Lugarno Fund

INFORMATION MEMORANDUM

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Important notice

This Information Memorandum provides information concerning an offer of investment in The Lugarno Fund, a wholesale managed investment scheme. Lugarno Partners Pty Ltd is the issuer of this Information Memorandum. This Information Memorandum has been prepared for distribution only to wholesale clients as defined in section 761G of the Corporations Act and to sophisticated investors under section 761GA of the Corporations Act. This Information Memorandum does not constitute an offer or invitation to subscribe for investment in any jurisdiction where, or to any person to whom, it would not be lawful to make an offer. This Information Memorandum is dated 25 August 2020 and is current at that date.

LUGARNO FUND - OVERVIEW

The Lugarno Fund will replace the '*contrarian investments*' strategy advised on by Lugarno Partners since 2016.

The Lugarno Fund waits patiently for those rare instances where we are able to invest with minimal risk to our capital but with significant upside.

The priority is to avoid losing money and the goal is to make as much as possible. The fund does not benchmark itself against any index or return.

Underpinned by a belief the market is inefficient, the fund seeks those rare and temporary opportunities to purchase businesses and assets at significant discounts to intrinsic value.

It is theoretically impossible for an investment to be in favour yet cheaply priced. As such, we often find ourselves investing in companies under researched, overlooked, or out of favour

We believe that great returns are difficult to achieve if we are following the herd. To be successful the Lugarno Fund carries a healthy dose of cynicism and maintains its contrarian nature.

The fund represents our own biases and personal investment preferences. We will concentrate most of the fund's capital in our best ideas. As a result, the fund will experience very large swings. We suggest investors only invest a small portion of their overall wealth in the fund.

A concentrated portfolio of out of favour stocks has the potential to provide significant returns in the long run. However, we have no control over how long it takes for our investment thesis to be realised by others. There has been and will continue to be times when the portfolio has low to negative returns. We have found these periods often coincide with periods when the market is very strong.

Risk management or risk limitation is the priority and so margin of safety will be the ultimate principle underpinning decisions. We require a sufficient difference between the price we pay and a reliable valuation. While value can be found in a variety of places, we seek value in net tangible assets, cash flows and ideally a combination of the two.

Our main priority in any investment decisions is to avoid losing capital permanently. Compounding returns becomes much harder if chunks of the portfolio are permanently lost. We value a business on what exists today. We use facts not forecasts to form our thesis. While growth is nice, it is not something we are willing to pay a premium and sacrifice capital for.

Investments will only be made on an opportunistic basis. The fund will hold cash for as long as it takes to find compelling opportunities. Without a margin of safety, capital will not be invested. The larger the margin of safety, the larger the investment.

AT A GLANCE

Name:	**Lugarno Fund**
Trustee:	**DDH Graham Limited ACN 010 639 219 AFSL 226319**
Investment Manager:	**Lugarno Partners Pty Ltd ACN 607 035 138, AFSL No. 508934 and issuer of this Information Memorandum**
Administrator:	**DDH Graham Limited**

Structure
- Unlisted managed investment scheme (unregistered).
- Units offered via unit in the fund.
- Trustee is DDH Graham Limited, a privately-owned Brisbane based business with 30 years in financial services.
- Administration is also provided by DDH Graham Limited.
- Compliance is provided by Trebuchet Consulting Pty Ltd whose principal has over 20 years of providing financial services compliance advice.

Investment priority
To avoid the long-term impairment of investor's capital.

Investment goal
To compound capital at +15% pa.

Investments
The fund's investment mandate is unconstrained. While the focus of the fund will be investing in Australian stocks, the fund can hold private or public assets in any currency. It can also invest in unit trusts, derivatives and foreign currencies.

Min investment
$250,000 [a lower minimum may be accepted at the investment manager's discretion]

Time horizon
+7 years

Applications
Applications are on the first day of each month OR on a separate subscription day as determined by us. We will only accept applications from wholesale clients.

Redemptions
Redemption date is the last business day of each month[1].

As the investment time horizon is at least seven years, the minimum investment term is two years[2]. After the minimum investment term, redemption requests can be lodged with the Trustee. The Trustee has at least three months within which to process and pay the redemption request.

Redemptions can be provided in cash or in specie transfer of the investors pro-rata holdings (at our discretion).

Unit pricing
Generally monthly as at the last business day of each month (valuation day). However, we may wish to calculate on a regular interval usually for application purposes.

Management fee
Nil.

Performance fee
The performance fee is up to 25% of the increase in the NAV of the class of units (after Trustee fees and fund costs are deducted) above the benchmark being the higher of 6% pa or the Australian inflation rate and subject to a high watermark. The fee will accrue monthly and is payable quarterly in arrears. Examples of performance fees are explained in greater detail within "Fees & expenses".

Trustee fee
$25,000 per annum (adjusted annually for CPI increases) plus, where the fund NAV exceeds $20 million, an amount equal to 0.025% of the amount by which fund NAV exceeds $20 million. This fee is calculated and payable to the Trustee monthly in arrears and allocated proportionately between each class of units.

Fund costs
Costs incurred in the general running of the fund will be incurred by and paid out of the fund. We intend to keep these costs to a minimum.

GST
All fees quoted in this document are exclusive of the effect of GST and input tax credits.

Buy/sell spread
Equal to the unit net asset value (NAV) on the valuation day plus 0.5% for applications and redemptions.

Distributions
All distributable income is automatically reinvested into the fund.
Cash distributions may be available on request.

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[1] Or as otherwise approved by us
[2] We may at our absolute discretion allow early withdrawals

OUR INVESTMENT PRINCIPLES

Margin of safety
See next page.

Long term orientation
Business and investment are much easier with a long-term view. Buying (or selling) early is not the same as being wrong.

Patience
Great investing is in the waiting (not the acting).

Contrarian mindset
Abnormally outstanding returns (by definition) cannot be found in the crowd.

The miracle of compounding
The longer we maintain our original investment for, the easier doubling our original investment becomes.

Size does matter
Returns come easier with a smaller pool of money.

Incentives drive behaviour
Lugarno Partners will be subsidising some of the operating costs in the initial period, until returns generated build up the assets.

Unconstrained insight
We fish where the fish are.

Stick with our areas of competence
Do we understand it? Can we explain it? We are happy to miss an investment if we are not fully confident.

Cloning
Plenty before us have succeeded. We learn from them and we do our best to clone the aspects which put ourselves in the best position to deliver great returns.

Say no quickly
If we are not confident the investment will meet our objectives it doesn't deserve the family's capital.

Simple
Investing should be hard but not complex.

MARGIN OF SAFETY

The Lugarno Fund leans on the concept of margin of safety in order to reduce the risk of losing the funds capital.

Definition of Risk: *the difference between the current price of a stock and our perception of its intrinsic value.*

The easiest way to understand margin of safety is, as Seth Klarman puts it, "a buffer that allows for human error, bad luck or extreme volatility in a complex, unpredictable, and rapidly changing world."

Permanent loss of capital is unacceptable to us and it becomes even more important to factor in a margin of safety when choosing a stock.

So, what is a margin of safety exactly? Consider this example:

Imagine you are driving a small truck and are approaching a bridge crossing. There is a sign posted that says the bridge can take a maximum weight of 3 tonnes. You are pretty certain that the truck you are driving weighs approximately 2.8 tonnes. If you choose not to cross this bridge, you will need to take another route, adding an extra two hours to your journey.

What would you do?
Such an example leaves very little margin for error. There are a number of unknown factors that make crossing the bridge decidedly more risky. Sure, if all circumstances are perfect you could probably cross without incident, but if they are not, the consequences could be catastrophic. Perhaps the bridge's foundations are worn, or the sign is incorrect, or the truck actually weighs more than you estimate — any of these factors could change the outcome significantly. There is quite simply an unacceptable margin of safety.

By ensuring every investment opportunity has an appropriate margin of safety, we position ourselves to weather the inevitable challenges that arise along the way.

This concept sits perfectly into a major theme of ours which is to look down before looking up. By seeking to avoid the chance of permanently losing money, we are substantially increasing our chances of making it.

WHAT MAKES A GOOD INVESTMENT?

We want investment opportunities with payoffs that are in our favour. As Mohnish Pabrai puts it, “*heads I win, tails I don’t lose much*”.

How do we do that?

1) We only invest when the odds are obviously stacked in our favour. If it isn’t we would prefer to hold cash.

2) We look down before we look up, we mitigate our downside first. We hinge our valuation on tangible assets and/or cash flows which exist today and will likely exist under any sort of stress.

3) We make our own assessment of a company’s intrinsic value and will only invest if the market price is a fraction of that estimate.

4) We focus on the facts that exist today rather than what we hope may eventuate in the future. While we like companies which we ‘think’ have growth prospects but are generally reticent to pay for future earnings.

These simple rules will often exclude businesses with weak balance sheets; new industries; and fads or fashions for which the general market has lofty growth assumptions.

Our ideal investment is a business with strong and growing cash flows trading a discount to its net tangible asset value. These opportunities are rare but well worth the wait.

In Summary,

- The fund will only consider tangible assets or cash flows (preferably both) when estimating value.
- The fund prioritises actual reported cash flows NOT earnings.
- The greater the margin of safety, the greater the discount to intrinsic value, the more the fund will invest.
- The fund only values what is today not what may be tomorrow.
- The fund prioritises cash flows which are contracted, or which have been earned consistently over long periods.
- The fund heavily discounts cash flows earned in third world or highly regulated industries.

KEY PEOPLE / FIRMS

MANAGER: LUGARNO PARTNERS
Started in August 2015 by Simon Harradence, Lugarno Partners is a client aligned investment adviser and manager. Simon was a director at UBS for 7 years and before that was an associate with Goldman Sachs JBWere for 3 years. Simon established Lugarno Partners to deepen his relationship with his clients and improve his chances of making money for them.

All investment decisions have a clearly defined investment philosophy with its roots in value investing. Lugarno Partners believes that returns are made very difficult inside of large institutions due to mis-aligned fee structures and a smaller investment universe due to size. Lugarno Partners also believes that strong returns are impossible if you are investing with the crowd – at big firms you are the crowd making consistent outperformance nearly impossible.

Lugarno Partners maintains a small number of clients to limit assets (maximise investment returns) to maintain high service levels. The firm prioritises avoiding losing money over chasing returns. Lugarno Partners think a long-term mindset is the single best asset an investor can have and cultivate an independent mindset with only carefully selected external influences to ensure it can think as a contrarian.

Lugarno Partners recognises their investment strategy is not conventional, as such, maintains a client base which believes in the philosophy and is genuinely supportive in its execution.

TRUSTEE (Licensee), ADMINISTRATOR: DDH GRAHAM LIMITED
DDH Graham Limited (DDH) is an independently owned Queensland-based funds management and administration organisation founded in 1981. As trustee of the fund, DDH is responsible for management and administration of the fund.

DDH has considerable experience in trust management and administration; it acts as a responsible entity or trustee or fund manager for several property and financial asset funds as well as providing and servicing money market products.

DDH is an unlisted public company and the holder of an Australian Financial Services Licence (Licence No. 226319).

Whilst DDH Graham acts as the trustee of the fund, DDH Graham is not responsible for the content of this information memorandum or the investment decisions of the fund as they are conducted by Lugarno Partners. DDH Graham does not guarantee investments in the fund or any particular return.

KEY RISKS

Investment in the fund like all investment carries certain risks. We cannot and do not guarantee the fund will achieve its investment objective and investors should fully understand and be capable of assuming the risks of investing in the fund.

In deciding whether to invest, you should consider that you may lose some or all of your investment, the value of your investment may go down, you could receive little or no income and there may be delays in the repayment of capital.

You should not invest in the fund if you are seeking a short-term investment; unwilling to accept significant fluctuations in unit prices; and/or unable to accept loss of your investment capital.

This section outlines some of the significant risks that could affect the performance of the fund. Many of these risks are outside our control, however we apply appropriate mitigation measures where possible.

Market risk
Returns from listed securities can fluctuate significantly. These fluctuations can be caused by market volatility, interest rates, economic cycles, political events and levels of economic growth, both global and domestic. We do not seek to replicate the standard industry benchmarks.

The fund's portfolio is constructed on contrarian investment principles with a high concentration on a limited number of securities.

Security specific risk
There is always a risk that an investment could perform poorly. Securities prices are dependent upon the financial circumstances of the companies in which the securities are purchased, their profits, market sentiment, earnings and cash flows. The return on an equity investment may also be affected by the quality of company management, the general health of the sector in which it operates and government policy. As a contrarian investor we focus on the fundamentals of the company and whether they represent value. Whilst capital is not guaranteed, its preservation is our primary focus.

Withdrawal risk
Withdrawal risk is the risk that if the fund invests in assets that cannot be readily bought and sold, or market events reduce the liquidity of a security or asset class, the generally applicable timeframe for meeting withdrawal requests may not be met. This is because it may take longer to sell these types of investments at an acceptable price.

The Trustee may transfer fund assets to a withdrawing investor in order to facilitate the withdrawal.

Leverage risk
The fund may be exposed to investment strategies that use leverage. The exposure of a leveraged portfolio to movements in the instruments and markets in which it invests can magnify gains and losses.

Foreign investment risk
Exposure to securities issued in foreign markets may include certain risks associated with:
- Differences in trading, settlement and clearing procedures;
- Currency risk being the risk that foreign currencies change in value relative to the Australian dollar, which may affect a fund's investment returns;
- Countries may be subject to considerable degrees of market volatility, economic, political and social instability, which may reduce or preclude the ability to trade security exposures or negatively affect a security's value; and
- Differences in accounting, financial reporting, taxation, legal, regulatory, liquidity and pricing practices that are subject to change and if so, may adversely affect the fund.

Counterparty risk
Counterparty risk is the risk that the counterparty to a transaction or contract (such as a broker or custodian) may default on their obligations and the fund may, as a result, experience an adverse investment outcome or liability.

Concentration risk
Our investment strategy is contrarian with a focus on a limited number of investments. This may cause the value of the fund's investments to be more affected by any single adverse economic, political, or regulatory event than the investments of a more diversified investment portfolio.

FEES AND EXPENSES

Lugarno Partners does not intend charging a management fee. Should this change, Lugarno Partners will provide all investors with details of any change.

Lugarno Partners may receive a performance fee. A performance fee may be charged by the Trustee and paid to Lugarno Partners when the fund exceeds certain performance criteria. Performance fees form part of the management costs of the fund.

The performance fee is up to 25% of the excess investment return of a class of units (net of all fees, including performance fees) provided **all of the following hurdles** are met during the performance fee calculation period:

- The fund's total return is above 0%;
- The fund outperforms the benchmark being the higher of 6% or the CPI All Cities Index (Australian inflation rate) (net of all fees, including performance fees already accrued for prior months);
- The previous High Water Mark has been exceeded.

The High Water Mark means no performance fee is payable for a calculation period where at the end of a calculation period the unit price on an accumulation basis (adjusted to reflect any increase in the NAV resulting from new applications and reduced to reflect distributions and withdrawals) is lower than the previous highest unit price at which the performance fee was paid, calculated on the same basis at the end of any calculation period. Calculation periods are each calendar month of the year.

The High Water Mark is carried forward to each new performance period. The accrual of a performance fee in a unit price can result in different implied levels of performance fees for individual investors depending on the timing of their investment and relative performance of the fund over time. The performance fee is calculated and accrued monthly and paid quarterly in arrears (if payable).

The following are examples of the calculation under various scenarios.

Example 1

Assume the NAV of the fund, since the last time a performance fee was accrued, was $500,000 and the fund's NAV at the end of the month was $550,000 (excluding the impact of any applications into or withdrawals from the fund and any trustee fees or fund costs). The increase of 10% or $50,000 was due to investment performance only.

This example assumes that the CPI All Cities Index was below the 6% per annum. Therefore, the benchmark would have achieved a return of $2,500 on the initial $500,000 for the month.

The resultant performance fee for the month would be the amount by which the total fund return for the fund exceeds the benchmark return, being $47,500 ($50,000 - $2,500) multiplied by the performance fee rate ($47,500 x 25%) giving a performance fee for the month of $11,875.

Example 2

Assume the NAV of the fund, since the last performance fee was accrued, was 550,000 (High Water Mark) and the fund's NAV at the end of the month was $540,000 (excluding the impact of applications into or withdrawals from the fund), a decrease of 1.82% or $10,000 due to investment performance only.

As the NAV of the fund has not exceeded the current High Water Mark criteria the fund is not subject to a performance fee. The High Water Mark would remain at the $550,000.

Example 3

Assume the NAV of the fund, since the last time a performance fee was accrued, was $500,000 and the fund's NAV at the end of the month was $502,500 (excluding the impact of any applications into or withdrawals from the fund), an increase of 0.42% or $2,083 due to investment performance only.

This example assumes that the CPI All Cities Index was below the 6% per annum. Therefore, the benchmark would have achieved a return of $2,500 on the initial $500,000 for the month.

Based on the above, the fund's performance of 0.42% or $2,083 has not exceeded the additional benchmark hurdle of 0.5% or $2,500. Therefore, the fund is not subject to a performance fee for the month. The High Water Mark would remain at the $500,000.

Trustee fees
For being the trustee and operating the fund, the trustee will receive a trustee fee of $25,000 per annum (adjusted annually for CPI increases) plus, where the fund NAV exceeds $20 million, an amount equal to 0.025% of the amount by which fund NAV exceeds $20 million. This fee is calculated and payable to the trustee monthly in arrears and allocated proportionately between each class of units.

Fund costs
Lugarno Partners and the Trustee are entitled to be reimbursed from the fund assets for operating expenses and expenses paid to third parties in relation to the fund such as, accounting, audit, tax returns and brokerage (other the brokerage incurred as a result in applications and redemptions by investors which is covered by the buy/sell spread).

Lugarno Partners and the Trustee are also entitled to be reimbursed from the fund assets for all extraordinary expenses in relation to managing the fund, such as convening investor meetings or defending a third party claim made against the fund. We do not anticipate any extraordinary expenses will be incurred in the foreseeable future.

Buy/sell spread
A buy/sell spread to cover costs incurred in buying and selling fund assets associated with investors entering and exiting the fund is added to, or subtracted from, the unit value to determine application price and redemption price for each class of units. The buy/sell spread is a cost payable by the transacting investor to the fund and is not a fee payable to the Trustee or Investment Manager.

GST
All fees quoted in this information memorandum are exclusive of the effect of GST and input tax credits. The fund may be charged additional amounts for GST and be entitled to claim Reduced Input Tax Credits in respect of certain fees.

TAXATION

Taxation laws are complex, and each investor's circumstances are different. We recommend you obtain appropriate taxation advice on the tax implications for you when investing in the fund.