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# HUNTER HALL INTERNATIONAL LIMITED

## Proposed Acquisition of Pengana Holdings Pty Ltd

Independent Expert's Report and Financial Services Guide

27 April 2017

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The Independent Directors
Hunter Hall International Limited
GPO Box 3955
Sydney NSW 2001

Dear Directors,

# Independent Expert's Report for Hunter Hall International Limited

## 1. Introduction

Hunter Hall International Limited ("**Hunter Hall**") is a specialist global equities investment manager that is listed on the Australian Securities Exchange ("**ASX**"). Hunter Hall was founded in 1993 by Peter Hall. Following Peter Hall's departure from Hunter Hall in December 2016, Hunter Hall's board and advisers explored a number of alternative transactions to create value for Hunter Hall's shareholders. The board has assessed the alternative proposals and concluded that the most attractive for shareholders is the proposed acquisition of Pengana Holdings Pty Limited ("**Pengana**") an equities focussed diversified fund manager for the issue of 74.1 million Hunter Hall shares, equivalent to a 73% holding in Hunter Hall post transaction ("**Proposed Transaction**").

Washington H Soul Pattinson & Company Limited ("**WHSP**") is an ASX listed conglomerate with a market capitalisation of approximately $4.5 billion as at 7 April 2017. WHSP has a wide range of business interests including investment management, including a 46% holding in Hunter Hall and a 37% holding in Pengana.

Further information regarding the Proposed Transaction is set out in Section 1 of this report.

## 2. Purpose of the report

The Directors of Hunter Hall have prepared an Explanatory Memorandum ("**Explanatory Memorandum**") in relation to the Proposed Transaction. In order to assist Hunter Hall shareholders not associated with either Pengana or WHSP ("**Shareholders**") evaluate the Proposed Transaction, the independent directors of Hunter Hall have requested Leadenhall Corporate Advisory Pty Limited ("**Leadenhall**") to prepare an independent expert's report advising whether the Proposed Transaction is fair and reasonable. This report is to be included in the Explanatory Memorandum that will be sent to Hunter Hall's shareholders regarding the Proposed Transaction.

Further information regarding the purpose of this report is provided in Section 2 of this report.

## 3. Basis of evaluation

In order to assess whether the Proposed Transaction is fair and reasonable we have:

- Assessed it as fair if the value of a Hunter Hall share before the transaction, on a control basis, is less than or equal to the value of a Hunter Hall share after the transaction, on a minority basis.
- Assessed it as reasonable if it is fair, or if despite not being fair the advantages to Shareholders outweigh the disadvantages

Further details of the basis of evaluation are provided in Section 2 of this report.

## 4. Analysis of fairness

We have assessed the current fair market value of Hunter Hall based on the discounted cash flow methodology. Our analysis is based on a three-year forecast prepared by Hunter Hall management, adjusted as appropriate based on our review of the forecast and analysis of the Hunter Hall business. We have applied a discount rate of 11.5% to 12.5% to the projected cash flows, to determine a range of values for Hunter Hall shares as set out in the table below.

**Table 1: Valuation of Hunter Hall ($'000)**

| Description | Low | High |
|---|---|---|
| Present value of projected cash flows | 36,281 | 38,130 |
| Terminal value | 16,736 | 20,966 |
| **Enterprise value on a control basis** | **53,017** | **59,096** |
| Surplus assets | 19,823 | 19,823 |
| Non-operating liabilities | (3,200) | (3,200) |
| Net cash | 9,124 | 9,124 |
| **Equity value on a control basis** | **78,764** | **84,843** |
| Number of share on issue | 27,330 | 27,330 |
| **Equity value per share ($)** | **2.88** | **3.10** |

*Source: Leadenhall Analysis*

Based on the analysis above, we have assessed the value of a Hunter Hall share to be in the range of $2.90 to $3.10 on a control basis.

The result from this methodology was cross-checked using a capitalisation of future maintainable earnings and share market trading analysis. Further details of the valuation of Hunter Hall are set out in Section 8 of this report.

In order to assess the consideration offered to Hunter Hall shareholders as a result of the Proposed Transaction, we have assessed the value of Hunter Hall, assuming the Proposed Transaction is completed resulting in a merged entity comprising Hunter Hall and Pengana ("**Proposed Merged Entity**"). This analysis was also based on the discounted cash flow methodology. Our cash flows include the standalone cash flows for Hunter Hall as discussed above, the projected cash flows for Pengana on a standalone basis and the projected synergies arising from the Proposed Transaction. We have applied a discount rate of 10.5% to 12.0% to these aggregated cash flows. The discount rate is lower than the discount rate for Hunter Hall on a standalone basis due to the scale and diversification benefits of the Proposed Merged Entity. This resulted in a range of values for the Proposed Merged Entity as follows:

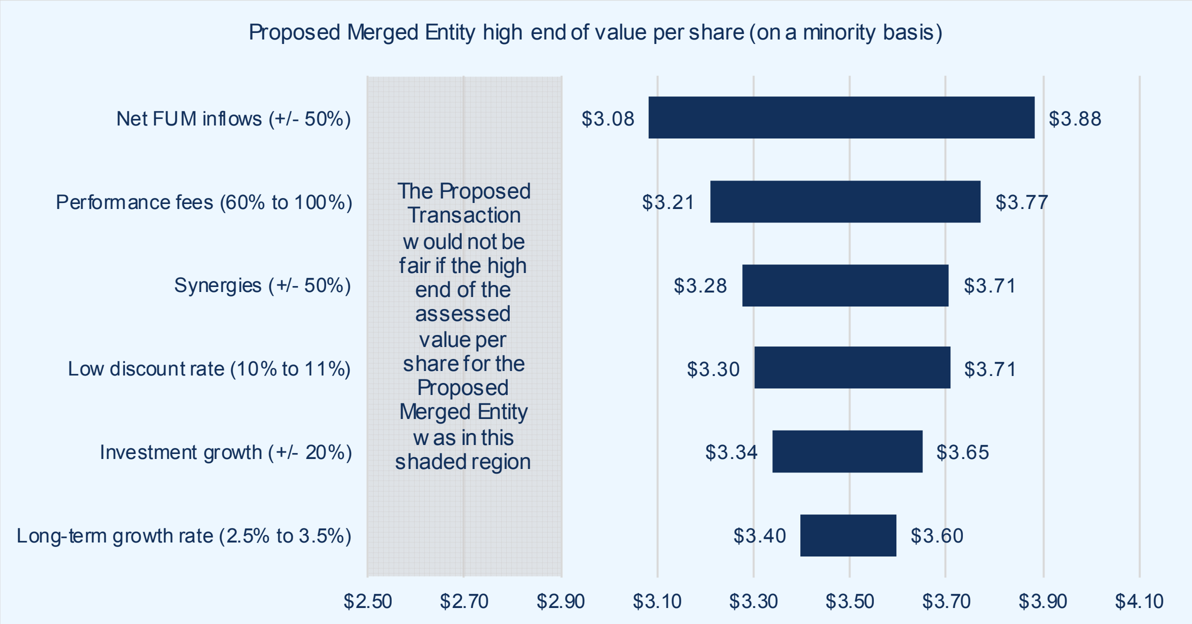
**Table 2: Valuation of Proposed Merged Entity ($'000)**

| Description | Low | High |
|---|---|---|
| Present value of projected cash flows | 192,531 | 209,381 |
| Terminal value | 110,230 | 157,147 |
| **Enterprise value on a control basis** | **302,762** | **366,528** |
| DLOC at 20% | 20% | 20% |
| **Enterprise value on a minority basis** | **242,209** | **293,222** |
| Surplus assets | 52,372 | 52,372 |
| Non-operating liabilities | (4,200) | (4,200) |
| Net cash | 12,624 | 12,624 |
| **Equity value on a minority basis** | **303,005** | **354,018** |
| Number of share on issue | 101,477 | 101,477 |
| **Minority equity value per share ($)** | **2.99** | **3.49** |

*Source: Leadenhall analysis*

We have also undertaken a sensitivity analysis of key assumptions concerning the Proposed Merged Entity as follows:

**Figure 1: Proposed Merged Entity sensitivity**




*Source: Leadenhall analysis*
*Note: As our valuation is based on 80% of the average historical performance fees, the sensitivity shown is from 60% to 100% of the average historical level.*

Based on the analysis above, we have assessed the value of a Proposed Merged Entity share to be in the range of $3.00 to $3.50 on a minority basis.

As the valuation of a Proposed Merged Entity share is in line with the value of a Hunter Hall share on a standalone basis the Proposed Transaction is fair.

## 5. Analysis of reasonableness

We have defined the Proposed Transaction as being reasonable if it is fair, or if despite not being fair, the overall advantages of the proposal outweigh its disadvantages to Shareholders. We have therefore considered the advantages and disadvantages to Shareholders of the Proposed Transaction.

### Advantages

The main advantages of the Proposed Transaction are:

- **Scale and liquidity** - If the Proposed Transaction is completed, Shareholders will hold shares in the Proposed Merged Entity, which is a considerably larger business than Hunter Hall. This should lead to increased liquidity in Hunter Hall shares as well as a potential market re-rating.
- **Likely share price** - Hunter Hall's share price responded positively to the announcement of the Proposed Transaction. If the transaction is not approved, it is likely that the price will decrease, at least to the levels prior to the announcement of the Proposed Transaction and potentially further.
- **Growth potential** - Hunter Hall's funds under management ("**FUM**") is currently declining and is not expected to see rapid growth in the near future on a standalone basis. By comparison, Pengana is currently experiencing significant growth in FUM, which is projected to continue for the medium term. This growth more than outweighs the projected outflows for Hunter Hall in the Proposed Merged Entity. Thus, if the Proposed Transaction is completed, Shareholders will be exposed to a company with significant growth expectations, which may in time lead to share price appreciation.
- **Stability and succession planning** - Since the resignation of Peter Hall, Hunter Hall has been considering the long-term structure of its investment team. This leads to a degree of uncertainty for investors in both Hunter Hall and its funds. The Proposed Transaction removes this uncertainty by merging Hunter Hall with Pengana, which has adequate resources to manage the Hunter Hall funds as well as its own existing funds.

- **Potential synergies -** Our valuation of the Proposed Merged Entity does not allow for any revenue synergies from combining Hunter Hall and Pengana. However, Pengana management believes they will be able to achieve revenue synergies, by reducing the outflows from Hunter Hall's funds and potentially attracting inflows to those funds. If these synergies are achieved that will represent upside to Hunter Hall shareholders.

### Disadvantages

The main disadvantages of the Proposed Transaction are:

- **Loss of control –** If the Proposed Transaction is completed Shareholders will lose control of Hunter Hall. However, the Proposed Merged Entity will have two major shareholders, making it less likely that one individual holder can implement decisions in its own favour at the expense of other investors**.**
- **Pengana is not paying the full value of synergy benefits –** Pengana and Hunter Hall have identified significant synergy benefits that could be realised by combining the businesses. Based on our analysis of the Proposed Transaction, Pengana does not appear to be paying a material amount related to potential synergies, as the consideration offered is consistent with our assessed value of a Hunter Hall share including only a moderate level of cost synergies that we believe could be realised by alternative acquirers. However, in the absence of a competing proposal, it is common for an acquirer not to pay the full value of potential synergies they may obtain in a business combination.
- **Risks of achieving FUM growth and synergies -** Our assessed value of the Proposed Merged Entity includes significant projected growth in FUM for Pengana as well as significant projected synergy savings. There is a risk that these expectations will not be realised (or fully valued by the market), in which case the value of the Proposed Merged Entity may decline or fail to trade at levels implied by our assessed value. These risks are not currently faced by Hunter Hall shareholders. However, Hunter Hall on a standalone basis faces risks in relation to continued FUM outflows.
- **Proportionate share of combined business -** Hunter Hall represents 28% of the combined value of Hunter Hall and Pengana before the Proposed Transaction, and Hunter Hall shareholders will hold 27% of the Proposed Merged Entity if the Proposed Transaction proceeds. Thus Hunter Hall shareholders will receive a slightly lower share of the synergies expected to be realised from the Proposed Transaction than the proportion of pre-transaction value contributed by Hunter Hall.
- **No longer an ethical investment pure play –** Hunter Hall currently provides ethically screened investments only. By contrast Pengana provides investments that are not ethically screened. Thus, investors that chose to invest in Hunter Hall from an ethical stand-point may not wish to hold an investment in the Proposed Merged Entity.

### Conclusion on reasonableness

As the Proposed Transaction is fair it is also reasonable.

## 6. Opinion

In our opinion, the Proposed Transaction is fair and reasonable to Shareholders.

This opinion should be read in conjunction with our detailed report which sets out our scope, analysis and findings in more detail.

Yours faithfully

| | |
|---|---|
| Richard Norris | Dave Pearson |
| **Director** | **Director** |

*Note: All amounts stated in this report are in Australian dollars unless otherwise stated.*

*Tables in this report may not add due to rounding.*

**LEADENHALL CORPORATE ADVISORY PTY LTD**

**ABN 11 114 534 619**

**Australian Financial Services Licence No: 293586**

# *FINANCIAL SERVICES GUIDE*

Leadenhall Corporate Advisory Pty Ltd ("**Leadenhall**" or "**we**" or "**us**" or "**our**" as appropriate) has been engaged to issue general financial product advice in the form of a report to be provided to you.

### Financial Services Guide

In providing this report, we are required to issue this Financial Services Guide ("**FSG**") to retail clients. This FSG is designed to help you to make a decision as to how you might use this general financial product advice and to ensure that we comply with our obligations as a financial services licensee.

### Financial Services We are Licensed to Provide

We hold Australian Financial Services Licence 293586 which authorises us to provide financial product advice in relation to securities (such as shares and debentures), managed investment schemes and derivatives.

We provide financial product advice by virtue of an engagement to issue a report in connection with a financial product. Our report will include a description of the circumstances of our engagement and the party who has engaged us. You will not have engaged us directly but will be provided with a copy of the report because of your connection to the matters in respect of which we have been engaged to report.

Any report we provide is provided on our own behalf as a financial service licensee authorised to provide the financial product advice contained in that report.

### General Financial Product Advice

The advice produced in our report is general financial product advice, not personal financial product advice, because it has been prepared without taking into account your personal objectives, financial situation or needs. You should consider the appropriateness of this general advice having regard to your own objectives, financial situation and needs before you act on the advice. Where the advice relates to the acquisition or possible acquisition of a financial product, you should also obtain a product disclosure statement relating to the product and consider that statement before making any decision about whether to acquire the product.

### Benefits that We May Receive

We charge fees for providing reports. These fees will be agreed with the person who engages us to provide the report. Fees will be agreed on either a fixed fee or time cost basis. Leadenhall is entitled to receive a fixed fee of $45,000 (excl. GST) for preparing this report. This fee is not contingent upon the outcome of the Proposed Transaction.

Except for the fees referred to above, neither Leadenhall, nor any of its directors, consultants, employees or related entities, receive any pecuniary or other benefit, directly or indirectly, for or in connection with the provision of this report.

### Remuneration or Other Benefits Received by our Employees, Directors and Consultants

All our employees receive a salary. Our employees are eligible for bonuses which are not based on the outcomes of any specific engagement or directly linked to the provision of this report. Our directors and consultants receive remuneration based on time spent on matters.

### Referrals

We do not pay commissions or provide any other benefits to any person for referring clients to us in connection with the reports that we are licensed to provide.

### Complaints Resolution

As the holder of an Australian Financial Services Licence, we are required to have a system in place for handling complaints from persons to whom we have provided reports. All complaints must be in writing, to the following address:

Leadenhall Corporate Advisory Pty Ltd
GPO Box 1572
Adelaide SA 5001

Email: office@leadenhall.com.au

We will try to resolve your complaint quickly and fairly and will endeavour to settle the matter within 14 days from the time the matter is brought to our attention.

If you do not get a satisfactory outcome, you have the option of contacting the Financial Ombudsman Service ("**FOS**"). The FOS will then be able to advise you as to whether or not they can assist in this matter. The FOS can be contacted at the following address:

Financial Ombudsman Service
GPO Box 3
Melbourne VIC 3001

Telephone: 1300 780 808
Email: info@fos.org.au

### Compensation Arrangements

Leadenhall holds professional indemnity insurance in relation to the services we provide. The insurance cover satisfies the compensation requirements of the Corporations Act 2001.

27 April 2017

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# 1 THE PROPOSED TRANSACTION

On 30 December 2016, Hunter Hall announced that Peter Hall (founder and Chief Investment Officer) had sold part of his shareholding, equivalent to 19.9% of the issued capital of Hunter Hall, to WHSP for $1.00 per share, a substantial discount to market trading in Hunter Hall shares. On the same date WHSP announced that it intended to make a takeover offer for the remaining 80.1% of the equity in Hunter Hall.

Following the WHSP offer, Pinnacle made a competing takeover offer for Hunter Hall at $1.50, and subsequently increased the offer to $2.40 if Pinnacle achieved a 24% holding in Hunter Hall. In response to the offer from Pinnacle, WHSP increased its offer to $2.60. WHSP has acquired a further 27% holding in Hunter Hall (primarily Peter Hall's remaining 24% holding) taking its total holding to 47%.

In response to the uncertainty caused by Peter Hall's departure and the takeover offers from WHSP and Pinnacle, Hunter Hall's board and advisers explored a number of alternative transactions to create value for Hunter Hall's shareholders. The board has assessed the alternative proposals and concluded that the most attractive for shareholders is the proposed acquisition of Pengana by Hunter Hall for the issue of 74.1 million Hunter Hall shares, equivalent to a 73% holding in Hunter Hall post transaction.

If the Proposed Transaction is approved, Hunter Hall and Pengana will merge their operations to create a combined funds management business with $3.1 billion of FUM. Following the Proposed Transaction, Hunter Hall's ethical screening process will be retained for existing Hunter Hall funds and it is proposed that it will be applied to the Proposed Merged Entity's international fund strategies going forward, although other aspects of the stock selection process may be adapted. Hunter Hall and Pengana have identified $6 million of annual cost savings from combining the businesses. Section 5 of this report provides a description of Pengana and section 6 includes information concerning the Proposed Merged Entity comprising Hunter Hall and Pengana.

The main conditions which the Proposed Transaction is subject to are:

- Hunter Hall shareholder approval, noting that WHSP is not entitled to vote on the transaction
- Acceptance of the offer by all Pengana shareholders

Further details of the terms of the Proposed Transaction are set out in the Explanatory Memorandum.

# 2 SCOPE

## 2.1 Purpose of the report

### Corporations Act requirement

If the Proposed Transaction is approved, Mr Russel Pillemer (Pengana's founder) would acquire a 26% interest in Hunter Hall. An issue or sale of securities that enables a shareholder to increase its relevant interests in a listed company from below 20% to above 20% is prohibited under Section 606 of the Corporations Act 2001 ("**s606**"), except in certain circumstances.

One of the exceptions to s606 is where the acquisition is approved at a general meeting of the target company in accordance with item 7 of Section 611 of the Corporations Act 2001 ("**s611**"). Approval for the Proposed Transaction is therefore being sought at a general meeting of Hunter Hall shareholders in accordance with item 7 of s611.

Item 7 of s611 requires shareholders to be provided with all of the information known to the company and to the potential acquirer that is material to the shareholders' decision. *Regulatory Guide 74: Acquisitions Approved by Members* ("**RG74**") issued by the Australian Securities and Investment Commission ("**ASIC**") provides additional guidance on the information to be provided to shareholders. RG74 states that the directors of the target company should provide members with an independent expert's report or a detailed directors' report on the Proposed Transaction.

*Regulatory Guide 111: Content of Expert Reports* ("**RG111**") issued by ASIC requires an independent expert assessing a transaction that has a similar effect to a takeover bid to assess whether the transaction is fair and reasonable.

### Listing Rules requirement

ASX Listing Rule 10.1 requires a listed entity to obtain shareholders' approval before it acquires a substantial asset from a related party. An asset is substantial if its value, or the consideration being paid for it, is 5% or more of the equity in the listed entity, as set out in its latest accounts lodged with the ASX. As the value of shares to be issued to the vendors of Pengana significantly exceeds 5% of the equity of Hunter Hall as at 31 December 2016, Pengana is a substantial asset for the purposes of Listing Rule 10.1. WHSP currently holds a 46% interest in Hunter Hall and is one of the vendors of Pengana. Accordingly, the Proposed Transaction is with a related party. Thus, the Proposed Transaction must be approved by Hunter Hall's shareholders that are not associated with WHSP (which we have defined as Shareholders).

ASX Listing Rule 10.10 requires that the Notice of Meeting sent to shareholders in respect of such a transaction must include a report on the Proposed Transaction from an independent expert. The independent expert's report must state whether the transaction is fair and reasonable to Shareholders.

### Purpose

The directors of Hunter Hall have therefore requested Leadenhall to prepare an independent expert's report assessing whether the Proposed Transaction is fair and reasonable to Hunter Hall's shareholders for the purposes of both s611 and Listing Rule 10.10. This report is to be included in the Explanatory Memorandum and has been prepared for the exclusive purpose of assisting Shareholders in their consideration of the Proposed Transaction.

## 2.2 Basis of evaluation

### Introduction

As the vendors of Pengana will hold the majority of the shares outstanding in Hunter Hall should the Proposed Transaction be approved, we have assessed the Proposed Transaction as a control transaction. RG111 requires a separate assessment of whether a transaction is '*fair*' and whether it is '*reasonable*' for both control transactions under s611 and related party transactions under Listing Rule 10. We have therefore considered the concepts of '*fairness*' and '*reasonableness*' separately.

Consistent with RG111.63 we have provided only one analysis of whether the Proposed Transaction is fair and reasonable. The basis of assessment selected and the reasons for that basis are discussed below.

### Fairness

RG111.25 requires an independent expert to evaluate an issue of securities under s611 that has a similar effect to a takeover offer as if it was a takeover offer. RG 111.11 defines a takeover offer as being fair if the value of the consideration is equal to, or greater than, the value of the securities subject to the offer.

Conversely, RG111.57 requires an expert assessing a related party transaction to compare the benefit provided by the entity to the related party (i.e. shares in the Proposed Merged Entity) with the consideration being provided to the entity (i.e. a 100% ownership interest in Pengana).

We assessed whether the Proposed Transaction is fair by treating it as if it was a takeover offer because:

- The assessment of the Proposed Transaction as if it were a takeover offer is the more onerous of the two tests of fairness described above due to the requirement to allow for a control premium. Thus if the test is met, the alternative test described by RG111.57 would also be met.
- In substance the Proposed Transaction is effectively a takeover offer, and it is offered as an alternative to shareholders instead of a takeover offer. Thus, we consider the relative value of Hunter Hall shares before and after the transaction to be the most relevant consideration for shareholders, not the details of the related party element of the transaction.

Accordingly, we have assessed whether the Proposed Transaction is fair by comparing the value of a Hunter Hall share before the Proposed Transaction with the consideration offered to Shareholders. As Hunter Hall's shareholders would retain their Hunter Hall shares if the Proposed Transaction proceeds (as opposed to exchanging them for cash or the acquirer's scrip as in a takeover offer) the effective consideration is the continued ownership of a Hunter Hall share, which will become a share in the Proposed Merged Entity.

The value of a Hunter Hall share has been determined on a control basis (i.e. including a control premium). This is consistent with the requirement of RG 111.11 that the comparison for a takeover must be made assuming a 100% interest in the target company.

After the Proposed Transaction, a Hunter Hall share will effectively be a share in the Proposed Merged Entity (i.e. Hunter Hall and Pengana combined). This has been assessed on a minority interest basis (i.e. excluding a control premium) as Hunter Hall's current shareholders would own a minority stake in the Proposed Merged Entity should the Proposed Transaction occur.

We have assessed the values of a Hunter Hall share and a Proposed Merged Entity share using the concept of fair market value, which is defined by the International Glossary of Business Valuation Terms as:

> *The price, expressed in terms of cash equivalents, at which property would change hands between a hypothetical willing and able buyer and a hypothetical willing and able seller, acting at arm's length in an open and unrestricted market, when neither is under compulsion to buy or sell and when both have reasonable knowledge of the relevant facts.*

While there is no explicit definition of value in RG 111, this definition of fair market value is consistent with the basis of value described at RG 111.11 and common market practice.

Special value is defined as the amount a specific purchaser is willing to pay in excess of fair market value. A specific purchaser may be willing to pay a premium over fair market value as a result of potential economies of scale, reduction in competition or other synergies they may enjoy arising from the acquisition of the asset. However, to the extent a pool of hypothetical purchasers could all achieve the same level of synergies the value of those synergies may be included in fair market value. Our valuations of Hunter Hall and the Proposed Merged Entity do not include any special value in accordance with RG 111. However, the valuation of the Proposed Merged Entity does include expected synergies from the Proposed Transaction.

### Reasonableness

In accordance with RG 111, we have defined the Proposed Transaction as being reasonable if it is fair, or if, despite not being fair, Leadenhall believes that there are sufficient reasons for Shareholders to accept the offer. We have therefore considered whether the advantages to Shareholders of the Proposed Transaction outweigh the disadvantages. To assess the reasonableness of the Proposed Transaction we have considered the following significant factors recommended by RG 111.13:

- The shareholder composition of Hunter Hall, including WHSP's existing 46% holding
- The liquidity of the market in Hunter Hall's shares
- Taxation losses, cash flow or other benefits through achieving 100% ownership of Hunter Hall
- Any special value of Hunter Hall to Pengana
- The likely market price of Hunter Hall shares if the Proposed Transaction does not proceed
- The value of Hunter Hall to an alternative bidder and the likelihood of an alternative offer

We have also considered the other significant advantages and disadvantages to Shareholders of the Proposed Transaction.

## 2.3 Individual circumstances

We have evaluated the Proposed Transaction for Shareholders as a whole. We have not considered its effect on the particular circumstances of individual investors. Due to their personal circumstances, individual investors may place a different emphasis on various aspects of the Proposed Transaction from the one adopted in this report. Accordingly, individuals may reach a different conclusion to ours on whether the Proposed Transaction is fair and reasonable. If in doubt investors should consult an independent financial adviser about the impact of this Proposed Transaction on their specific financial circumstances.

# 3 FUNDS MANAGEMENT INDUSTRY

## 3.1 Summary

Fund managers invest money on behalf of clients through collective investment vehicles or separate accounts. These investment services are provided to clients for a fee, the clients bear all credit, market and liquidity risks and share in any losses or gains made. As at 31 December 2016, the managed funds industry in Australia had $2.84 trillion of FUM according to the Australian Bureau of Statistics. This FUM was split between the following types of institutions:

- Superannuation funds (78.1% of total FUM)
- Public offer (retail) unit trusts (11.7% of total FUM)
- Life insurance corporations (8.3% of total FUM)
- All other managed funds institutions (1.9% of total FUM)

Industry revenue is forecasted to grow at an annualised 3.1% over the five years through FY22 to reach $9.0 billion according to IBISWorld. This growth is likely to be driven by strong growth in FUM from the popularity of alternative investment products and rising investor confidence.

Strong industry performance is expected to continue in the future, predominantly supported by ongoing FUM inflows from Australia's compulsory superannuation scheme. However, downward pressure on management fees caused by increasing competition (such as direct investment by larger retail and institutional investors and the increasing prominence of low fee index tracking products), may negatively impact industry profitability.

The industry has seen consolidation over recent years as a result of acquisitions and attrition of smaller funds. This has led to higher margins achieved by the industry, particularly for larger fund managers, due to economies of scale enjoyed from spreading relatively fixed costs over the larger FUM base.

## 3.2 Industry structure and participants

The industry is made up of large institutional fund managers and smaller boutique investment managers who generally manage anywhere between $300 million and $2 billion. Smaller funds often have clear investment strategies, but are disadvantaged due to their relative lack of resources compared with larger fund managers. A summary of the three largest players in the Australian funds management market is provided in the table below:

**Table 3: Three largest Australian Fund Managers**

| Fund Manager | Description | FUM ($ billion) |
|---|---|---|
| Macquarie Group Ltd | Macquarie Group operates in the industry through Macquarie Asset Management ("**MAM**"). MAM is a full-service asset manager, offering a diverse range of products including infrastructure and real asset management, securities and investment management and tailored investment solutions over funds and listed equities. | $501.7 |
| Commonwealth Bank of Australia Ltd ("**CBA**") | CBA operates in the industry through its subsidiaries Colonial First State Global Asset Management ("**CFSGAM**") and Colonial First State ("**CFS**"). CFSGAM focuses on serving institutional investors and manages a range of asset classes including equity, debt securities, infrastructure and property. CFS focuses on retail investors, providing wealth management & superannuation services. | $203.2 |
| AMP Limited ("**AMP**") | AMP operates in the industry through its AMP Capital division. In addition to managing investments across all major asset classes, AMP Capital provides commercial, industrial and retail property management services. | $165.4 |

*Source: IBISWorld and company websites*
*Note: FUM as at 31 December 2016 (latest available)*

Large institutional fund managers are often restricted to investing in companies with relatively large market capitalisations, and thus their returns are often closely correlated to market indices. As a result, a large number of boutique fund managers have emerged that seek to differentiate their products without the constraints of a larger operation. The emergence of boutique fund managers has been assisted by the development of specialised distribution businesses that can be engaged by boutique fund managers, allowing the managers to concentrate on investment decision making rather than marketing and distribution.

Whilst there are many boutique fund managers in the Australian market, there are two main players that have an ethically focussed investment policy, as summarised in the table below:

**Table 4: Australian fund managers with ethical investment focus**

| Fund Manager | Description | FUM ($ billion) |
|---|---|---|
| Australian Ethical Investment Ltd | Australian Ethical Investment was established in 1986 and is a funds management and superannuation company that takes an ethical approach to investment decisions to ensure capital is used for the good of people and the planet. | $1.8 |
| Hunter Hall | Founded in 1993, Hunter Hall is a specialist global and Australian equity investment manager and one of Australia's largest dedicated ethical investment managers. | $0.9 |

*Source: Company websites*
*Note: FUM as at 31 December 2016 (latest available)*

A number of other large and boutique fund managers have individual products that have an ethical investment mandate, however they do not employ an ethical investment philosophy across all of their products. The Responsible Investment Association of Australia estimates that total funds under management in responsible investment portfolios in Australia totalled $633.2 billion as at 31 December 2015, compared to just $13.9 billion in 2002.

Other notable Australian boutique fund managers include Pengana Capital, established in 2003 as an equities focussed, active fund manager with funds under management of approximately $2.2 billion as at 31 December 2016; Pinnacle Investment Management Group Ltd, established in 1996 as a multi-affiliate investment manager with total funds under management of approximately $23 billion as at 31 December 2016 and Bennelong Funds Management, established in 2008 as an active fund manager with total funds under management of approximately $7 billion as at 31 December 2016.

Industry participant numbers have declined by approximately 18% over the past five years, primarily due to consolidation. Despite this, industry employment has increased over the same period, recovering from a low base after the downsizing which occurred during the global financial crisis.

## 3.3 Key success factors

The key success factors for operators in the funds management industry are summarised below:

- **Historical returns:** fund managers with strong historical returns are more likely to attract investors.
- **Investment team:** a highly experienced and qualified investment team with a good track record and suitable retention incentives are hallmarks of successful funds management enterprises.
- **Ratings:** when choosing a fund manager, investors often consider ratings given to funds and fund managers. Therefore, good relationships with ratings providers, coupled with adequate relative performance and investment team perception, can ensure that ratings agencies have sufficient information available to make their assessments.
- **Distribution network:** fund managers with extensive distribution networks, generally through relationships with financial advisers, have the ability to grow FUM (particularly retail) more quickly and spend less time and money on marketing.
- **Size:** the amount of FUM may impact the investment decisions of some larger institutional investors which may be restricted from investing with smaller fund managers.
- **Access to technology:** industry operators should develop modern communications and analytical solutions to reduce the cost of building/maintaining portfolios and delivering services to clients.

## 3.4 Products, services and major markets

A brief overview of the products, services and major markets of the funds management industry is provided in the table below.

| Products & Services | Major Markets |
|---|---|
| **Australian equities:** Australian equities include listed company shares, shares in unlisted companies and units issued in both listed and unlisted unit trusts which hold equities as underlying assets. The proportion of funds invested in equities has increased over the past five years due to the strong performance of the share market and investors' willingness to take on riskier and higher yield investments as market performance improved. | **Superannuation funds:** Australia has a compulsory superannuation scheme, whereby employers make contributions into employees' nominated superannuation funds. Superannuation funds may then engage fund managers to invest client money on their behalf. FUM from superannuation contributions has continued to grow over the past five years, however this growth will decline in the future as more Australians reach retirement age. |
| **Overseas assets:** Overseas asset investments include both debt and equity securities. Following a low base year brought about by the adverse impact of the global financial crisis, the value of overseas assets has generally increased over the past five years as stability has returned to international markets. Improved technology and market transparency have also facilitated cross-border transactions. | **Wholesale financial trusts:** Wholesale financial trusts are only open to institutional investors and high net-worth individuals. Institutional clients are large sophisticated investors that include insurance companies, financial companies and fund administrators that outsource the management of their investment funds. |
| **Australian real estate:** This segment comprises investments in commercial and industrial real estate. Several fund managers specialise in developing real estate portfolios. Over the last five years, the stronger performance of equity markets has resulted in decreased demand for real estate based products. | **Government sources:** Governments often need to invest excess funds. Over the past five years investment from state governments has been increasing due to the sale of government assets. However, federal government investment has been decreasing as the government attempts to reduce the budget deficit. |
| **Australian debt securities:** This segment includes short-term and long-term debt securities. Over the past five years, Australian debt securities have been attractive to investors because of their superior risk adjusted returns relative to global bond markets. | **Overseas investors:** This market is made up of various overseas investors, including retail, institutional and government clients from outside Australia. The portion of overseas funds managed by Australian fund managers has grown significantly over the past five years. An estimated 65% of the funds from this market are derived from Asia-Pacific based investors. |
| **Deposits:** Funds in this segment are held in cash and invested with banks and other institutions in return for interest payments. This class of asset grew in popularity following the global financial crisis when investor confidence was low. | **Public unit trusts:** Public unit trusts include listed property trusts, listed equity trusts and unlisted equity trusts, while cash management trusts usually limit their investments to securities available in short-term money markets. Investing in public trusts is achieved by purchasing the units of those trusts. A fund manager is then employed to invest those funds on behalf of the trust. |
| **Other assets:** Other assets include derivatives, other financial assets and non-financial assets. The proportion of funds invested in this segment has declined over the past five years as investors have tended to shift funds to domestic equities and overseas assets. | **Other:** Other markets include cash management trusts, individual retail investors and life and general insurance companies where premiums paid by clients are pooled and invested, often through fund managers. |

*Source: IBISWorld*

## 3.5 Industry outlook

Total FUM in Australia increased by 60% over the five years to December 2016, from $1.78 trillion to $2.84 trillion, representing a compound annual growth rate ("CAGR") of 9.79%. This growth in FUM was the main driver of industry revenue growth over this period. Several factors are expected to drive demand for funds management services over the next five years, including an ageing population, increasing superannuation contributions, growing wealth and new and evolving investment products. Strong share market performance and rising investor confidence are also expected to contribute to FUM growth. However, revenue growth is expected to be more modest due to continued fee erosion from increased competition.

Alternative investments (e.g. real estate, hedge funds, private equity and infrastructure) have grown in popularity over the past decade and this trend is expected to continue. Investor confidence in these asset classes is anticipated to rise as pricing methods and the set of historical returns improves. Growing interest in alternative asset classes is likely to provide a boost to industry profitability as management fees in these niche areas are often higher.

As well as new asset class development, client demands are expected to change over the next five years and industry operators will have to accommodate this shift. In particular, as the Australian population ages, more emphasis will likely be placed on portfolios that provide income streams rather than capital growth. More investors are likely to opt for passive investment strategies amid an increasing focus on cost, as many managers of active investment funds will continue to struggle to outperform the benchmark returns.

Industry consolidation is expected to continue, with the growing size of superannuation funds likely to lead to fund management capabilities continuing to be brought in house. Outsourcing has been a growing trend with fund managers increasingly transferring back office operations to specialist third party providers. Economies of scale from industry consolidation and an increased focus on cost savings are expected to allow investment managers to continue lowering fees without significantly affecting their profit margins.

Increased integration of technology is also likely to have an impact on the industry. Fund managers are increasingly integrating their digital wealth management platforms, offering clients greater convenience when using their services. Some industry players have also introduced 'robo-advice' platforms, which offer their clients computer generated financial advice based on their spending behaviour, risk tolerance, asset allocation preferences and expected investment returns.

# 4 PROFILE OF HUNTER HALL

## 4.1 Introduction

Founded in 1993, Hunter Hall is a specialist global and Australian equity investment manager and one of Australia's largest dedicated ethical investment managers. Hunter Hall's strategy is to offer a range of responsibly invested equities funds with a value and small-mid caps bias. Hunter Hall's objective is to provide investors with superior returns over the medium to long term by investing in stocks that are in Hunter Hall's opinion undervalued.

Hunter Hall is an active investment manager that employs a team of analysts and investment managers that rely on analytical research, forecasts and their experience to make investment decisions with the aim of constructing a portfolio of securities that outperforms the relevant market index benchmark. This is in contrast to passive investment products, whereby portfolios are constructed to track market indices and returns are therefore reflective of market returns.

Hunter Hall employs a value investment strategy which is based on the view that equity markets are inefficient and opportunities exist to identify securities that are temporarily priced below their intrinsic value. By identifying and investing in these securities, Hunter Hall expects to generate above market returns.

Hunter Hall has a longer-term investment focus with a recommended investment timeframe of more than five years for each of its funds. Whilst short-term returns may fluctuate significantly, the aim of Hunter Hall is to outperform the relevant benchmarks over the longer term. In this respect, each of Hunter Hall's funds, except the Global Deep Green Trust, has outperformed its benchmark since inception (further information regarding individual fund performance is included in Section 4.3 below).

Hunter Hall applies a variety of responsible investment policies across different funds, primarily through their negative screening policy. This policy is used to screen out stocks that are considered to be harmful to people, destructive to the environment or cruel to animals. In addition, the Global Deep Green Trust, employs a positive screening process, whereby investments are identified based on their ability to positively contribute to society and the environment. In addition to their responsible investment policies, Hunter Hall also donates 5% of pre-tax profits to charities or charitable purposes through its charitable giving program.

## 4.2 History

A brief history of Hunter Hall is set out in the table below:

| Year | Event |
|---|---|
| **1993** | Founded by Peter Hall |
| **1994** | Hunter Hall Value Growth Trust ("**VGT**") was established |
| **2001** | Hunter Hall Global Equities Trust ("**GET**") and Hunter Hall Australian Value Trust ("**AVT**") were established and Hunter Hall was listed on the ASX |
| **2004** | HHV was listed on the ASX and Hunter Hall Investment Management Limited ("**HHIML**"), a subsidiary of Hunter Hall, was appointed as the investment manager for HHV |
| **2007** | Hunter Hall Global Deep Green Trust ("**GDG**") was established |
| **2014** | Hunter Hall High Conviction Equities Trust ("**HCT**") was established |
| **2016** | Peter Hall resigned as Chief Investment Officer and sold a 19.9% stake in Hunter Hall to WHSP. WHSP subsequently announced a takeover offer for the remaining 80.01% of shares in Hunter Hall |
| **2017** | On 14 March 2017, Peter Hall sold his remaining stake in Hunter Hall to WHSP, giving WHSP a total of 44.2%<br>Announcement of proposed merger with Pengana on 9 March 2017 |

*Source: Hunter Hall*

## 4.3 Funds

Hunter Hall manages the following funds:

**Table 5: Summary of funds managed by Hunter Hall**

| Fund | Region | Established | FUM ($'m) | Benchmark | Mgmt fee | Perf. fee |
|---|---|---|---|---|---|---|
| VGT | Global | May 1994 | 452.1 | All Ords | 1.64% | 15% |
| GET | Global | Nov 2001 | 81.6 | MSCI World | 1.50% | 15% |
| HCT | Global | Dec 2014 | 42.9 | Cash + 3% | 1.80% | 15% |
| AVT | Australia | Nov 2001 | 31.5 | Small Ords | 1.00% | 15% |
| GDG | Global | Oct 2007 | 4.7 | MSCI World | 1.64% | 15% |
| HHV | Global | Mar 2004 | 307.9 | MSCI World | 1.50% | 15% |

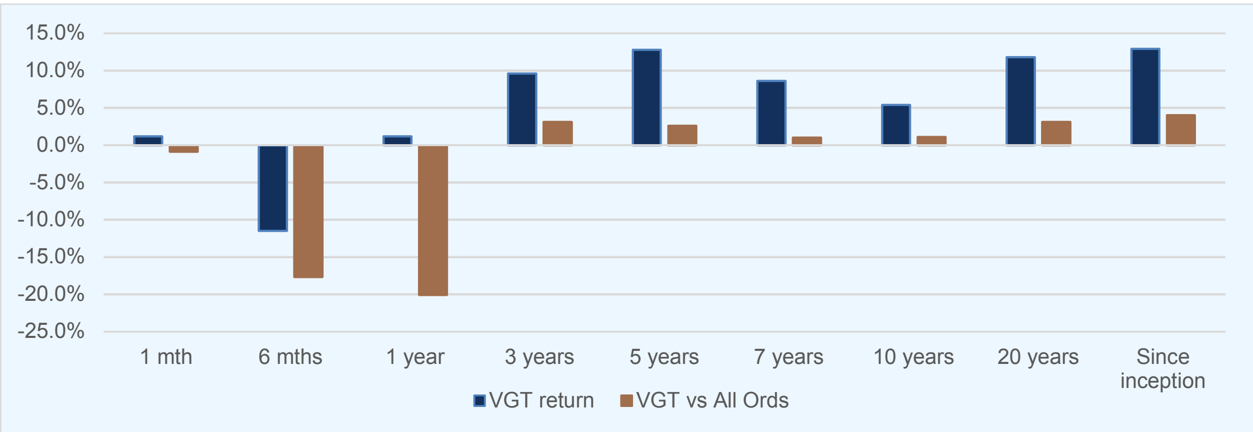
*Source: Hunter Hall as at 28 February 2017*

All funds managed by Hunter Hall are ethically screened and adopt a value approach to investment. The second half of 2016 saw a decline in short term performance predominantly due to rising bond yields in the United States which caused downward pressure on gold prices as well as other stock-specific factors within the various portfolios. Poor performance in December was not uncommon across the sector, particularly for those managers without exposure to cyclical stocks. The year to date performance of VGT and some of the smaller funds at February 2017 was below benchmark, due to a combination of below expectation interim results and market headwinds from the Federal Reserve rate rise. Further information in respect of each of the funds managed by Hunter Hall is provided below.

### Hunter Hall Value Growth Trust ("VGT")

Established on 2 May 1994, the VGT is invested in an ethically screened portfolio of global equities. The objective of the VGT is to substantially outperform global stock markets, benchmarked by the MSCI World Total Return Index, Net Dividends Reinvested, in Australian Dollars ("**MSCI World Index**"), over the medium to long term without incurring significant risk to capital. The VGT has a minimum initial investment of $5,000 and a management fee of 1.64% per annum (inclusive of GST). Performance fees are based on outperformance of the Australian All Ordinaries Accumulation Index ("**All Ords**") rather than the MSCI World Index as this was the benchmark established upon inception of the fund. However, Hunter Hall believes that due to the VGT's stock composition and its international focus, it would be more appropriate for the investment objective and portfolio performance to be measured against the MSCI World Index. Performance fees of 15% of any return greater than the All Ords are payable half yearly. The historical performance of the VGT as at 28 February 2017 is set out in the figure below.

**Figure 2: VGT historical returns**




*Source: Hunter Hall as at 28 February 2017*

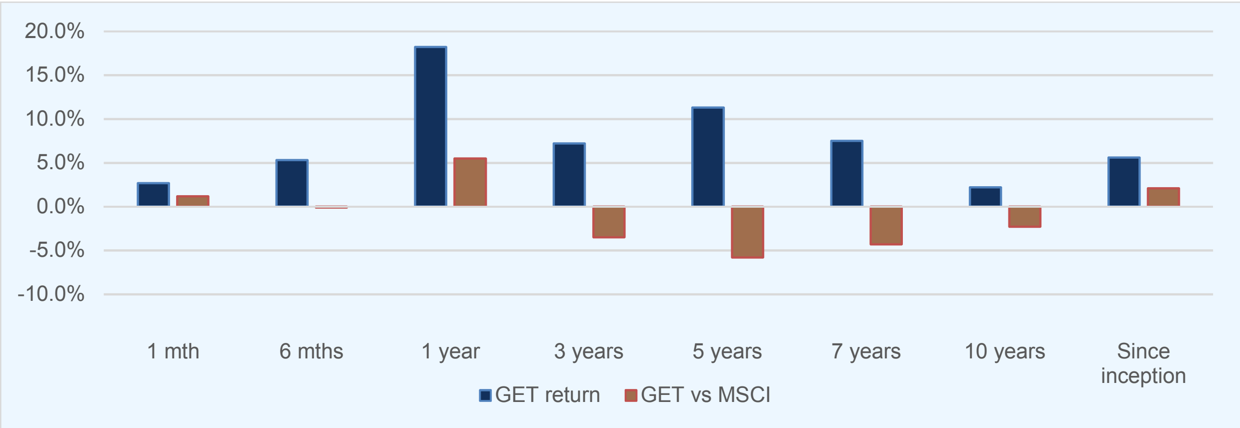
As at 28 February 2017, VGT had $452.1 million of FUM. Since inception, it has generated a return of 12.9% per annum, which rewarded investors with 4.0% per annum above the All Ords. As at 31 January 2017 (latest information available), approximately 22% was derived directly from individual investors and 14% from clients of Commonwealth Securities Limited ("**CommSec**"). The remaining FUM was derived from over 500 financial and wealth advisory practices (collectively known as "**dealer groups**") with no individual dealer group representing more than 5% of total FUM.

The current VGT investment team is led by James McDonald, Hunter Hall's interim Chief Investment Officer. The VGT investment team is managed under a federation/multi-portfolio manager structure where portfolio managers are responsible for managing individual portfolio sleeves in which they deploy their best stock ideas. These portfolio sleeves are then aggregated to establish VGT's final portfolio. Portfolio managers carry direct authority and full accountability for their individual portfolio sleeves. Peter Hall and James McDonald have, on average, each managed 28% and 25% respectively of the VGT since the federation/multi-portfolio manager structure was introduced in 2005. Since Mr Hall's retirement, Mr McDonald has taken overall responsibility for the VGT and Mr's Hall's portfolio sleeve has been re-allocated among the other five VGT portfolio managers. The overall VGT investment team comprises eight experienced investment professionals with an average of 14.5 years' experience in the industry and an average of 7.5 years' tenure at Hunter Hall.

### Global Equities Trust ("GET")

Established on 29 November 2001, the GET is invested in an ethically screened portfolio of global equities (excluding Australia and New Zealand) with a bias towards small to mid-sized companies. The objective of the GET is to substantially outperform global stock markets, benchmarked by the MSCI World Index, over the medium to long term without incurring significant risk to capital. The GET has a minimum initial investment of $5,000 and a management fee of 1.5% per annum (inclusive of GST). A performance fee of 15% of any return greater than the MSCI World Index is payable half yearly. The historical performance of the GET as at 28 February 2017 is set out in the figure below:

**Figure 3: GET historical returns**




*Source: Hunter Hall*

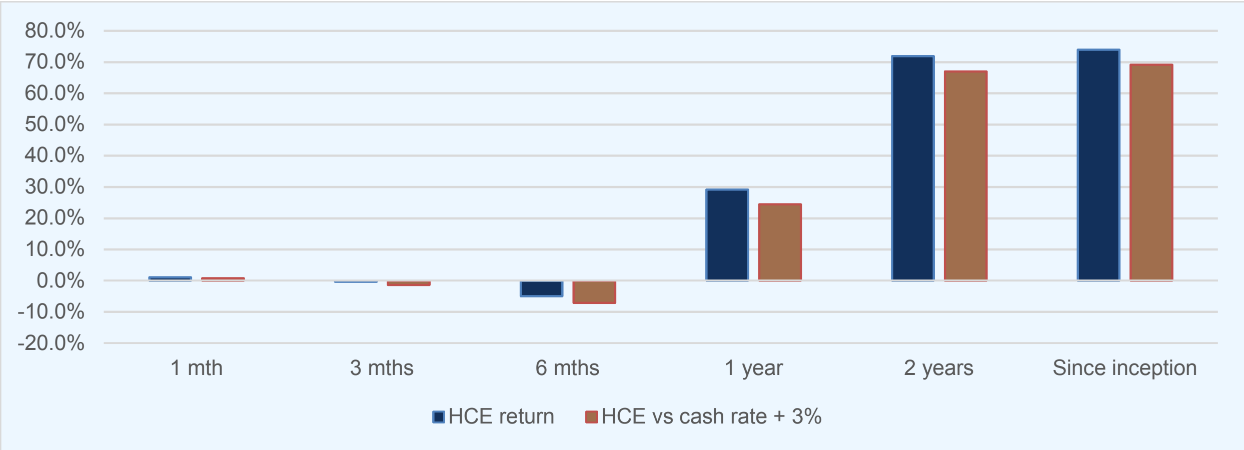
As at 28 February 2017, GET had $81.6 million of FUM. Since inception, it has generated a return of 5.6% per annum, which rewarded investors with 2.1% per annum above the MSCI World Index. As at 31 January 2017 (latest information available), approximately 18% was derived directly from individual investors. The remaining FUM was derived from over 300 dealer groups. There were no dealer groups which represented more than 5% of total FUM.

The GET investment team is led by James McDonald, who has been the GET fund manager since 2013. James is supported in the management of the portfolio by Jonathon Rabinovitz, Li Zhang, Yizhong Chan, Arden Jennings, Time Blake, Andrew Marvell and Alex Weibin Ge. James continues to manage the GET in line with its investment objectives and philosophy, including the ethical investment policy. The GET investment team has an average of 14.5 years' experience in the industry and an average of more than 7.5 years' tenure at Hunter Hall.

## High Conviction Equities Trust ("HCT")

Established on 11 December 2014, the HCT is a higher risk fund that holds a highly concentrated portfolio of typically no more than 20 stocks although a single stock could make up the majority of the portfolio. A majority of the portfolio may be made up of small, illiquid companies that may result in the loss of some or all of the capital invested. The HCT has a minimum investment of $5,000 and a management fee of 1.8% (including GST). A performance fee of 15% of any return greater than the RBA's Cash Rate target plus 3% is payable half yearly. The historical performance of the HCE as at 28 February 2017 is set out in the figure below:

**Figure 4: HCT historical returns**




*Source: Hunter Hall*

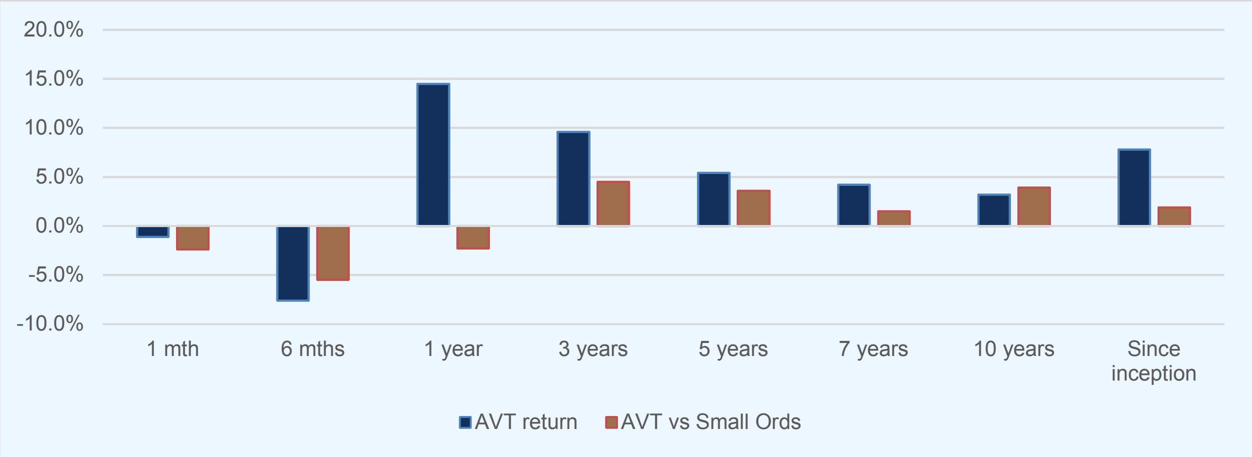
As at 28 February 2017, HCT had $42.9 million of FUM. Since inception, it has generated a return of 74.0% per annum, which rewarded investors with 69.1% per annum above the RBA Cash Rate target plus 3%. As at 31 January 2017 (latest information available), approximately 72% of FUM was derived directly from individual investors and 8% was derived from investors trading through CommSec. AdviceIQ Partners Pty Ltd was the largest contributing dealer group with approximately 10% of the total FUM. The remaining FUM was derived from approximately 38 dealer groups.

The HCT investment team was led by former Chief Investment Officer Peter Hall prior to his resignation on 27 December 2016. The investment team is now led by James McDonald, the Interim Chief Investment Officer. James is supported by Jonathan Rabinovitz, Li Zhang, Yizhong Chan, Arden Jennings, Tim Blake, Andrew Marvell and Alex Weibin Ge. The HCT investment team has an average of 14.5 years' experience in the industry and an average of more than 7.5 years' tenure at Hunter Hall.

### Australian Value Trust ("AVT")

Established on 29 November 2001, the AVT is principally invested in an ethically screened portfolio of Australian small capitalisation equities. The objective of the AVT is to substantially outperform the S&P / ASX Small Ordinaries Accumulation Index ("**Small Ords**") over the medium to long term without incurring significant risk to capital. The AVT has a minimum initial investment of $5,000 and a management fee of 1% per annum (inclusive of GST). A performance fee of 15% of any return greater than the Small Ords plus 1% is payable half yearly. The historical performance of the AVT as at 28 February 2017 is set out in the figure below:

**Figure 5: AVT historical returns**




*Source: Hunter Hall*

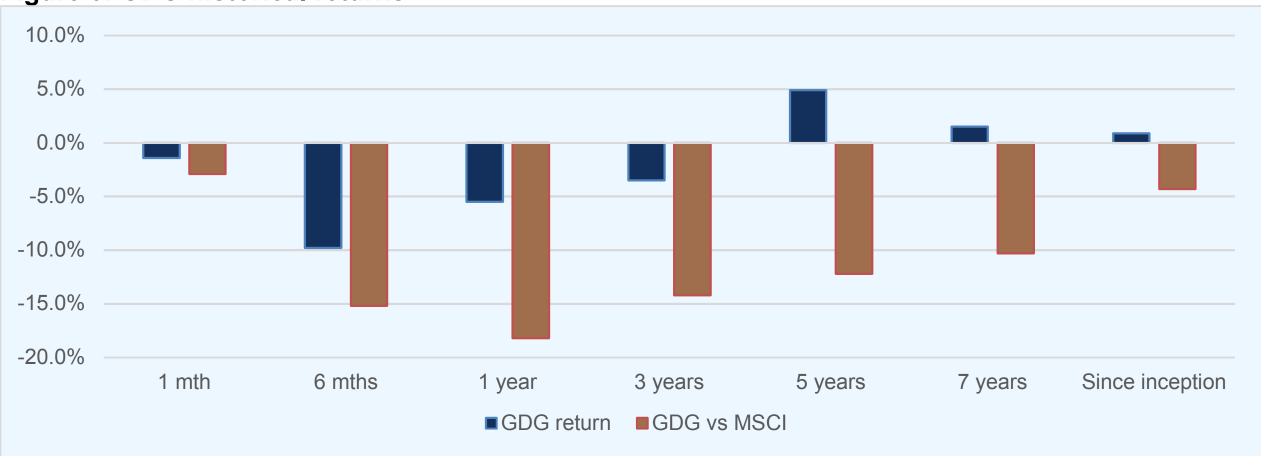
As at 28 February 2017, AVT had $31.5 million of FUM. Since inception, it has generated a return of 7.8% per annum, which rewarded investors with 1.9% per annum above the Small Ords. As at 31 January 2017 (latest information available), approximately 17% was derived directly from individual investors. The remaining FUM was derived from over 250 dealer groups. Two dealer groups each contributed more than 5% of total FUM with a combined total FUM contribution of $4.1 million.

The AVT investment team is led by Jonathan Rabinovitz who has had direct responsibility for this fund since 2013. Jonathon is the Hunter Hall Deputy Chief Investment Officer and his considerable experience in the Australian equities market has been gained over 31 years. Jonathan is supported in the management of the AVT portfolio by James McDonald, Arden Jennings, Li Zhang, Yizhong Chan, Time Blake, Andrew Marvell and Alex Weibin Ge. The AVT investment team has an average of 14.5 years' experience in the industry and an average of more than 7.5 years' tenure at Hunter Hall.

### Global Deep Green Trust ("GDG")

Established on 31 October 2007, the GDG is invested in an ethically-screened portfolio of global equities with a specific focus on enterprises which are considered to make a positive impact on the wellbeing of humans, animals and the environment. The objective of the GDG is to substantially outperform global stock markets, benchmarked by the MSCI World Index, over the long term. The GDG has a minimum investment of $5,000 and a management fee of 1.64% per annum (inclusive of GST). A performance fee of 15% of any return greater than the MSCI World Index is payable half yearly. The historical performance of the GET as at 28 February 2017 is set out in the figure below:

**Figure 6: GDG historical returns**




*Source: Hunter Hall*

As at 28 February 2017, GDG had $4.7 million of FUM. Since inception, it has generated a return of 0.9% per annum, 4.3% per annum short of the return from the MSCI World Index. As at 31 January 2017 (latest information available), approximately 22% was derived directly from individual investors. The remaining FUM was derived from approximately 44 dealer groups with the top five dealer groups by FUM size contributing 45% of the total FUM.

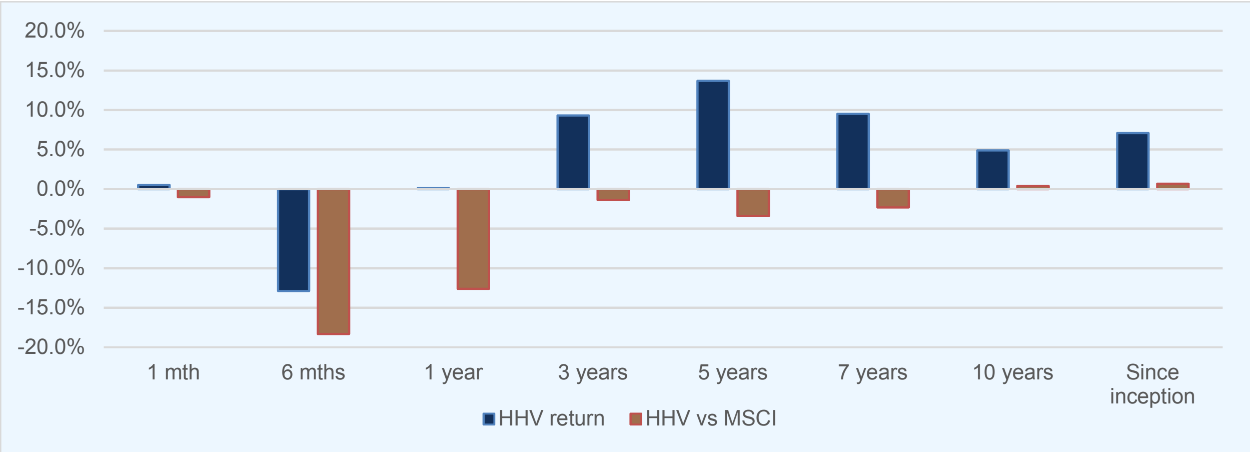
The GDG investment team was led by former Chief Investment Officer Peter Hall prior to his resignation on 27 December 2016. The investment team is now led by James McDonald, the Interim Chief Investment Officer. As the former Deputy Chief Investment Officer, James has worked with Peter in relation to key decisions relating to the GDG including in respect of asset mix, capital allocation, team management and team selection since 2011. James is supported by Jonathan Rabinovitz, Li Zhang, Yizhong Chan, Arden Jennings, Tim Blake, Andrew Marvell and Alex Weibin Ge. The GDG investment team has an average of 14.5 years' experience in the industry and an average of more than 7.5 years' tenure at Hunter Hall.

### Hunter Hall Global Value Limited ("HHV")

Hunter Hall, through its subsidiary HHIML is the investment manager for HHV, a listed investment company that has traded on the ASX since 19 March 2004. HHV is managed by Hunter Hall under a 25 year investment management agreement.

HHV gives investors easy access to a diversified portfolio of 40 to 60 global equities, including strategic allocation to Australian equities, with a small to mid-cap bias. Hunter Hall is paid an annual fee of 1.5% of the gross portfolio value and is eligible for a performance fee of 15% of any outperformance, after fees, of the MSCI World Index. The historical performance of HHV as at 28 February 2017 is set out in the figure below:

**Figure 7: HHV historical returns**




*Source: Hunter Hall*

As at 18 March 2017, the top ten shareholders in HHV accounted for approximately 24.3% of total shares on issue. Of this, the largest shareholder, Wilson Asset Management ("**WAM**"), held approximately 31.6 million shares (12.97%). WAM has been increasing its shareholding since January 2017. The HHV share price has been on a declining trend since the announcement of Mr Hall's resignation from $1.235 on 30 December 2016 to $1.225 on 31 March 2017. HHV has historically traded at a discount to net tangible assets ("**NTA**") although this gap has been narrowing recently. As at 31 March 2017, HHV's discount to pre-tax NTA was 4.9%. By comparison the discount was 6.7% at 30 June 2016 and the average over the prior three years was 11.6%.

The HHV investment team is led by James McDonald, who has been the HHV fund manager since 2015. James will maintain leadership of the HHV investment team and is supported in the management of the portfolio by Jonathan Rabinovitz, Li Zhang, Yizhong Chan, Arden Jennings, Tim Blake, Andrew Marvell and Alex Weibin Ge. The HHV investment team has an average of 14.5 years' experience in the industry and an average of more than 7.5 years' tenure at Hunter Hall.

HHV's largest shareholder, WAM, has recently proposed that HHV should conduct a share buyback program. On 24 January 2017, the board of HHV issued a response to the WAM buyback proposal which stated that the board did not believe such a proposal was in the best interest of all shareholders and as such did not intend to put the proposal to a shareholder vote. A requisition notice was then formally issued by WAM on 14 February 2017 for a general meeting to propose resolutions to remove the current directors of HHV. On 6 April 2017, HHV shareholders rejected all resolutions proposed by WAM with the exception of the proposal for the removal of Independent Chairman, Paul Jensen, which was carried.

We are unable to disclose the content of the IMA due to confidentiality considerations. However, we have reviewed the IMA and note that there are limited circumstances under which the IMA can be terminated prior to its expiry in 2029 and we are not aware of any current events that could result in the possible early termination of the IMA. In addition, we consider that it is unlikely that any of the termination events would occur during the remaining life of the IMA. We understand that there are no termination provisions in the IMA in relation to a change of control in Hunter Hall.

## 4.4 Key personnel

The investment team is comprised of:

| Name | Title | Tenure (years) | Industry Experience (years) | Prior Experience |
|---|---|---|---|---|
| **James McDonald** | CIO & Senior Portfolio Manager | 14 | 20 | BT Funds Management |
| **Jonathan Rabinovitz** | Deputy CIO & Senior Portfolio Manager | 10 | 31 | Pembroke Securities Ltd, Jardine Fleming Australia Securities Ltd, UBS Warburg Ltd, Credit Suisse First Boston Ltd, Shaw Stockbroking Ltd, Thorney Investments |
| **Li Zhang** | Portfolio Manager | 7 | 16 | Smartec Capital |
| **Yizhong Chan** | Portfolio Manager | 9 | 9 | n/a |
| **Arden Jennings** | Portfolio Manager | 5 | 5 | n/a |
| **Tim Blake** | Investment Analyst | 2 | 15 | Five Oceans Asset Management, Macquarie Group, Man Investments, Goldman Sachs Asset Management |
| **Alex Weibin Ge** | Investment Analyst & Dealer | 4 | 11 | BBY Ltd, Bandini Investment Holdings |
| **Andrew Marvell** | Investment Analyst & Dealer | 10 | 10 | n/a |

*Source: Hunter Hall*

The investment team's remuneration is a mix of fixed remuneration, performance based incentives and tenure based incentives. The objective of fixed remuneration is to provide a base level of remuneration that is appropriate to the executive's responsibilities, experience, role and competitive standing in the market and it is assessed annually with reference to available market data. The investment teams' performance based incentives link the individual's performance to the benchmark associated with the respective Fund and reward the team with cash based incentives. Finally, tenure based incentives have been designed to align the long-term interests of investors with the investment team by introducing retention measures for all investment team members.

As at 31 December 2016 there was an overall net cash weighting of 25% or $240m. Out of the remaining $730m, which was invested in equites, Peter Hall managed 42%, James McDonald 28%, Jonathan Rabinovitz 11% and the remaining 19% split across three additional portfolio managers. The experienced investment management team that was working with Peter on his funds remains in place and thus Peter's departure is expected to have limited impact on the performance of Hunter Hall's major funds.

The current senior management team of Hunter Hall (excluding investment team) comprises:

**Table 6: Hunter Hall senior management team**

| Name and title | Experience |
|---|---|
| **Paula Ferrao**<br>CFO and Interim CEO | Paula has 19 years' experience in the funds management industry, having been with Hunter Hall since 1998. Most recently Paula has been Deputy CEO and has experience in financial reporting and tax for listed corporate entities, managed investment schemes and public offer superannuation funds in all aspects of fund operations. |
| **Anthony Rule**<br>Head of Finance and Operations | Anthony joined Hunter Hall in July 2016 and has 14 years' experience in funds management, holding finance and operations positions in both the listed and unlisted space including at CBA and Centuria Capital. Anthony is a member of CPA Australia. |
| **Asher Lockhart**<br>Head of Product and Risk | Asher has been with Hunter Hall for over eight years and over this time has had responsibility for fund administration, custody, investor relations and technology functions. Prior to joining Hunter Hall, Asher had over ten years' experience in technology, project management and management consulting across a range of industries. |
| **Monica Hood**<br>Senior Business Development Manager | Monica is a marketing and business development professional with a proven track record in retail funds management and wholesale back office services. Monica focusses on servicing the needs of research houses, financial planning firms, masterfund/wrap providers, asset consultants and superannuation funds. Prior to joining Hunter Hall in 2001, Monica worked for a variety of financial services companies including Austraclear, State Street Australia and Permanent Trustee Company. |

*Source: Hunter Hall*

The Board of Directors of Hunter Hall comprises:

**Table 7: Directors of Hunter Hall**

| Directors | Experience |
|---|---|
| **Kevin Eley**<br>Chairman | Mr Eley is a Chartered Accountant, a Fellow of the Financial Services Institute of Australia and a Fellow of the Australian Institute of Company Directors. Mr Eley has over 31 years' experience in management, financing and investment and has worked for a major international accounting firm, two investment banks and was CEO of HGL Limited where he remains as a non-executive director. Other current non-executive directorships include Milton Corporation Limited and Equity Trustees Holdings Limited. |
| **Wayne Hawkins**<br>Non-executive director | Mr Hawkins has over four decades' experience in investment management. Previously he was funds manager and investment analyst with City Mutual Life Assurance Society Limited, group investment manager with New Zealand South British Insurance, chief executive of NZI Investment Services Limited, chief investment officer and managing director (funds management) with Oceanic Capital Corporation Group. |
| **David Groves**<br>Non-executive director | Mr Groves has 25 years' experience as a company director, including 15 years in financial services. Mr Groves' is a director of Pipers Brook Vineyard Pty Ltd and Tasman Sea Salt Pty Ltd. Mr Groves' is a former director of Equity Trustees Ltd, Tassall Group Ltd, GrainCorp Ltd and Camelot Resources N.L. and a former executive with Macquarie Bank Limited and its antecedent, Hill Samuel Australia. Mr Groves is a member of the Chartered Accountants Australia and New Zealand and a Fellow of the Australian Institute of Company Directors. |

*Source: Hunter Hall*

## 4.5 Financial performance

From time to time, Hunter Hall will seed new funds. By virtue of the timing of these investments, Hunter Hall is often deemed to initially hold a controlling stake in the seeded funds and is therefore required to consolidate the funds' results in its annual report. For the purposes of our analysis we have removed the effect of the any seeded fund consolidation in the statements of financial performance set out below.

**Table 8: Hunter Hall's financial performance**

| | FY15 | FY16 | 6 months to Dec-16 |
|---|---|---|---|
| **Revenue** | | | |
| Management fee income | 15,909 | 16,621 | 8,717 |
| Entry fee income | (0) | 0 | (5) |
| Performance fee income | 298 | 1,782 | - |
| **Total revenue** | **16,207** | **18,403** | **8,712** |
| **Other income** | | | |
| Realised gains on investments | - | 1,503 | - |
| Other income | 188 | 1,934 | 373 |
| **Total other income** | **188** | **3,437** | **373** |
| **Total income** | **16,395** | **21,840** | **9,085** |
| **Expenses** | | | |
| Staff costs | (5,975) | (5,816) | (2,992) |
| Incentives | (1,444) | (1,513) | (234) |
| Occupancy costs | (581) | (546) | (268) |
| Marketing | (537) | (743) | (540) |
| Corporate | (501) | (482) | (305) |
| Office | (220) | (228) | (153) |
| Professional fees | (516) | (631) | (312) |
| Other | (37) | 19 | (18) |
| Charitable donations | (374) | (651) | (231) |
| Non-reimburseable trust expenses | (142) | (132) | (65) |
| **Total expenses** | **(10,327)** | **(10,723)** | **(5,118)** |
| **EBITDA** | **6,068** | **11,117** | **3,967** |
| Depreciation and amortisation | (170) | (179) | (86) |
| **EBIT** | **5,897** | **10,938** | **3,881** |
| Interest income | 180 | 219 | 96 |
| **Net profit before tax** | **6,078** | **11,157** | **3,977** |
| Income tax expense | (1,890) | (3,334) | (864) |
| **Net profit after tax** | **4,188** | **7,824** | **3,114** |
| Movement in value of seeded funds | 2,781 | 2,578 | (1,735) |
| **Statutory profit** | **6,969** | **10,402** | **1,379** |
| **Other financial information** | | | |
| FUM (average) ($m) | 1,039 | 1,129 | 1,086 |
| Operating profit from investment management | 5,789 | 6,370 | 3,751 |
| EBITDA margin | 37% | 51% | 44% |
| EBIT margin | 36% | 50% | 43% |
| Revenue (as a % of FUM) | 1.56% | 1.63% | 1.60% |
| Expenses (as a % of FUM) | 0.99% | 0.95% | 0.94% |

*Source: Hunter Hall*

In relation to the historical financial performance of Hunter Hall set out above, we note the following:

- Management fees have been fairly stable over the three years which is consistent with relatively flat FUM.
- Other income predominantly relates to dividends received from investments.
- Employee benefits and performance fees paid to employees represent a large proportion of total expenses which is expected in an industry which requires a highly skilled and specialised workforce.
- Occupancy costs have declined due to a reduction in rent for the Sydney and London offices and the closure of the Singapore office.
- Hunter Hall donates a portion of operating profit to charities each year. Donations increased in FY16 as a result of an increase in operating profit.
- The results for the six months 31 December 2016 have deteriorated mainly as a result of a lack of investment income and performance fees due to recent subdued performance. The full-year results for FY17 will also be adversely impacted by the significant loss of FUM over the year.

## 4.6 Financial position

As with the statements of financial performance, we have removed the effect of the seeded fund consolidation in the audited statements of financial position as at 30 June 2015 and 30 June 2016 and unaudited statement of financial position as at 31 December 2016 set out in the table below.

**Table 9: Hunter Hall's financial position**

| | Jun-15 | Jun-16 | Dec-16 |
|---|---|---|---|
| **Current asset** | | | |
| Cash and cash equivalents | 12,734 | 12,040 | 10,867 |
| Other current assets | 3,005 | 4,731 | 2,116 |
| **Total current assets** | **15,740** | **16,771** | **12,983** |
| **Non-current assets** | | | |
| Shares in HHV at market value | 1,787 | 6,639 | 6,206 |
| Units in HCT at market value | 7,853 | 12,034 | 10,660 |
| Units in Hunter Hall Australian Equities Fund | 1,372 | - | - |
| Other investments | 23 | 23 | 23 |
| Other non-current assets | 1,485 | 1,314 | 1,032 |
| **Total non-current assets** | **12,520** | **20,010** | **17,921** |
| **Total assets** | **28,259** | **36,781** | **30,904** |
| **Current liabilities** | | | |
| Employee benefits | (1,819) | (2,514) | (688) |
| Current tax liabilities | (984) | (1,511) | (259) |
| Provision for charitable donations | (315) | (340) | (398) |
| Other current liabilities | (987) | (1,015) | (825) |
| **Total current liabilities** | **(4,105)** | **(5,380)** | **(2,171)** |
| **Non-current liabilities** | | | |
| Employee benefits | (592) | (668) | (674) |
| Deferred tax liabilities | (965) | (2,465) | (1,892) |
| **Total non-current liabilities** | **(1,558)** | **(3,133)** | **(2,566)** |
| **Total liabilities** | **(5,662)** | **(8,513)** | **(4,737)** |
| **Net assets** | **22,597** | **28,268** | **26,168** |

*Source: Hunter Hall*

In relation to the historical financial position of Hunter Hall set out above, we note the following:

- Other current assets predominantly relate to trade and other receivables, the majority of which are management fees which are paid monthly in arrears.
- Hunter Hall carries investments in some of its funds, in particular HHV and HCT which are carried at market values on the respective balance dates.
- Other non-current assets include plant and equipment, deferred tax assets and intangible assets.
- The reduction in current liabilities in December 2016 was due to a substantial level of employee benefits and taxation liabilities accrued at financial year end which were subsequently paid.
- Other current liabilities primarily relate to trade and other payables.
- Deferred tax liabilities primarily relate to unrealised gains on investments.

## 4.7 Capital structure and shareholders

As at 28 March 2017 Hunter Hall had a total of 27.3 million ordinary shares on issue. There were no options, convertible notes or other potential shares. The following table sets out details of Hunter Hall's substantial shareholders as at that date:

**Table 10: Hunter Hall's substantial shareholders**

| Shareholder | Shares held | % total shares |
|---|---|---|
| Washington H Soul Pattinson and Company Limited | 12,651,308 | 46.3% |
| John Bridgeman Limited and associates | 1,788,405 | 6.5% |
| Other shareholder | 12,889,930 | 47.2% |
| **Total** | **27,329,643** | **100.0%** |

*Source: Hunter Hall and ASX announcements*

## 4.8 Share price performance

The following chart shows the share market trading of Hunter Hall shares for the past two years:

**Figure 8: Hunter Hall's share price performance**


*Source: FactSet*
*Note: Actual volume traded on 3 January 2017 was 6,886,383 shares*

In relation to the trading of Hunter Hall shares over the last two years we note the following:

- Shares are thinly traded with an average daily volume of approximately 15,000 shares prior to the announcement of Mr Hall's retirement in December 2016. The spike in share trading on 3 January 2017 predominantly relates to Mr Hall's initial sale of 5,434,653 shares to WHSP.
- During 2015 the share price remained fairly stable between $2.00 and $2.50. Between January 2016 and September 2016 the share price gradually rose to reach a peak of $4.66 on 8 September 2016. This was likely due to continued increases in FUM as well as positive FY16 performance which included performance fees and significant unrealised gains on investments.
- In the second quarter of FY17, short term returns on a number of funds declined sharply, as noted in Section 4.3 above, which had a negative impact on Hunter Hall's performance and share price.
- Upon the announcement of the resignation of Mr Hall and the takeover offer from WHSP the share price fell from $3.10 on 30 December 2016 to $2.50 on 3 January 2016. The share price continued to fall to a low of $2.23 on 24 January 2017.
- On the back of the announcement of the Proposed Transaction on 9 March 2017, the market reacted positively with a jump in trading volume and price to close at $2.55. Since that date until 6 April 2017, Hunter Hall shares have traded in the range from $2.45 to $2.67 with a volume-weighted average price ("**VWAP**") of $2.59.

# 5 PROFILE OF PENGANA

## 5.1 Introduction

Founded in 2003 by Russel Pillemer (CEO) and Malcolm Turnbull (Ex-Chairman), Pengana is an equities focused, diversified fund manager based in Australia with the aim of providing investors with strong long term absolute investment returns with reduced risks. Pengana currently manages seven funds and one early stage fund as described in section 5.4 below.

Pengana's overall investment philosophy involves aligning the interests of expert fund managers with the interests of investors within a disciplined and risk controlled structure, in order to foster an optimal active funds management environment. Its lead fund managers all hold a significant ownership stake in their respective business units (as described below) and invest their own money into the funds. Many also hold shares in Pengana.

Pengana runs separate profit and loss management accounts for each fund, including the appropriate allocation of overhead costs. Typically, 50% of all profits are distributed to the fund management teams in the form of a "shadow equity" program. The lead investment specialists own "shadow equity" in the division that manages their strategy and invest their own capital in their respective funds. The economics of these profit-sharing arrangements are substantially similar regardless of whether the investment management teams are internally-employed or partnered with through joint ventures with external managers.

Pengana has generated strong profitability over the last five years (largely due to consistently earning performance fees) and is positioned to create higher earnings margins given its scalability and the investment already made in distribution access and a new range of global equity funds. In addition, Pengana's array of products are carefully constructed to deliver investors superior risk adjusted returns and identifiable alpha that is uncorrelated with the market. This provides business stability via uncorrelated performance fees between funds as well as stickiness in FUM over market cycles. Over the last 10 years, Pengana has built a quality retail distribution platform with a diverse client base of approximately 40,000 retail relationships, reaching across both advised and direct non-advised channels.

## 5.2 History

A brief history of Pengana is set out in the table below:

| Year | Event |
|---|---|
| **2003** | Founded by Russel Pillemer and Malcolm Turnbull |
| **2004** | Inception of Pengana Emerging Companies Fund ("**ECF**") |
| **2008** | Inception of Pengana Australian Equities Fund ("**AEF**")<br>Turnbull stake sold to the National Australia Bank ("**NAB**")<br>Inception of Pengana Asia Special Events Fund |
| **2010** | Inception of Pengana Absolute Return Asia Pacific Fund ("**PARAPF**") |
| **2015** | Entered into a Joint Venture with Lizard Investors LLC ("**Lizard**") on the Pengana Global Small Companies Fund ("**GSC**")<br>Inception of Pengana International Equities Fund ("**IEF**")<br>Entered into a Joint Venture with PanAgora Asset Management, Inc. ("**PanAgora**") on the Pengana PanAgora Absolute Return Global Equities Fund ("**PanAgora Fund**") |
| **2016** | Inception of Pengana International Equities Fund Managed Risk ("**PIEFMR**") |
| **2017** | NAB sold its stake to Washington H. Soul Pattinson<br>Announcement of proposed merger with Hunter Hall International Ltd on 9 March 2017 |

*Source: Pengana*

## 5.3 Joint Ventures

An overview of the key terms of the Joint Ventures with PanAgora and Lizard is set out below.

### PanAgora

On 5 November 2015, Pengana entered into an IMA appointing PanAgora as the investment manager of the PanAgora Fund. This appointment is part of a broader arrangement entered into by PanAgora and Pengana on 25 June 2015 ("**PanAgora Arrangement**").

Under the terms of the PanAgora Arrangement, Pengana will pay PanAgora 50% of the revenue, less agreed expenses, accruing to the division from retail client investments. The percentage paid to PanAgora may be greater if profits are generated from the investments of certain institutional clients.

If either party terminates the PanAgora Arrangement other than for cause, the terminating party will lose all rights under the PanAgora Arrangement and will be restricted from offering competing products to Australian and New Zealand retail clients for a period of 2 years. If the PanAgora Arrangement is terminated for cause the breaching party loses all rights under the PanAgora Arrangement and will be prohibited from competing for a period of 2 years.

### Lizard

Lizard was appointed as the investment manager of GSC under a Binding Sub-Advisory Agreement dated 11 March 2015 ("**SAA**"). Under the terms of the SAA, Pengana will pay Lizard 50% of the revenue, less agreed expenses, accruing to the division.

If Lizard terminates the SAA other than for cause, they are restricted from offering competing products in Australia, New Zealand and Asia for a period of 36 months. If Pengana terminates the SAA other than for cause, Pengana will continue to pay Lizard 50% of any management fees which are received in respect of the fund for 24 months.

## 5.4 Funds

Pengana manages the following main funds:

**Table 11: Summary of funds managed by Pengana**

| Fund | Region | Established | FUM[1] ($'m) | Performance Fee Benchmark | Mgmt Fee | Perf. fee |
|---|---|---|---|---|---|---|
| AEF | Australia | Jul 2008 | 1,210 | Zero | 1.025% | 10.25% |
| ECF | Australia | Nov 2004 | 739 | S&P/ASX Small Ordinaries Accumulation | 1.334% | 20.50% |
| PanAgora Fund | Global | Dec 2015 | 116 | RBA Cash Rate | 1.520% | 20.22% |
| PARAPF | Asia Pacific | Sep 2010 | 49 | RBA Cash Rate | 1.500% | 20.50% |
| IEF | Global | Jul 2015 | 16 | n/a[2] | 1.334% | N.A. |
| GSC | Global | Apr 2015 | 10 | MSCI ACWI SMID Cap Net AUD unhedged | 1.334% | 20.50% |

*Source: Pengana as at 28 February 2017*
*Note:*
1. *None of the funds have reached capacity, but have been managed as if they were at full capacity, without size constraints.*
2. *The IEF does not charge performance fees. As such, a performance hurdle is not applicable to the fund. The IEF investment objective is to outperform the MSCI ACWI Net AUD unhedged.*

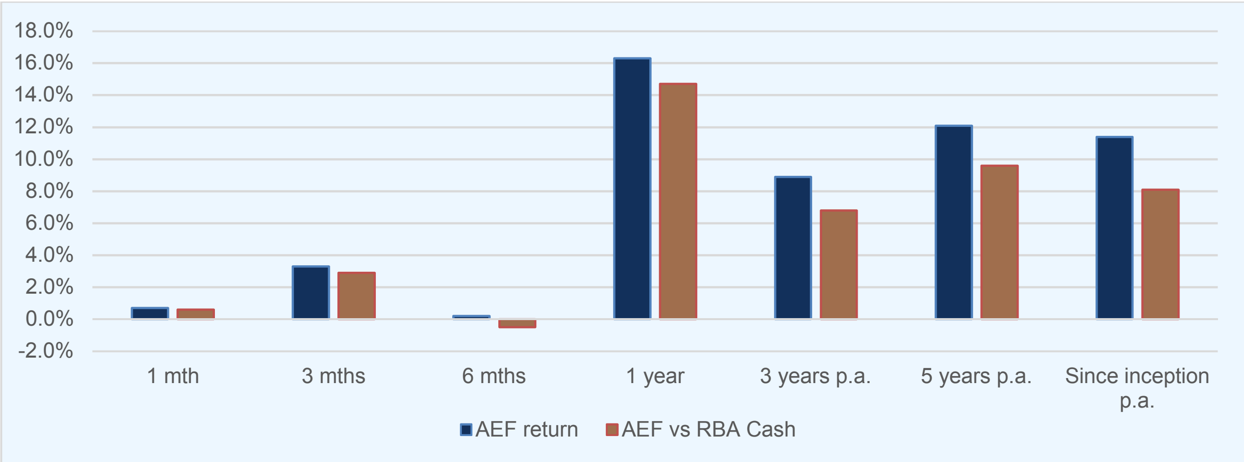
In addition to the above, Pengana also manages the Pengana Asia Special Events (Offshore) Fund and Master Fund ("**PASE**") and an early-stage fund, the Pengana International Equities Fund Managed Risk ("**PIEFMR**"). The PARAPF fully invests into the PASE funds which are managed by the same portfolio manager and employ the same investment strategy as the PARAPF.

**Pengana Australian Equities Fund ("AEF")**

Established on 1 July 2008, the philosophy of the AEF is based on identifying good quality companies that are reasonably priced by focusing on their operating leverage, balance sheet and an after-tax cash earnings yield of 6% growing to 10% over a 5-year period. Capital preservation is the focus of the fund while achieving a fair return of 6% in excess of the risk-free rate per annum. This philosophy is supported by the ability to hold an unlimited amount of cash when acceptable investments cannot be found and insisting on finding, assessing and owning 'good deals' rather than being underweight or overweight index determined stock weightings.

The AEF has a minimum initial investment of $20,000 and a management fee of 1.025% per annum, inclusive of GST and net of reduced income tax credit ("**RITC**"). A performance fee of 10.25% (inclusive of GST net of RITC) of any increase in Net Asset Value ("**NAV**") of the fund, defined as the market value of all shares held in the portfolio less the liabilities, may be payable semi-annually. The historical performance of the AEF as at 28 February 2017 is set out in the figure below:

**Figure 9: AEF historical returns**




*Source: Pengana*

As at 28 February 2017, the AEF had $1,210 million of FUM with a capacity target of 0.5% of the index market capitalisation of mid and small cap Australian equities with no more than 50% of the AEF invested in mid and small cap Australian equities. Due to the limited available capacity, Pengana are actively managing the availability of the AEF by restricting flows to ensure that inflows do not impact on performance. Since inception, AEF has generated a return of 11.4% per annum, which rewarded investors with 8.1% per annum above the RBA cash rate. The fund has a diverse client base enjoying support from both aligned dealer groups and independent financial advisers with over 400 dealers in total supporting the fund and very little concentration.

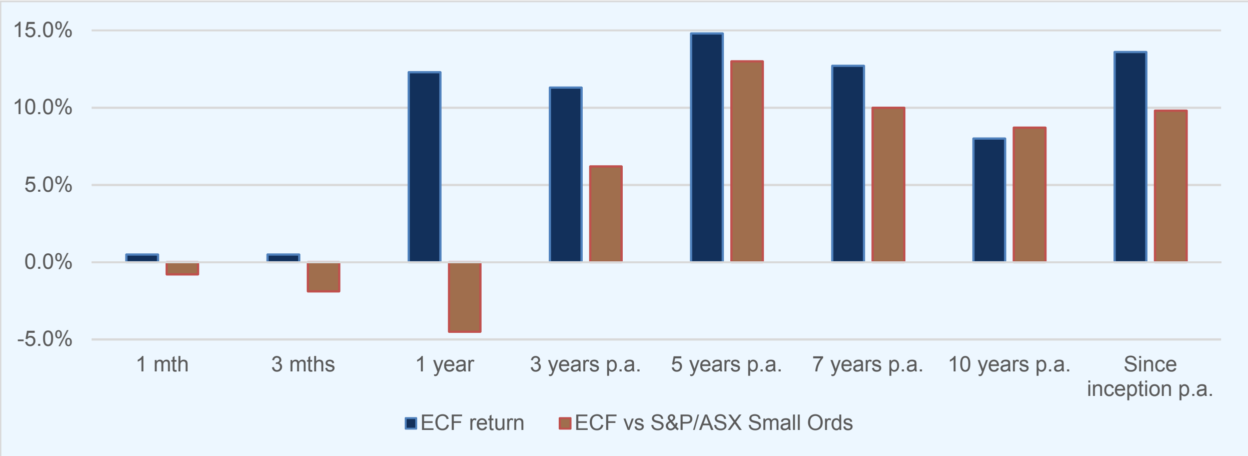
The AEF investment team is led by Rhett Kessler, who has been with Pengana since 2007 and Anton du Preez, who joined Pengana in 2009. They are supported by Mark Christensen and Chris Tan.

**Pengana Emerging Companies Fund ("ECF")**

Established on 1 November 2004, the philosophy of the ECF is based on an underlying belief that smaller companies' share prices are often incorrectly priced due to a lack of sell-side research coverage. Therefore, it seeks to capitalise on this inefficiency by employing a very active company visitation program to qualitatively assess investments in the sector. Favoured stocks are then fully modelled providing the inputs for a standardised cashflow based valuation. The objective of the ECF is to obtain returns greater than the Small Ords over rolling three year periods after fees.

The ECF has a minimum initial investment of $25,000 and a management fee of 1.334% per annum (inclusive of GST net of RITC). A performance fee of 20.5% (inclusive of GST net of RITC) of any increase in the NAV above the Small Ords may be payable semi-annually. The historical performance of the ECF as at 28 February 2017 is set out in the figure below:

**Figure 10: ECF historical returns**




*Source: Pengana*

As at 28 February 2017, the ECF had $739 million of FUM and is nearing its current expected capacity (determined as 0.5% of benchmark capitalisation). Due to the limited available capacity, Pengana have soft-closed the fund, restricting flows from new advised investors and not accepting flows from new direct investors. Since inception, it has generated a return of 13.6% per annum, which rewarded investors with 9.8% per annum above the Small Ords. For the twelve months to February, it has generated a return of 12.3% but underperformed by 4.5% relative to the Small Ords. The bulk of the FUM is derived from advised clients from over 500 aligned and non-aligned dealer groups with minimal concentration in any particular dealer group. ECF also enjoys significant support from direct investors.

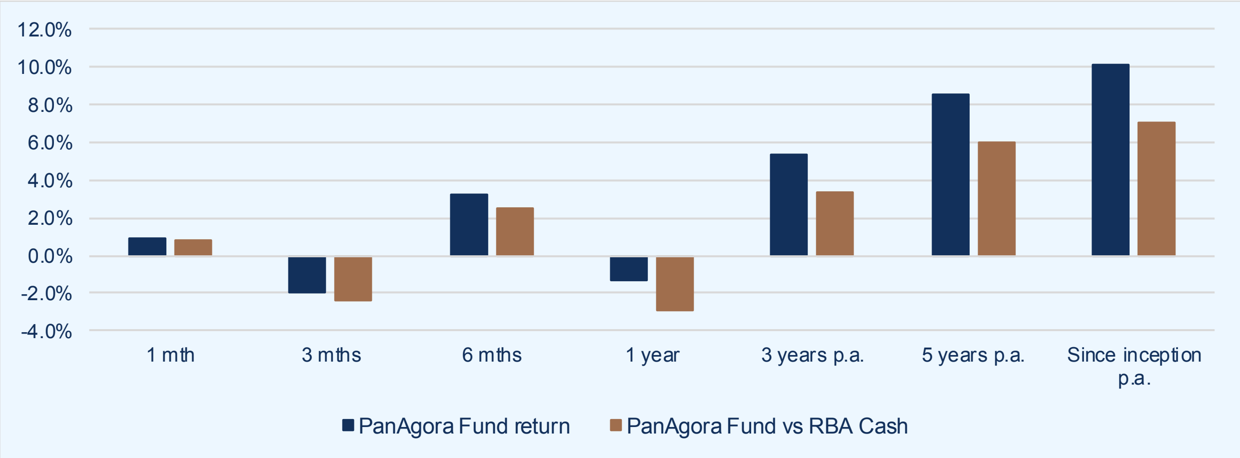
The ECF investment team is led by both Steve Black and Ed Prendergast who co-established the fund in 2004. Both had seven to ten years of experience in the finance industry before joining Pengana.

**Pengana PanAgora Absolute Return Global Equities Fund ("PanAgora Fund")**

Established via a joint-venture with PanAgora on 9 December 2015, the philosophy of PanAgora is based on the belief that stock prices are largely driven by the fundamental strengths or weaknesses of a company's business prospects and that certain fundamentally based measures are indicative of a company's likely success or failure. As many investors either lack the ability to identify and evaluate these measures with sufficient breadth and speed, or are hampered by institutional rigidities, stocks are mispriced from time to time. Therefore, by combining fundamental analysis with robust quantitative techniques, PanAgora is able to capitalise on these inefficiencies. The objective of the PanAgora Fund is to seek attractive absolute returns by identifying and exploiting multiple inefficiencies that may exist in global equity markets. It aims to generate an annualised return of 8% to 14% with an annualised volatility of 4% to 8% over a suggested investment timeframe of at least three to five years.

The PanAgora Fund has a minimum investment of $20,000 and a management fee of 1.52% per annum (including GST net of ITCs). A performance fee of 20.22% per annum (including GST net of ITCs) of any increase in the NAV greater than the RBA cash rate may be payable semi-annually. The historical performance of the PanAgora Fund as at 28 February 2017 is set out in the figure below:

**Figure 11: PanAgora Fund historical returns**




*Source: Pengana*
*Note: From December 2015, performance figures are those of the fund's class A units (including reinvestment of distributions). Between September 2010 and November 2015, AUD performance has been simulated by Pengana from the actual USD Composite gross strategy returns using 3 month rolling forwards to hedge movements in the AUD/USD spot rate.*

As at 28 February 2017, the PanAgora Fund had $116 million of FUM. Since inception, it has generated a return of 10.1% per annum, which rewarded investors with 7.2% per annum above the RBA cash rate. The fund has a significant institutional investor and is well supported by a core group of dealer groups.

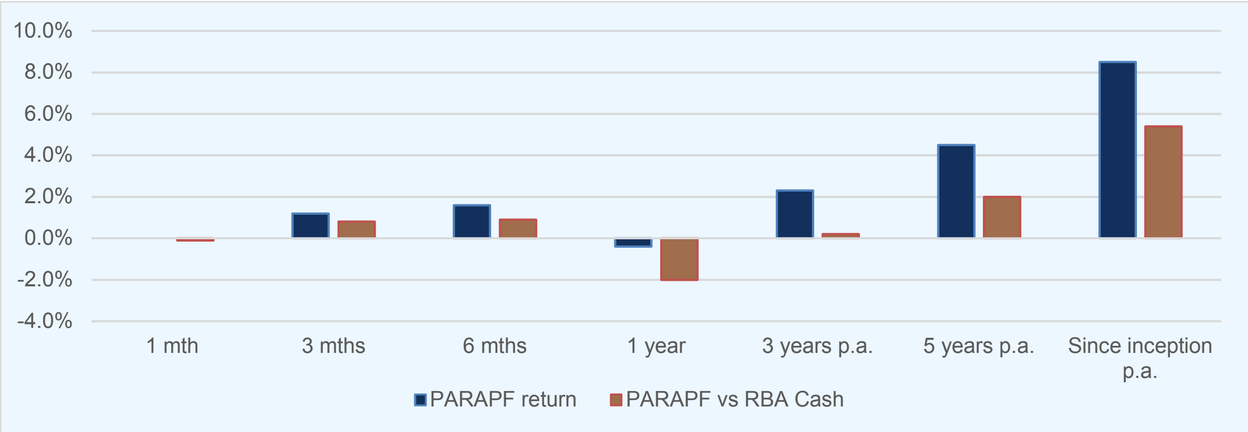
The PanAgora Fund's team is led by George Mussalli who is the Chief Investment Officer and Head of Equity Research of PanAgora. Richard Tan, a director on PanAgora's Diversified Arbitrage and Stock Selector teams, is responsible for the daily management and ongoing research efforts for the PanAgora Fund.

**Pengana Absolute Return Asia Pacific Fund ("PARAPF")**

Established on 1 September 2010, the philosophy of the PARAPF is based on seeking absolute returns for investors, rather than returns driven by the general direction of equity markets, through exploiting corporate events because of the belief that these events create market inefficiencies. The investment team thoroughly understands the behaviour and sensitivity of companies' share prices before and after an event, using historical data, research and market experience to identify key events. The objective of the PARAPF is to generate a net annualised return greater than 5% above the RBA cash rate with low volatility and low correlation to Asian security markets over a three to five-year period. PARAPF obtains its exposure to this strategy by fully investing in the Pengana Asia Special Events (Offshore) Fund which in turn fully invests into the Pengana Asia Special Events Master Fund (described in further detail below).

The PARAPF has a minimum initial investment of $20,000 and a management fee of 1.50% per annum (inclusive of GST net of RITC). A performance fee of 20.5% (inclusive of GST net of RITC) of any increase in the NAV greater than the RBA cash rate may be payable annually. The historical performance of the PARAPF as at 28 February 2017 is set out in the figure below:

**Figure 12: PARAPF historical returns**




*Source: Pengana*

As at 28 February 2017, the PARAPF had $49.4 million of FUM. Since inception, it has generated a return of 8.49% per annum, which rewarded investors with 5.35% per annum above the RBA cash rate. The FUM is primarily derived from over 60 dealer groups which represent the majority of the total FUM.

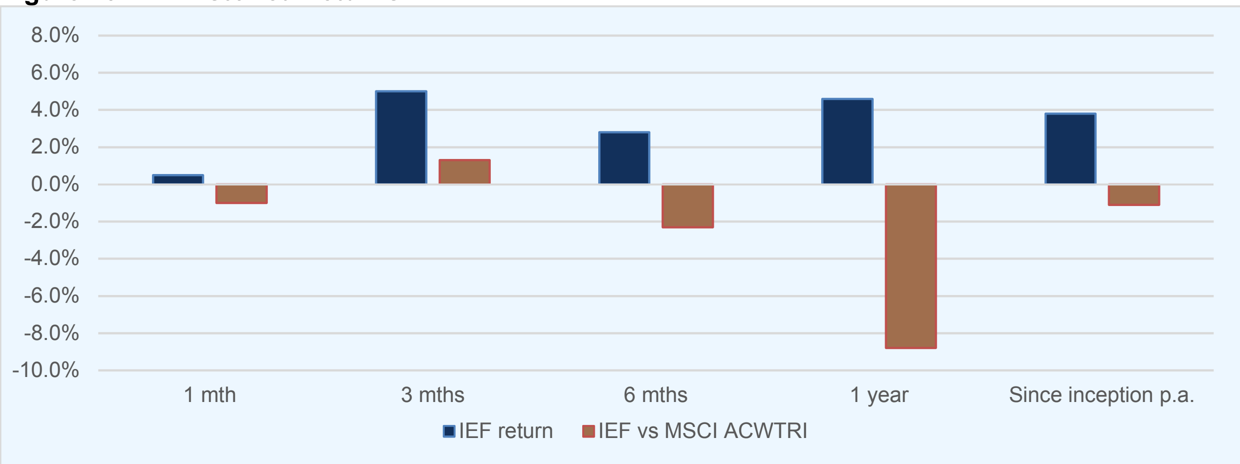
The current PARAPF investment team is led by Antonio Meroni who has over 24 years' experience in financial markets, including 14 years' experience in Asian equities. Antonio is supported in the management of the portfolio by Vikas Kumra, a fund manager with over nine years' experience in the finance industry, as well as, Lee Ann Lee, Jingqing Hong and Vivien Lee who are all based in Pengana's Singapore office.

**Pengana International Equities Fund ("IEF")**

Established on 1 July 2015, the philosophy of the IEF is based on creating a sufficiently diversified portfolio of highly cash flow generative companies with favourable outlooks that are trading at attractive valuations. After identifying the potential investment candidates, a comprehensive analysis of the company is performed to understand the sustainability of its cash generation. Then, they are divided into three segments in Core, Cyclical or Opportunistic as a guidance on the appropriate weight to be assigned. The objective of the IEF is to obtain returns greater than the MSCI All Country World Total Return Index Net AUD unhedged ("**MSCI ACWI Net AUD unhedged**") and with lower volatility than the index over the medium to long term.

The IEF has a minimum investment of $25,000 and a management fee of 1.334% per annum (including GST net of RITC). However, unlike the other funds, no performance fees are charged. The historical performance of the IEF as at 28 February 2017 is set out in the figure below:

**Figure 13: IEF historical returns**




*Source: Pengana*

As at 28 February 2017, the IEF had $16 million of FUM. Since inception, it has generated a return of 3.82% per annum. However, this is 1.09% short of the return generated by MSCI ACWI Net AUD unhedged. The minimum suggested timeframe for an investment in the IEF is three years in order to realise the investment objective. The IEF is currently less than two years old. The bulk of the FUM is currently derived from direct high-net-worth investors as the fund has not yet been broadly offered to dealer groups and advisers.

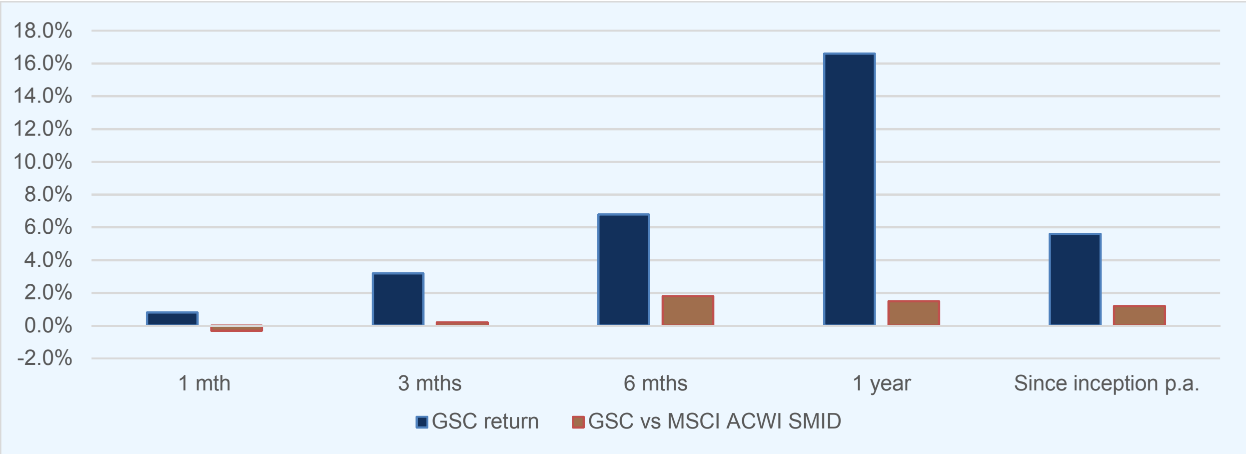
The IEF investment team is led by Jordan Cvetanovski who is also the Chief Investment Officer and has over fourteen years' experience as a portfolio manager and analyst. Jordan is supported in the management of the portfolio by Steven Glass, the Head of Research with over thirteen years' experience as a portfolio manager and equities analyst, Ronald Yu.

**Pengana Global Small Companies Fund ("GSC")**

Established via a joint-venture with Lizard Investors LLC on 1 April 2015, the philosophy of the GSC is based on the belief that unique investment opportunities and compelling valuations exist in global small to mid-cap stocks due to limited available research, corporate actions or unfavourable investor perception. The objective of the GSC is to obtain returns greater than the MSCI All Country World Index SMID Cap unhedged in Australian dollars ("**MSCI AWI SMID Cap Net AUD unhedged**") over rolling 3 year periods after fees.

The GSC has a minimum investment of $25,000 and a management fee of 1.334% per annum (inclusive of GST net of RITC). A performance fee of 20.5% (inclusive of GST net of RITC) of any increase in the NAV above the MSCI AWI SMID Cap Net AUD unhedged may be payable half yearly. The historical performance of the GSC as at 28 February 2017 is set out in the figure below:

**Figure 14: GSC historical returns**




*Source: Pengana*

As at 28 February 2017, the GSC had $10 million of FUM. Since inception, it has generated a return of 5.6% per annum, which rewarded investors with 1.2% per annum above the MSCI AWI SMID Cap Net AUD unhedged. The bulk of the total FUM is derived from individuals. However, there are currently 18 dealer groups supporting the fund.

The GSC investment team is led by Leah Zell, who is a recognised expert in international investing, and a pioneer in the international small-cap category. Leah established Lizard in 2008 and is the CIO. Jonathan Moog, David Li and Michael Ryan are responsible for the daily management of the portfolio.

**Pengana Asia Special Events (Offshore) Fund and Master Fund ("PASE")**

PASE is managed by the same portfolio manager and employs the same investment strategy as the PARAPF. PASE consists of the Pengana Asia Special Events (Offshore) Fund ("**Offshore Fund**") and the Pengana Asia Special Events Master Fund ("**Master Fund**"). The investments for this strategy are held in the Master Fund.

The two funds were incorporated as exempted companies with limited liability under the provisions of the Companies Law (as amended) of the Cayman Islands on 28 May 2008. Each of the Offshore Fund and Master Fund are registered as regulated mutual funds under the Mutual Funds Law. The investment objectives of PASE are as follows:

- For AUD shares in PASE, the objective is to generate a net annualised return greater than 5% above the RBA Cash Rate Target over a three to five year period with low volatility and low correlation to Asian security markets.
- For USD shares in PASE, the objective is to generate a net annualised return greater than 5% above the Federal Funds Rate over a three to five year period with low volatility and low correlation to Asian security markets.

The minimum initial subscription amount is US$250,000 for USD shares and AUD$250,000 for AUD shares. PASE charges a management fee of 1.5% per annum and a performance fee of 20% of any increase in the NAV.

As at 28 February 2017, PASE had $20.4 million in FUM with 83% in USD shares.

**Pengana International Equities Fund Managed Risk ("PIEFMR")**

The fund is a managed risk version of the IEF which was seeded on 22 June 2016. The strategy has been designed for investors who are seeking an investment in global securities but are concerned with the risks and potential events that may cause equity markets to fall. It will be marketed to high-net-worth clients and a select group of boutique dealer groups. An investment in the PIEFMR consists of units in the IEF and a derivative overlay which dynamically reduces the exposure to the market during periods of higher risk and equity market falls. Pengana has appointed Milliman Pty Ltd ("**Milliman**") as a sub-advisor to run the overlay which is effectively comprised of two components:

- **Volatility management:** Dynamic adjustment of the equity exposure to stabilise portfolio volatility of returns.
- **Capital protection:** Increase effective cash to reduce losses in severe market declines.

In addition to the investment objective of the IEF, the PIEFMR has an additional objective to stabilise portfolio return volatility, capture growth in up markets and defend against sustained market falls.

The PIEFMR charges a management fee of 1.334% per annum including capped expense recovery amount (including GST net of RITC) and a performance fee of 15.375% (including GST net of RITC) of any percentage increase in the NAV which is greater than the MSCI ACWI Net AUD unhedged after deduction of the capped expense recovery amount and the management fee and adjusted for applications, redemptions and distributions to investors.

As at 28 February 2017, the fund had $3.5 million of seed capital.

## 5.5 Key personnel

The investment team is comprised of:

| Name | Fund | Title | Tenure (years) | Industry Experience (years) | Prior Experience |
|---|---|---|---|---|---|
| **Rhett Kessler** | AEF | Senior Fund Manager | 9 | 24 | IAG Asset Management, UBS Australia, Liberty Asset Management |
| **Anton Du Preez** | AEF | Fund Manager | 7 | 20 | RMB Fund, PSG Asset Management, ABN Amro |
| **Ed Prendergast** | ECF | Senior Fund Manager | 12 | 23 | Citigroup, ABN Amro |
| **Steve Black** | ECF | Senior Fund Manager | 12 | 21 | Goldman Sachs, JBWere |
| **George Mussalli** | PanAgora Fund | CIO & Head of Research at PanAgora | 17 | 22 | Putnam Investments, John Hancock Funds |
| **Richard Tan** | PanAgora Fund | Fund Manager, Director Equity at PanAgora | 8 | 19 | Wellington Management, Fidelity Investments, Accenture |
| **Antonio Meroni** | PARAPF | Senior Fund Manager | 9 | 26 | Rubicon, Antiro Abacus, Credit Suisse, Von Ernst |
| **Vikas Kumra** | PARAPF | Fund Manager | 8 | 11 | Credit Suisse HOLT division |
| **Jordan Cvetanovski** | IEF | CIO & Portfolio Manager | 1 | 16 | Carmignac Gestion, Robeco, Platinum, BTIM |
| **Steven Glass** | IEF | Head of Research & Portfolio Manager | 2 | 17 | Hunter Hall, Tricom, Platinum |
| **Leah Zell, PhD** | GSC | CIO at Lizard | 8 | 38 | Lehman Brothers, Harris Associates, Columbia Wanger Asset Management, Acorn International Fund, Wanger Asset Management |
| **Jon Moog, CFA** | GSC | Portfolio Manager at Lizard | 8 | 14 | Brightpoint Capital, Loomis, Sayles & Co |

*Source: Pengana*

The current Senior Management team of Pengana (excluding investment team) comprises of:

**Table 12: Pengana Senior Management team**

| Name and title | Experience |
|---|---|
| **Russel Pillemer**<br>Director & CEO | Russel Pillemer co-founded Pengana in 2003 together with Malcolm Turnbull. He has been the company's Chief Executive Officer since inception. Prior to founding Pengana, Russel worked in the Investment Banking Division of Goldman Sachs in New York where he specialised in providing advice to funds management businesses. Before moving to New York, he was responsible for leading Goldman Sachs' Australian Financial Institutions Group. Russel was previously Chairman of Centric Wealth Group and a Principal of Turnbull Pillemer Capital. |
| **Damian Crowley**<br>Director of Distribution | Damian Crowley is the Director of Distribution for Pengana and has responsibility for all the distribution of Pengana's funds in Australia and offshore across multiple channels and client segments. Damian joined Pengana in July 2011 and has over 25 years' experience in financial services distribution. Prior to joining Pengana, Damian worked at Perpetual Investments for 17 years most recently as General Manager Distribution for the past 12 years. |
| **Nick Griffiths**<br>Director & CIO | As Chief Investment Officer, Nick is responsible for manager monitoring, performance analysis and risk management across Pengana's investment strategies. He also chairs the Risk Management Committee and is an Executive Director of Pengana Capital. Nick has more than 20 years' experience in the actuarial and investment industries in the UK and Australia. Prior to his current role, Nick was Head of Investment Research within Aon's Investment Consulting Practice in Sydney. |
| **Katrina Glendinning**<br>Director & CFO | Katrina is the Chief Financial Officer of Pengana and has held this role since the inception of the company in 2003. She is an Executive Director of Pengana Capital and is a member of Pengana's Compliance and Risk Committees. Katrina is an experienced financial services executive with over 25 years' experience across a diverse range of products, investors and regulatory regimes. Prior to joining Pengana, Katrina was an Executive Vice President at BT Funds Management (BT) where she held a number of roles and prior to that worked for Price Waterhouse for over nine years specialising in banking and financial services audit. |
| **Adam Myers**<br>Executive Director | Adam Myers is an executive director with oversight of strategic initiatives and responsibility for the quantitative and structuring capability within the group. Adam developed an appreciation of market risk during a 15 year career trading equity derivatives, structuring derivative transactions and managing equity derivative traders. Prior to joining Pengana he headed the Equity Derivatives business at Investec Bank in South Africa and the Corporate Equity Structuring function at Investec Bank in Australia. |

*Source: Pengana*

The Board of Directors of Pengana comprises of:

**Table 13: Directors of Pengana**

| Directors | Experience |
|---|---|
| **Robert Barry**<br>Chairman | Robert Barry is currently the chairman of Pengana Holdings. He was previously Chairman of Snowy Hydro Limited, Deputy Chairman of AWB Limited and chairman or director of a number of other public and charitable organisations. He has spent 27 years in the investment banking industry. He co-founded the Dominguez & Barry Group and was chief executive of Dominguez Barry Samuel Montagu Limited, a predecessor to UBS Australia. He has had extensive experience in the financial services industry, both in Australia and internationally with three years in London as head of International Capital Markets for the Midland Bank Group. |
| **Warwick Negus**<br>Non-executive director | Warwick Negus is a non-executive director at Pengana Holdings. Warwick was previously CEO of Colonial Fist State Global Asset Management, co-founder of 452 Capital and Managing Director of Goldman Sachs Asset Management. |
| **Jeremy Dunkel**<br>Non-executive director | Jeremy Dunkel is a non-executive director at Pengana Holdings, and a director of Taurus Capital, a family office investment consultancy specialising in philanthropy. His accounting and finance experience includes working for Chemical Bank, Chase Manhattan and Price Waterhouse. He is a director of Education Heritage Foundation, and the Moriah College Foundation, as well as the chair of Y2i. |
| **Dean Smorgon**<br>Non-executive director | Dean Smorgon is a non-executive director at Pengana Holdings. Dean graduated from Monash University with a Bachelor of Economics degree before commencing his stockbroking career at ANZ McCaughan Securities in 1991. Dean then joined HSBC James Capel in 1996 where he continued to develop his industry knowledge base. Dean later took up the role of senior advisor at ABN AMRO in 1999 and then continued on as Associate Director until 2008 at ABN AMRO Morgans. He has been a Director of Wealth Management at Canaccord Genuity since 2008 and sits on numerous family office boards. |
| **Russel Pillemer**<br>Executive director | Refer to Table 12 above. |

*Source: Pengana*

## 5.6 Financial performance

The audited statements of financial performance for the two years ended 30 June 2015 and 2016, and the reviewed statement of financial performance for the 6 months to 31 December 2016 are set out in the table below.

**Table 14: Pengana's financial performance**

| $'000 | FY15 | FY16 | 6 months to Dec-16 |
|---|---|---|---|
| **Revenue** | | | |
| Management fees | 16,139 | 18,846 | 11,371 |
| Performance fees | 27,440 | 16,505 | 9,028 |
| **Total revenue** | **43,579** | **35,351** | **20,399** |
| **Other gains / (losses)** | | | |
| Share of profits / (losses) of associates accounted for using the equity method | 1,599 | (746) | 426 |
| Net gain / (loss) on financial instruments held at fair value through profit or loss | 111 | (345) | - |
| Net changes in fair value of held-for-trading financial assets | (22) | (56) | - |
| Other revenue / income | 428 | 315 | 182 |
| Net change in assets attributable to unitholders | - | 45 | - |
| **Expenses** | | | |
| Human resources expenses | (9,193) | (9,810) | (4,641) |
| Team distribution expenses | (17,752) | (13,672) | (8,268) |
| Fund administration expenses | (2,831) | (2,890) | (1,079) |
| Distribution expenses | (1,047) | (1,621) | (521) |
| Occupancy expenses | (1,013) | (953) | (494) |
| IT and telecommunication expenses | (1,124) | (1,182) | (557) |
| Marketing, travel and entertainment expenses | (451) | (845) | (392) |
| Legal, accounting and consulting expenses | (483) | (497) | (199) |
| Other operating expenses | (406) | (397) | (148) |
| Loss on disposal of fixed assets | (28) | (4) | - |
| **Total expenses** | **(34,328)** | **(31,871)** | **(16,298)** |
| **EBITDA** | **11,367** | **2,693** | **4,709** |
| Depreciation and amortisation | (257) | (203) | (96) |
| **EBIT** | **11,110** | **2,490** | **4,613** |
| Interest income | 264 | 82 | 43 |
| Finance costs | (921) | (201) | 4 |
| **Net profit before tax** | **10,453** | **2,371** | **4,660** |
| Income tax expense | (3,206) | (362) | (1,398) |
| **Net profit after tax** | **7,247** | **2,009** | **3,262** |
| **Profit for the year attributable to:** | | | |
| Non-controlling interest | 7 | 23 | - |
| Owners of Pengana Holdings Pty Ltd | 7,240 | 1,986 | 3,262 |
| | **7,247** | **2,009** | **3,262** |
| **Other financial information** | | | |
| FUM (average) ($m) | 1,271 | 1,552 | 1,942 |
| EBITDA margin | 26% | 8% | 23% |
| EBIT margin | 25% | 7% | 23% |
| Revenue (as a % of FUM) | 3.43% | 2.28% | 2.10% |
| Expenses (as a % of FUM) | 2.70% | 2.05% | 1.68% |

*Source: Pengana*

In relation to the historical financial performance of Pengana set out above, we note the following:

- Management fees have been experiencing a steady increase over the three years which is consistent with the growth in FUM.
- Performance fees are dependent on fund performance. The structure of Pengana's fund performance benchmarks results in a higher likelihood of funds achieving those performance hurdles compared to their peers. Pengana is also currently pursuing a strategy of managing non-correlated funds in order to mitigate variations in year-on-year fees. However, the current mix of funds is still heavily concentrated in the two mature Australian Equities and Australian Emerging Companies funds which has resulted in significant fluctuations in performance fees over the period FY15 to December 2016.
- Share of profits of associates over the period relates to Pengana's equity-accounted investments in PASE, IEF, PIEFMR, PARAPF, GSC, and Pengana Global Resources Fund (now closed). These represent initial investments to provide the funds with a minimum scale.
- Human resources expenses have increased from FY15 to FY16. This is primarily due to redundancy costs associated with the winding up of the Global Resources Fund.
- Team distribution expenses represent the profit sharing arrangements with fund managers. Movement in this expense is largely correlated to the profitability of the funds.
- Fund administration expenses comprise fund direct expenses which are relatively stable and driven by size of FUM and client numbers.
- Other expenses incurred by Pengana are mainly support and back-office overheads as well as marketing and distribution costs.

In relation to the above, we note that Pengana's statutory profit includes Pengana's share of profits / (losses) in associates, adding to the volatility in statutory profit attributable to fluctuations in performance fees. The following table presents normalised operating results based on unaudited management accounts, excluding profits / (losses) from associates and other minor year-end adjustments.

**Table 15: Operating results**

| $'000 | FY15 | FY16 | 6 months to Dec-16 |
|---|---|---|---|
| **Revenue** | | | |
| Management fees | 16,353 | 18,384 | 11,168 |
| Performance fees | 27,604 | 16,663 | 9,038 |
| **Total revenue** | **43,957** | **35,047** | **20,205** |
| **Expenses** | | | |
| Team distributions and fund-related expenses | (21,085) | (17,114) | (10,159) |
| Operating expenses | (12,380) | (13,549) | (6,267) |
| **Total expenses** | **(33,465)** | **(30,663)** | **(16,426)** |
| **EBITDA** | **10,492** | **4,384** | **3,779** |
| Depreciation and amortisation | (257) | (203) | (96) |
| **EBIT** | **10,235** | **4,181** | **3,683** |
| **Other financial information** | | | |
| FUM (average) ($m) | 1,271 | 1,552 | 1,942 |
| EBITDA margin | 24% | 13% | 19% |
| EBIT margin | 23% | 12% | 18% |
| Revenue (as a % of FUM) | 3.46% | 2.26% | 2.08% |
| Expenses (as a % of FUM) | 2.63% | 1.98% | 1.69% |

*Source: Pengana*

## 5.7 Financial position

The audited statements of financial position as at 30 June 2015 and 2016, and the reviewed statement of financial position as at 31 December 2016 are set out in the table below.

**Table 16: Pengana's financial position**

| $'000 | Jun-15 | Jun-16 | Dec-16 |
|---|---|---|---|
| **Current asset** | | | |
| Cash and cash equivalents | 5,958 | 6,347 | 6,529 |
| Trade and other receivables | 4,977 | 7,153 | 2,487 |
| Financial assets at fair value | 1,011 | 3,620 | - |
| Derivative financial instruments | - | 29 | - |
| Income tax refund due | - | 319 | - |
| Other current assets | 365 | 511 | 700 |
| **Total current assets** | **12,311** | **17,979** | **9,716** |
| **Non-current assets** | | | |
| Other receivables | 953 | 842 | 842 |
| Investments accounted for using the equity method | 22,480 | 21,726 | 23,362 |
| Property, plant and equipment | 411 | 314 | 395 |
| Deferred tax | 937 | 813 | 810 |
| Loan to shareholders | 1,935 | 1,935 | 1,882 |
| **Total non-current assets** | **26,716** | **25,630** | **27,291** |
| **Total assets** | **39,027** | **43,609** | **37,007** |
| **Current liabilities** | | | |
| Trade and other payables | (6,707) | (8,971) | (6,869) |
| Derivative financial instruments | (2) | (11) | - |
| Income tax liability | (1,488) | - | (378) |
| Employee benefits | (451) | (274) | (274) |
| **Total current liabilities** | **(8,648)** | **(9,256)** | **(7,522)** |
| **Non-current liabilities** | | | |
| Security deposits held | (71) | (18) | - |
| Employee benefits | (303) | (240) | (240) |
| **Total non-current liabilities** | **(374)** | **(258)** | **(240)** |
| **Total liabilities** | **(9,022)** | **(9,514)** | **(7,761)** |
| **Net assets** | **30,005** | **34,095** | **29,246** |

*Source: Pengana*

*Note: The audited statement of financial position as at 30 June 2016 recognised "Net assets attributable to unitholders" as a liability. We have restated net assets as at 30 June 2016 by including "Net assets attributable to unitholders" in equity as it is the "minority" interest that non-controlling unitholders have in funds which have been consolidated by Pengana.*

In relation to the historical financial position of Pengana set out above, we note the following:

- Pengana is required to maintain a minimum balance of $5 million in regulatory capital under the terms of its Australian Financial Services Licence ("**AFSL**"). Of this, half is to be held in cash or "cash-like" items while the remainder can be held in other forms of liquid assets.
- Trade and other receivables consist mainly of trade receivables and accrued income which relate to management and performance fees. The increase in receivables in FY16 was largely driven by a redeemed investment in the PanAgora Fund.
- Financial assets at fair value comprise listed shares held for trading.
- Pengana's equity-accounted investments consist of initial investments in its own funds.
- Loans to shareholders are made to assist senior management and fund managers in acquiring equity. These loans do not have a set repayment schedule. Interest on these loans is minimal.
- Borrowings of $11.7 million were repaid during FY15. These borrowings mainly related to a bank loan drawn to invest in the Pengana Absolute Return Asia Pacific Fund.

On 1 and 3 March 2017, the CEO and key executives were provided with limited recourse loans totalling $27.2 million to purchase shares in Pengana under a loan-funded employee share plan. Under this arrangement, the key executives were issued 58,075 new shares which vest after five years of continuous service and the CEO received 132,040 shares with different vesting conditions including listing on the ASX or another exchange. These CEO shares were transferred from other holders.

In the following table, we have presented the unaudited balance sheet as at 28 February 2017 with proforma adjustments for the effects of Pengana's share buyback (as part of the loan-funded employee share plan), repayments of shareholder loans and a dividend payment.

**Table 17: Proforma balance sheet (Feb 2017)**

| $'000 | Actual Feb-17 | Proforma adjustments | Proforma Feb-17 |
|---|---|---|---|
| **Current asset** | | | |
| Cash and cash equivalents | 23,911 | (18,469) | 5,441 |
| Trade and other receivables | 2,191 | - | 2,191 |
| Income tax refund due | 237 | - | 237 |
| Other current assets | 1,147 | - | 1,147 |
| **Total current assets** | **27,485** | **(18,469)** | **9,016** |
| **Non-current assets** | | | |
| Other receivables | 442 | - | 442 |
| Investments | 3,479 | - | 3,479 |
| Property, plant and equipment | 378 | - | 378 |
| Deferred tax | 810 | - | 810 |
| Loan to shareholders | 2,282 | (466) | 1,816 |
| **Total non-current assets** | **7,390** | **(466)** | **6,925** |
| **Total assets** | **34,875** | **(18,935)** | **15,940** |
| **Liabilities** | | | |
| Trade and other payables | (4,318) | 30 | (4,288) |
| Employee benefits | (240) | - | (240) |
| **Total liabilities** | **(4,557)** | **30** | **(4,528)** |
| **Net assets** | **30,318** | **(18,905)** | **11,413** |

*Source: Pengana*

In relation to the above proforma balance sheet, we note that:

- The significant reduction in net assets is a result of the issue and transfer of employee shares under the loan-funded employee share plan funded through a redemption of units in two funds.
- The limited recourse loans are not recognised on the balance sheet for accounting purposes as the loans and their related shares effectively provide employees with an option to purchase shares in Pengana for the loan amount. In substance, these arrangements represent share options and they have been treated as such for accounting.

## 5.8 Capital structure and shareholders

As at 10 April 2017, Pengana had a total of 616,816 ordinary shares on issue (including the 190,115 shares issued or transferred to executives and the CEO under the employee share plan). There were no other options, convertible notes or other potential shares. The following table sets out details of Pengana's substantial shareholders as at that date:

**Table 18: Pengana's substantial shareholders**

| Shareholder | Shares held | % total shares |
|---|---|---|
| Washington H Soul Pattinson and Company Limited | 226,076 | 36.7% |
| Russel Craig Pillemer | 218,140 | 35.4% |
| Other shareholders | 172,600 | 28.0% |
| **Total** | **616,816** | **100.0%** |

*Source: Pengana*
*Note: WHSP acquired its stake in Pengana from NAB on 1 March 2017.*

# 6 PROFILE OF PROPOSED MERGED ENTITY

## 6.1 Introduction

The Proposed Merged Entity will consist of the integrated Hunter Hall and Pengana following the Proposed Transaction. It will remain listed on the ASX and it is proposed that the entity will be renamed Pengana Capital Group. A significant amount of cost synergies, which represent a key part of the strategic rationale for the transaction, are expected to be realised through the merger. These synergies originate from streamlining of front and back office operations, occupancy costs, marketing / distribution and process improvements.

The merger is also expected to be highly complementary with significant economies of scale due to an increase in total FUM to approximately $3 billion and expansion of existing distribution capabilities. The merged entity will maintain the current Hunter Hall ethical screen for Hunter Hall's funds and it is proposed that the ethical screen will be applied to the Proposed Merged Entity's international fund strategies going forward.

## 6.2 Funds and ratings

The main funds which will be managed by the Proposed Merged Entity with their current ratings are as follows.

**Table 19: Hunter Hall fund ratings**

| Fund | FUM ($'m) | Lonsec | Mercer | Morningstar | IIR |
|---|---|---|---|---|---|
| VGT | 452 | Sell | B, ESG2 | Negative | n/a |
| HHV | 308 | Sell | n/a | Negative | Under Review |
| GET | 82 | Sell | B, ESG2 | n/a | n/a |
| HCT | 43 | n/a | n/a | n/a | n/a |
| AVT | 32 | Sell | B, ESG2 | n/a | n/a |
| GDG | 5 | n/a | n/a | n/a | n/a |

*Source: Hunter Hall*

**Table 20: Pengana fund ratings**

| Fund | FUM ($'m) | Lonsec | Mercer | Morningstar | SQM | Zenith |
|---|---|---|---|---|---|---|
| AEF | 1,210 | Recommended | B+ | n/a | n/a | Recommended |
| ECF | 739 | Highly Recommended | A- | Silver | n/a | Recommended |
| PanAgora Fund | 116 | Investment Grade | n/a | n/a | n/a | Recommended |
| PARAPF | 49 | Investment Grade | B+ | n/a | Superior | Approved |
| IEF | 16 | n/a | n/a | n/a | Favourable | n/a |
| GSC | 10 | Recommended | n/a | n/a | Superior | Approved |

*Source: Pengana*

Detailed descriptions of these funds are provided in Sections 4 and 5 respectively.

## 6.3 Key personnel

The proposed Board of Directors of the Proposed Merged Entity will consist of six directors as follows:

**Figure 15: Directors of Proposed Merged Entity**

| Directors | Description |
|---|---|
| **Warwick Negus**<br>Chairman | Former CEO of Colonial First State Global Asset Management, co-founder of 452 Capital and Managing Director of Goldman Sachs Asset Management |
| **Russel Pillemer**<br>CEO | Founder and Managing Director of Pengana and second largest Pengana shareholder |
| **Kevin Eley** | Current Hunter Hall Chairman |
| **David Groves** | Current Hunter Hall Board member |
| **Robert Barry** | Current Pengana Chairman and co-founder of Dominguez & Barry. Former CEO of Dominguez Barry Samuel Montagu Limited |
| **Jeremy Dunkel** | Founding Director of Pengana |

## 6.4 Post-merger capital structure

The following table summarises the major shareholdings in the Proposed Merged Entity after acquisition:

**Figure 16: Proposed Merged Entity substantial shareholding**

| Shareholder | Shares held | % total shares |
|---|---|---|
| Washington H Soul Pattinson and Company Limited | 39,827,865 | 39.2% |
| Russel Craig Pillemer | 26,222,572 | 25.8% |
| Other shareholders | 35,426,551 | 34.9% |
| **Total** | **101,476,988** | **100.0%** |

*Source: Hunter Hall and Pengana*

## 6.5 Proforma financial performance

Proforma statements of financial performance have not been prepared. Thus, we have not presented this information.

## 6.6 Proforma financial position

The historical statements of financial position for Hunter Hall and Pengana as at 31 December 2016 have been presented on a proforma, combined basis in the following table:

| $'000 | Pengana Dec-16 | Hunter Hall Dec-16 | Proforma adjustments | Proposed Merged Entity |
|---|---|---|---|---|
| **Current assets** | | | | |
| Cash and cash equivalents | 6,529 | 16,809 | (4,200) | 19,138 |
| Trade and other receivables | 2,487 | 3,716 | - | 6,203 |
| Financial assets at fair value | - | 278 | - | 278 |
| Other current assets | 700 | - | - | 700 |
| **Total current assets** | **9,716** | **20,803** | **(4,200)** | **26,319** |
| **Non-current assets** | | | | |
| Other receivables | 842 | - | - | 842 |
| Investments accounted for using the equity method | 23,362 | - | (18,900) | 4,462 |
| Financial assets | - | 42,848 | - | 42,848 |
| Property, plant and equipment | 395 | 313 | - | 708 |
| Deferred tax assets | 810 | 573 | - | 1,383 |
| Loan to shareholders | 1,882 | - | - | 1,882 |
| Intangible assets | - | 151 | 47,556 | 47,707 |
| **Total non-current assets** | **27,291** | **43,885** | **28,656** | **99,832** |
| **Total assets** | **37,007** | **64,688** | **24,456** | **126,151** |
| **Current liabilities** | | | | |
| Trade and other payables | (6,869) | (2,286) | - | (9,155) |
| Income tax liability | (378) | (296) | - | (674) |
| Employee benefits | (274) | - | - | (274) |
| Short term provisions | - | (787) | - | (787) |
| **Total current liabilities** | **(7,522)** | **(3,369)** | **-** | **(10,891)** |
| **Non-current liabilities** | | | | |
| Employee benefits | (240) | - | - | (240) |
| Long term provisions | - | (325) | - | (325) |
| Deferred tax liabilities | - | (173) | - | (173) |
| **Total non-current liabilities** | **(240)** | **(498)** | **-** | **(738)** |
| **Total liabilities** | **(7,761)** | **(3,867)** | **-** | **(11,628)** |
| **Net assets** | **29,246** | **60,821** | **24,456** | **114,523** |

*Source: Hunter Hall and Pengana*
*Note: The above Hunter Hall statement of financial position as at 31 December 2016 includes the effects of seeded fund consolidation which we have excluded from the statements of financial position presented in Section 4.6.*

The above proforma adjustments relate to:

- Transaction costs of $4.2 million relating to the Proposed Transaction.
- Reduction in net assets as a result of the loan-funded employee share plan discussed in Section 5.7 (funded through redemption of units in two funds).
- Provisional accounting entries relating to the intangible assets acquired as part of the Proposed Transaction.

# 7 VALUATION METHODOLOGY

## 7.1 Available valuation methodologies

To estimate the fair market value of Hunter Hall and the Proposed Merged Entity we have considered common market practice and the valuation methodologies recommended in RG111. There are a number of methods that can be used to value a business including:

- The discounted cash flow method
- The capitalisation of earnings method
- Asset based methods
- Analysis of share market trading
- Industry specific rules of thumb

Each of these methods is appropriate in certain circumstances and often more than one approach is applied, at least as a secondary cross-check to a primary method. The choice of methods depends on factors such as the nature of the business being valued, the return on the assets employed in the business, the valuation methodologies usually applied to value such businesses and the availability of the required information. A detailed description of these methods and when they are appropriate is provided in Appendix 2.

## 7.2 Selected methodology – Hunter Hall

In selecting an appropriate valuation methodology to value Hunter Hall, we have considered the following factors:

- Hunter Hall is neither an asset based business nor an investment holding company. It is also considered to be a going concern, thus an asset approach is not appropriate.
- Due to the recent departure of Peter Hall and the expectation of FUM outflows for Hunter Hall in the short to medium term, there are a limited number of listed companies with businesses that are directly comparable to Hunter Hall as the earnings of other listed investment management businesses are unlikely to include an expectation of significant FUM outflows. This limits the reliability of the capitalisation of earnings approach.
- Hunter Hall has experienced a significant change in its business recently with the retirement of founder and Chief Investment Officer, Peter Hall. The potential impact of this change (in the form of potential loss in FUM and consequent impact on revenue and earnings) in the short to medium term can be best estimated using a discounted cash flow analysis.

Accordingly, we are of the opinion that the most appropriate methodology to value Hunter Hall is the discounted cash flow method with a capitalisation of earnings and analysis of share market trading as cross-checks.

## 7.3 Selected methodology – Proposed Merged Entity

In selecting an appropriate valuation methodology to value the Proposed Merged Entity we have considered the following factors:

- While it would be possible to assess the value of the Proposed Merged Entity by aggregating an assessed value for Pengana with our assessed value Hunter Hall, this approach would not reliably capture estimated synergies, transaction costs, diversification and scale benefits of the merged business. Thus, we believe it is appropriate to value the Proposed Merged Entity as a single combined business.
- The Proposed Merged Entity would not be an asset based business nor an investment holding company. It is also considered to be a going concern, thus an asset approach is not appropriate.
- There are a limited number of listed companies with businesses that are directly comparable to the Proposed Merged Entity for the reasons discussed above. This limits the reliability of the capitalisation of earnings approach.
- The uncertainty surrounding FUM outflows for Hunter Hall and the strong FUM inflows projected for Pengana are both best captured with a discounted cash flow analysis.

- A detailed financial model has been prepared for Pengana. This can be aggregated with the cash flow model for Hunter Hall, with adjustments made for expected synergies and transaction costs, to derive a cash flow model for the Proposed Merged Entity. This aggregated model provides a reasonable basis for a discounted cash flow analysis.
- Proposed Merged Entity shares do not currently exist, thus market trading cannot be directly observed. However, to the extent that the market expects the Proposed Transaction to complete, market trading in Hunter Hall shares after the Proposed Transaction was announced may give an indication of the market's assessment of the value per share of the Proposed Merged Entity.

While the recent acquisition of a significant stake in Pengana by WHSP could be used as a cross-check to the reasonableness of the valuation of Pengana as part of the Proposed Merged Entity, there are a number of problems with this approach including:

- Due to confidentiality restrictions, we are unable to disclose any details of the transaction, thus any analysis we undertook could not be presented in our report.
- We understand there were certain constraints affecting the transaction, that may have affected the price paid. Thus, the price is unlikely to be representative of a fair market value. We are unable to provide further details of these constraints for confidentiality reasons.
- The Pengana shares acquired by WHSP were a minority position in an unlisted company. Such holdings generally trade at lower prices than listed company shares due to investors' preference for liquidity. This difference is referred to as a discount for lack of marketability and can typically range from 10% to 40%.

Accordingly, we are of the opinion that the most appropriate methodology to value the Proposed Merged Entity is the discounted cash flow method with a capitalisation of earnings and analysis of share market trading in Hunter Hall shares post announcement of the Proposed Transaction as cross-checks.

# 8 VALUATION OF HUNTER HALL

## 8.1 Background

We have assessed the fair market value of Hunter Hall using the discounted cash flow method, with cross-checks by reference to the capitalisation of earnings method and an analysis of recent share marketing trading in Hunter Hall shares. This assessment has been made on a control basis which is consistent with our treatment of the Proposed Transaction as a takeover offer as Pengana's shareholders are seeking to acquire control of Hunter Hall via the Proposed Transaction.

## 8.2 Discounted cash flow

In order to determine the value of a Hunter Hall share on a control basis using the discounted cash flow method, we have considered the following:

- An analysis of projected cash flows
- The determination of an appropriate discount rate
- The determination of a terminal value beyond the projected cash flow period
- The value of any surplus assets
- The value of non-operating liabilities
- The level of surplus cash held

These are discussed below.

### 8.2.1 Projected cash flows

We have been provided with a detailed financial forecast for the period from March 2017 to FY19 prepared by Hunter Hall's management. This forecast has been reviewed by the board of Hunter Hall. We have discussed the assumptions behind the forecast with Hunter Hall's management and considered the risks associated with achieving the forecast in order to assess the likelihood of the forecast being achieved. In particular, we have considered the following key drivers of the Hunter Hall business:

- Likely future FUM flows particularly in light of the recent resignation of Peter Hall and current performance of the funds
- Fund performance over the forecast period
- The terms of the IMA for HHV and the likelihood of these management rights being terminated or otherwise impacted prior to the expiry of the IMA in 2029

In our previous report, dated 1 February 2017 in relation to the Takeover Offer from WHSP, we included three potential cash flow scenarios due to the significant uncertainties facing Hunter Hall. As a result of the HHV shareholder meeting rejecting the board appointments proposed by WAM, a significant uncertainty for Hunter Hall has been removed. We have therefore adopted a single scenario representing our best assessment of the future cash flows for Hunter Hall. The key assumptions are set out below.

**Revenue**

Hunter Hall generates revenue based on FUM multiplied by the relevant management fee for each fund. FUM is calculated based on the following:

| | |
|---|---|
| | **Opening FUM** |
| *Plus* | Net FUM flows |
| *Less* | Distributions |
| *Plus* | Net performance growth |
| *Equals* | **Closing FUM** |

In respect of management's FUM assumptions we note:

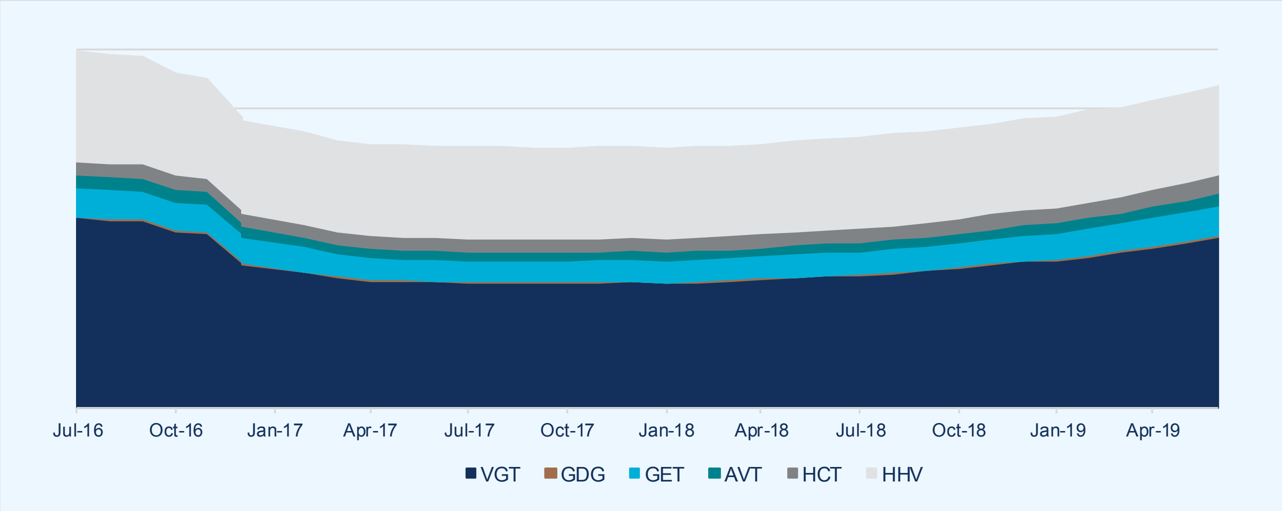
**Table 21: FUM Assumptions**

| Assumption | Leadenhall comment |
|---|---|
| **Inflows / outflows**<br><br>There has been some loss in FUM since Peter Hall announced his resignation and intention to sell his shareholding in Hunter Hall to WHSP.<br><br>Management have assumed that most investors who would be influenced by the departure of Peter Hall would have acted quickly in redeeming their investments. To date, FUM outflows were the highest in January 2017 with a slight decline in outflows in February 2017. FUM outflows beyond February 2017 are forecast to gradually move to a modest net monthly inflow position after 10 months.<br><br>We have not presented the precise assumptions adopted due to the commercially sensitive nature of this information. | We do not consider the FUM assumptions adopted by Hunter Hall management beyond February 2017 to be unreasonable due to the following factors:<br><br>♦ While actual FUM outflows to date have been slightly higher than expected, mainly due to higher than anticipated outflows in February 2017, the difference has been small at approximately \$11 million out of total FUM of \$923 million.<br><br>♦ The experienced investment team remaining at Hunter Hall. The interim Chief Investment Officer, James McDonald has been working with Peter Hall as the Deputy Chief Investment Officer for a number of years and has a deep understanding of the funds managed by Hunter Hall and its investment philosophy. We understand that James is well known by investors and has been heavily involved in marketing and investor presentation activities in the past. This, along with the stability of the rest of the Hunter Hall investment team should provide some reassurance to investors regarding the future of Hunter Hall.<br><br>♦ A number of the major ratings agencies had hold or sell positions on Hunter Hall funds prior to the resignation of Peter Hall with two subsequent ratings downgrades in January 2017. These downgrades resulted in an increase in outflows in early February but have been on a downward trend since. It is unlikely that any further downgrades would have a significant impact on the investment decisions of dealers with research coverage.<br><br>♦ None of the funds have any significant individual or institutional investors that would result in a large drop in FUM if they withdrew their investment. Furthermore, the composition of FUM is primarily retail investors that tend to be more sticky relative to larger institutional investors.<br><br>Overall management assumptions beyond February 2017 do not appear unreasonable. |

<table>
<tr><th>Assumption</th><th>Leadenhall comment</th></tr>
<tr><td>HHV<br><br>The existing IMA with HHV has approximately 12 years remaining. Upon the expiration of the existing agreement a new agreement would need to be negotiated.<br><br>Management have assumed that HHIML is retained as the investment manager of HHV indefinitely through continuing renewals of the IMA and that there is no buy-back undertaken by HHV.</td><td>We do not consider the assumptions in respect of the IMA for HHV adopted by Hunter Hall management to be unreasonable due to the following factors:<br><br>♦ We consider it reasonable to assume that HHIML is retained as the investment manager for HHV for the duration of the IMA due to the protection of HHIML's role afforded by the IMA as discussed in Section 4.3.<br><br>♦ Given the cost and uncertainty involved with appointing a new investment manager (in particular one with a similar investment strategy), and in the absence of any information to the contrary, we have also assumed the IMA is renewed at the end of its term on similar terms to the current arrangement.</td></tr>
<tr><td>Fund performance<br><br>Annualised performance of 2.5% is forecast across all funds for FY17, increasing to 5% thereafter.<br><br>The long-term assumption of 5% per annum is based on Hunter Hall's long term average return on the largest two funds over the past ten years.<br><br>The assumed performance is lower in FY17 due to relatively high cash weightings and the potential liquidation of the more illiquid positions across the portfolio.</td><td>We do not consider the assumptions in respect of fund performance to be unreasonable due to the following factors:<br><br>♦ The long-term assumption of 5% per annum is consistent with the average return on the largest two funds over the past ten years.<br><br>♦ Portfolio composition, in particular the relative high cash weighting at the moment, coupled with the existing low-interest rate environment will continue drag on returns in the short-term.<br><br>We also note that once gains are realised, they are paid out as distributions, thus this assumption needs to be considered in conjunction with the distribution assumption discussed below. Thus, alternative assumptions for fund performance do not have a significant impact on the valuation conclusion.</td></tr>
<tr><td>Distributions<br><br>Distributions (dividends in the case of HHV) are paid twice annually and increase over the forecast period as performance is forecast to improve.</td><td>We do not consider the assumptions in respect of distributions to be unreasonable due to the following factors:<br><br>♦ Distributions are projected to exceed market growth, thus overall reducing FUM before the impact of inflows. This is projected in the near term due to a level of unrealised gains in the portfolios managed by Hunter Hall and is therefore not unreasonable.</td></tr>
</table>

The figure below sets out forecast closing monthly FUM, based on the assumptions described above.

**Figure 17: Actual and forecast closing monthly FUM July 2016 to June 2019**




*Source: Hunter Hall and Leadenhall analysis*

To calculate revenue, the average FUM is multiplied by the management fee for each fund, net of non-rebateable GST. The management fee for each fund is set out in Table 5. We consider that, despite the potential for fee compression over the longer term, it is reasonable to assume flat management fees given Hunter Hall's specialist investment strategy and level of retail investment which is likely to result in less investor fee sensitivity.

We have assumed average semi-annual performance fees of 0.1% of FUM based on an analysis of historical performance fees received. We note there will be periods in which no such fees are earned, but over time there is equal likelihood they will be achieved compared to past performance.

### Operating expenses

In respect of the operating expense assumptions we note:

- FY17 operating expense assumptions are based on the second half of the Hunter Hall FY17 budget. FY17 expenses are largely in line with previous years.
- January and February 2017 operating expenses are, in large part, tracking against budget with minor positive and negative differences to budget generally offsetting each other.
- Hunter Hall are in the process of closing their London office and expect that this will be complete by May 2017.
- FY18 expenses are expected to be in line with FY17 after taking into account cost savings from the closure of the London office and 3.0% growth is assumed on the majority of expenses in FY19.
- Staff incentives are linked to operating profit and are in line with agreed parameters.
- Charitable donations have been forecast as a percentage of operating profit in line with historical actuals.

We have excluded projected corporate costs (which include listing costs and directors' fees) of $0.2 million in FY17 and $0.4 million in FY18 with these synergies forecast to grow at 3.0% per annum beyond FY18. These costs have been excluded from our analysis as we consider that most potential acquirers could achieve this level of synergies.

Based on our review of the projected expenses and discussions with management nothing has to come to our attention to indicate the expense projections are not reasonable.

### Capital expenditure

Hunter Hall is not a capital intensive business and therefore requires a low level of capital expenditure. We have assumed capital expenditure approximates depreciation.

### Working Capital

Hunter Hall collects management fees on a monthly basis and has limited accounts payable. As such it operates with a negligible working capital balance. Therefore, projected movements in working capital are insignificant.

### Tax

We have applied tax at the Australian corporate tax rate of 30%.

### Reasonableness of assumptions

While we have not undertaken a review of the projections in accordance with AUS 804 – The Audit of Prospective Financial Information, we have undertaken a detailed review of the forecasts prepared by management and have discussed the key assumptions with management. Based on this analysis we consider these assumptions to be reasonable for the purposes of our analysis.

### 8.2.2 Discount rate

We have applied a discount rate of between 11.5% and 12.5% (nominal, post-tax, WACC) to the projected cash flows. We calculated the discount using the capital asset pricing model based on the assumptions set out in Appendix 3.

### 8.2.3 Terminal value

The terminal value represents the value of the cash flows beyond the forecast period. Terminal values are commonly calculated based on the expected long-term growth rate of future cash flows. We have used a terminal growth rate of 3.0% which we consider is a reasonable estimate of long term growth in cash flows after considering industry prospects, in particular in relation to superannuation and greater social awareness of investors, and the impact of distribution of capital gains.

### 8.2.4 Surplus assets

Surplus assets are assets owned by an entity that are not required to generate the earnings of its business. This could be investments, unused plant and equipment held for resale, or any other asset that is not required to run the operating business. It is necessary to ensure that any income from surplus assets (e.g. rent / dividends) is excluded from the business value.

We have identified the following surplus assets owned by Hunter Hall.

**Table 22: Surplus assets**

| Surplus Asset | $'000 |
|---|---|
| Investment in HCT | 12,004 |
| Investment in HHV | 7,796 |
| Units in managed funds | 23 |
| **Total surplus assets** | **19,823** |

*Source: Hunter Hall and Leadenhall analysis*

A brief summary of each of the identified surplus assets is provided below.

### Investment in HCT

As at 31 March 2017, Hunter Hall held 4.0 million units in HCT and the redemption price on this date was $2.988, resulting in a current market value of $12.0 million.

### Investment in HHV

As at 31 March 2017, Hunter Hall held 6.4 million shares in HHV and the closing price on this date was $1.23, resulting in a current market value of $7.8 million.

### Units in managed Funds

Hunter Hall holds units in a small number of other managed funds. Management have advised that any unrealised gains on this investment would be immaterial and as such we have included these investments at cost in our analysis.

### 8.2.5 Non-operating liabilities

Non-operating liabilities are liabilities that are not related to the ongoing business operations, although they may relate to previous business activities, for example legal claims against the entity.

Hunter Hall is expected to incur extraordinary expenses of approximately $3.7 million in relation to the proposed merger with Pengana. Of this, $1.3 million is contingent on completion of the transaction. We note that a break fee of $800,000 would likely be payable by Hunter Hall in the event that the Proposed Transaction is not approved by Shareholders. For the purposes of our analysis, we have included the break fee and excluded contingent costs from this estimate of extraordinary expenses which equates to $3.2 million of non-operating liabilities.

### 8.2.6 Surplus cash

As at 31 March 2017, Hunter Hall had a cash balance of $9.1 million and no borrowings. Management have advised that there has been no material change in the cash balance since 31 March 2017.

### 8.2.7 Discounted cash flow summary

Based on the preceding analysis, the assessed value is as set out in the table below.

**Table 23: Discounted cash flow summary ($'000)**

| Description | Low | High |
|---|---|---|
| Present value of projected cash flows | 36,281 | 38,130 |
| Terminal value | 16,736 | 20,966 |
| **Enterprise value on a control basis** | **53,017** | **59,096** |
| Surplus assets | 19,823 | 19,823 |
| Non-operating liabilities | (3,200) | (3,200) |
| Net cash | 9,124 | 9,124 |
| **Equity value on a control basis** | **78,764** | **84,843** |
| Number of share on issue | 27,330 | 27,330 |
| **Equity value per share ($)** | **2.88** | **3.10** |

*Source: Leadenhall analysis*

Based on the analysis above, we have assessed the value of a Hunter Hall share to be in the range of $2.90 to $3.10 on a control basis.

## 8.3 Capitalisation of earnings

As a cross-check of our valuation, we have conducted a capitalisation of future maintainable earnings analysis. To do so, we have calculated the EBITDA, EBIT and PE multiples and the enterprise value as a percentage of FUM implied by our assessed valuation range and compared this to the same metrics of comparable listed companies. The metrics implied by our preferred valuation range are set out in the table below.

**Table 24: Implied multiples**

| | Historical | | FY17 Forecast | | FY18 Forecast | |
|---|---|---|---|---|---|---|
| | Low | High | Low | High | Low | High |
| Implied EBITDA multiple (adjusted) | 6.1x | 6.8x | 7.3x | 8.1x | 7.9x | 8.9x |
| Implied EBIT multiple (adjusted) | 6.3x | 7.0x | 7.5x | 8.4x | 8.2x | 9.1x |
| Implied PE multiple (adjusted) | 9.0x | 10.0x | 10.7x | 12.0x | 11.7x | 13.0x |
| Implied % of FUM | 4.9% | 5.4% | 5.4% | 6.0% | 5.2% | 5.8% |

*Source: Leadenhall analysis*

*Notes:*

1. *The FY17 forecast multiples are based on actual earnings for the eight months to February 2017 and forecast earnings for four months for the period from March 2017 to June 2017*
2. *The adjusted multiples are based on earning excluding distributions from investments or interest income and our assessed values excluding surplus assets and cash*

The adjusted EBITDA and EBIT multiples exclude realised gains on investments and dividends received in FY16. As these amounts are not included in our forecasts, and may not be included in the earnings of comparable companies, the adjusted multiples provide a better basis for comparison.

To cross-check the assessed multiple, we have identified multiples implied by market trading prices of public companies with similar businesses to Hunter Hall, and compared these implied multiples to those calculated for Hunter Hall in the table above. It should be noted that the multiples set out below are based on market trading and consequently do not include the impact of a control premium.

**Table 25: Comparable company market trading multiples**

| Company | Market | EV/FUM | EBITDA multiple | | | EBIT multiple | | | PE multiple | | |
|---|---|---|---|---|---|---|---|---|---|---|---|
| | Cap ($'m) | (historical) | 1YH | Current | 1YF | 1YH | Current | 1YF | 1YH | Current | 1YF |
| Hunter Hall (assessed value) | 70.5 | 5.7% | 6.5x | 7.7x | 8.4x | 6.6x | 7.9x | 8.7x | 9.5x | 11.3x | 12.4x |
| **Diversified** | | | | | | | | | | | |
| Magellan Financial Group | 4,093.7 | 8.1% | 14.6x | 15.2x | 12.8x | 14.6x | 15.2x | 12.6x | 20.6x | 21.4x | 17.8x |
| BT Investment Management | 3,082.8 | 2.7% | 11.2x | 11.7x | 9.7x | 11.8x | 11.9x | 9.9x | 21.7x | 20.1x | 16.7x |
| Platinum Asset Management | 2,968.6 | 11.7% | 9.7x | 10.6x | 10.7x | 9.7x | 10.6x | 10.8x | 14.9x | 16.5x | 16.7x |
| IOOF Holdings | 2,500.1 | 2.3% | 8.1x | 10.6x | 10.0x | 9.7x | 11.6x | 10.8x | 12.5x | 16.0x | 15.1x |
| Perpetual | 2,444.2 | 6.9% | 11.2x | 10.4x | 9.7x | 12.2x | 11.6x | 10.8x | 18.5x | 18.5x | 17.3x |
| ***Average*** | | ***6.3%*** | ***10.9x*** | ***11.7x*** | ***10.6x*** | ***11.6x*** | ***12.2x*** | ***11.0x*** | ***17.6x*** | ***18.5x*** | ***16.7x*** |
| ***Median*** | | ***6.9%*** | ***11.2x*** | ***10.6x*** | ***10.0x*** | ***11.8x*** | ***11.6x*** | ***10.8x*** | ***18.5x*** | ***18.5x*** | ***16.7x*** |
| **Boutique and specialised** | | | | | | | | | | | |
| HFA Holdings | 327.5 | 2.3% | 7.0x | 7.1x | 6.5x | 8.6x | 7.3x | 6.6x | 17.2x | 14.0x | 12.5x |
| Fiducian Group | 128.2 | n/a | 12.4x | 10.3x | 9.0x | 12.5x | 11.7x | 10.0x | 22.0x | 17.3x | 14.5x |
| Australian Ethical Investment | 104.6 | 5.0% | 19.8x | n/a | n/a | 20.6x | n/a | n/a | 34.8x | n/a | n/a |
| K2 Asset Management | 84.1 | 12.0% | 13.7x | 12.1x | 6.5x | 13.8x | 12.2x | 6.5x | 22.0x | 18.6x | 10.2x |
| ***Average*** | | ***6.4%*** | ***13.2x*** | ***9.8x*** | ***7.3x*** | ***13.9x*** | ***10.4x*** | ***7.7x*** | ***24.0x*** | ***16.6x*** | ***12.4x*** |
| ***Median*** | | ***5.0%*** | ***13.0x*** | ***10.3x*** | ***6.5x*** | ***13.2x*** | ***11.7x*** | ***6.6x*** | ***22.0x*** | ***17.3x*** | ***12.5x*** |

*Source: FactSet (as at 20 March 2017), ASX announcements and Leadenhall analysis*

*Note: We also considered Pacific Current Group as a comparable company, however recent poor performance resulted in trading multiples that were not meaningful for the purposes of our analysis.*

The adjusted implied multiples and EV/FUM % for Hunter Hall are significantly lower than the average and median multiples observed for comparable companies. The primary driver of this difference is the assumption of FUM outflows for Hunter Hall which is not reflected in the market multiples of comparable companies. This is to some extent offset by the implied control premium included in our valuation of Hunter Hall.

Of the above companies, the boutique and specialised funds management companies are more similar to Hunter Hall in terms of both market capitalisation and size of FUM. We note that Australian Ethical Investment ("AEI") historical multiples are significantly higher than Hunter Hall and other comparable companies. This can be attributed to recent operational growth as well as an extraordinary downward adjustment to earnings in the June 2016 financial year due to a provision for remediation of superannuation members for errors in unit pricing. These errors do not appear to have affected the company's growth with strong FUM inflows continuing. Excluding these extraordinary costs, the implied historical EBITDA, EBIT and PE multiples for AEI are 16.6x, 17.2x and 26.8x respectively.

In contrast to Hunter Hall's forecast FUM losses, we note that K2 Asset Management ("**K2**") is expected to grow significantly and AEI has recently had strong earnings performance and growth. This results in a significant disparity between the multiples for Hunter Hall and these companies.

The Fiducian Group, on the other hand, is a more diversified business providing a combination of financial planning, platform administration and funds management services. All things being equal, more diversified businesses tend to attract higher multiples.

Hunter Hall's implied multiples are closer to HFA Holdings. Earnings growth for HFA Holdings is forecast to be more moderate with revenue growth expected to be relatively low. Thus, we consider the relatively low multiples implied by our valuation of Hunter Hall to be reasonable given the forecast FUM losses for Hunter Hall.

We have not identified any control transactions involving suitably comparable businesses for which there is sufficient publicly available information to calculate the relevant multiples for comparison purposes.

## 8.4 Analysis of share trading

Market trading in Hunter Hall shares since the announcement of Peter Hall's resignation and up to the announcement of the Proposed Transaction provides an indication of the market's assessment of the current value of Hunter Hall on a minority basis. We have presented an analysis of recent trading in Hunter Hall's shares in Section 4.8 above. When assessing market trading it is necessary to consider whether the market is informed and liquid. In this regard we note:

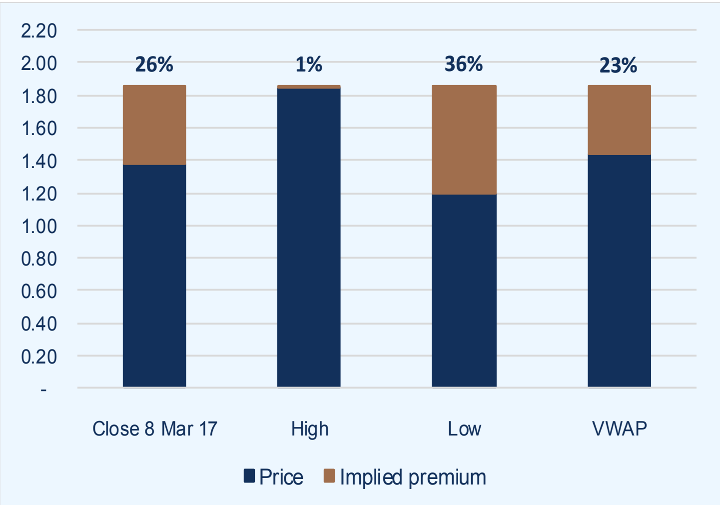
- As our valuation analysis takes into account the impact of Mr Hall's resignation, in particular in relation to FUM outflows, we do not consider that it is appropriate to include an analysis of Hunter Hall's share price prior to the announcement of Peter Hall's resignation on 30 December 2016.
- Hunter Hall shares are fairly tightly held reducing the number of shares available for market trading. Daily values traded are often under $100,000. This level is below the level at which large institutional investors may wish to invest and may be seen as a deterrent for other significant investors.
- Hunter Hall has continuous disclosure obligations under the ASX Listing Rules, thus the market is reasonably well informed about its activities.

As a result of these factors we consider the market trading to be reasonably well informed and moderately liquid. We have therefore undertaken only a high level analysis of share market trading, by assessing the level of control premium implied by our valuation range compared to Hunter Hall's share price since the announcement of Mr Hall's resignation.

In addition, we have excluded the impact of Mr Hall's sale of a 19.9% stake to WHSP on 3 January 2017 from our analysis below.

The figure below sets out the control premium implied by the mid-point of our valuation range. In conducting this analysis we have removed the value of cash, surplus assets and net debt ($1.04 per share) from the share price and our assessed value as these do not relate to the operating business and as such a purchaser is unlikely to pay a premium for these assets.

**Figure 18: Implied control premium to market trading prices**




*Source: FactSet and Leadenhall analysis*

Hunter Hall's closing share price on 8 March 2017 was $2.42. The volume VWAP over the period 4 January 2017 to 8 March 2017 was $2.47. Over the same period the highest closing price was $2.88 on 17 January 2017 and the lowest closing price was $2.23 on 24 January 2017. After adjusting for the value of cash and surplus assets, this results in an implied control premium over the mid-point of our assessed valuation range of between 1% on the highest observed price, 36% on the lowest observed price, 23% on the VWAP and 26% on 8 March 2017 closing price.

The generally observed range for control premiums is between 20% to 40%. In addition, the average control premium observed for transactions in the finance sector in Australia between 2005 and 2015 was 35%. Further information on observed control premiums is included in Appendix 5.

The control premium implied by our assessed value of a Hunter Hall share appears to be at the lower end of the generally observed range. However, we do not consider this to be unreasonable given the current uncertainty surrounding the business. Furthermore, there have been multiple takeover offers from WHSP and Pinnacle since the announcement of Peter Hall's resignation. Thus, it is possible that the market was pricing in other potential takeover offers and therefore an element of the share price movement between Peter Hall's resignation and the announcement of the Proposed Transaction is likely to be attributed to a control premium.

## 8.5 Conclusion on value

Based on our discounted cash flow analysis and valuation cross-checks, we have selected a valuation range for a share in Hunter Hall of between $2.90 and $3.10, on a control basis.

We note that this valuation is slightly higher than our assessed value disclosed in our previous report dated 1 February 2017. We consider this difference to be reasonable given the reduced uncertainty facing Hunter Hall in respect of the proposed share buyback for HHV and FUM flows more generally.

# 9 VALUATION OF PROPOSED MERGED ENTITY

## 9.1 Background

We have assessed the fair market value of the Proposed Merged Entity using the discounted cash flow method, with cross-checks by reference to the capitalisation of earnings method, and an analysis of recent share marketing trading in Hunter Hall shares as a proxy for trading in the Proposed Merged Entity shares. This assessment has been made on a minority basis as the Shareholders will be minority holders in the Proposed Merged Entity if the Proposed Transaction is completed.

## 9.2 Discounted cash flow

In order to determine the value of a share in the Proposed Merged Entity on a minority basis using the discounted cash flow method, we have considered the following:

- An analysis of projected cash flows
- The determination of an appropriate discount rate
- The determination of a terminal value beyond the projected cash flow period
- The value of any surplus assets
- The value of non-operating liabilities
- The level of surplus cash held
- A discount for lack of control ("**DLOC**")

These are discussed below.

### 9.2.1 Projected cash flows

By aggregating the cash flows forecasts for Hunter Hall (as described in Section 8) with Pengana cash flow projections (discussed below), we have developed a set of cash flow forecasts for the Proposed Merged Entity including the expected synergies from the Proposed Transaction and attributable transaction costs.

We have been provided with a detailed forecast model for Pengana for the period FY17 to FY21 prepared by an advisor ("**Advisor**") to WHSP ("**Pengana Model**"). This model was developed to facilitate WHSP's acquisition of a 40.5% stake in Pengana from NAB, which completed in early March 2017. As part of the evaluation of Pengana, an external third-party consultant ("**Consultant**") specialising in the wealth and asset management industry was commissioned by the Advisor to assess the prospects for Pengana's business and funds. The Consultant developed a set of forecast assumptions on a fund-by-fund basis which were utilised as inputs in the Pengana forecast model. In addition, financial due diligence was undertaken on the Pengana model by a separate advisor to substantiate its mathematical accuracy / logic, assess the model assumptions against previous due diligence undertaken on Pengana's historical performance and verify net FUM inflow and performance assumptions to the Consultant's forecast assumptions.

After considering the above, we have prepared a discounted cash flow model for the Proposed Merged Entity based on the aggregated Hunter Hall forecasts and the Pengana Model. The key assumptions for the Hunter Hall forecasts are discussed in Section 8.2.1 and the key assumptions for the Pengana forecasts are set out below.

## Revenue

In respect of Pengana's FUM and performance assumptions we note:

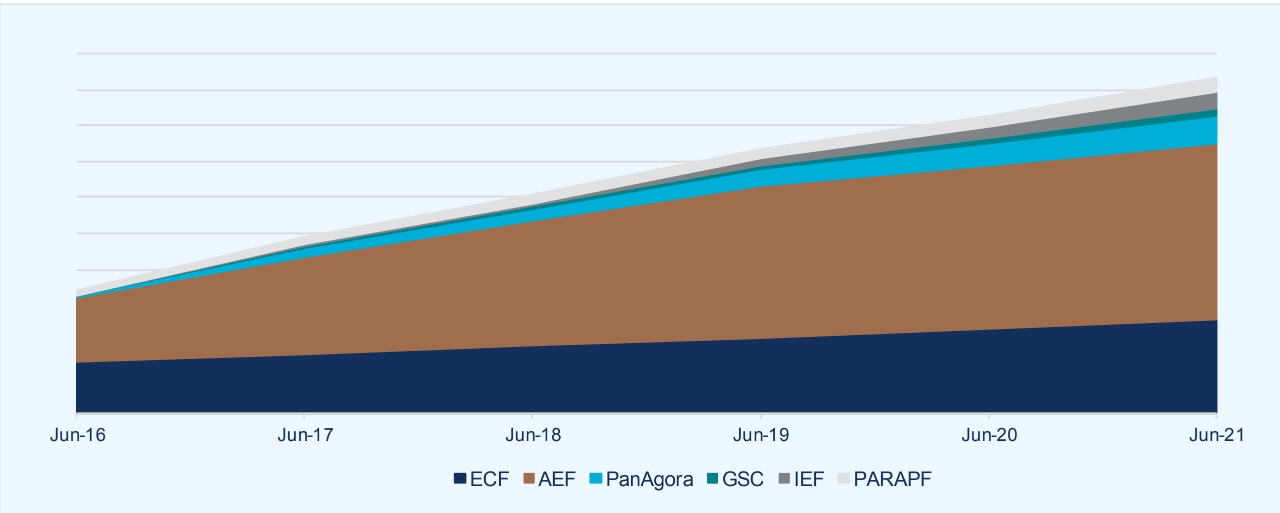
**Table 26: FUM and performance assumptions**

| Assumption | Leadenhall comment |
|---|---|
| **Net inflows**<br><br>Assumptions of Pengana's net FUM inflows are based on independent assessments of likely future growth, on a fund-by-fund basis. These assumptions include considerations of the capacity of each fund, current trends in the funds management industry, capabilities / experience of the investment management teams and the infrastructure in place to support fund growth (such as marketing / distribution networks and back-office infrastructure including governance processes).<br><br>The forecast FUM flows also include assumptions that Pengana's two well-established funds (AEF and ECF) will be hard-closed in FY19. One of these funds, ECF, is currently in "soft close" as discussed in Section 5.4.<br><br>FY17 total average FUM is forecast to increase by approximately 32% over FY16 with FUM growth slowing considerably from FY19 due to the abovementioned hard closing of the two main funds. This slowing in growth is mitigated to some extent by the anticipated ramp-up in growth from Pengana's other early-stage funds. These other funds employ investment strategies which are expected to capitalise on Pengana's performance track record and reputation as well as current industry trends of investors moving away from institutionally managed products towards more niche and alternative investment strategies.<br><br>We have not presented the precise assumptions adopted due to the commercially sensitive nature of this information. | We do not consider the FUM assumptions adopted by Pengana management to be unreasonable due to the following factors:<br><br>♦ FUM flows were independently assessed by an industry expert for the purpose of WHSP's investment in Pengana.<br><br>♦ Year-to-date FUM inflows have been significantly higher than projections.<br><br>♦ Each of Pengana's investment teams has a strong performance track record and are well-regarded in the industry.<br><br>♦ Pengana's funds currently have favourable ratings from a number of well-known ratings agencies.<br><br>♦ Pengana's growth funds appear to be well-aligned to current trends in the funds management industry based on our analysis of available independent research.<br><br>♦ From discussion with Pengana management, we understand that Pengana's structure, in terms of both investment team and back-office support, has been designed to support significant growth in the short-term.<br><br>♦ The historical track record of Pengana's two largest funds show strong total net FUM inflows over the past two years of approximately $158 million in FY15 and $301 million in FY16.<br><br>♦ Pengana management have expressed a view that the assumptions are conservative.<br><br>Overall these assumptions do not appear unreasonable. We note that the risk to Hunter Hall shareholders is for Pengana to be overvalued and that as the Pengana Model was developed for WHSP as a buyer, it is more likely to be conservative. |

| Assumption | Leadenhall comment |
|---|---|
| **Fund performance**<br><br>Forecast annual investment returns by fund range from 7.0% to 10.6% per annum. | We do not consider the assumptions in respect of fund performance to be unreasonable due to the following factors:<br>♦ Forecast returns for the largest two funds are similar to the historical returns generated by those funds over the period since inception to the last three years.<br>♦ Once funds reach capacity, performance growth has minimal effect on FUM levels as any investment growth is returned to investors as distributions. |
| **Distributions**<br><br>We note that the FUM forecasts do not include an assumption for distributions. | We do not consider the lack of distribution assumptions to be unreasonable due to the following factors:<br>♦ Based on discussions with Pengana management, distributions are primarily used as a means to manage FUM flows and capacity, especially for Pengana's larger funds.<br>♦ The assumptions of Pengana's FUM flows discussed above are on a net basis and include considerations of fund capacity and likely distributions.<br>Given that FUM flows are forecast on a net basis, we consider it to be reasonable for the model to exclude explicit assumptions around distributions. |

The figure below sets out Pengana's forecast closing yearly FUM, based on the assumptions described above.

**Figure 19: Pengana actual and forecast closing yearly FUM June 2016 to June 2021**




*Source: Pengana and Leadenhall analysis*

To calculate revenue from management fees, the average FUM is multiplied by the management fee for each fund. We note that the model uses management fee charges which are slightly lower than the management fees for each fund as set out in Table 11 attributable to non-rebateable GST. Similar to Hunter Hall, we consider that, despite the potential for fee compression over the longer term, it is reasonable to assume flat management fees given both Hunter Hall and Pengana utilise specialist investment strategies and the high level of retail investment across their funds is likely to result in less investor fee sensitivity.

Performance fees for Pengana are forecast based on assumed benchmark outperformance rates of between 3% to 9% per annum, multiplied by average FUM and the performance fee percentage for each fund (described in Table 11). Assumed outperformance for the two main funds is largely in line with average historical outperformance over the period since inception to the last three years. The model assumes performance fees are broadly in with historical performance fees on a percentage basis. While this is not unreasonable, we consider performance fees to be less reliable than management fees and have therefore adopted a lower level of performance fees. In our cash flow projections, we have assumed performance fees of 80% of the level earned historically. We consider these performance fee assumptions to be reasonable given Pengana's demonstrated ability to produce strong performance fee income.

### Fund-related expenses

The Pengana fund-related expense assumptions are as follows:

- Fund-related expenses comprise commissions, rebates, direct fund expenses, research fees and platform fees.
- Forecast fund-related expenses are expected to decrease in FY17 compared to FY16 due to a reduction in commissions payable. This is a result of the cessation of the NAB distribution agreement in September 2016. We understand that Pengana has now established its own distribution networks including relationships with NAB-aligned dealer groups and platforms.
- AEF fund-related expenses are expected to remain flat going forward as the fund has reached scale (at approximately $1.2 billion in FUM) and further FUM increases are unlikely to require significant additional expenditure.
- With the exception of AEF, fund-related expenses are forecast to grow at a CAGR of approximately 6.9% per annum from FY17 to FY21. From discussions with management, we understand that considerable scale benefits are expected to be achieved through FUM growth due to Pengana's existing infrastructure. As such, these costs are not expected to increase significantly over time.

### Team distribution expenses

The Pengana team distribution expense assumptions are as follows:

- The investment teams for each fund receive profit distributions for management and performance fees earned by the fund. These distributions make up a significant proportion of costs to Pengana and are calculated based on the terms of the profit sharing arrangements with each investment team.
- Typically, investment teams are entitled to receive 50% of distributable profit (management and performance fees after deducting fund-related expenses).
- Forecast team distribution expenses as a percentage of fees are in line with agreed distributions and historical actuals.

### Operating expenses

In respect of the Pengana operating expense assumptions we note:

- FY17 operating expense assumptions are based on the Pengana FY17 overhead budget. We also note that FY16 operating expenses were higher than normal due to one-off costs relating to the winding up of the Global Resources Fund. Excluding these non-recurring costs, FY17 forecasts are largely in line with previous years.
- Overheads are expected to increase at 3% per annum beyond FY17 reflecting the mostly fixed nature of operating expenses.

### Capital expenditure

Pengana is not a capital intensive business and therefore requires a low level of capital expenditure. We have assumed capital expenditure approximates depreciation.

### Working Capital

Pengana collects management fees on a monthly basis and has limited accounts payable. As such it operates with a negligible working capital balance. Therefore, projected movements in working capital are insignificant.

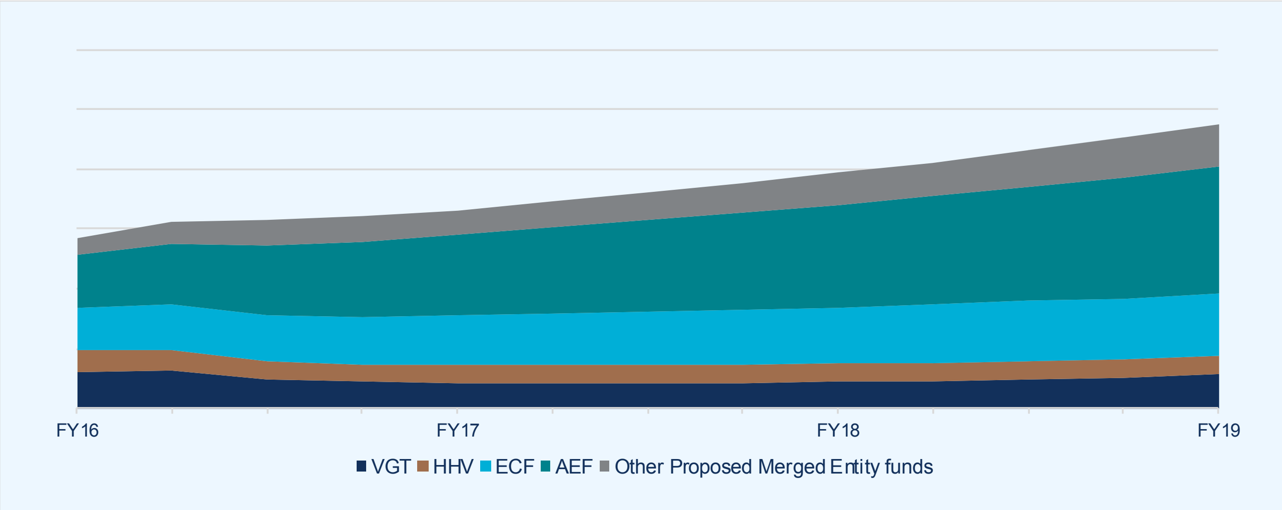
### Tax

We have applied tax at the Australian corporate tax rate of 30%.

### 9.2.2 Proposed Merged Entity cash flow projections

We have aggregated the Hunter Hall and Pengana management forecasts in order to develop a set of cash flow projections for the Proposed Merged Entity. The aggregated forecasts produce the following projected levels of FUM:

**Figure 20: Proposed Merged Entity actual and forecast FUM June 2016 to June 2019**




*Source: Hunter Hall, Pengana and Leadenhall analysis*

We have also been provided with analysis of the synergies expected to be realised from the Proposed Transaction by Hunter Hall and Pengana. Our review of these proposed synergies is set out below.

### Synergies analysis

Hunter Hall and Pengana have estimated annual synergies from the Proposed Transaction to be approximately $6 million from FY17 onwards. We have analysed these synergies for reasonableness and consistency with management forecasts and note the following:

- Estimated synergies relate to cost savings on operating expenses. The bulk of these synergies originate from staff costs (70%), marketing costs (10%) and occupancy costs (7%).
- Management have not estimated any revenue synergies. We consider this to be reasonable given the expected synergies may be offset by possible dis-synergies which may result from investor dissatisfaction with the change in ownership and strategic direction of the new combined business.
- Certain cost synergies overlap with cost savings which have already been included in management forecasts. We have adjusted the estimated amount of cost synergies for consistency with the forecasts.
- Synergies from expenses linked to operating profit have been estimated in line with forecasts of operating profit.
- The realisation of these synergies requires approximately $6.0 million of termination costs to be incurred.

Based on our analysis, we have included $1.8 million of synergies and $6.0 million of termination costs in FY17 cash flow projections. In FY18, we have included synergies of $5.7 million. Beyond FY18, the majority of these synergies are forecast to grow at 3% per annum in line with the expenses from which these synergies originate. Exceptions to this are the synergies from expenses linked to operating profit which are forecast in line with operating profit.

### Reasonableness of assumptions

While we have not undertaken a review of the projections in accordance with AUS 804 – The Audit of Prospective Financial Information, we have undertaken a detailed review of the forecasts prepared by both Hunter Hall and Pengana management and have discussed the key assumptions with them. Based on this analysis we consider these assumptions to be reasonable for the purposes of our analysis.

### 9.2.3 Discount rate

We have applied a discount rate of between 10.5% and 12.0% (nominal, post-tax, WACC) to the projected cash flows. We calculated the discount rate using the capital asset pricing model based on the assumptions set out in Appendix 3.

### 9.2.4 Terminal value

The terminal value represents the value of the cash flows beyond the forecast period. Terminal values are commonly calculated based on the expected long-term growth rate of future cash flows. We have assumed the projected growth for FY21 tapers down to a long-term growth rate of 3.0% over the four years to FY25. Consistent with our valuation of Hunter Hall, we consider 3.0% to be a reasonable estimate of long term growth in FUM after considering industry prospects, in particular in relation to superannuation and greater social awareness of investors, and the impact of distribution of capital gains.

### 9.2.5 Surplus Assets

Surplus assets are assets owned by an entity that are not required to generate the earnings of its business. This could be investments, unused plant and equipment held for resale, or any other asset that is not required to run the operating business. It is necessary to ensure that any income from surplus assets (e.g. rent / dividends) is excluded from the business value.

We have identified the following surplus assets owned by the Proposed Merged Entity.

**Table 27: Surplus assets**

| Surplus Assets | $'000 |
|---|---|
| Investment in HCT | 12,004 |
| Investment in HHV | 7,796 |
| Units in managed funds | 23 |
| Investment in GSC | 1,129 |
| Investment in Pengana Asia Special Events | 1,487 |
| Investment in PIEFMR / IEF | 896 |
| Shareholder loans | 1,816 |
| Employee share plan loans | 27,220 |
| **Total surplus assets** | **52,372** |

*Source: Hunter Hall, Pengana and Leadenhall analysis*

A brief summary of each of the identified surplus assets is provided below.

### Investments in HCT, HHV and units in managed funds

Refer to Section 8.2.4 for a description of these investments.

### Investment in GSC

As at 31 March 2017, Pengana held 1.0 million units in GSC and the redemption price on this date was $1.1321, resulting in a current market value of $1.1 million.

### Investment in Pengana Asia Special Events

As at 31 March 2017, Pengana held 377 AUD units and 427 USD units in Pengana Asia Special Events. The redemption price on this date was $1,861 for the AUD units and US$1,404 for the USD units, resulting in a current market value of $1.5 million (USD amounts were converted to AUD at a rate of 0.7644).

### Investment in IEF

As at 31 March 2017, Pengana held 0.9 million units in PIEFMR and IEF (over two classes). The redemption price on this date ranged between $0.9989 and $1.0832, resulting in a current market value of $0.9 million.

### Shareholder loans

Shareholder loans comprise loans which were made to key management personnel at the time of the NAB investment in Pengana. Minimal interest is charged on these loans. However, the difference between the face value and the market value of these loans is not expected to be material.

### Employee share plan loans

As described in Section 5.7, key executives and the CEO of Pengana were provided with limited recourse loans totalling $27.2 million to assist in the purchase of 190,115 Pengana shares. We have included the loans as surplus assets of the Proposed Merged Entity and recognised the corresponding shares in the total number of shares on issue.

### 9.2.6 Non-operating liabilities

Non-operating liabilities are liabilities that are not related to the ongoing business operations, although they may relate to previous business activities, for example legal claims against the entity.

The Proposed Merged Entity is expected to incur extraordinary expenses of approximately $4.2 million in relation to the Proposed Transaction which we have included as a non-operating liability.

### 9.2.7 Surplus cash

As at 31 March 2017, the Proposed Merged Entity would have a surplus cash balance of $12.6 million and no borrowings. We understand that Pengana is required to maintain a minimum cash balance of $2.5 million under the terms of its AFSL which we have excluded from our determination of surplus cash. Management have advised that there have been no other material changes in the cash balance since 31 March 2017.

### 9.2.8 Discount for lack of control

The value of a controlling interest is not the same as the value of a minority stake, on a per share basis. Controlling interests offer the holder the ability to do many things that the holder of a minority interest cannot. For this reason, the value of a controlling interest is usually higher than the pro-rata value of a non-controlling minority interest. This difference is known as a DLOC and is the inverse of a control premium.

The appropriate level of DLOC can range widely depending on the circumstances, with discounts anywhere in the range of 10% to 30% commonly observed, although DLOC's above and below this range can occur.

In selecting a discount to apply to the Proposed Merged Entity, we have considered the following:

- The generally observed range of control premiums is between 20% and 40% which equates to a DLOC of 17% to 29%.
- The average takeover premium in the finance industry in Australia for the period 2005 to 2015 was 35%.
- The observed minority discounts are measured based on an increase in equity value. Also, the majority of observed discounts are for companies with some degree of net debt. Thus, the level of discount which should apply at the enterprise value level (as in our analysis) is lower than the generally observed range.
- The Shareholders will have a relatively small holding (27%) in the Proposed Merged Entity should the Proposed Transaction be approved. Smaller stakes generally attract a higher DLOC.
- There will be two large shareholders in the Proposed Merged Entity. This will help ensure that significant control does not rest entirely with one party to the detriment of other shareholders. A wider dispersion of holdings results in a lower DLOC.
- The Proposed Merged Entity will have an independent Board which is beneficial to minority holdings thereby reducing the level of DLOC.
- The Proposed Merged Entity will have an experienced management team focussed on improving performance of the company and therefore generating more value for its shareholders. This would imply a lower level of DLOC.

Based on the above considerations, we have selected a DLOC of 20% which is towards the lower end of the generally observed range. Further information on observed control premiums is included in Appendix 5.

### 9.2.9 Discounted cash flow summary

Based on the preceding analysis, the assessed value for the Proposed Merged Entity is as set out in the table below.

**Table 28: Discounted cash flow summary ($'000)**

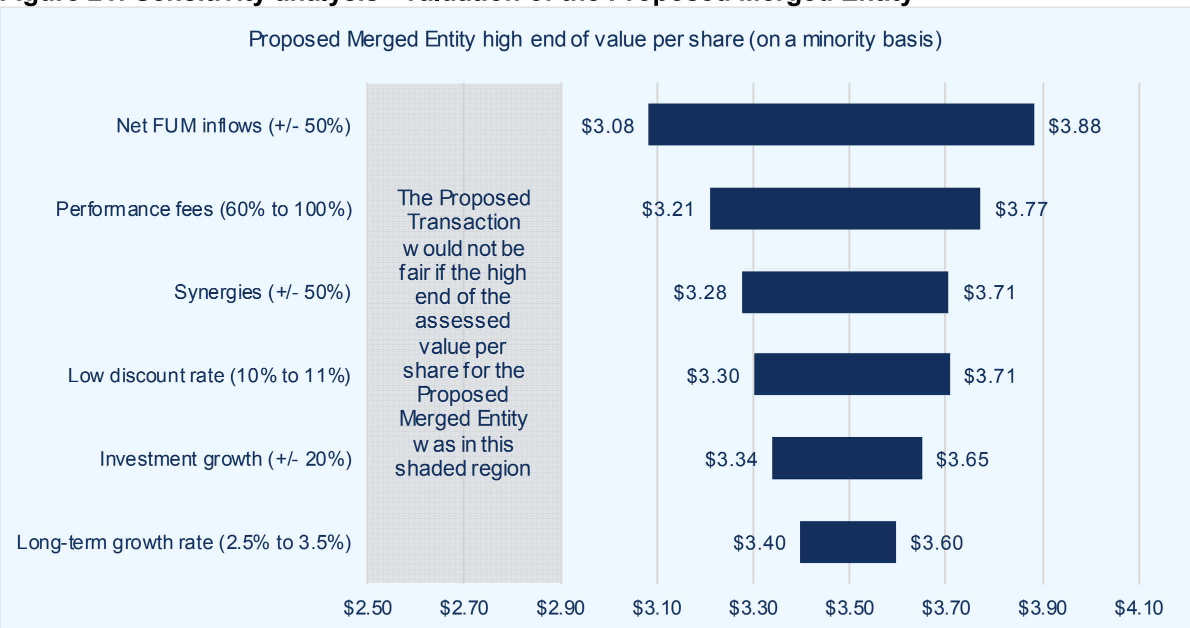
| Description | Low | High |
|---|---|---|
| Present value of projected cash flows | 192,531 | 209,381 |
| Terminal value | 110,230 | 157,147 |
| **Enterprise value on a control basis** | **302,762** | **366,528** |
| DLOC at 20% | 20% | 20% |
| **Enterprise value on a minority basis** | **242,209** | **293,222** |
| Surplus assets | 52,372 | 52,372 |
| Non-operating liabilities | (4,200) | (4,200) |
| Net cash | 12,624 | 12,624 |
| **Equity value on a minority basis** | **303,005** | **354,018** |
| Number of share on issue[1] | 101,477 | 101,477 |
| **Minority equity value per share ($)** | **2.99** | **3.49** |

*Source: Leadenhall analysis*
*Note 1: Refer to Section 6.4 for the total number of shares on issue in the Proposed Merged Entity.*

### 9.2.10 Sensitivity

The analysis presented above is highly sensitive to a number of key assumption in the Pengana Model. We have therefore presented a sensitivity analysis of the high end of the assessed values for the Proposed Merged Entity to those assumptions in the following figure:

**Figure 21: Sensitivity analysis - valuation of the Proposed Merged Entity**




*Source: Leadenhall analysis*
*Note: As our valuation is based on 80% of the average historical performance fees, the sensitivity shown is from 60% to 100% of the level included in the Pengana Model.*

### 9.2.11 Discounted cash flow conclusion

Based on the analysis above, we have assessed the value of a Proposed Merged Entity share to be in the range of $3.00 to $3.50 on a minority basis.

## 9.3 Capitalisation of earnings

As a cross-check of our valuation, we have conducted a capitalisation of future maintainable earnings analysis. To do so, we have calculated the EBITDA, EBIT and PE multiples and the enterprise value as a percentage of FUM implied by our assessed valuation range and compared this to the same metrics of comparable listed companies. The metrics implied by our preferred valuation range are set out in the table below.

**Table 29: Implied multiples**

| | Historical | | FY17 Forecast | | FY18 Forecast | |
|---|---|---|---|---|---|---|
| | Low | High | Low | High | Low | High |
| **Proposed Merged Entity (minority basis)[1]** | | | | | | |
| Implied EBITDA multiple (adjusted) | 19.6x | 23.8x | 12.8x | 15.6x | 9.5x | 11.6x |
| Implied EBIT multiple (adjusted) | 20.3x | 24.6x | 13.1x | 15.9x | 9.6x | 11.7x |
| Implied PE multiple (adjusted) | 28.0x | 34.0x | 18.7x | 22.7x | 13.7x | 16.7x |
| Implied % of FUM | 7.5% | 9.2% | 7.4% | 9.0% | 6.0% | 7.3% |
| **Pengana standalone (control basis)[3]** | | | | | | |
| Implied EBITDA multiple (adjusted) | 22.6x | 25.0x | 18.7x | 20.8x | 12.1x | 13.4x |
| Implied EBIT multiple (adjusted) | 23.3x | 25.8x | 19.2x | 21.2x | 12.3x | 13.6x |
| Implied PE multiple (adjusted) | 33.3x | 36.9x | 27.4x | 30.3x | 17.6x | 19.5x |
| Implied % of FUM | 7.7% | 8.6% | 7.3% | 8.1% | 5.5% | 6.1% |

*Source: Leadenhall analysis*

*Notes:*

1. *The FY17 forecast multiples are based on forecast earnings for the Proposed Merged Entity for FY17 which includes eight months of Hunter Hall's actual earnings to February 2017 and six months of Pengana's actual earnings to December 2016.*
2. *The adjusted multiples are based on operating earnings excluding distributions from investments or interest income and our assessed values excluding surplus assets and cash*
3. *Pengana's control value has been assessed using a discount rate for Pengana on a standalone basis. The historical multiples are calculated based on average historical earnings for FY15 and FY16 due to volatility in year-on-year earnings attributable to fluctuations in performance fees.*

The adjusted EBITDA and EBIT multiples are based on operating earnings and exclude the impact of realised gains on investments and dividends received in FY16. As these amounts are not included in our forecasts, and may not be included in the earnings of comparable companies, the adjusted multiples provide a better basis for comparison.

To cross-check the assessed multiple, we have identified multiples implied by market trading prices of public companies with similar businesses to the Proposed Merged Entity, and compared these implied multiples to those calculated for the Proposed Merged Entity in the table above. It should be noted that the multiples set out in Table 25 are based on market trading and consequently do not include the impact of a control premium.

Furthermore, we consider FY18 forecast multiples to be the most comparable to the forecast multiples in Table 25 due to the near-term FUM growth expected by Pengana as well as the expectation that synergy benefits will be fully ramped up by that time.

The adjusted implied multiples and EV/FUM % are somewhat higher than the average and median multiples observed for comparable companies which we consider reflects the relative growth, profitability and market position of the Proposed Merged Entity relative to its listed peers (despite its smaller size). We also note that the multiples are significantly higher than Hunter Hall's multiples. This is consistent with Hunter Hall's forecast FUM outflows and the significant earnings growth forecast for the Proposed Merged Entity which is not reflected in growth forecasts of most comparable companies.

Comparable companies with recent strong growth and / or growth forecasts are AEI and K2. However, the aggregated FUM of Hunter Hall and Pengana as at 31 December 2016 was approximately $3.1 billion; 1.7x higher than AEI's FUM and 4.5x higher than K2's FUM at the same date. Furthermore, AEI does not have earnings forecasts and its historical results include extraordinary downward adjustments to earnings (discussed in Section 8.3). Excluding these costs, the implied historical EBITDA, EBIT and PE multiples for AEI are 16.6x, 17.2x and 26.8x respectively. Given that the Proposed Merged Entity's historical earnings do not include synergy benefits from the Proposed Transaction, we consider the forecast multiples to be the more relevant indicator of value. Therefore, we do not consider AEI's multiples to be a good comparison for the Proposed Merged Entity's.

The Proposed Merged Entity's forecast multiples are more in line with K2's current multiples. Similar to the Proposed Merged Entity, K2's earnings are also heavily performance fee dependent. Given K2's strong growth forecasts but significantly lower levels of FUM and more volatile performance fees than the Proposed Merged Entity, we consider it reasonable that the Proposed Merged Entity has higher implied forecast multiples than K2.

We have not identified any control transactions involving suitably comparable businesses for which there is sufficient publicly available information to calculate the relevant multiples for comparison purposes.

## 9.4 Analysis of share trading cross-check

Market trading in Hunter Hall shares since the announcement of Proposed Transaction may provide an indication of the market's assessment of the Proposed Merged Entity. In considering the implications of share trading for the value of the Proposed Merged Entity we note:

- When assessing market trading it is necessary to consider whether the market is informed and liquid. In this regard, we note that Hunter Hall shares are fairly tightly held reducing the number of shares available for market trading.
- We also note that the market has, to date, been provided with somewhat limited information concerning both Pengana and the prospects for the Proposed Merged Entity. Thus, market participants are less informed about the Proposed Merged Entity than they would typically be about a listed security. For these reasons, we do not consider an analysis of market trading to provide a particularly reliable assessment of the value of a Proposed Merged Entity share.
- After the Proposed Transaction was announced, market trading prices have increased to be in the range of $2.45 to $2.67, with a VWAP of $2.59. Until the Proposed Transaction is approved, there is a risk it will not complete. This risk will be reflected in market trading during the period analysed. Thus, it is expected that the market trading price will be below our assessed valuation of the Proposed Merged Entity.
- The market may not fully reflect our assessed value due to the execution risk associated with the Proposed Transaction, the significant gap between information available to us compared to information available to the market and the low liquidity of Hunter Hall shares.

As a result of these factors, on balance, we consider market trading provides some support to the assessed range for the value of a Proposed Merged Entity share, although it is not conclusive due to the limitations noted above.

## 9.5 Conclusion on value

Based on our discounted cash flow analysis and valuation cross-checks, we have selected a valuation range for a share in the Proposed Merged Entity of between $3.00 and $3.50, on a minority basis. We note that this is a relatively broad range which reflects the wide range of potential outcomes in relation to medium term FUM growth, performance fees and synergies.

# 10 EVALUATION

## 10.1 Fairness

We have assessed whether the Proposed Transaction is fair by comparing our assessed fair market value of a Hunter Hall share on a control basis before the Proposed Transaction with our assessed value of the consideration, being a Proposed Merged Entity share on a minority basis. This comparison is set out in the table below.

**Table 30: Assessment of fairness**

| | Low | High |
|---|---|---|
| Fair market value of a Hunter Hall share (control basis) | $2.90 | $3.10 |
| Fair market value of a Proposed Merged Entity share (minority basis) | $3.00 | $3.50 |

*Source: Leadenhall analysis*

Since the consideration offered is in line with our assessed range of values of a Hunter Hall share the Proposed Transaction is fair to Shareholders.

## 10.2 Reasonableness

We have defined the Proposed Transaction as reasonable if it is fair, or if despite not being fair, there are sufficient reasons for Shareholders to vote for the proposal. We have therefore considered the following advantages and disadvantages of the Takeover Offer to Shareholders.

### 10.2.1 Advantages

**Scale and liquidity**

If the Proposed Transaction is completed, Shareholders will hold shares in the Proposed Merged Entity, which is a considerably larger business than Hunter Hall. This should lead to increased liquidity in Hunter Hall shares as well as a potential market re-rating.

**Likely share price**

Hunter Hall's share price responded positively to the announcement of the Proposed Transaction. If the transaction is not approved, it is likely that the price will decrease, at least to the levels prior to the announcement of the Proposed Transaction and potentially further.

**Growth potential**

Hunter Hall's FUM is currently declining and is not expected to see rapid growth in the near future on a standalone basis. By comparison, Pengana is currently experiencing significant growth in FUM, which is projected to continue for the medium term. This growth more than outweighs the projected outflows for Hunter Hall in the Proposed Merged Entity. Thus, if the Proposed Transaction is completed, Shareholders will be exposed to a company with significant growth expectations, which may in time lead to share price appreciation.

**Stability and succession planning**

Since the resignation of Peter Hall, Hunter Hall has been considering the long-term structure of its investment team. This leads to a degree of uncertainty for investors in both Hunter Hall and its funds. The Proposed Transaction removes this uncertainty by merging Hunter Hall with Pengana, which has adequate resources to manage the Hunter Hall funds as well as its own existing funds.

**Potential synergies**

Our valuation of the Proposed Merged Entity does not allow for any revenue synergies from combining Hunter Hall and Pengana. However, Pengana management believes they will be able to achieve revenue synergies, by reducing the outflows from Hunter Halls funds and potentially attracting inflows to those funds. If these synergies are achieved that will represent upside to Hunter Hall shareholders.

#### 10.2.2 Disadvantages

**Loss of control**

If the Proposed Transaction is completed Shareholders will lose control of Hunter Hall. However, the Proposed Merged Entity will have two major shareholders, making it less likely that one individual holder can implement decisions in its own favour at the expense of other investors.

**Pengana is not paying the full value of synergy benefits**

Pengana and Hunter Hall have identified significant synergy benefits that could be realised by combining the businesses. Based on our analysis of the Proposed Transaction, Pengana does not appear to be paying a material amount related to potential synergies, as the consideration offered is consistent with our assessed value of a Hunter Hall share including only a moderate level cost synergies that we believe could be realised by alternative acquirers. However, in the absence of a competing proposal, it is common for an acquirer not to pay the full value of potential synergies they may obtain in a business combination.

**Risks of achieving FUM growth and synergies**

Our assessed value of the Proposed Merged Entity includes significant projected growth in FUM for Pengana as well as significant projected synergy savings. There is a risk that these expectations will not be realised (or fully valued by the market), in which case the value of the Proposed Merged Entity may decline or fail to trade at levels implied by our assessed value. These risks are not currently faced by Hunter Hall shareholders. However, Hunter Hall on a standalone basis faces risks in relation to continued FUM outflows.

**Proportionate share of combined business**

Hunter Hall represents 28% of the combined value of Hunter Hall and Pengana before the Proposed Transaction, based on our stand-alone valuations of the two entities. If the Proposed Transaction proceeds, Hunter Hall shareholders will hold 27% of the Proposed Merged Entity. Thus Hunter Hall shareholders will receive a slightly lower share of the synergies expected to be realised from the Proposed Transaction than the proportion of pre-transaction value contributed by Hunter Hall.

**No longer an ethical investment pure play**

Hunter Hall currently provides ethically screened investments only. By contrast Pengana provides investments that are not ethically screened. Thus, investors that chose to invest in Hunter Hall from an ethical stand-point may not wish to hold an investment in the Proposed Merged Entity.

#### 10.2.3 Conclusion on reasonableness

As the Proposed Transaction is fair it is also reasonable.

### 10.3 Opinion

The Proposed Transaction is fair and reasonable to Shareholders.

# APPENDIX 1: GLOSSARY

| Term | Meaning |
|---|---|
| Advisor | Advisor to WHSP |
| All Ords | Australian All Ordinaries Accumulation Index |
| AEF | Pengana Australian Equities Fund |
| AEI | Australian Ethical Investment |
| AMP | AMP Limited |
| ASIC | Australian Securities and Investments Commission |
| ASX | ASX Limited |
| AUD | Australian Dollar |
| AVT | Hunter Hall Australian Value Trust |
| BT | BT Investment Management |
| CAGR | Compound annual growth rate |
| CAPM | Capital Asset Pricing Model |
| CBA | Commonwealth Bank of Australia Limited |
| CFS | Colonial First State |
| CFSGAM | Colonial First State Global Asset Management |
| CommSec | Commonwealth Securities Limited |
| Consultant | External consultant commissioned by the Advisor to assess the prospects for Pengana's business and funds |
| Corporations Act | The Corporations Act 2001 |
| Dealer groups | Financial and wealth advisory practices |
| DLOC | Discount for lack of control |
| EBIT | Earnings before interest and tax |
| EBITDA | Earnings before interest, tax, depreciation and amortisation |
| ECF | Pengana Emerging Companies Fund |
| Explanatory Memorandum | The explanatory memorandum prepared by the Directors of Hunter Hall in relation to the Proposed Transaction |
| Fair market value | The price, expressed in terms of cash equivalents, at which property would change hands between a hypothetical willing and able buyer and a hypothetical willing and able seller, acting at arms' length in an open and unrestricted market, when neither is under compulsion to buy or sell and when both have reasonable knowledge of the relevant facts |
| FOS | Financial Ombudsman Service |
| FSG | Financial Services Guide |
| FUM | Funds under management |
| FY | Financial year |
| GDG | Hunter Hall Global Deep Green Trust |
| GET | Hunter Hall Global Equities Trust |
| GSC | Global Small Companies Fund |
| HCT | Hunter Hall High Conviction Equities Trust |
| HHIML | Hunter Hall Investment Management Limited |
| HHV | Hunter Hall Global Value Limited |
| Hunter Hall | Hunter Hall International Limited |
| IEF | Pengana International Equities Fund |
| IMA | Investment Management Agreement |
| K2 | K2 Asset Management |
| Leadenhall | Leadenhall Corporate Advisory Pty Ltd |
| Lizard | Lizard Investors LLC |
| Magellan | Magellan Financial Group |
| MAM | Macquarie Asset Management |

| | |
|---|---|
| Master Fund | Pengana Asia Special Events Master Fund |
| Milliman | Milliman Pty Ltd |
| MSCI ACWI Net AUD unhedged | MSCI All Country World Total Return Index Net unhedged in Australian dollars |
| MSCI AWI SMID Cap Net AUD unhedged | MSCI All Country World Index SMID Cap unhedged in Australian dollars |
| MSCI World Index | MSCI World Total Return Index |
| NAB | National Australia Bank |
| NAV | Net asset value |
| NPAT | Net profit after tax |
| NTA | Net tangible assets |
| Offshore Fund | Pengana Asia Special Events (Offshore) Fund |
| PanAgora | PanAgora Asset Management, Inc |
| PanAgora Arrangement | Arrangement entered into by PanAgora and Pengana on 25 June 2015 |
| PanAgora Fund | PanAgora Absolute Return Global Equities Fund |
| PARAPF | Pengana Absolute Return Asia Pacific Fund |
| PASE | Pengana Asia Special Events (Offshore) Fund and Master Fund |
| PBT | Profit before tax |
| Pengana | Pengana Holdings Pty Ltd |
| Pengana Model | Forecast model for Pengana for the period FY17 to FY21 prepared by the Advisor |
| PIEFMR | Pengana International Equities Fund Managed Risk |
| Pinnacle | Pinnacle Investment Management Group |
| RG74 | Regulatory Guide 74: Acquisitions Approved by Members |
| RG111 | Regulatory Guide 111: Content of Expert Reports |
| s606 | Section 606 of the Corporations Act 2001 |
| s611 | Section 611 of the Corporations Act 2001 |
| SAA | Binding Sub-Advisory Agreement dated 11 March 2015 appointing Lizard as the investment manager of GSC |
| Shareholders | Hunter Hall shareholders not associated with WHSP |
| Small Ords | S&P/ASX Small Ordinaries Accumulation Index |
| Proposed Merged Entity | The integrated Hunter Hall and Pengana following the Proposed Transaction |
| Proposed Transaction | The proposed acquisition of Pengana by Hunter Hall for the issue of 74.1 million Hunter Hall shares equivalent to a 73% holding in the Hunter Hall post-transaction |
| RITC | Reduced income tax credit |
| VGT | Hunter Hall Value Growth Trust |
| VWAP | Volume weighted average price |
| WACC | Weighted Average Cost of Capital |
| WAM | Wilson Asset Management |
| WHSP | Washington H Soul Pattinson & Company Limited |

# APPENDIX 2: VALUATION METHODOLOGIES

In preparing this report we have considered valuation methods commonly used in practice and those recommended by RG 111. These methods include:

- The discounted cash flow method
- The capitalisation of earnings method
- Asset based methods
- Analysis of share market trading
- Industry specific rules of thumb

The selection of an appropriate valuation method to estimate fair market value should be guided by the actual practices adopted by potential acquirers of the company involved.

## Discounted Cash Flow Method

### Description

Of the various methods noted above, the discounted cash flow method has the strongest theoretical standing. It is also widely used in practice by corporate acquirers and company analysts. The discounted cash flow method estimates the value of a business by discounting expected future cash flows to a present value using an appropriate discount rate. A discounted cash flow valuation requires:

- A forecast of expected future cash flows
- An appropriate discount rate

It is necessary to project cash flows over a suitable period of time (generally regarded as being at least five years) to arrive at the net cash flow in each period. For a finite life project or asset this would need to be done for the life of the project. This can be a difficult exercise requiring a significant number of assumptions such as revenue growth, future margins, capital expenditure requirements, working capital movements and taxation.

The discount rate used represents the risk of achieving the projected future cash flows and the time value of money. The projected future cash flows are then valued in current day terms using the discount rate selected.

The discounted cash flow method is often sensitive to a number of key assumptions such as revenue growth, future margins, capital investment, terminal growth and the discount rate. All of these assumptions can be highly subjective sometimes leading to a valuation conclusion presented as a range that is too wide to be useful.

### Use of the Discounted Cash Flow Method

A discounted cash flow approach is usually preferred when valuing:

- Early stage companies or projects
- Limited life assets such as a mine or toll concession
- Companies where significant growth is expected in future cash flows
- Projects with volatile earnings

It may also be preferred if other methods are not suitable, for example if there is a lack of reliable evidence to support a capitalisation of earnings approach. However, it may not be appropriate if:

- Reliable forecasts of cash flow are not available and cannot be determined
- There is an inadequate return on investment, in which case a higher value may be realised by liquidating the assets than through continuing the business

## Capitalisation of Earnings Method

### Description

The capitalisation of earnings method is a commonly used valuation methodology that involves determining a future maintainable earnings figure for a business and multiplying that figure by an appropriate capitalisation multiple. This methodology is generally considered a short form of a discounted cash flow, where a single representative earnings figure is capitalised, rather than a stream of individual cash flows being discounted. The capitalisation of earnings methodology involves the determination of:

- A level of future maintainable earnings
- An appropriate capitalisation rate or multiple.

A multiple can be applied to any of the following measures of earnings:

**Revenue** – most commonly used for companies that do not make a positive EBITDA or as a cross-check of a valuation conclusion derived using another method.

**EBITDA** - most appropriate where depreciation distorts earnings, for example in a company that has a significant level of depreciating assets but little ongoing capital expenditure requirement.

**EBITA** - in most cases EBITA will be more reliable than EBITDA as it takes account of the capital intensity of the business.

**EBIT** - whilst commonly used in practice, multiples of EBITA are usually more reliable as they remove the impact of amortisation which is a non-cash accounting entry that does not reflect a need for future capital investment (unlike depreciation).

**NPAT** - relevant in valuing businesses where interest is a major part of the overall earnings of the group (e.g. financial services businesses such as banks).

Multiples of EBITDA, EBITA and EBIT are commonly used to value whole businesses for acquisition purposes where gearing is in the control of the acquirer. In contrast, NPAT (or P/E) multiples are often used for valuing minority interests in a company.

The multiple selected to apply to maintainable earnings reflects expectations about future growth, risk and the time value of money all wrapped up in a single number. Multiples can be derived from three main sources. Using the guideline public company method, market multiples are derived from the trading prices of stocks of companies that are engaged in the same or similar lines of business and that are actively traded on a free and open market, such as the ASX. The merger and acquisition method is a method whereby multiples are derived from transactions of significant interests in companies engaged in the same or similar lines of business. It is also possible to build a multiple from first principles.

### Use of the Capitalisation of Earnings Method

The capitalisation of earnings method is widely used in practice. It is particularly appropriate for valuing companies with a relatively stable historical earnings pattern which is expected to continue. This method is less appropriate for valuing companies or assets if:

- There are no suitable listed company or transaction benchmarks for comparison
- The asset has a limited life
- Future earnings or cash flows are expected to be volatile
- There are negative earnings or the earnings of a business are insufficient to justify a value exceeding the value of the underlying net assets

# Asset Based Methods

### Description

Asset based valuation methods estimate the value of a company based on the realisable value of its net assets, less its liabilities. There are a number of asset based methods including:

- Orderly realisation
- Liquidation value
- Net assets on a going concern basis
- Replacement cost
- Reproduction cost

The orderly realisation of assets method estimates fair market value by determining the amount that would be distributed to shareholders, after payment of all liabilities including realisation costs and taxation charges that arise, assuming the company is wound up in an orderly manner. The liquidation method is similar to the orderly realisation of assets method except the liquidation method assumes the assets are sold in a shorter time frame. Since wind up or liquidation of the company may not be contemplated, these methods in their strictest form may not necessarily be appropriate. The net assets on a going concern basis method estimates the market values of the net assets of a company but does not take account of realisation costs.

The asset / cost approach is generally used when the value of the business' assets exceeds the present value of the cash flows expected to be derived from the ongoing business operations, or the nature of the business is to hold or invest in assets. It is important to note that the asset approach may still be the relevant approach even if an asset is making a profit. If an asset is making less than an economic rate of return and there is no realistic prospect of it making an economic return in the foreseeable future, an asset approach would be the most appropriate method.

### Use of Asset Based Methods

An asset-based approach is a suitable valuation method when:

- An enterprise is loss making and is not expected to become profitable in the foreseeable future
- Assets are employed profitably but earn less than the cost of capital
- A significant portion of the company's assets are composed of liquid assets or other investments (such as marketable securities and real estate investments)
- It is relatively easy to enter the industry (for example, small machine shops and retail establishments)

Asset based methods are not appropriate if:

- The ownership interest being valued is not a controlling interest, has no ability to cause the sale of the company's assets and the major holders are not planning to sell the company's assets
- A business has (or is expected to have) an adequate return on capital, such that the value of its future income stream exceeds the value of its assets

# Analysis of Share Trading

The most recent share trading history provides evidence of the fair market value of the shares in a company where they are publicly traded in an informed and liquid market. There should also be some similarity between the size of the parcel of shares being valued and those being traded. Where a company's shares are publicly traded then an analysis of recent trading prices should be considered, at least as a cross-check to other valuation methods.

# Industry Specific Rules of Thumb

Industry specific rules of thumb are used in certain industries. These methods typically involve a multiple of an operating figure such as eyeballs for internet businesses, numbers of beds for hotels etc. These methods are typically fairly crude and are therefore usually only appropriate as a cross-check to a valuation determined using an alternative method.

# APPENDIX 3: DISCOUNT RATE

The selected discount rates applied in our DCF analysis for Hunter Hall and the Proposed Merged Entity have been determined using the weighted average cost of capital ("**WACC**"). We have estimated the cost of equity with the capital asset pricing model ("**CAPM**").

### Post-tax cost of equity ($K_e$)

The CAPM is based on the assumption that investors require a premium for investing in equities rather than in risk-free investments (such as government bonds). The cost of equity, $K_e$, is the rate of return that investors require to make an equity investment in a firm.

The cost of equity capital under CAPM is determined using the following formula:

$$K_e = R_f + \beta \times (R_m - R_f) + \alpha$$

The components of the CAPM formula are:

**Table 31: Components of CPAM**

| Input | Definition |
|---|---|
| $K_e$ | The required post-tax return on equity |
| $R_f$ | The risk-free rate of return |
| $R_m$ | The expected return on the market portfolio |
| MRP | The market risk premium ($R_m - R_f$) |
| $\beta$ | The beta, the systematic risk of a stock (this is an equity or levered beta) |
| $\alpha$ | The specific company risk premium |

Each of the components in the above equation is discussed below.

### Risk-free rate ($R_f$)

The relevant risk-free rate of return is the return on a risk-free security, typically over a long-term period. In practice, long dated government bonds are an acceptable benchmark for the risk-free security. We have selected a risk-free rate of 2.70%, being the yield on 10 year Australian Government bonds as at 28 March 2017.

### Equity market risk premium (MRP)

The MRP ($R_m - R_f$) represents the additional return that investors expect from an investment in a well-diversified portfolio of assets (such as a market index). It is the excess return above the risk-free rate that investors demand for their increased exposure to risk, when investing in equity securities.

Leadenhall undertakes a review of the MRP at least every six months, taking account of market trading levels and industry practice at the time. Based on this research, we have adopted an MRP of 6.5%.

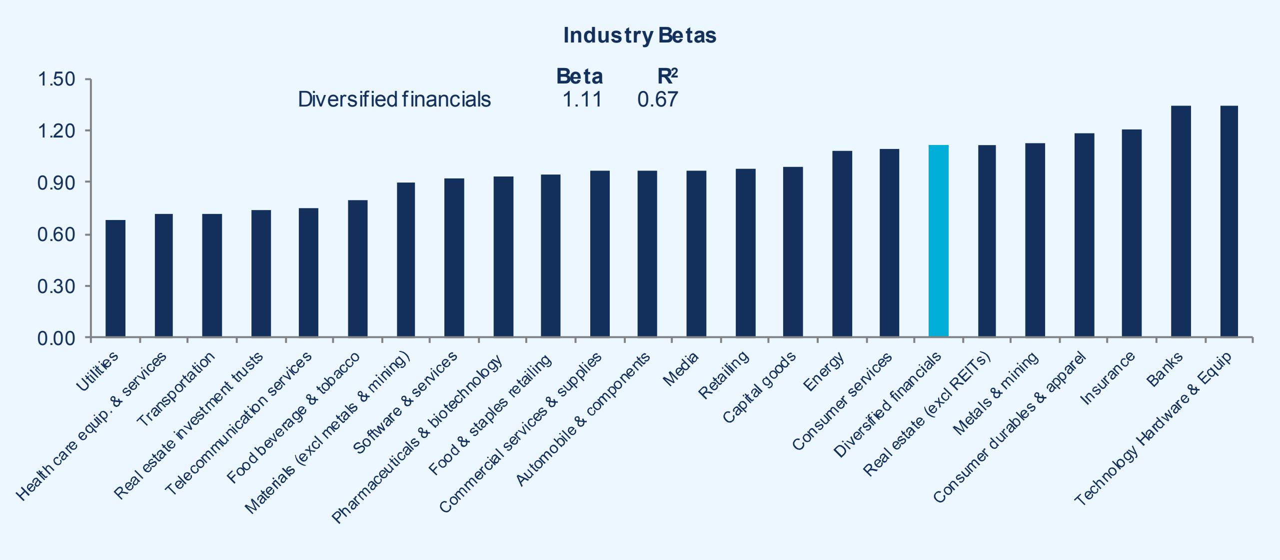
### Beta estimate ($\beta$)

#### *Description*

The beta factor is a measure of the risk of an investment or business operation, relative to a well-diversified portfolio of assets. The only risks that are captured by beta are those risks that cannot be eliminated by the investor through diversification. Such risks are referred to as systematic, undiversifiable or uninsurable risk.

Beta is a measure of the relative riskiness of an asset in comparison to the market as a whole – by definition the market portfolio has an equity beta of 1.0. The equity beta's of various Australian industries listed on the Australian Stock Exchange are reproduced below.

**Figure 22: Industry betas**




*Source: SIRCA as at 31 December 2016 (latest available)*

Betas derived from share market observations represent equity betas, which reflect the degree of financial gearing of the company. In order to eliminate the impact of differing capital structures, analysts often 'unlever' observed betas to calculate an asset beta. The selected asset beta is then 'relevered' with a target level of debt. In this instance the unlevering and relevering process is unnecessary as the comparable companies generally have no debt.

The betas of Hunter Hall and companies with similar business are included in the following table.

**Table 32: Comparable company betas**

| Company | Equity Beta | | | $R^2$ | | |
|---|---|---|---|---|---|---|
| | SIRCA | Factset | Leadenhall | SIRCA | Factset | Leadenhall |
| Australian Ethical Investment Ltd | *0.16* | *0.16* | *0.16* | 0.01 | 0.01 | 0.01 |
| BT Investment Management Limited | *2.05* | *1.70* | *1.67* | 0.43 | 0.35 | 0.34 |
| HFA Holdings Limited | *0.47* | *0.37* | *0.35* | 0.03 | 0.02 | 0.02 |
| Hunter Hall International Limited | 1.39 | 1.33 | 1.29 | 0.15 | 0.14 | 0.13 |
| IOOF Holdings Ltd | 1.58 | 1.41 | 1.41 | 0.58 | 0.56 | 0.55 |
| K2 Asset Management Holdings Ltd | *1.93* | 1.33 | 1.33 | 0.23 | 0.19 | 0.18 |
| Magellan Financial Group Ltd | 1.26 | 0.93 | 0.92 | 0.20 | 0.13 | 0.14 |
| Perpetual Limited | 1.51 | 1.30 | 1.29 | 0.46 | 0.39 | 0.38 |
| Platinum Asset Management Ltd | 1.33 | 1.04 | 1.04 | 0.26 | 0.20 | 0.20 |
| Pacific Current Group Ltd | 1.36 | 1.05 | 1.06 | 0.20 | 0.12 | 0.13 |
| Fiducian Group Ltd | 0.86 | 0.71 | 0.75 | 0.10 | 0.08 | 0.09 |
| **Average** | **1.26** | **1.03** | **1.03** | | | |
| **Average excluding outliers[1]** | **1.33** | **1.14** | **1.14** | | | |
| **Median** | **1.36** | **1.05** | **1.06** | | | |

*Source: SIRCA, FactSet and Leadenhall analysis as at 20 March 2017*
*Note:*
1. *Excluded outliers are presented in grey italics.*
2. *$R^2$ is a measure of how well the regression approximates the underlying data.*

### *Selected beta ($\beta$)*

In selecting an appropriate beta for Hunter Hall and the Proposed Merged Entity, we have considered the following:

- The average equity beta of the comparable Australian companies is between 1.03 and 1.26
- The median equity beta of the comparable Australian companies is between 1.05 and 1.36
- The most relevant industry beta is 1.11
- Hunter Hall's observed beta is a single data point with a relatively low $R^2$ and should thus not be relied upon in isolation
- We consider the similarities between in the nature of Hunter Hall's business and the Proposed Merged Entity's business to be sufficient to warrant the selection of the same beta for both entities.

As a result of these considerations we have selected an equity beta between 1.1 and 1.2 for both Hunter Hall and the Proposed Merged Entity.

## Specific company risk premium (α)

### *Size premium*

The size premium is the additional return that investors require for the risks of investing in small businesses. To date it has not been possible to isolate the specific causes of size premiums (other than simply size), many factors have been suggested including:

- Depth of management
- Reliance on key personnel
- Weak market position
- Reliance on key customers
- Reduced access to capital
- Deeper pool of investors for larger companies
- Reliance on key suppliers
- Lack of geographic diversification
- Limited access to technology
- Absence of broker analysis
- Supplier concentration
- Investors in large companies often more diversified

A number of studies have been undertaken attempting to measure the size premium, in particular in the US. The Valuation Handbook published by Duff & Phelps contains calculations of the size premium for each decile of market capitalisation. As the size premium is most significant for very small companies, the tenth decile is then further divided into four equal segments. The following table summarises the size premium data from the 2015 Valuation Handbook.

**Table 33: Evidence of size premium**

| Size Premium | | | |
|---|---|---|---|
| **Decile** | **Mkt Cap Range (US$m)** | | **Size** |
| | ***Low*** | ***High*** | **Premium** |
| 1 (Largest) | 24,429 | 591,016 | -0.4% |
| 2 | 10,171 | 24,273 | 0.6% |
| 3 | 5,864 | 10,106 | 0.9% |
| 4 | 3,723 | 5,845 | 1.1% |
| 5 | 2,552 | 3,724 | 1.6% |
| 6 | 1,689 | 2,543 | 1.7% |
| 7 | 1,011 | 1,687 | 1.7% |
| 8 | 549 | 1,011 | 2.2% |
| 9 | 301 | 549 | 2.7% |
| 10w | 232 | 301 | 3.2% |
| 10x | 191 | 232 | 5.5% |
| 10y | 116 | 191 | 7.5% |
| 10z (Smallest) | 3 | 116 | 12.0% |

*Source: Duff & Phelps 2015 Valuation Handbook*
*Notes:*
*1. Measured over the period from January 1926 to December 2013*
*2. Size premium compared to return predicted by CAPM*
*3. Market capitalisation as at 31 December 2013*

As mentioned above, the existence of the size premium has been well documented. However, there are limited studies setting out the appropriate bands of size premium and the quantum of size premium applicable to each band. For this reason, the above table should be taken as broad support for the size effect and not an exact guide to the extent of any particular discount or premium that should be applied.

Although there is considerable evidence from the US, in the Australian context, the relatively small size of the Australian equity market makes it more difficult to observe the existence of this phenomenon.

Leadenhall and others have conducted a number of high level studies which have confirmed the existence of the size effect in the Australian market. However, we are not aware of any Australian studies that have been performed with the same detail and rigour as the US studies, such as the Duff & Phelps data presented above. Based on the evidence from US studies and our knowledge of prices actually paid in Australian transactions, from which a discount rate can be implied, we believe the size premium ranges in the below table are appropriate. This table should be taken as a guide to the appropriate size premium for a given business and needs to be considered in conjunction with the specific circumstances of a particular business.

**Table 34: Leadenhall size premium bandings**

| Size Premium Guide for Australia | | | | |
|---|---|---|---|---|
| **Size** | **Mkt Cap Range (AU$m)** | | **Size Premium** | |
| | ***Low*** | ***High*** | ***Low*** | ***High*** |
| Largest | 4,000 | Above | - | - |
| Large | 1,000 | 4,000 | - | 1.0% |
| Mid-cap | 300 | 1,000 | 1.0% | 2.0% |
| Low-cap | 100 | 300 | 2.0% | 3.0% |
| Small-cap | 50 | 100 | 3.0% | 5.0% |
| Micro-cap | 10 | 50 | 5.0% | 8.0% |
| *Medium private [1]* | *5* | *10* | *8.0%* | *11.0%* |
| *Small private [1]* | *2* | *5* | *11.0%* | *15.0%* |
| *Smallest [1]* | *-* | *2* | *15.0%* | *20.0%* |

*Note:*

1. *We do not generally consider the CAPM model to be reliable for entities of this size as they often do not meet the background assumptions underpinning the CAPM. In particular investors are often not diversified and it is rarely possible to lend or borrow stock of entities this size. These suggested size premiums are therefore presented as an approximate guide only as alternate models, studies and rules of thumb are commonly utilised for these types of companies.*

*Source: Leadenhall analysis*

Based on our assessed valuations, Hunter Hall would be considered a small-cap company and as such a size premium of between 3.5% and 4.0% would generally apply. By contrast, the Proposed Merged Entity would be at the low end of the mid-cap company range and thus a size premium of approximately 2.0% would be appropriate. However, we have also considered how the factors leading to the generally observed size premiums apply to Hunter Hall and the Proposed Merged Entity. In particular, we note that:

- Hunter Hall has a strong and experienced board of directors supporting a management team which also has reasonable depth and experience for a business of this size, while Pengana has a very strong board and management team for an entity of its size.
- Hunter Hall has a low level of key client dependence given the wide spread of funds and investors. This will be further reduced by the addition of Pengana in the Proposed Merged Entity.
- The key person risk common with smaller businesses has effectively been taken into account in the projected cash flows of Hunter Hall which already reflect the impact of Peter Hall's departure. Thus, including an allowance for this risk in the discount rate would be double counting. Pengana has a business model designed to minimise key person risk, for example by:
  - diversifying investment teams across the various funds managed
  - ensuring investment teams have a significant amount of their own money invested in the funds they manage
  - promoting more than one portfolio manager for each fund.

After considering these factors, we have selected a size premium of 1.5% to 2.0% for Hunter Hall and no size premium for the Proposed Merged Entity.

***Other company specific risks***

The specific company risk premium adjusts the cost of equity for company specific factors, including unsystematic risk factors such as reliance on key customers, reliance on key suppliers, existence of contingent liabilities etc. We consider that these factors are reflected in either the cash flow forecasts or adjustments to size premium discussed above for Hunter Hall, thus we have not applied an additional company specific risk premium on top of the size premium for Hunter Hall.

By contrast the cash flows for Pengana included in the Proposed Merged Entity include substantial projected growth, as well as relying on the achievement of synergies. Both of these factors increase the level of risk of achieving the forecasts. We have quantified the potential impact of these risks as follows:

- Including a specific risk premium of approximately 1.0% in the discount rate of the Proposed Merged Entity results in the same assessed value for the Proposed Merged Entity as assuming only 50% of the projected FUM growth is achieved.
- Allowing for a specific risk premium of approximately 0.5% results in the same assessed value for the Proposed Merged Entity as assuming only 50% of the projected synergy benefits are achieved.

There are also a number of areas where the Pengana cashflow forecasts may be exceeded, for example if revenue synergies are achieved. This potential reduces the level of specific risk premium that should be applied. After considering these factors, we have applied a specific risk premium to the Proposed Merged Entity of 0.5% to 1.5%.

### Dividend Imputation

Since July 1987, Australia has had a dividend imputation system in place, which aims to remove the double taxation effect of dividends paid to investors. Under this system, domestic equity investors receive a taxation credit (franking credit) for any tax paid by a company. The franking credit attaches to any dividends paid out by a company and the franking credit offsets personal tax. To the extent the investor can utilise the franking credit to offset personal tax, then the corporate tax is now not a real impost. It is best considered as a withholding tax for personal taxes. It can therefore be argued that the benefit of dividend imputation should be added to any analysis of value.

However, in our view, the evidence relating to the value that the market attributes to imputation credits is inconclusive. There are diverse views as to the value of imputation credits and the appropriate method that should be employed to calculate this value. Due to the uncertainty surrounding the extent to which acquirers of assets factor in dividend imputation, we have taken the conservative approach and not factored in dividend imputation.

### Conclusion on cost of equity

The following table sets out our cost of equity estimate for Hunter Hall and the Proposed Merged Entity based on the assumptions and inputs discussed above:

**Table 35: Estimated cost of equity (post-tax, nominal)**

| Discount rate | Hunter Hall | | Proposed Merged Entity | |
|---|---|---|---|---|
| | Low | High | Low | High |
| Risk-free rate | 2.70% | 2.70% | 2.70% | 2.70% |
| Equity beta | 1.10 | 1.20 | 1.10 | 1.20 |
| Market risk premium | 6.50% | 6.50% | 6.50% | 6.50% |
| Specific company risk premium | 1.50% | 2.00% | 0.50% | 1.50% |
| **Calculated cost of equity** | **11.35%** | **12.50%** | **10.35%** | **12.00%** |

*Source: Leadenhall analysis*

### Corporate tax rate ($t_c$)

The corporate tax rate in Australia is 30%. In calculating the WACC for Hunter Hall and the Proposed Merged Entity we have therefore used this rate of 30%.

### Cost of debt capital ($K_d$)

The cost of borrowing is the expected future borrowing cost of the relevant project and/or business. The cost of debt is not relevant to our analysis as we have assumed there is no debt in an optimal capital structure for Hunter Hall or the Proposed Merged Entity.

### Debt and equity mix

The selection of an appropriate capital structure is a subjective exercise. The tax deductibility of the cost of debt means that the higher the proportion of debt, the lower the WACC for a given cost of equity. However, at significantly higher levels of debt, the marginal cost of borrowing would increase due to the greater risk which debt holders are exposed to. In addition, the cost of equity would also be likely to increase due to equity investors requiring a higher return given the higher degree of financial risk that they have to bear.

Ultimately for each company there is likely to be a level of debt/equity mix that represents the optimal capital structure for that company. In estimating the WACC, the debt/equity mix assumption should reflect what would be the optimal or target capital structure for the relevant asset. For both Hunter Hall and the Proposed Merged Entity we have selected a capital structure with no debt based on the comparable companies' gearing levels, the nature of the businesses and their actual current gearing levels.

### Calculation of WACC

The table below summarises the discount rates we have derived for Hunter Hall and the Proposed Merged Entity, based on the assumptions and inputs discussed above.

**Table 36: Estimated WACC (post-tax, nominal)**

| Discount rate | Hunter Hall | | Proposed Merged Entity | |
|---|---|---|---|---|
| | Low | High | Low | High |
| **Calculated cost of equity** | **11.35%** | **12.50%** | **10.35%** | **12.00%** |
| Debt to enterprise value ratio | 0.0% | 0.0% | 0.0% | 0.0% |
| Tax rate | 30.0% | 30.0% | 30.0% | 30.0% |
| Cost of debt | N/a | N/a | N/a | N/a |
| **Calculated WACC** | **11.35%** | **12.50%** | **10.35%** | **12.00%** |
| **Selected WACC** | **11.5%** | **12.5%** | **10.5%** | **12.0%** |

*Source: Leadenhall analysis*

# APPENDIX 4: COMPARABLE COMPANIES

The following company descriptions are extracted from descriptions provided by FactSet.

| Company | Description |
|---|---|
| Australian Ethical Investment Ltd | Australian Ethical Investment Ltd. provides investment management services. The company invests in portfolio of industries, which includes clean energy, Sustainable Products, Medical Solutions, Innovative Technology, Healthcare, Recycling, Energy Efficiency, Education and aged care. Australian Ethical Investment was founded in 1986 and is headquartered in Sydney, Australia. |
| BT Investment Management Limited | BT Investment Management Ltd. engages in the provision of investment management services. It manages funds across different investments, including equities, fixed income, cash and global macro products. The firm provides investment management services to institutional clients as well as to all of BTIM's registered and unregistered trusts. The company operates through two segments comprise of the investment management business in Australia (BTIM) and outside of Australia (BTIM UK). BT Investment Management was founded on October 19, 2007 and is headquartered in Sydney, Australia. |
| Fiducian Group Ltd | Fiducian Group Ltd. Is a financial services company, which provides financial services solutions both individuals and organizations. It provides financial planning, funds management, investment platform administration, information technology and accounting/accountancy resourcing services. The company operates through its segments: Platform Administration, Financial Planning, Business Services, Funds Management and Administration. It services include wrap platforms and client portfolio administration, wealth management and financial planning services, information technology solutions for financial planners. Fiducian Group was founded by Inderjit Singh in 1996 and is headquartered in Sydney, Australia. |
| HFA Holdings Limited | HFA Holdings Ltd. engages in global funds management business, primarily providing absolute return fund products and services to investors. It operates through two business subsidiaries: Lighthouse Investment Partners, LLC; and Certitude Global Investments Ltd. The Lighthouse Investment Partners engages in the business of hedge fund investing. The Certitude Global Investments focuses on providing Australian investors access to global investment opportunities across a variety of asset classes. The company was founded in 1998 and is headquartered in Brisbane, Australia. |
| Hunter Hall International Limited | Hunter Hall International Ltd. engages in the investment management business. It operates through the following segments: Investment Management Business, Investing Activities, and Consolidation of Seeded Funds. The Investment Management Business segment refers to five retail equity funds managed by the company. The Investing Activities segment comprises the investment services. The Consolidation of Seeded Funds segment includes the new funds seeded by the company. The company was founded by Peter James MacDonald Hall on March 3, 1993 and is headquartered in Sydney, Australia. |
| IOOF Holdings Ltd | IOOF Holdings Ltd. engages in the provision of financial services. It operates through the following segments: Platform Management and Administration, Investment Management, Financial Advice and Distribution, Trustee Services, and Corporate and Other. The Platform Management and Administration segment involves in providing administration and management services, which offer a single access point to investment products. The Investment Management segment offers management and investment of money on behalf of corporate, superannuation, institutional clients, and private individual investor clients. The Financial Advice and Distribution segment includes financial planning advice and stock broking services supported by services such as investment research, training, compliance support, and access to financial products. The Trustee Services segment consists of estate planning, trustee, custodial, agency and estate administration services. The Corporate and Other segment comprises of strategic, shareholder or governance nature incurred in carrying on business. The company was founded in 1846 and is headquartered in Melbourne, Australia. |

| Company | Description |
|---|---|
| K2 Asset Management Holdings Ltd | K2 Asset Management Holdings Ltd. operates as a holding company of K2 Asset Management Ltd. K2 Asset Management specializes in funds management. It has three investment funds focuses on Australian, Asian and international equities markets. K2 Asset Management Holdings was founded on March 27, 2007 and is headquartered in Melbourne, Australia. |
| Magellan Financial Group Ltd | Magellan Financial Group Ltd. is an Australia based fund management company. It manages global equities and global listed infrastructure strategies for high net worth, retail and institutional investors. It operates through three segments: Funds Management, Principal Investments and Corporate. The company was founded by Hamish Macquarie Douglass and Christopher John Mackay on March 19, 2004 and is headquartered in Sydney, Australia. |
| Pacific Current Group Ltd | Pacific Current Group Ltd. is an investment and financial services business focused on boutique funds management companies. The company invests in and supports the management of small to medium sized asset management companies. It provides funds management services to institutions, master funds and wraps, retail investors and private clients. The company offering can include Capital investment structured as equity, debt or otherwise for various purposes, distribution and marketing services, responsible entity services and other business support services including risk and compliance, accounting, finance, HR and operations. The company was founded by Lee IaFraté in 1998 and is headquartered in Sydney, Australia. |
| Perpetual Limited | Perpetual Ltd. operates as an independent and diversified financial services group, which provides specialized investment management, wealth advice and corporate fiduciary services to individuals, families, financial advisers and institutions. It operates through the following segments: Perpetual Investments, Perpetual Private and Perpetual Corporate Trust. The Perpetual Investments segment manufactures financial products, management and investment of monies on behalf of private, corporate, superannuation and institutional clients. The Perpetual Private segment provides a range of investment and non-investment products and services, including a comprehensive advisory service, portfolio management, philanthropic, executorial and trustee services to high net worth and emerging high net worth Australians. This segment also provides many of these services to charities, not for profit and other philanthropic organizations. The Perpetual Corporate Trust segment provides fiduciary services incorporating safe-keeping and recording of assets and transactions as custodian, responsible entity services, trustee services for securitization, unit trusts, REITS and debt securities, data warehouse and investor reporting and registrar, or agent for corporate and financial services clients. Perpetual was founded on September 28, 1886 and is headquartered in Sydney, Australia. |
| Platinum Asset Management Ltd | Platinum Asset Management Ltd. is a non-operating holding company, which engages in the provision of financial services. It operates through the following business segments: Funds Management, Investments and Other segments. The Funds Management segment deals with investment vehicles. The Investments and Other segment include foreign cash holdings, dollar term deposits, and trust funds. The company was founded by Kerr Neilson and Andrew M. Clifford in February 1994 and is headquartered in Sydney, Australia. |

# APPENDIX 5: CONTROL PREMIUM

### Background

The difference between the control value and the liquid minority value is the control premium. The opposite of a control premium is a minority discount (also known as a discount for lack of control). A control premium is said to exist because the holder of a controlling stake has several rights that a minority holder does not enjoy (subject to shareholders agreements and other legal constraints), including:

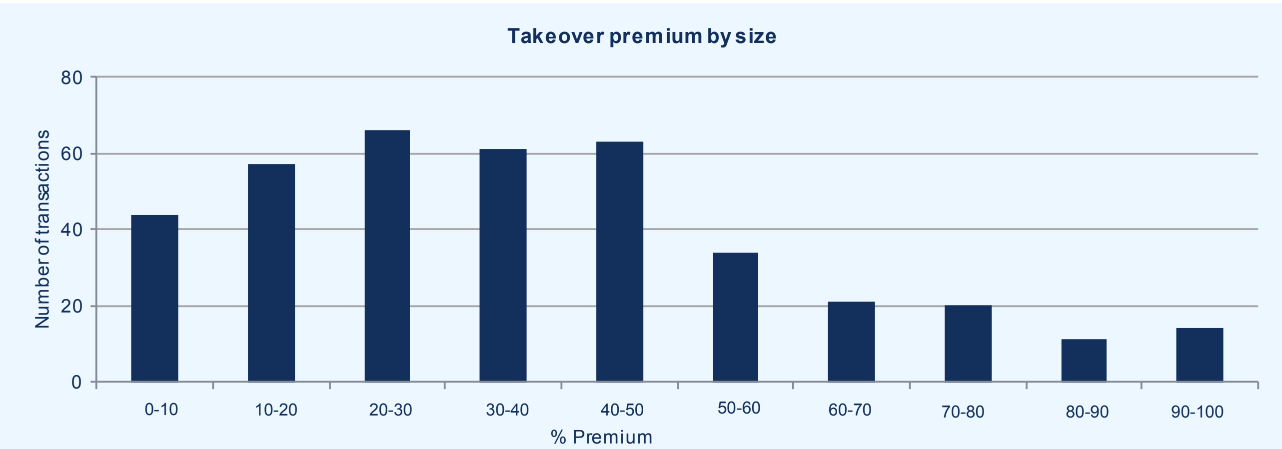
- Appoint or change operational management
- Appoint or change members of the board
- Determine management compensation
- Determine owner's remuneration, including remuneration to related party employees
- Determine the size and timing of dividends
- Control the dissemination of information about the company
- Set strategic focus of the organisation, including acquisitions, divestments and any restructuring
- Set the financial structure of the company (debt / equity mix)
- Block any or all of the above actions

The most common approach to quantifying a control premium is to analyse the size of premiums implied from prices paid in corporate takeovers. Another method is the comparison between prices of voting and non-voting shares in the same company. We note that the size of the control premium should generally be an outcome of a valuation and not an input into one, as there is significant judgement involved.

## Takeover Premiums

### Dispersion of premiums

The following chart shows the spread of premiums paid in takeovers between 2005 and 2015. We note that these takeover premiums may not be purely control premiums, for example the very high premiums are likely to include synergy benefits, while the very low premiums may be influenced by share prices rising in anticipation of a bid.

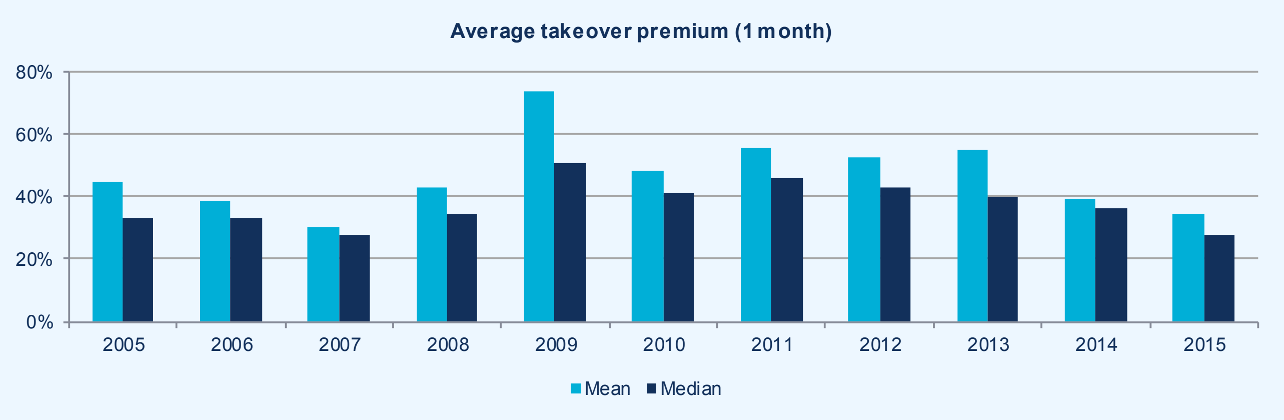



*Sources: FactSet, Leadenhall analysis*

This chart highlights the dispersion of premiums paid in takeovers. The chart shows a long tail of high premium transactions, although the most common recorded premium is in the range of 20% to 30%, with approximately 60% of all premiums falling in the range of 0% to 40%.

### Premiums over time

The following chart shows the average premium paid in completed takeovers compared to the price one month before the initial announcement.

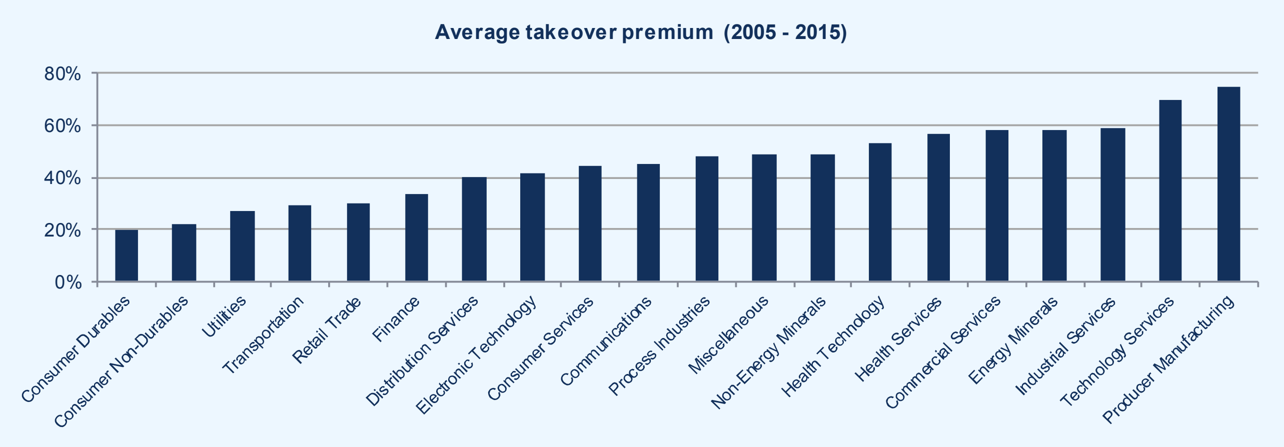



*Sources: FactSet, Leadenhall analysis*

The chart indicates that while premiums vary over time, there is no clearly discernible pattern. The mean is higher than the median due to a small number of high premiums.

### Premiums by industry

The following chart shows the average takeover premium by industry, compared to the share price one month before the takeover was announced. Most industries show an average premium of 20% to 50%.




*Sources: FactSet, Leadenhall analysis*

A number of industries have fairly high averages which have been impacted by specific transactions as set out below:

- **Producer Manufacturing:** includes two transactions with control premiums over 100%. The average premium is 25% lower when these transactions are excluded.
- **Technology Services:** includes four transactions with control premiums in excess of 100%. The average premium is 30% lower when these transactions are excluded.
- **Industrial Services:** includes two transactions with control premiums in excess of 100%. The average premium is 30% lower when these transactions are excluded.
- **Energy Minerals:** includes six transactions with control premiums in excess of 100%. The average premium is 20% lower when these transactions are excluded.
- **Commercial Services:** includes four transactions with control premiums in excess of 100%. The average premium is 20% lower when these transactions are excluded.
- **Health Services:** includes one transaction with a control premium of 183%. The average premium is 20% lower when this transaction is excluded.

Key factors that generally lead to higher premiums being observed are more than one party presenting a takeover offer, favourable trading conditions in certain industries (e.g. recent mining and tech booms), when the price includes special value and scrip offers where the price of the acquiring entity's shares increases between announcement and completion.

## Industry Practice

In Australia, industry practice is to apply a control premium in the range of 20% to 40%, as shown in the following list quoting ranges noted in various independent experts' reports.

- Deloitte - 20% to 40%
- Ernst & Young - 20% to 40%
- Grant Samuel - 20% to 35%
- KPMG - 25% to 40%
- Lonergan Edwards - 30 to 35%
- PwC - 20% to 40%

The range of control premiums shown above is consistent with most academic and professional literature published by leading valuation experts.

## Alternative View

Whilst common practice is to accept the existence of a control premium, in the order of 20% to 40%, certain industry practitioners (particularly in the US) disagree with the validity of this conclusion. Those with an alternate view point to the fact that very few listed companies are acquired each year as evidence that 100% of a company is not necessarily worth more than the proportionate value of a small interest. The reason we see some takeovers at a premium is that if a company is not well run, there is a control premium related to the difference in value between a hypothetical well run company and the company being run as it is.

## Impact of Methodologies Used

The requirement for an explicit valuation adjustment for a control premium depends on the valuation methodology and approach adopted and the level of value to be examined. It may be necessary to apply a control premium to the value of a liquid minority value to determine the control value. Alternatively, in order to estimate the value of a minority interest, it may be necessary to apply a minority discount to a proportional interest in the control value of the company.

### Discounted cash flow

The discounted cash flow methodology generally assumes control of the cash flows generated by the assets being valued. Accordingly, such valuations reflect a premium for control. Where a minority value is sought a minority discount must therefore be applied. The most common exception to this is where a discounted dividend model has been used to directly determine the value of an illiquid minority holding.

### Capitalisation of earnings

Depending on the type of multiple selected, the capitalisation of earnings methodology can reflect a control value (transaction multiples) or a liquid minority value (listed company trading multiples).

### Asset based methodologies

Asset based methodologies implicitly assume control of the assets being valued. Accordingly, such valuations reflect a control value.

## Intermediate Levels of Ownership

There are a number of intermediate levels of ownership between a portfolio interest and 100% ownership. Different levels of ownership/strategic stakes will confer different degrees of control and rights as shown below.

- 90% - can compulsory purchase remaining shares if certain conditions are satisfied
- 75% - power to pass special resolutions
- > 50% - gives control depending on the structure of other interests (but not absolute control)
- > 25% - ability to block a special resolution
- > 20% - power to elect directors, generally gives significant influence, depending on other shareholding blocks
- < 20% generally has only limited influence

Conceptually, the value of each of these interests lies somewhere between the portfolio value (liquid minority value) and the value of a 100% interest (control value). Each of these levels confers different degrees of control and therefore different levels of control premium or minority discount.

**50%**

For all practical purposes, a 50% interest confers a similar level of control to holdings of greater than 50%, at least where the balance of the shares are listed and widely held. Where there are other significant holders, such as in a 50/50 joint venture, 50% interests involve different considerations depending upon the particular circumstances.

Strategic parcels do not always attract a control premium. In fact, if there is no bidder, the owner may be forced to sell the shares through the share market, usually at a discount to the prevailing market price. This reflects the fact that the sale of a parcel of shares significantly larger than the average number of shares traded on an average day in a particular stock generally causes a stock overhang, therefore there is more stock available for sale than there are buyers for the stock and in order to clear the level of stock available, the share price is usually reduced by what is referred to as a blockage discount.

**20% to 50%**

Holdings of less than 50% but more than 20% can confer a significant degree of influence on the owner. If the balance of shareholders is widely spread, a holding of less than 50% can still convey effective control of the business. However, it may not provide direct ownership of assets or access to cash flow. This level of holding has a strategic value because it may allow the holder significant influence over the company's management, possibly additional access to information and a board seat.

**<20%**

Holdings of less than 20% are rarely considered strategic and would normally be valued in the same way as a portfolio interest given the stake would not be able to pass any ordinary or special resolution on their own if they were against the interests of the other shareholders. Depending on the circumstances, a blockage discount may also apply.

As explained above, the amount of control premium or minority discount that would apply in specific circumstances is highly subjective. In relation to the appropriate level of control premium, Aswath Damodaran[1] notes "the value of controlling a firm has to lie in being able to run it differently (and better)". A controlling shareholder will be able to implement their desired changes. However, it is not certain that a non-controlling shareholder would be able to implement changes they desired. Thus, following the logic of Damodaran and the fact that the strategic value of the holding typically diminishes as the level of holding decreases, the appropriate control premium for a non-controlling shareholder should be lower than that control premium for a controlling stake.

*[1] Aswath Damodaran is a Professor of Finance at the Stern School of Business at New York University, where he teaches corporate finance and equity valuation. He has written several books on equity valuation, as well as corporate finance and investment. He is also widely published in leading finance journals.*

### Key Factors in Determining a Reasonable Control Premium

Key factors to consider in determining a reasonable control premium include:

- **Size of holding** – Generally, larger stakes attract a higher control premium
- **Other holdings** – The dispersion of other shareholders is highly relevant to the ability for a major shareholder to exert control. The wider dispersed other holdings are, the higher the control premium
- **Industry premiums** – Evidence of premiums recently paid in a given industry can indicate the level of premium that may be appropriate
- **Size** – medium sized businesses in a consolidating industry are likely to be acquired at a larger premium than other businesses
- **Dividends** – a high dividend payout generally leads to a low premium for control
- **Gearing** – a company that is not optimally geared may attract a higher premium than otherwise, as the incoming shareholder has the opportunity to adjust the financing structure
- **Board** – the ability to appoint directors would increase the control premium attaching to a given parcel of shares. The existence of independent directors would tend to decrease the level of premium as this may serve to reduce any oppression of minority interests and therefore support the level of the illiquid minority value
- **Shareholders agreement** - the existence and contents of a shareholders agreement, with any protection such as tag along and drag along rights offered to minority shareholders lowers the appropriate control premium

# APPENDIX 6: QUALIFICATIONS, DECLARATIONS AND CONSENTS

### Responsibility and purpose

This report has been prepared for Hunter Hall's Shareholders for the purpose of assessing the fairness and reasonableness of the Proposed Transaction. Leadenhall expressly disclaims any liability to any shareholder, or anyone else, whether for our negligence or otherwise, if the report is used for any other purpose or by any other person.

### Reliance on information

In preparing this report we relied on the information provided to us by Hunter Hall and Pengana being complete and accurate and we have assumed it has been prepared in accordance with applicable Accounting Standards and relevant national and state legislation. We have not performed an audit, review or financial due diligence on the information provided. Drafts of our report were issued to Hunter Hall's and Pengana's management for confirmation of factual accuracy.

### Prospective information

To the extent that this report refers to prospective financial information, we have considered the prospective financial information and the basis of the underlying assumptions. The procedures involved in Leadenhall's consideration of this information consisted of enquiries of Hunter Hall's and Pengana's personnel and analytical procedures applied to the financial data. These procedures and enquiries did not include verification work nor constitute an audit or a review engagement in accordance with Australian Auditing Standards, or any other standards. Nothing has come to our attention as a result of these enquiries to suggest that the financial projections for Hunter Hall and Pengana, when taken as a whole, are unreasonable for the purpose of this report.

We note that the forecasts and projections supplied to us are, based upon assumptions about events and circumstances that have not yet transpired. Actual results in the future may be different from the prospective financial information of Hunter Hall and Pengana referred to in this report and the variation may be material, since anticipated events frequently do not occur as expected. Accordingly, we give no assurance that any forecast results will be achieved.

### Market conditions

Leadenhall's opinion is based on prevailing market, economic and other conditions as at the date of this report. Conditions can change over relatively short periods of time. Any subsequent changes in these conditions could impact upon the conclusion reached in this report.

As a valuation is based upon expectations of future results it involves significant judgement. Although we consider the assumptions used and the conclusions reached in this report are reasonable, other parties may have alternative expectations of the future, which may result in different valuation conclusions. The conclusions reached by other parties may be outside Leadenhall's preferred range

### Indemnities

In recognition that Leadenhall may rely on information provided by Hunter Hall and Pengana and their officers, employees, agents or advisors, Hunter Hall and Pengana have agreed that they will not make any claim against Leadenhall to recover any loss or damage which they may suffer as a result of that reliance and that they will indemnify Leadenhall against any liability that arises out of Leadenhall's reliance on the information provided by Hunter Hall and Pengana and their officers, employees, agents or advisors or the failure by Hunter Hall and Pengana and their officers, employees, agents or advisors to provide Leadenhall with any material information relating to this report.

### Qualifications

The personnel of Leadenhall principally involved in the preparation of this report were Richard Norris, BA (Hons), FCA, M.App.Fin, F.Fin, Dave Pearson, BCom., CA, CFA, CBV, M.App.Fin, Simon Dalgarno, B.Ec, FCA, F.FINSIA and Chern Fung Yee, BCom., CPA.

This report has been prepared in accordance with "APES 225 – Valuation Services" issued by the Accounting Professional & Ethical Standards Board and this report is a valuation engagement in accordance with that standard and the opinion is a Conclusion of Value.

### Independence

Leadenhall has acted independently of Hunter Hall. Compensation payable to Leadenhall is not contingent on the conclusion, content or future use of this report.