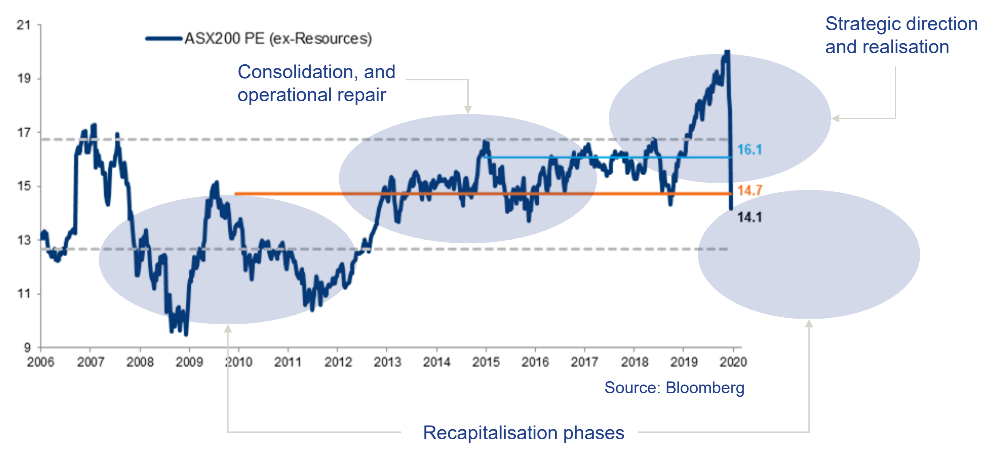
When an economy is in the process of emerging from a recession many companies remain in a defensive stance. Still reeling from a lack of market liquidity and available credit, companies tend to build up excess cash on their balance sheets. As the economy improves, however, sales typically pick up and unemployment rates decrease.

With improving access to capital, liquidity in the market improves. This encourages management teams to invest in new projects in order to generate organic growth as well as actively seek out corporate transactions to promote growth through acquisitions. Such an environment is usually the best for the strategic turnaround activist approach. With a more willing management and an equally receptive market, activist investors, with their wide network of CEOs and toolkit of operational and financial engineering tactics, can more easily facilitate strategic transactions and restructurings.

III. Activism in the current market environment

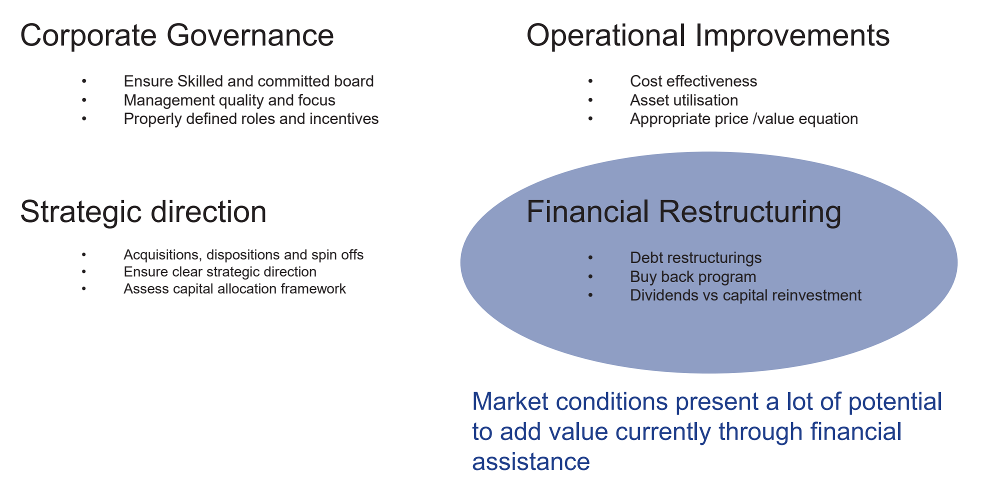
In an environment where organic growth is difficult to achieve, corporate managements have two options for investing their cash: they can either use that cash to restructure their balance sheet by conducting share buybacks or paying out dividends, or they can seek to grow the company strategically by engaging in M&A transactions. However, not all CEOs and managements possess the skill set required to engage in such strategic and financial manoeuvres. Both situations provide excellent investment opportunities for activist investors to add value.

Activist Opportunities over a Market Cycle



Source: Manager

Current Market Environment Opportunity Set



Source: Manager

The Manager notes that current market conditions lend themselves to three particular means to value uplift and types of tactics: 1) unrecognised value, with the divergence between "value" and "growth" at generational highs; 2) recapitalisation needs, with clear evidence of an increasing need for recapitalisation as financing becomes harder to obtain; and 3) Corporate renovation, with low interest rates had created complacency amongst small and mid companies (zombie companies).

Engagement Tactics

The following are the tactics that have in the past been utilised by the PM to engage with the management, directors and share holders of target companies:1) private communications (letters, meetings, etc.) and informal proposals; 2) seeking board representation without a proxy contest or confrontation with the existing management or board; 3) making formal shareholder proposals; 4) launching a proxy contest to replace one or more directors, including the chief executive, chairman or the entire board; and, 5) seeking control of the target, such as via a takeover bid.

These engagement initiatives have either been undertaken solely the PM or in collaboration with other industry players, including fund managers (some being 'occasional activists') or private equity players. This partnering can be important, clearly providing both more influence as well as financial fire power collectively to acquire a greater equity stake in a targeted company than undertaking an engagement solo.

As noted, the PM has generally utilised constructivist engagement tactics. Activist industry analysis supports this being a more effective approach in all geographies outside of the United States, where aggressive tactics by activists are more likely to be utilised. The general industry view is immediately hostile activism outside of the U.S. has broadly failed, with co-operation from a company's board being less likely. That said, activists have and continue to successfully use hostile tactics outside of the U.S. (just not to the same degree).

Hostile campaigns also typically require a larger stake in the target company to pull off and hostile campaigns are usually significantly more expensive. Additionally, there are other, unquantifiable advantages and disadvantages to taking a collaborative or confrontational approach. For instance, hostile campaigns are often highly public and the activist can use that attention to put further pressure on target company management and directors.

Conversely, such publicity may also expose the fund manager to reputational damage in the case the campaign fails. Some major shareholders, whose support the activist may need to win in more than one campaign, may also be less willing to back activists employing the most aggressive tactics. Further, in a collaborative process, activists often enjoy regular access to management and corporate information. In contrast activists are generally cut off in times when the campaign is more hostile.

Market capitalization

As noted, the Fund intends to make investments into companies which are initially valued at $20m-$500m. IIR believes this is sensible, being a more prospective market cap segment. While activist investing can span the equity market capitalization spectrum, research indicates that the activist strategy lends itself more readily to small and mid-cap companies for three primary reasons.

First, management teams in small and mid-cap companies are relatively inexperienced compared to large cap companies. They are generally less sophisticated in their capital allocation decisions and therefore tend to be more amenable to changes proposed by an activist investor. Collaborating with such a management team can lead to lower expenses and faster resolutions and an activist campaign can generally be resolved in a less hostile manner. These factors can significantly boost returns.

Second, a relatively smaller investment is required in small and mid cap companies to acquire a status of a significant minority shareholder (this is also a necessity for the Fund given FUM is starting from a low base). In other words, it is easier for an activist manager to garner support from other shareholders in small and mid-cap companies with a smaller, more concentrated shareholder base.

Lastly, stock valuations can potentially show a significant improvement in small and mid-cap companies, which trade in a relatively inefficient sector of the market; i.e. it is easier to "move the needle" on the price of smaller companies. Large cap companies, in contrast, are generally more efficiently priced and can have limited upside.

What is unique to Australia is the relative absence of public activist demands towards mid- to large-cap ASX companies – those with a market value greater than $2 billion. Proxy contests at the top end of the ASX are extremely rare, with a mere handful observed over the last decade. In fact, around 80 per cent of public shareholder activist demands in the first half of 2019 (up from around 60 per cent in 2018) targeted ASX companies with a market value below $50 million. Globally, just over 40 per cent of shareholder activist campaigns targeted mid- and large-cap companies in the first half of 2019.

Investment Horizon and Exit

Contrary to claims that activist alternative investors are primarily focused on realising short-term profits, most activist funds have relatively long investment horizons.

At the conclusion of an activist campaign, a manager may crystallise value in the following ways: 1) the sale of target company shares in the open market and which is by far the most common exit strategy; 2) the acquisition or merger with a third party; 3) taken private or otherwise delisted; and 4) the repurchase of the activist's shares by the target company or a takeover of the target by the activist (both of which are less common).

PORTFOLIO CONSTRUCTION

The target portfolio is 10-20 high quality growth companies. Given current market conditions, the Manager aims to build the portfolio position by position, applying a strict focus on absolute returns, and having a clear view as to how the positions will be maximised over a 3-5-year period.

Due to market cyclicality (oscillating between being under and overvalued through time) the Fund could also hold a substantial amount of cash, or cash like investments, at any one time. It will also be prudent to manage the cash of the Fund to support M&A and value enhancing initiatives of investee companies, from time to time.

However, the Fund primarily aims to build its core portfolio via investing in companies whereby the Manager's skills, expertise and experience can be applied to move the businesses up the quality ladder and become highly sought after in the market.

The Manager views targeted $20m-$500m market cap segment as prospective, as the weight of investable funds in Australia has migrated to larger value businesses and become more passive in nature. IIR notes that due to the Manager's experience and continued active mandate within the marketplace, the Fund already has a significant initial pipeline of opportunities.

Potential investors should to be very clear on the following portfolio characteristics in considering whether the Fund is a suitable investment:

- As most activists do not have large teams, activist portfolios tend to focus on a limited number of ideas that they are able to research and engage with at any given point in time. The less diversified a portfolio, the more potential impact any one position can have on the returns (activist strategies are more exposed to idiosyncratic shocks).
- With such concentration, there exists much greater opportunity – and risk – for idiosyncratic or company-specific factors to drive an alpha outcome over the long term, as opposed to mere beta. But investors need to be clear that prior to achieving an activist outcome (assuming it is indeed achieved) an activist strategy may well have just as much beta risk as a traditional value strategy. Over time, this is likely to be mitigated by way of diversification in the expected time line of activist engagement outcomes through multiple investments. Again, investors must adopt a long term investment horizon in order to both realise the raison d'etre of activist strategies, namely as a return enhancer and portfolio diversifier.
- Given most of the target companies are micro and small caps, liquidity can be come a material risk, both on the upside and downside. The liquidity risk may manifest in two ways. On the upside, it may lead to a significant degree of portfolio concentration, with an uncomfortable weighting to one stock if the manager is precluded from materially trimming its position (and further increasing what is already a high degree of portfolio concentration). On the downside, the liquidity risks are obvious but the overall performance impact on a fund would be greatly amplified where the particular stock had increased to a very significant weight prior to a share price fall (this is precisely what occurred in relation to the PM's past Emeco investment in the First Samuel fund - refer to Performance Analytics section).
- The portfolio will be built progressively over time as FUM increases and opportunities present. Consequently, the portfolio is expected to be very highly concentrated in the initial circa two years. Given this and the long-term nature of such investments before activist outcomes are generally achieved (expected to be 3-5 years) investors should be prepared for significant volatility and potential drawdowns. It is imperative that investors view an investment in the Fund as a long-term investment, and more so than a traditional value fund.
- A by-product of the longer-term focus on valuations and business building as opposed to short-term price action and half yearly earnings numbers is a necessarily longer holding period (similar to private equity). Usually, activist funds have a multi-year average holding period and extremely low portfolio turnover. While an activist strategy can and do take advantage of investing through public markets by trading around core positions on large

price moves, the level of turnover in activist portfolios tends to be far lower than other equity funds.

- The Fund intentionally does not have defined portfolio diversification stipulations. This is sensible given 1) FUM will be starting from a low base and 2) the nature of activist opportunities can be very different at any given point in time and market cycle. That said, IIR would ultimately expect prudent diversification by sector / industry and the nature of activist strategy to achieve target outcomes. To highlight this, Dennison Hambling has provided a sample of past activist engagements, illustrating both diversification by way of sector and engagement strategy (see table below). Furthermore, the expected progressive increase in FUM will naturally lead to a mitigation of market timing risk and, given activist opportunities tend to vary over the full market cycle, diversification by activist strategy.

Select Sample of Past Campaigns (both Positive and Negative Outcomes)

Co.	Period / IIR	Strategy	Background	Active Position	Key Takeaways
Emeco	Sep 09 - Sep 19 IIR: 9.8%	Corporate and Industry Repair and build	Began position early into down cycle for business, but built position as liquidity disappeared (19.9% company holding at the lowest price) in preparation for a recapitalization	1) Led board and management change. 2)This enabled a three-way merger of Emeco / Andy's / Orionstone and simultaneous debt restructure and recapitalisation. 3) Provided key (cash) funding to facilitate and complete the recapitalisation. 4) Closely supported the company with two further value enhancing acquisitions	Using industry down cycles to improve the economic position of investees can create substantial value. Ideal position is to come in at time of recap, and avoid as much downside as possible
Energy Dev-elopments	Oct 07 - Oct 15 IIR: 19.1%	Corporate repair and sale	Company a turnaround story at time of initial investment. Value not being recognized by market, major owner distracted / underwhelming	1) Decision to hold off PEP takeover (despite the then premium offered). 2) Offered PEP a portion of holding in order to have them take control (get through 50% ownership) 3) Withdrew balance of holding from sale in order to participate in upside with PEP. 4) Ultimately taken over by DUET for a substantial return.	The change in control from a distracted owner to a focused operator resulted in substantial value being unlocked. Focus and alignment of investments is imperative to unlocking value.
Elders Hybrid	May-09 - Oct-13 IIR:-22.8%	Worst industry restructure	Brought dominant (19.9%) position in the Hybrid Equity of Elders, during the GFC. Pushed for Elders & Ruralco merger. Failed to bring Elders and Ruralco together for once in a generation deal	Sold the hybrid to purchase other investment (Ingenia)	The hybrid recovered with a substantial return. Patience is important. If hadn't sold to fund a successful investment, this would have been a mistake. Parties got too focused on relative value, rather then end value.
Challenger		Best large cap investment	Challenger initially a turn around from Founder led to Corporate. Operating in a large but under appreciated niche. GFC sell off indiscriminate across wider sector group	Acquired stake during GFC at 50% of book value. Saw substantial appreciation in value as business grew, and market appreciation increased. Sold holding down as price rallied to recognise fundamental short term volatility inherent in company earnings	Hedge funds shorted Challenger, due to fixation on short term P&L assets, but lost sight of the fundamental growth nature of the assets. Most of the money was made simply holding a good business.

Initial Investment: Cardioscan

The Fund has made an initial investment in unlisted company Cardioscan. Cardioscan is an Australian headquartered, unlisted, global provider of cardiac monitoring services. Its offers cardiologists a high-quality cardiac monitoring and reporting service, with some of the fastest and most accurate readings globally.

Established in Australia more than 30 years ago, Cardioscan has evolved via greenfield expansion: in 2016/17 expanding its low cost, high service and speed model globally. It now has operations in the UK, Hong Kong, Singapore, Malaysia, and Brunei. In 2018 it also expanded into the US via acquisition.

Cardioscan has grown its revenue by 19% p.a. since 2015, and is well positioned for strong organic growth as it builds its position in the key US and UK markets. The Manager sees substantial, and accelerating growth ahead of Cardioscan for some time. Cardioscan positioned generates significant incremental returns from its investment and has a strong economic (cost and service) advantage globally.

The Investment Manager assesses a favourable price (including consideration of the normalized forward EBITDA) was paid, with the Fund owning 5% of the shares in the company. Its two listed competitors are trading at higher multiples, than our investment.

The investment is viewed by the Manager as a structural growth opportunity, and therefore is expected to be a core holding opportunity. The Manager anticipates that Cardioscan will generate enough scale either to IPO, or trade sale, when appropriate.

In terms of active engagement, the Manager has partnered with Harbert (US PE firm) and together have two board seats).

PERFORMANCE ANALYTICS

As noted, prior to participating in the formation of the Manager and Fund, Dennison was the Chief Investment Officer at First Samuel Ltd for 12 years, commencing in October 2007 through to July 2019.

During this period he was responsible for managing the Concentrated Equity Strategies Fund. The investment philosophy was based on a small/mid cap long-only Australian equities strategy based on largely the same investment strategy that will be deployed in the Fund. The key distinction, however, was the portfolio was generally 50/50 split between pure activist investments and general market beta positions (a more traditional investment strategy).

The pure activist strategy was also run in isolation for a particular client group. This was a more concentrated portfolio (with 10-15 names typically) and in situations where the manager was "actively" involved. It was a mandate created for a number of high wealth investors who used the sub-stratregy as a part of their asset allocation.

On this basis, the Manager has provided two performance track records: the returns profile of the broader mandate ('Series 1') and, separately, that of the more concentrated activist pure-play sub-strategy ('Series 2'). The key distinction being concentration and the focus on active value (as distinct to just value) situations.

Series 2 is clearly the more relevant indicator of prospective performance and capabilities of the Manager, but the distinction in performance of the two is illuminating in a number of ways too. This distinction provides insight into the possible performance characteristics of a pure active strategy (alpha) versus a more traditional style of long-only investing.

The two performance metrics and time series are tabled and diagrammatically presented below. As noted, returns in active strategies are highly idiosyncratic being subject to the success or otherwise of each particular engagement.

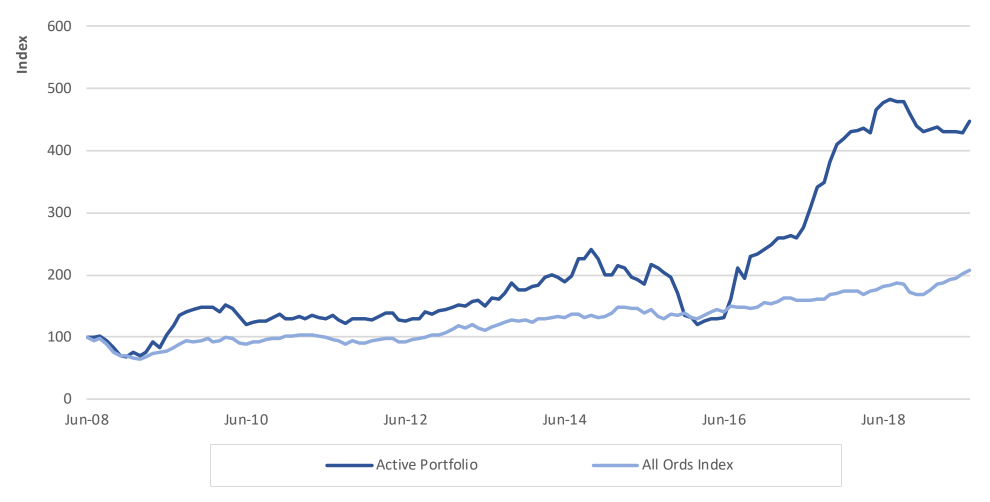
Importantly, each engagement is unique in various ways, with the engagement strategy reflecting this. Consequently, the specific returns and risk metrics are likely to be l**ess indicative of potential performance** than would ordinarily otherwise be the case. What IIR deems as more important is the 'shape' of performance and whether it is 'true to style' with respect to an activist strategy. As such, IIR places more importance on this shape than the absolute metrics of return and risk.

Historic Performance - Active Portfolio vs All ords

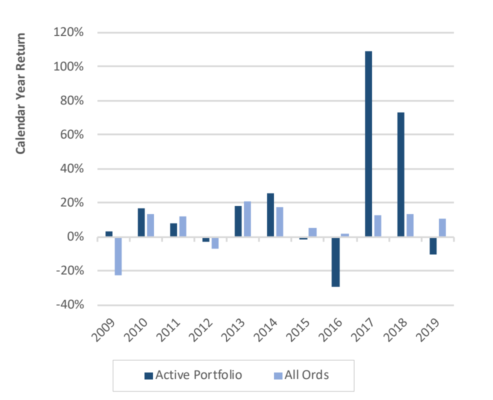
	1-yr	3-yr	5-yr	7-yr	10-yr	Incept.
Active Portfolio	-7.1%	40.6%	17.7%	19.3%	14.2%	15.9%
All Ords	12.9%	11.4%	8.7%	11.7%	9.5%	6.4%
Alpha	-20.0%	29.2%	9.0%	7.7%	4.7%	9.5%
	Vol	**Max DD**	**Recovery**	**Correlation**	**Downside Deviation**	

Historic Performance - Active Portfolio vs All ords	1-yr	3-yr	5-yr	7-yr	10-yr	Incept.
Active Portfolio	23.3%	-50.2%	7 mths	0.38	3.9%	
All Ords	11.7%	-15.5%	15 mths	n/a	2.1%	

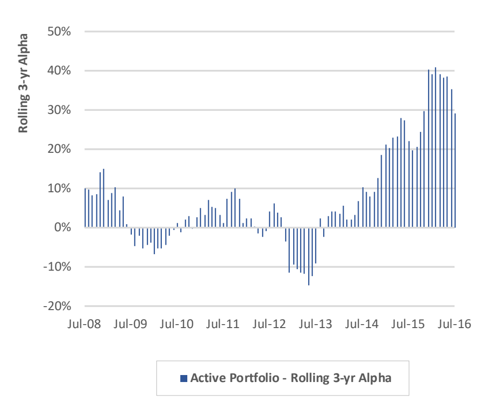
Historic Performance Time Series - Active Portfolio



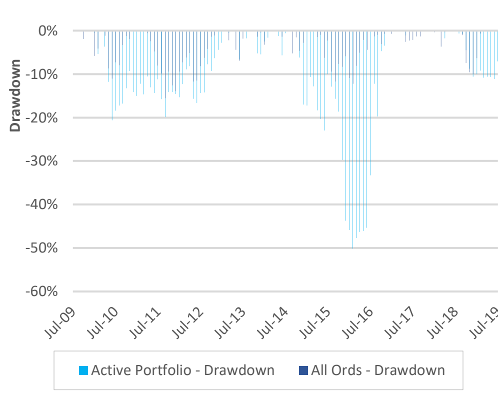
Active Portfolio Annual Returns Time Series



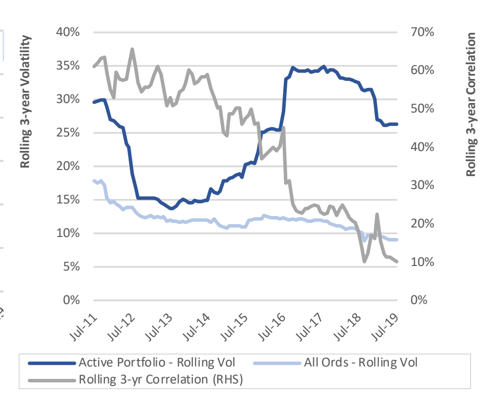
Active Portfolio Rolling 3-year Excess Returns



Maximum Drawdown



Risk & Diversification Measures - Rolling 3-years



Overall, performance has been very true to style as well as there being a high degree of alpha over the longer term. The key performance points:

- The active portfolio was characterised by high volatility, a very significant maximum drawdown (-50%), and exceptionally fast time to recovery from the maximum drawdown (7 months), a significant run of strong returns towards the latter years (as activist campaigns successfully realised), and, related to the latter, declining beta (market) 'risk' over time. In relation to the latter, investors need to be cognisant of the fact that activist strategies run beta risk during the period from initial investment up until the realisation of a successful activist campaign.

- Dennison had a successful campaign hit rate of 80% of completed investments. This exceeds global and geographic specific averages, being 53% globally, 61% in the U.S., 50% in Europe, and only 18% in Asia.
- While overall volatility was particularly high, the more important measure of volatility is downside deviation, the latter of which was significantly lower than overall volatility. This is a strong positive as it essentially means that the downside volatility in the return stream was lower than the overall volatility (the combined volatility of negative AND positive months). If the reverse was true (where the downside deviation was higher than the standard deviation), that would mean that the negative months were much more volatile than the positive months.
- The very significant drawdown and exceptionally fast time to recover was largely related to one investment, namely Emeco. The manager went 'over the wall' (that is, privy to inside information and therefore unable to acquire additional shares until such information had been released to the market) to assist with the company with a significant debt restructure, acquisition of two players and an equity raise. When this occurred, given the manager had been the marginal buyer up until that point, the price dropped a further 70% (from very depressed levels already) before the manager completed the deal. The irony is that at the business and investment level the manager was very comfortable with the investment through the whole journey, with the likelihood of losing money at the end of the activist campaign being assessed as low. It was a 10% position at investment, but then rose in price to represent 26% of the portfolio at its height. The manager sold down one-third of the holding at around this price, and was actively working to sell the position back to a more standard 6% weight. The Emeco investment ultimately came good by way of a phased sell down as prices rose strongly.
- While the above investment / situation (which was instrumental in the overall shape of performance) could just as easily not have occurred, the overall shape of performance highlights characteristics very consistent with activist strategies. Namely, 1) a J-curve returns profile, 2) the need to take a long-term view, and 3) there is a material risk of periods of significant drawdown, partly due to the concentrated nature of such strategies. The returns profile of activist strategies bear a strong resemblance to that of the private equity asset class.
- Investors should generally expect lumpy and divergent performance to the broader market, with periods of material out- and under-performance (refer to second chart above). It can be difficult to judge the timing and quantum of returns to an activist campaign, and a large proportion of those returns may come all at once, particularly on the occurrence of an activist "outcome," such as a restructuring and/or acquisition of a target company.
- Activism often appears to be a 'win-lose' proposition to a substantial degree. Returns to activism depend significantly on the ability of the activist to achieve an "outcome," and that some outcomes are generally more profitable than others. For example, a study of global activism strategies by a team at Citi found that 52% of targets showed negative excess returns over both one and two year periods, meaning that the large average improvements were driven by a relative minority of activist efforts that resulted in outsized share price gains. Highlighting this skew by engagement, research by JP Morgan Asset Management notes that the **average** activist return is three times larger than the **median** activist return. What partly drives this skew is, as evident by way of market research, is that the types of engagement generally have different return profiles. Takeovers or multiple outcomes, such as board changes followed up restructurings or spin-offs, are very profitable, compared with changes in payout.
- The win-lose characteristic, tied with concentrated portfolios, highlights why downside risk mitigation by investment is even more important in an activist strategy than traditional beta strategies. The key to mitigating risk is selecting companies with solid fundamentals and defensive cashflows. In such cases, if an activist engagement fails alpha downside risk is more likely to be offset by limited beta downside risk.

APPENDIX: RESURGENCE OF ACTIVE INVESTING?

In IIR's view, there are a range of market dynamics that are supportive of active (vs passive), activism and value investing for the foreseeable future. Active investing comes in three different forms: growth, value, and agnostic (a combination of growth and value to varying degrees as opportunities present).

Less 'Trafficked' Investment Style

In a low returns, concentrated investing world the need for a strategic allocation to active, long only investing has never been higher. Counter-intuitively the amount of capital now proportionately allocated and managed to 'active' long only investing has never been lower. Market conditions are favourable, with many quality companies now trading at distressed prices, ripe for "active" ownership.

There has been a ~14% decline in the number of "active" fund managers in Australia between 2014 and Jan-2019. Since Jan 2019, there have been a significant number of Australian equity fund mangers close:

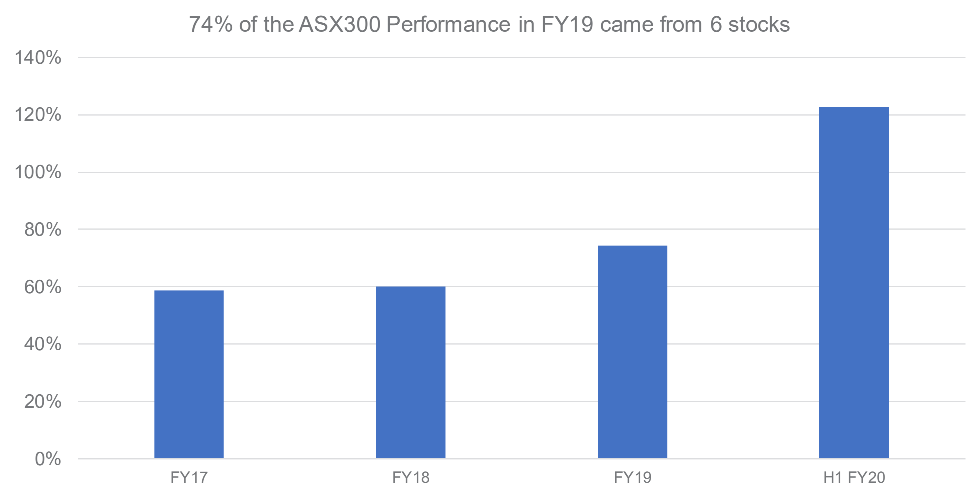
Notable examples being: KIS Capital; Sigma Funds; JCP Investment Partners; Dual Momentum; Janus Henderson Australian equity funds; MHOR Asset Management; Discovery Asset Management; Denning Pryce; Adam Smith Asset Management; Concise Asset Management; Arnhem Investment Management; UBS Asset Management Australian equity funds (transferred to Yarra Capital); Altair Asset Management

Combined with the rise of, industry funds, and passive investing, this has created the least "active" equity market in a generation. Only 5% of Australian portfolios are allocated to "active" equity investing today.

As such, few investors are competing for small and mid cap assets (given passive strategies are disproportionately larger cap mandates). Fewer are seeking to actively manage those holdings to maximise returns. Returns in the rest of the market are increasingly correlated and based on momentum (based on size or "hotness").

Furthermore, as evident from the chart below, the breadth of returns that has driven ASX 300 returns has become concerningly narrow. For example, in FY19 74% of the ASX300 performance derived from six stocks. Being underweight CSL alone, which would have been the case for the vast majority of active investors based on single stock portfolio construction limits alone, would have cost active mandates considerably.

Percentage of S&P/ASX 300 Returns from Top 6 Market Cap Weighted Performers



Source: IRESS, 360 Capital (6 largest market capitalisation movements as a percentage of the market capitalisation movement of the ASX300 Index).

This narrowness in itself implies material risk in relation to the continued likelihood of passive strategies outperforming the majority of active strategies. And that is without the economic impact of COVID-19. It is now a universal view amongst market commentators that successfully negotiating the equity market fallout of the virus will require careful stock selection to weed out the losers from the relative winners. Furthermore, it is IIR's view that the equity markets are under appreciating the duration of the recovery process, even without the prospect of a second and possibly even third wave of infections ('W' shape recession).

The Cyclicality of Active vs Passive

The active versus passive investing debate is relentless. If you do a simple cost/benefit analysis, advocates of passive investing have compelling facts on their side. Over the last five years, 82% of U.S. large-cap equity mutual funds lagged the S&P 500 index. In the U.S., expense ratios for active mutual funds typically range between 0.5% to 0.75%, while most passive index funds are between zero and 0.25%.

However, in IIR's view the choice between active and passive management is not a zero-sum game, with each having a place in investor portfolios based on the individual needs and wants of the investor.

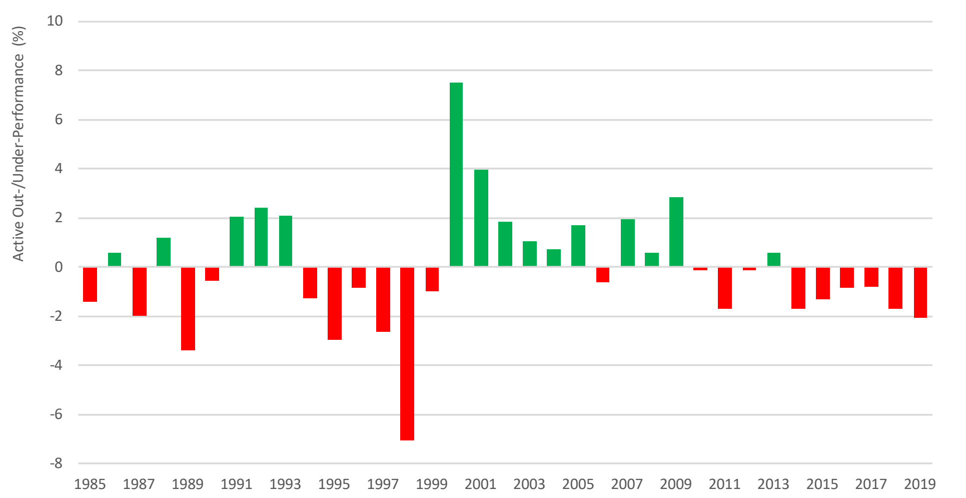
Over and above this general view, IIR notes that the performance of active and passive management has been cyclical, with each style trading periods of outperformance. Market corrections are inevitable and a common occurrence in equity markets over time. Excluding the current correction, there have been 26 market corrections over the past 31 years, and active management outperformed passive management in 19 out of 26 corrections.

During market corrections, the flexibility of active management allows for reducing exposure on the downside and ramping up exposure to capture alpha in the early stages of recovery. Active management has typically outperformed passive management during market corrections, because active managers have captured less downside (passive largely capture 100% downside) and more upside as the market recovers.

A time series comparison of active versus passive investment style illustrates the cyclical nature of performance. To represent active management in this comparison, all index funds and enhanced index funds have been removed. To represent passive management, the Morningstar S&P 500 Tracking category. The same cyclicality is present in other investment categories such as mid-caps, small-caps, and global/international equities.

As illustrated in the chart below, passive large-blend strategies have outperformed active large-blend strategies for the last six years, which helps to explain why in 2019 passive US equity funds had inflows of $164 billion, while more than $205 billion under active management headed for the exits.

Active vs Passive Out- / Under-Performance



But the past six years only tell part of the story. A wider look at the chart reveals active and passive have traded the lead in performance over time. From 2000 to 2009, active outperformed passive nine out of 10 times. During the 1990s, passive outperformed active seven out of 10 times. And over the course of the past 35 years, active outperformed 15 times while passive outperformed 20 times.

The chart also illustrates that during those corrections, active outperformed passive 19 out of 26 times, with an average rate of outperformance of 1.48%. By allowing investors to respond to changing markets, active management empowers investors to maximize opportunity as conditions demand.

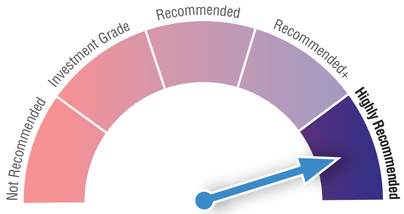
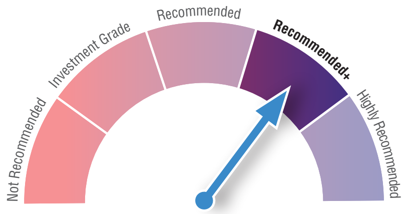
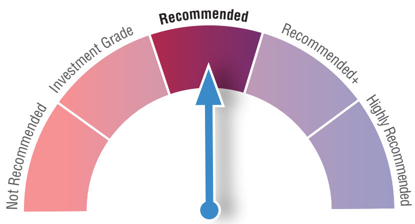
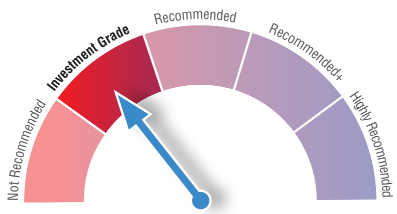
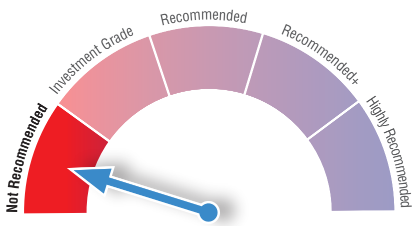
Valuations Move in Favour of Active Value

With the recent market turbulence valuations have most likely declined from previously over valued levels. We say 'most likely' because right now there is little transparency on medium term earnings. That said, IIR believes there has and will be a reassessment of risk premia, which should compress valuations for the foreseeable future.

APPENDIX A – RATINGS PROCESS

Independent Investment Research Pty Ltd "IIR" rating system

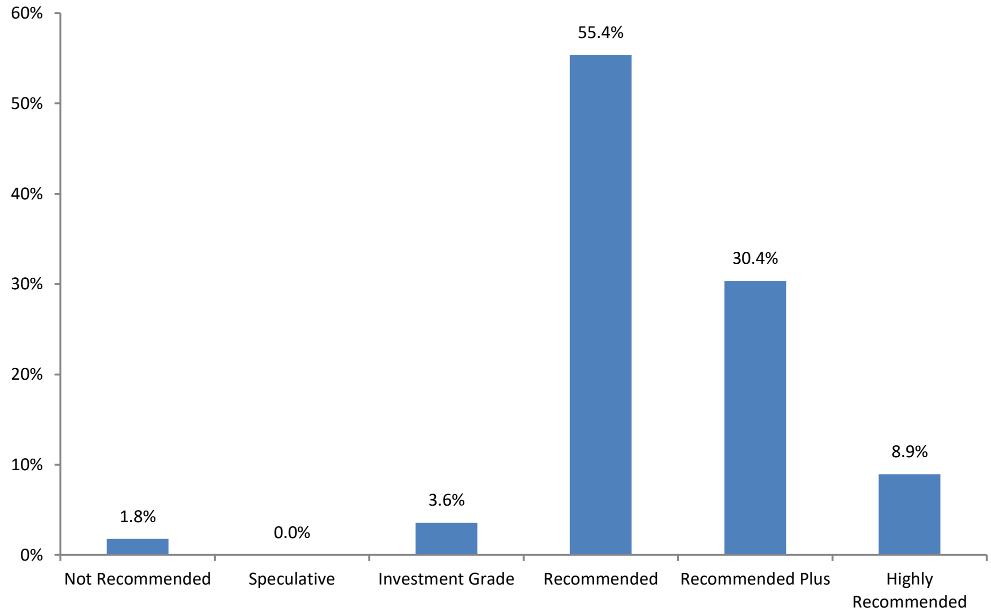
IIR has developed a framework for rating investment product offerings in Australia. Our review process gives consideration to a broad number of qualitative and quantitative factors. Essentially, the evaluation process includes the following key factors: management and underlying portfolio construction; investment management, product structure, risk management, experience and performance; fees, risks and likely outcomes.

LMI Ratings	SCORE
Highly Recommended	**83 and above**
	This is the highest rating provided by IIR, indicating this is a best of breed product that has exceeded the requirements of our review process across a number of key evaluation parameters and achieved exceptionally high scores in a number of categories. The product provides a highly attractive risk/return trade-off. The Fund is likely effectively to apply industry best practice to manage endogenous risk factors, and, to the extent that it can, exogenous risk factors.
Recommended +	**79–83**
	This rating indicates that IIR believes this is a superior grade product that has exceeded the requirements of our review process across a number of key evaluation parameters and achieved high scores in a number of categories. In addition, the product rates highly on one or two attributes in our key criteria. It has an above-average risk/return trade-off and should be able consistently to generate above average risk-adjusted returns in line with stated investment objectives. The Fund should be in a position effectively to manage endogenous risk factors, and, to the extent that it can, exogenous risk factors. This should result in returns that reflect the expected level of risk.
Recommended	**70–79**
	This rating indicates that IIR believes this is an above-average grade product that has exceeded the minimum requirements of our review process across a number of key evaluation parameters. It has an above-average risk/return trade-off and should be able to consistently generate above-average risk adjusted returns in line with stated investment objectives.
Investment Grade	**60-70**
	This rating indicates that IIR believes this is an average grade product that has exceeded the minimum requirements of our review process across a number of key evaluation parameters. It has an average risk/return trade-off and should be able to consistently generate average risk adjusted returns in line with stated investment objectives.
Not Recommended	**<60**
	This rating indicates that IIR believes that despite the product's merits and attributes, it has failed to meet the minimum aggregate requirements of our review process across a number of key evaluation parameters. While this is a product below the minimum rating to be considered Investment Grade, this does not mean the product is without merit. Funds in this category are considered to be susceptible to high risks that are not reflected by the projected return. Performance volatility, particularly on the down-side, is likely.

APPENDIX B – MANAGED INVESTMENTS COVERAGE

The below graphic details the spread of ratings for managed investments rated by Independent Investment Research (IIR). The managed investments represented below include listed and unlisted managed funds, fund of funds, exchange traded funds and model portfolios.

SPREAD OF MANAGED INVESTMENT RATINGS



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