

flexibility with accountability



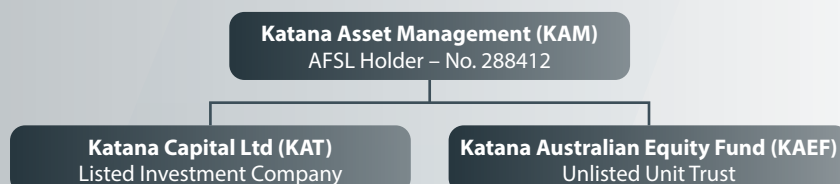
KATANA
ASSET MANAGEMENT LTD

www.katanaasset.com

Katana Asset Management ('KAM') was founded in September 2003 as a boutique investment management firm specialising in Australian Equities. KAM was granted an Australian Financial Services Licence in July 2005.

In September 2005, KAM established its first fund Katana Capital Ltd, which was listed on the ASX in December 2005 (ASX code KAT).

In April 2011 Katana Asset Management launched its second fund - the Katana Australian Equity Fund (KAEF). KAEF is an unlisted version of the first fund and is managed by the same team, employing the same investment philosophy.



Romano Sala Tenna

B.Bus (Distinction), Grad Dip Applied Investment Analysis, ADA 1&2, FFINSIA

Portfolio Manager

26 years experience

Romano commenced at Alcoa as a trainee programmer in 1989 and worked in a variety of roles including Systems Analyst. In 1996, Romano commenced work as a private client adviser at William Noall Ltd.

In 2000 Romano joined Johnson Taylor Potter which was subsequently assumed by Bell Securities to form Bell Potter Securities.

In 2003 Romano co-founded Katana Asset Management.

Romano is a past lead lecturer at FINSIA and the ASX and is regularly quoted in the AFR and a variety of national and local publications.

Skillset & Orientation Bottom-up value investing; small-mid-large caps; fundamentally driven with technical analysis overlay; trend-following contrarian opportunities.

Brad Shallard

B.Bus (Accounting), CPA, Dip of FP, Grad Dip Applied Investment Analysis, ADA 1&2, FFINSIA

Portfolio Manager

26 years experience

Brad commenced as a tax accountant in 1994 and then transitioned into financial planning. In 1995, Brad moved into stockbroking at William Noall Ltd.

In 2001 Brad joined Johnson Taylor Potter which was subsequently assumed by Bell Securities to form Bell Potter Securities.

In 2003 Brad co-founded Katana Asset Management.

Skillset & Orientation Large cap growth (business model and management) and market generated opportunities; high-conviction mid-cap.



Combined experience

Our team have a combined direct investment experience in excess of 82 years.

All of the Portfolio Managers have invested through at least 3 boom-bust cycles. In the world of professional investing, there can be no substitute for experience. And in terms of experience, the very best type is attained during times of crises.

During the 2008-2010 GFC, the KAM team fine tuned its philosophy, processes and culture. The KAM team has emerged with a strong track record and confirmation that their robust processes and conservative approach are able to survive the most trying of market gyrations.

Importantly, KAM has also built a stable team, with the 3 founding portfolio managers remaining at the firm.

Particular expertise

Each of the Managers has specific post-graduate training in investment theory and analysis.

In addition the team has specific undergraduate or post-graduate training in economics, business, accounting, finance and information systems.

The Portfolio Managers hail from diverse backgrounds in terms of geography, training and profession. Combining this diversity has lead to a stronger and more rigorous decision-making process.

Aligned interests

As at May 2020, the Managers owned approximately 35% of the funds under management.

Giuliano Sala Tenna

B.Bus (Distinction),
Grad Dip Applied Investment Analysis, GAICD

Investment Manager

22 years experience
Commenced January 2010

Giuliano has worked in the Finance Industry for over 18 years in various fields including Credit, Business Development, Product Structuring, Funds Management, Investment and Corporate Advisory.

He has completed a Bachelor of Commerce degree at Curtin University of Technology with a double major in Economics and Finance (With Distinctions). Giuliano has also completed the Graduate Diploma in Financial Planning at the Securities Institute of Australia, the Company Directors Course at the Australian Institute of Company Directors and is an ASX Derivatives Accredited Adviser.

Giuliano is regularly quoted in the AFR alongside appearing on the ABC News and Business Program.

Skillset & Orientation Macro top-down, mid / large cap growth companies especially financial services and technology.

Hendrik Bothma

B.Comm (Accounting & Banking),
Chartered Accountant, Dip.FP

Junior Equity Analyst

8+ years experience

Hendrik is a Corporate Finance professional with 8 years experience working on large scale transactions, building bespoke financial models and conducting in depth research.

In February 2020 Hendrik joined Katana Asset Management as a Junior Equity Analyst supporting the Portfolio Managers in investment research and evaluation.

Prior to joining, Hendrik held various positions within the Finance Industry including working on large debt restructure and capital raisings within the resource sector, Credit Analyst at Macquarie Bank and originally started his career as an Accountant at Ernst & Young.

Skillset & Orientation Fundamentally driven bottom-up modelling and analysis.



Investment approach

The team at Katana Asset Management (KAM) strive to think independently but act in unison with the market, by combining the best precepts of the 5 key investment disciplines:

- 1 Value Investing
- 2 Fundamental Analysis
- 3 Growth Investing
- 4 Technical Analysis
- 5 Market Dislocation and Reversion to Mean

KAM have an overriding pre-occupation with capital preservation and are comfortable to remain weighted in cash for extended periods.

With our team of portfolio managers, we have endeavoured to create an environment that emphasises flexibility within a strong overlying framework of accountability & risk management.

We recognise that companies are imperfect; our lot is therefore to choose the 'less imperfect' by clearly defining and prioritising investment criteria.

What we avoid

By definition, as a buyer of a company, we are backing that we are 'better guided' than the seller. We hence look for companies inside our 'circle of competence' and 'network of newsflow'.

Additionally, we generally avoid companies that lack cashflow; in particular:

- Technology / start-up
- Biotech, esp. pre-product release
- Greenfields exploration and except in exceptional circumstances brownfields/ pre-production.

Core Beliefs

- 1 **'Be fearful when others are greedy and greedy when others are fearful;'** (Warren Buffet) The best value is to be found at times of extreme fear : commonly this fear is restricted to a particular company. At times this fear is less discriminating. Similarly, stock prices both singularly and as a group overshoot to the upside as 'irrational exuberance' or misplaced optimism leap to the fore. Identifying and assessing potentially oversold stocks is an intrinsic part of the day to day function of the Manager. *As a further note, large asset dislocations are rare and may only occur every few years. The Manager is focussed on making large investments at stock and market extremes.*
- 2 **Investing is one part maths, one part economics and one part psychology.** Unless this is recognised and embraced, decisions will be negatively impacted. KAM Managers recognise and embrace the blend of skills and strive to consciously adjust for sub-conscious bias and strengthen individual weaknesses.
- 3 **Never forget Risk; it will return.** When the market ignores risk it is only a question of 'when not if'. Risk always reverts to the mean; sell assets when risk premiums evaporate. Buy assets as the cycle bottoms and risk appetite is on the rise.
- 4 **There is no perfect company; only inadequate research and analysis will fail to uncover risks and flaws.** We accept that we must purchase imperfect companies and hence turn the focus from trying to locate perfect companies to trying to identify the best stocks on a comparative basis.

- 5 **Mispriced stocks exist in all markets; the challenge is to identify them ahead of the market.** There is no substitute for turning over stones. Read the reports. Make the phone calls. Visit company offices and stay in regular contact with management.
- 6 **Emotional Quotient (EQ) is as important as Intelligence Quotient (IQ).** Test and re-test objectivity. Allow time to distil emotion. Strive for calmness and balance.
- 7 **One of the key questions is 'What's going to change?'** Share prices change as earnings change. Determine both at a macro and micro level, what is it that is likely to change and hence drive markets and share prices.
- 8 **Knowing how much to invest is part way as important as knowing what to invest in.** Building a diversified, well-risked portfolio is a relatively more simple task. The true challenge is to have the capacity and conviction to take a (substantially) overweight position when the rare 'fat pitch' arrives.
- 9 **Today, a substantial amount of money is being managed on a short term horizon.** The opportunity is to take a different time horizon. In assessing an investment, the Manager is prepared to take a 2-5 year view.
- 10 **Avoiding a loss is superior to making a gain;** from a loss of 50%, a return of 100% must be achieved with the remaining capital to return to par. Safety takes precedent over potential gain.

- 11 **The market is not a zero sum game.** The share market is unitised pieces of a country's economy. A growing economy translates into a growing stock market – a positive sum game. In a growing economy, the odds are stacked in favour of an investor. Accordingly, equities are the investment of choice over options, futures and other zero sum investments where no margin is afforded by a growing asset.
- 12 **The best investors know how to be wrong.** Document key company risks and review these risks against company news flow and management updates, to identify problems as early as possible. Additionally, it is useful to record what 'we would not want to see' when investing.
- 13 **Investors derive confidence from other investors.** A shareholder selling with conviction can lead other shareholders to sell. Aggressive selling / buying is not accepted as valid in itself. Look beyond market moves and assess the rationale.
- 14 **The Market reverts to its long term mean over time.** Take larger 'positions' the further the market deviates from the mean: like an elastic band, its return will be greater and swifter, the further it is stretched.
- 15 **Decision making is based on imperfect information;** the available information is never complete, possibly inaccurate and constantly changing. The focus is to aggressively filter companies at the front end, to restrict the number of stocks that we intimately research and monitor. Whilst it is acknowledged that information is imperfect, the goal is to nonetheless have an information advantage – to 'know more' on the companies in which we invest.

Key Metrics

As a simplistic summary, some key criteria that we seek (in approximate order of preference):

1 Management & Organisational Culture (‘Corporate Culture’)	<p>Ultimately, inside a company there are innumerable decisions that arise each and every day. How management respond to each of those decisions will – when collated over a period of time – determine the ultimate success [or failure] of our investment. Specifically we look for management that are:</p> <ol style="list-style-type: none"> Trustworthy Competent Shareholder focussed (put shareholders ahead of a building an empire) Passionate Visionary
2 Robust business model (short-medium term advantage) & Sustainable Competitive Advantage (medium to long term advantage)	<p>Above average long term returns require one or more sustainable competitive advantages. We think of competitive advantages in terms of:</p> <ol style="list-style-type: none"> Intellectual property, patents or brand Regulatory / legislative Cost and/or ‘effort’ of switching Network effect: more buyers creates more sellers creates more buyers Cost advantage (including economies of scale or cost of capital) First mover advantage and/or ‘pole position’ Geographical / physical / infrastructure constraints Management and corporate culture
3 Low Price Earnings Growth (PEG) ratio -or- Low PER & high sustainable dividend yield	<p>The PEG ratio is calculated by dividing the PER into the company’s annual earnings per share [EPS] growth. It measures how attractive the company’s growth is when compared to its current price. If a company is low growth, then it is only attractive where the dividend yield is well above market, sustainable and (preferably) contains upside potential.</p>
4 Positive macro outlook / tailwinds	<p>Macro factors such as population and industrialisation demographics, sector growth, ‘step-change’ technology and the phase within the economic cycle, can provide a ‘free kick’ and overcome a multitude of investment sins.</p>
5 Appropriate price action We seek to move ‘in harmony’ with the greater market. Technical analysis provides insights into investor sentiment	<p>An investor can be absolutely totally right fundamentally, but wrong on timing. Once we have identified a potential investment, we resist the urge to purchase until the stock price turns our way. In doing so we save both capital [‘cheap’ stocks getting cheaper], time and emotional quotient.</p>
6 Strong balance sheet indicating safety, prudent management and flexibility	<p>In addition to providing a snapshot of a company’s capacity to survive, the balance sheet also provides an insight into what capacity the company has to:</p> <ul style="list-style-type: none"> maintain or increase dividends implement a buyback or capital return grow organically or by acquisition. <p>It also provides a valuable insight into management’s state of mind: a ‘reckless’ balance sheet may indicate reckless management. The converse is also likely to be true.</p>
7 Quality of Earnings	<ol style="list-style-type: none"> Structurally sound sector <ol style="list-style-type: none"> Pricing power : clients vs suppliers Industry concentration Rational competitors Consistency & certainty of earnings Client concentration (large # of small clients vs small # of large clients) % of recurring revenue Determinants inside or outside of Management control High gross and net margins
8 High Operating Cash Flow (OCF) & High Free Cash Flow (FCF) FCF = OCF less major expenditures	<p>The very best businesses exhibit a high FCF and by extrapolation low annual capex. A company that converts a high proportion of its net profit after tax [NPAT] into tangible cash without the need to constantly reinvest, is considerably less likely to run into financial difficulty. But even more importantly, high FCF provides the capacity to payout an above average portion to shareholders in the usual forms.</p>
9 Return on Equity (ROE), Return on Price Equity (ROPE) & Return on Assets (ROA) To assess effect of gearing on ROE	<p>ROE measures the return that management have generated on shareholder’s funds. ROPE attempts to link the level of equity to the current market capitalisation. By connecting the ROE to the market price, we are able to assess the ROE based on the current stock valuation. ROA takes into account the impact that gearing has on ROE – eg has the high ROE been ‘manufactured’ by a high level of gearing?</p>
10 Liquidity and Size	<p>Liquidity is considerably more important than the average investor expects or respects. Invariably some investment decisions will be wrong. A lack of liquidity considerably impacts the ‘cost’ at which one is able to enter or exit a company – if indeed these actions can be achieved at all.</p>

Portfolio construction

Portfolio overview

- Long only
- ASX listed securities
- Benchmark 'Unaware'
i.e. flexibility to maximise returns without constraints on market capitalisation, sector or theme

By removing restrictions on size, sector and weightings, we enable each investment to be assessed on its merit.

It doesn't make sense to eliminate potential opportunities, yet many fund managers do so to enable themselves to be categorised.

We are not concerned about whether we fit neatly into an asset category; we are concerned about maximising the financial returns for all Katana investors, of which management are currently the largest.

Top Down Macro Overlay with Bottom Up Stock Analysis

- Economic cycle (timing) decisions.
- Asset allocation – preparedness to move to, and maintain a cash position.
- Sector allocation – portfolio based on prospectively not sector weighting.
- Stock selection and allocation.

Portfolio Parameters

- 45-60 individual stock positions.
- Average position size 1%–5%, with a pre-disposition towards holding a greater number of smaller positions.
- Mandated maximum position sizes based upon market capitalization and liquidity.
- Cash Position mandate range is 0 – 80%; historically 15%-35%.
- Generally towards the upper end of this range and has been as high as 50% of funds under management.
- Achieving high returns with a high cash balance reduces risk through the cycle.
- Significant value added with stock positions outside ASX100.
- Thematic exposure achieved through ASX100, but additional alpha derived through detailed bottom-up analysis of ex-100.
- No gearing or shorting applied in the portfolio.

Processes

Our goal is to combine the contrasting investment skills and personalities to encourage freedom to act within a framework of accountability and overall control, that favors capital preservation.

Flexibility

We provide our Portfolio Managers (PMs) with the 'freedom' to look at anything any time anywhere. Whether it is an emerging healthcare roll-up in Sydney, an infrastructure/service provider in the Pilbara or a rapidly growing financial services firm in Melbourne. Each PM has the flexibility to research and investigate any opportunity.

Each PM may work collaboratively with other PM(s) to harness their experience and skillset. Alternatively the PM may work extensively with external advisers and analysis.

Each PM has complete freedom in terms of how they allocate their time and the analysis they undertake.

At Katana, our goal is to de-clutter the PM's and free them up to locate above average investment opportunities.

Accountability

Each company must have a 'champion' who presents the case for investment to the Investment Committee (IC).

Every sizeable investment decision must be referred to an Investment Committee Meeting (ICM).

The IC ultimately makes all sizeable decisions.

However, the individual PM is responsible for the ultimate performance of each and every investment that they champion.

It is also the responsibility of the individual PM to ensure that they remain fully versed with all aspects of the investment on an ongoing basis until such time as it is realized.

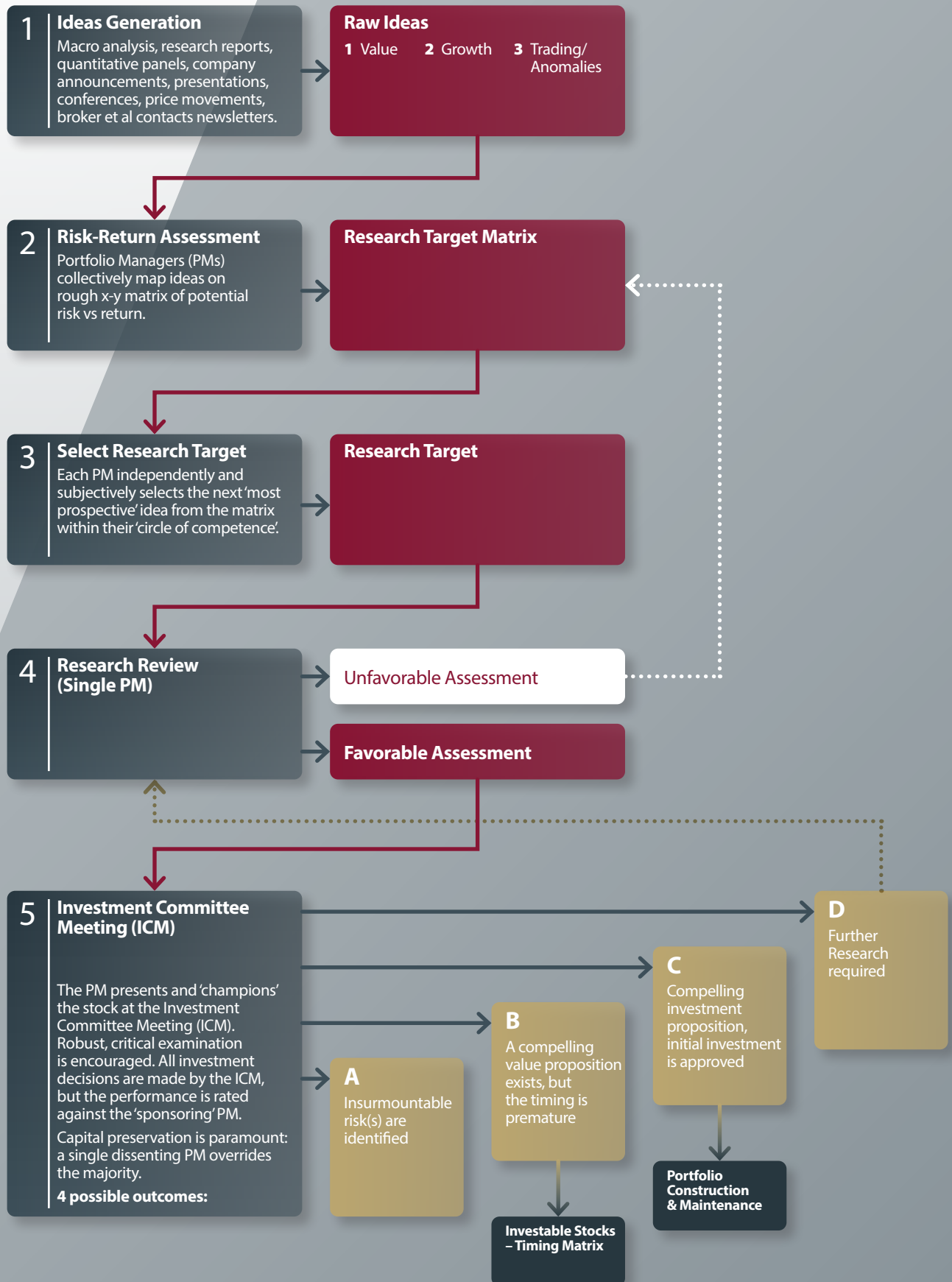
Capital preservation

Each PM has a mandated maximum number of active positions permitted at any given time. This adds to the investment rigor by forcing a PM to choose between competing opportunities.

The IC affords an overriding 'power of veto' to each individual PM. A single PM may override the decision of the majority. By implementing the ability for an individual PM to veto any investment, Katana gives true effect to the overriding aim of preserving capital ahead of making a profit.

Once a position is active, a mandatory stop loss review process is triggered if the stock price falls by certain specified thresholds. The PM is required to re-assess and re-submit the investment case to the IC.

Investment process





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Important Information

The information provided in this brochure is of a general nature only. Investors should consider the relevant disclosure documents and market information before investing.

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	COMPLIANCE	Jacqui Stewart, GRC Essentials
	BANKER	Macquarie Bank
	BOARD OF DIRECTORS	Romano Sala Tenna Brad Shallard Christine Fernandez
Katana Capital Limited	AUDITORS	Charles Foti Business Services
	AUDITORS	Ernst & Young
	SHARE REGISTRY	Computershare
	LEGAL ADVISORS	McMahon Clarke Legal
	BOARD OF DIRECTORS	Dalton Gooding (Chairman) Peter Wallace Giuliano Sala Tenna
Katana Australian Equity Fund	COMPANY SECRETARY	Gabriel Chiappini
	CUSTODIAN	One Managed Investment Funds Limited
	BANKER	One Managed Investment Funds Limited
	SCHEME AUDITORS	Regency Audit