Lonsec

Investment Grade

Product Review
Gryphon Capital Income Trust

ISSUE DATE 22-08-2019

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About this Review

ASSET CLASS REVIEWED	FIXED INTEREST
SECTOR REVIEWED	ALTERNATIVE INCOME HIGH
SUB SECTOR REVIEWED	LIT
TOTAL COMPANIES RATED	2

About this Trust

ASIC RG240 CLASSIFIED	NO
LIT REVIEWED	GRYPHON CAPITAL INCOME TRUST
ASX CODE	GCI
PDS OBJECTIVE	PROVIDE MONTHLY CASH INCOME & CAPITAL PRESERVATION AT A PORTFOLIO LEVEL BY INVESTING IN A PORTFOLIO OF FIXED INCOME SECURITIES INCL RMBS & ABS
INTERNAL OBJECTIVE	TARGET YIELD OF RBA CASH RATE +3.50% PA (NET) THROUGH THE ECONOMIC CYCLE
DISTRIBUTION POLICY	MONTHLY DISTRIBUTION
MANAGEMENT COSTS	(0.92% P.A. NAV)
RESPONSIBLE ENTITY	ONE MANAGED INVESTMENT FUNDS LTD

Market data

MARKET CAPITALISATION	$303M
UNITS ON ISSUE	148M
UNIT PRICE (21-8-2019)	$2.05
52 WEEK HIGH/LOW UNIT PRICE	$2.10 / $1.96
NAV (19-8-2019)	$2.01
52 WEEK HIGH/LOW NAV	$2.02 / $2.00
UNIT PRICE PREM/(DISC) TO NAV	2.02%

About the Fund Manager

FUND MANAGER	GRYPHON CAPITAL INVESTMENTS PTY LTD
OWNERSHIP	100% GRYPHON CAPITAL PARTNERS PTY LTD
ASSETS MANAGED IN THIS SECTOR	$1.98BN (30-06-2019)
YEARS MANAGING THIS ASSET CLASS	25

Investment Team

PORTFOLIO MANAGER	STEVEN FLEMING, ASHLEY BURTENSHAW
INVESTMENT TEAM SIZE	5
INVESTMENT TEAM TURNOVER	NIL
STRUCTURE / LOCATION	BRISBANE

Investment process

STYLE/ASSETS	INCOME/RMBS & ABS
BENCHMARK	RBA CASH RATE
TYPICAL NUMBER OF POSITIONS	60
SINGLE BORROWER LIMIT	10%
LEVERAGE	MAX 25% NAV (FOR USE IN FUTURE CAPITAL RAISES, SHORT TERM PURPOSES ONLY)
DERIVATIVES	YES
CURRENCY	100% HEDGED

Trust rating history

AUGUST 2019	INVESTMENT GRADE
AUGUST 2018	INVESTMENT GRADE

What this Rating means

The **'Investment Grade'** rating indicates that Lonsec has conviction the financial product can generate risk adjusted returns in line with relevant objectives. However, if applicable, Lonsec believes the financial product has fewer competitive advantages than its peers.

Scope of this rating

- Lonsec has used its Managed Funds research process in forming an opinion on this Listed Investment Trust's (LIT or Trust) ability to meet its stated investment objectives. The extent of any 'point-in-time' divergence between GCI's unit price and its underlying Net Asset Value (NAV) per unit is not part of the ratings consideration.
- Lonsec does consider whether structural or management issues could potentially lead to a LIT trading at a significant discount to its NAV over an extended period of time without any recourse for unitholders. This aspect forms part of the wider qualitative and quantitative assessment that Lonsec undertakes when assessing the relative investment merits of a LIT.

Strengths

- The two Portfolio Managers have deep and long standing experience in securitised markets.
- Disciplined, repeatable investment process.
- Risk management is embedded in the portfolio construction process.

Weaknesses

- The investment team size is small and is investing in an asset class which requires large volumes of data to be sourced, cleaned and analysed on an ongoing basis. Consequently, there is heightened key person risk as each of Fleming, Burtenshaw and Stanton bring a targeted skill set.
- The proprietary models used in the analysis process have not been audited by an external party.
- The Trust's assets are vulnerable to the negative impacts of a rising interest rate environment or increasing unemployment rates which could impact borrowers ability to make loan repayments.

Gryphon Capital Income Trust

Trust Risk Characteristics

	LOW		MODERATE		HIGH
BUSINESS SUSTAINABILITY RISK				●	
CAPITAL VOLATILITY				●	
CREDIT RISK				●	
FOREIGN CURRENCY EXPOSURE		●			
INTEREST RATE RISK			●		
SECURITY CONCENTRATION RISK			●		
SECURITY LIQUIDITY RISK				●	
LEVERAGE RISK		●			

Risk categories are based on Lonsec's qualitative opinion of the risks inherent in the financial product's asset class and the risks relative to other financial products in the relevant Lonsec sector universe.

BIOmetrics

Aggregated risks

	1	2	3	4	5	6	7
STD RISK MEASURE				●			

A Standard Risk Measure score of 4 equates to a Risk Label of 'Medium' and an estimated number of negative annual returns over any 20 year period of 2 to less than 3. This is a measure of expected frequency (not magnitude) of capital losses, calculated in accordance with ASFA/FSC guidelines.

	LOW		MODERATE		HIGH
RISK TO INCOME			●		

Features and benefits

	LOW		MODERATE		HIGH
COMPLEXITY				●	
ESG AWARENESS	●				

Fee profile

	LOW		MODERATE		HIGH
FEES VS. UNIVERSE				●	
FEES VS. ASSET CLASS			●		

Fee BIOmetrics are a function of expected total fee as a percentage of expected total return.

What is this Trust?

- Gryphon Capital Income Trust (ASX: GCI) completed an initial capital raising of approximately $175million listing on 25 May 2018. The first distribution was paid to investors on 9 July 2018 and has been monthly thereafter. A Private Placement of 5,911,000 units to Wholesale investors was completed on 3 May 2019 which raised approximately $11,822,000.
- On 21 June 2019 Gryphon announced a third capital raising via a pro-rata non-renounceable entitlement offer targeting a raise of $108million. Eligible investors were invited to apply for 1 new unit for every existing 2 units. Eligible unitholders were also able to apply for additional new units at the offer price in excess of their entitlement as part of the oversubscription facility. Any units not taken up by eligible unitholders were offered to new investors under the shortfall offer. The offer opened on 4 July 2019 with the entitlement offer closing on 25 July. The original shortfall offer close date of 31 July was brought forward to 8 July due to the very strong support shown by new investors. The offer was fully oversubscribed and achieved its target $108million at an offer price of $2.00 per unit. Approximately 54million units were issued under the offer, 19million to existing eligible unitholders (commenced trading on ASX 2 August) and 35million units to participants in the shortfall offer which will be issued on 13 August and will commence trading on ASX 14 August.
- Given the strong demand for the offer Gryphon issued a statement on 13 August that it will issue a further placement of 7,017,075 units (approximately $14million) at an offer price of $2.00.
- In total the size of the Trust has grown to approximately $309,190,150 assuming the additional placement offer is fully subscribed. As of the publishing date of this report, the Trust has 155million units listed.
- As at August 2019, Gryphon Capital Investments (GCI) had in excess of $2.0bn funds under management. GCI is a specialist manager of structured finance securities issued in Australia, UK and Europe.
- **The rating is not a credit assessment of Gryphon Capital Investments Limited or the Gryphon Group, who are party to the Manager Loan which forms part of the assets of the Trust.**
- GCI operates three existing bespoke mandates in the Australian market at present; High Grade Securitised (inception January 2010), Secured Opportunities (inception April 2015) and Investment Grade (inception September 2016). The Gryphon Capital Income Trust (GCI) will broadly approximate a 50/50 split of the Secured Opportunities and Investment Grade strategies. The Secured Opportunities strategy targets a return of the Bloomberg Ausbond Bank Bill Index + 5% by investing in a high conviction portfolio of Australian Residential Mortgage Backed Securities. There are no credit rating restrictions applied to this strategy which can invest heavily in non-rated and sub-investment grade tranches which have more limited liquidity. The Investment Grade strategy is a high conviction, low liquidity strategy with a target of the Bloomberg Ausbond Bank Bill Index + 2.7%. This strategy only invests in securities that are rated BBB- or higher.
- GCI believe the RMBS and ABS (Asset backed securities) markets are an important and substantial part of the Australian market, offering an alternative investment option for retail investors seeking exposure to income streams.
- The Trust aims to deliver predictable monthly income with low risk of capital loss. The Trust aims to achieve RBA cash rate + 3.5% net of all costs through the economic cycle. The look-through underlying securities in the Trust will be comprised of residential mortgage backed securities, asset backed securities (securitisations backed by consumer loans, loans to SMEs, auto loans among others) and cash. Investments will be predominantly invested in Australian dollars; however, the Manager reserves the right to invest in securities domiciled in other currencies. Any such investments will be hedged back to Australian dollars. Alpha is expected to be generated predominantly from security selection and sector rotation.
- Lonsec notes that the Trust is governed by an investment strategy which imposes some broad mandate limits in terms of sub-investment grade credit (maximum of 50% of the Portfolio), individual holdings (maximum of 10% in any one security) and

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exposure to an originator (must not exceed 30% of NAV).
- The Manager does not intend to use debt to enhance returns. The Trust's gearing policy limits debt to up to 25% of the Trust's NAV for short term liquidity timing purposes only. For example, the Manager does not intend to use debt unless it has also planned to raise new capital from the issue of new Units and identifies a buying opportunity for the portfolio which will settle prior to the new capital raise flowing into the Trust's bank account.
- Derivatives are only permitted for efficient portfolio management (e.g. hedging) and not for market speculative purposes to increase returns.
- The Responsible Entity has provided a working capital loan to the Manager for 10 years. As outlined in the initial review and acknowledged by Gryphon, the proceeds of the manager loan have been used to pay upfront costs of the capital raising. The loan balance as of 13 August 2019 was 2.6% of total funds raised or approximately $7.8m. The proceeds are also permitted to be used for working capital, including but not limited to investor relations, capital management and to facilitate future fund raisings from the Trust. However, Gryphon has stated there is no intention to call upon proceeds of the manager loan to facilitate anything other than the listing or capital raising costs. Interest will be paid on the loan at a 5% rate. The loan will be repaid over the ten-year initial term of the Investment Management Agreement ('IMA') and will be an asset of the Trust with its inherent credit risk.
- The appointment of the Manager is governed by an Investment Management Agreement (IMA) with an initial term of ten years subject to automatic extension.
- The management cost charged to retail investors is estimated to be between 0.98-0.92% p.a. The management cost is used to pay the operating costs of the Trust, including responsible entity fees, custody fees, administration, registry, annual ASX fees, and audit costs of the Trust. It excludes abnormal expenses which are payable from the assets of the Trust.
- The Manager does not charge a performance fee.

Using this Trust

This is General Advice only and should be read in conjunction with the Disclaimer, Disclosure and Warning on the final page.

- Funds in the **Alternative Income (High)** sector are typically managed with the aim of generating returns that exceed a cash proxy such as the Bloomberg AusBond Bank Bill Index by a margin or are absolute return in nature. Lonsec notes that whilst the Trust may exhibit relatively low volatility of NAV, this may be a function of the relatively low liquidity in terms of secondary market activity and lack of observable price points for the underlying securities.
- Lonsec suggests that the Trust should only be considered for those clients that are seeking yields greater than cash or cash-like instruments **and prepared to accept greater** credit risk.
- Investments in asset backed securities may provide diversification and income generation benefits to a traditional fixed income portfolio. A key risk of the type of securities this Trust will invest in is illiquidity risk. The Trust's underlying securities are not liquid and the ability of the Manager to dispose of an investment will depend on the market liquidity prevailing at that time. There may be a significant difference between a security's market price supporting the NAV and a transaction price resulting in sharp gains or losses. The Trust is also permitted to invest in up to 50% of the portfolio in sub-investment grade or lower credit quality securitised assets. The lower quality RMBS and ABS securities hold particular risks to investors with the potential for increased capital erosion due to the higher probability of default. Changing market conditions and interest rate levels can also have a larger impact on the values of high yielding RMBS and ABS. Ultimately the Trust is highly exposed to the Australian residential housing market through its exposures to RMBS, and therefore susceptible to the prevailing and forward-looking movement of mortgage interest rates. Historically long term interest rates in Australia have generally mirrored the U.S. in terms of trajectory, although in more recent times this relationship has broken down given the challenges facing the domestic economy. However, longer term investors must remain mindful of the impact rising interest rates may have on homeowners ability to finance mortgage repayments. While acknowledging that the RBA policy on the cash rate may not be in sync with the U.S. for the foreseeable future, the impact on borrower's ability to service their mortgages at higher interest rates than the current historic lows is yet to be seriously tested.
- Other factors that can also greatly impact this asset class is the domestic unemployment rate and the risk of regulatory controls to control house prices by the Australian Prudential Regulatory Authority a statutory authority of the Australian Government.
- ABS that are not secured by mortgages over property also present additional risks for investors. Some ABS may not access the same degree of security or recourse over related collateral. For example, Credit Card receivables ABS are generally unsecured. In a default scenario, the collateral backing the loan may not be sufficient to support the required repayments.
- RMBS and ABS differ from traditional bond securities mainly due to the frequency of interest and principal repayments and thus the uncertainty of a final maturity date. The majority of securities pay interest (and may also pay down principal) on a monthly basis, though some securities may pay coupons quarterly. Prepayment speed (the speed with which principal is returned to investors) fluctuates with the ability of borrowers to service their debt or refinance. Maturity dates may be shorter than expected if prepayment occurs more quickly than anticipated or maturity dates may extend if borrowers take longer to repay, or use redraw facilities.
- Further, in a portfolio construction context, Lonsec recommends that allocations into the Trust be made from growth rather than defensive assets.
- The Trust expects to make distributions on a monthly basis, although this is not guaranteed. To date, since

Gryphon Capital Income Trust

June 2018 the Trust has successfully paid a monthly distribution to investors.

Suggested Lonsec risk profile suitability

SECURE	DEFENSIVE	CONSERVATIVE	BALANCED	GROWTH	HIGH GROWTH
			●	●	

For guidance on appropriate asset allocations and risk profiles, refer to the latest Lonsec Strategic Asset Allocation Review and Risk Profile Definitions on our website.

Changes Since Previous Lonsec Review

- A Private Placement of 5,911,000units to Wholesale investors was completed on 3 May 2019 which raised approximately $11,822,000.
- On 21 June 2019 Gryphon announced a third capital raising via a pro-rata non-renounceable entitlement offer targeting a raise of $108million. Eligible investors were invited to apply for 1 new unit for every existing 2. Eligible unitholders were also able to apply for additional new units at the offer price in excess of their entitlement as part of the oversubscription facility. Any units not taken up by eligible unitholders were offered to new investors under the shortfall offer. The offer opened on 4 July 2019 with the entitlement offer closing on 25 July. The original shortfall offer close date of 31 July was bought forward to 8 July due to the very strong support shown by new investors. The offer was fully subscribed and achieved its target $108million at an offer price of $2.00 per unit. Approximately 54million units were issued under the offer, 19 million to existing eligible unitholders (commenced trading on ASX 2 August) and 35million units to participants in the shortfall offer which will be issued on 13 August and will commence trading on ASX 14 August.
- Given the strong demand for the offer Gryphon issued a statement on 13 August that it will issue a further placement of 7,017,075 units at an offer price of $2.00.
- Gryphon has confirmed that all issuers are now providing monthly underlying loan data for analysis previously this was a mix of monthly and quarterly.
- Gryphon has made some enhancements to the internal reporting system. Essentially the enhancement will aggregate data across the various mandates in one central location. This allows the team to analyse exposures in aggregate across the book and then drill down into individual exposures.
- Vijay Singh, has joined the team in April 2019 to work alongside Shane Stanton in Analytics. Gryphon has also hired Rachelle Reed in the role of Investor Relations and Emmanuel Tumini as a Fund Administrator.
- Elizabeth Reddy has retired from the One Investment Group and stood down as a director on the RE Board. Sarah Wiesener joined the Responsible Entity Board as an Executive Director in October 2018.
- The Trust moved to daily pricing on 1 April 2019. Previously the Trust was priced on a weekly basis.
- The management cost of the Trust has reduced from 0.98% p.a. to 0.92% p.a.
- The largest shareholder in the Trust with 15,500,000 securities (approximately 10.5%) is Loannet Pty Ltd. Loannet Pty Ltd is a related party to Liberty Financial Pty Ltd, a significant issuer in non-prime mortgages (a sector in which this Trust invests into) and an entity Gryphon has had a longstanding relationship with. Gryphon has reaffirmed all potential investment opportunities are assessed at "arms-length" following the processes and procedures outlined in the body of the report. Gryphon employees must comply at all times with its Code of Business Conduct and Ethics Policy which includes a policy on dealing with Related Parties.
- Gryphon updated GCI's investment guidelines with effect from 15 May 2019. Key changes to guidelines include increasing single originator limit from 25% to 30% and sub-investment grade ABS limit from 5% to 15%.

Lonsec Opinion of this Trust

People and resources

- Gryphon Capital Investments is an asset management firm focused on investments in the structured finance and less liquid credit markets in both Europe and Australia. The firm was founded in 2014 by Steven Fleming, Ashley Burtenshaw and Henry Cooke. Fleming and Burtenshaw previously worked together at Babcock and Brown from 2005 before moving across to Columbia Threadneedle ('Threadneedle') in 2009 to run ABS portfolios. Cooke joined the team in 2010. In 2014 the team spun out from Threadneedle to establish GCI as a standalone entity. Burtenshaw and Fleming are responsible for the Australian fixed income mandates and are the Portfolio Managers on this Trust. Lonsec views the team's longstanding working relationships to be a positive attribute for the Trust.
- Fleming has 24 years industry experience across principal finance, structured finance, property and project finance in London, New York and Australia. He has held senior roles at Columbia Threadneedle, Babcock and Brown, and Nomura Principal Finance Group. Fleming acts as CEO for the firm and is responsible for the firm's business strategy, risk management, operational oversight and is a member of the Investment Committee (IC).
- Burtenshaw has 23 years industry experience with a background in credit trading both global and domestic markets, debt securitisation markets and funds management. Burtenshaw worked at Threadneedle Investments as co-head of Global Mortgages alongside Fleming from 2008. He was hired by Credit Suisse First Boston in 2004 to establish their Structured Credit and ABS business in Australia. He also spent time at Babcock & Brown managing ABS portfolios. Burtenshaw acts as CIO for GCI and is responsible for the firm's investments and portfolio management. He is the second member of the IC.
- Henry Cooke, with 31 years industry experience is the most senior member of the team and part owner of Gryphon Capital. Cooke is based in London and will not be involved with the management of the Trust, although he remains available if additional support is needed by the investment team.
- Fleming and Burtenshaw are considered to be particularly skilled in the analysis and investment of asset backed securities. Both have been closely involved with this asset class for several years with

domestic and global experience on both the buy and sell side. Lonsec considers both to be strong Portfolio Managers with the necessary in-depth knowledge to manage this LIT. The respective skill sets of each individual are considered to be complementary spanning across trading, funds management and deal structuring. As such Lonsec assigns high key person risk to both individuals. However, this is mitigated somewhat by the ownership structure. Entities controlled by Fleming and Burtenshaw own 40% each of the business with the remaining balance of 20% belonging to Cooke. Lonsec believes this structure also serves to strengthen alignment of interests with investors.

- Fleming and Burtenshaw are supported day-to-day by three analysts: Shane Stanton, Portfolio Management and Analytics, Sergey Podzorov, Database Management and new hire, Vijay Singh, Investment Analytics. Both Stanton and Podzorov were also part of the Threadneedle team with Fleming and Burtenshaw meaning all four have co-tenure and have worked together since 2005. Stanton has 13 years of credit market experience across securitisation, derivatives, funds management and structured finance. Stanton is responsible for developing the front-end user interface for GCI's analytical tools which are considered critical for this complex and data intensive asset class. Stanton is also responsible for sourcing the necessary data for accurate and timely assessment of issues, ensuring data quality, and the development and maintenance of cashflow models used in the regular assessment of issues. Stanton is also involved in the stress testing of individual assets and the overall portfolio. Singh was recently hired to assist Stanton and responsible for maintaining and developing Gryphon's portfolio applications including models, attribution systems, analytics and risk models. Podzorov is an experienced programmer and developer with 24 years experience, he is responsible for building and maintaining the firm's portfolio applications which assist the team with feeding the underlying loan tape data into front office systems, market pricing, and portfolio management.
- Although Stanton and Podzorov are not key decision makers for the Trust their support is vital in an asset class which Lonsec considers labour intensive in terms of data gathering, analysis and daily portfolio management. The addition of Singh bolsters Gryphon's analytical capacity and is viewed in a positive light. His addition has particular benefits for Stanton who is considered to have a heavy workload. Overall investment team resourcing is adequate at present, given recent funds under management growth, although in times of high issuance Lonsec considers resourcing could be stretched.
- Given that each member of the investment team is viewed as a critical part of the team puzzle with either asset class expertise or a key role in the development of the proprietary systems, Lonsec views key person risk as high in Fleming, Burtenshaw, Stanton and Podzorov with the departure of any potentially warranting a revision of the current rating. Lonsec also notes that Fleming and Burtenshaw may at times be drawn away to deal with business responsibilities common in a boutique structure acting as a distraction from day-to-day management of the portfolio.
- The team also has a dedicated compliance resource in Michael Groom, Head of Operations and Compliance. Groom is also ex-Threadneedle and is responsible for the firm's financial affairs, as well as managing GCI's operational compliance and company practises. Emmanuel Tumini fulfils the role of day to day Fund Administrator for the Trust, with Rachelle Reed responsible for Investors Relations. Lonsec considers the addition of Tumini and Reed in support functions over the past year is beneficial for the investment team.
- Pleasingly GCI has outsourced a number of operational business requirements to third party providers allowing the investment team to focus on portfolio management and day to day investing. Legal, IT Support, Accounting/Tax, Audit Service (internal controls only) are all undertaken by various third party providers. Lonsec views this as an appropriate structure.
- Accountability is viewed as adequate. The collegiate culture is believed to contribute positively to transparency and accountability within the investment team. Fleming and Burtenshaw drive decision making with the support of Stanton and the proprietary database and systems.

Board of directors and governance

- One Managed Investment Fund Limited is the Responsible Entity of the Trust. This means, in respect of the Portfolio, many of the functions traditionally performed by an entity's management are instead performed by the Manager. The Responsible Entity monitors the performance of the Manager in much the same way as a board monitors the performance of management of the entity they are appointed to. The Responsible Entity is a member of One Investment Group (OIG) which is a funds management business specialising in providing responsible entity, trustee, custody and administration services. OIG is not a fund manager.
- As the Responsible Entity is a member of OIG, a Board of Directors is appointed by OIG. The OIG Board consists of two Executive Directors; Frank Tearle and Sarah Wiesener and one non-Executive Director, Justin Epstein. The OIG Board does not have visibility into the firm's investments but is responsible for ensuring that corporate strategy is executed optimally and that the Trust is strictly compliant.
- The Board does not have a separate audit committee with the full board considering all financial reporting for the Trust. The Responsible Entity has appointed the Administrator, Mainstream Fund Services, and has delegated to the Administrator the responsibility for preparing all financial reporting for the Trust. The Board obtains appropriate representations from OIG management and where necessary the Manager and Administrator as to record-keeping, risk management and the compliance with accounting standards of the financial statements.
- Being ASX-listed, the Trust will also need to comply with the stringent listing rules of the ASX, including valuation of assets. Lonsec views securitised investments as more of a niche and at times opaque asset class with few actual trades to use as price

points in comparison to traditional fixed income assets. This can give rise to elevated mark to market risk for investors.

Research and portfolio construction

- The GCI process is a combination of top-down and bottom up analysis, with the latter the dominant driver of portfolio construction.
- Key to the GCI research and portfolio construction process is understanding the individual risk characteristics on each RMBS or ABS issue they chose to invest in. This cannot be ascertained in isolation with the top down macro research piece an important part of the process, specifically the key drivers of the Australian economy and trends in the housing market. The IC is responsible for top-down analysis which is discussed at their weekly meeting. The macro process shapes construction of the portfolio, specifically idea generation, asset allocation decisions, sector weightings and providing direction on the research agenda. Lonsec is of the opinion that the macro piece is not where GCI's key strength lies, although research undertaken is both thorough and appropriate. Ultimately GCI's key strength is considered to be bottom-up analysis of securities which is undertaken with care and skill.
- Over time, Fleming and Burtenshaw have developed long-standing relationships within the industry and will use this to their advantage. Often originators will contact GCI directly prior to an issue launching allowing the Portfolio Managers to begin assessing if the upcoming offer will be an appropriate fit for the portfolio. The first step is to assess if the issue displays relative value either at the portfolio level and/or individual transaction level. This decision is made by the IC. If the decision is made to move forward GCI undertake a formal underwrite report followed by a deep dive analysis of the securitisation, sourcing loan level data for all loans included in the pool. This data is used to create a 'Collateral Stratification' report which ascertains the overall risk in the portfolio. Factors assessed include the loan to value ratio (LVR) of each loan, employment statistics of borrowers, postcode analysis, type of dwelling, loan classification, repayment type. All this information and more (up to 50 data points per loan) are analysed and aggregated to illustrate how investing in an issue would affect the portfolio in an overall risk sense.
- Once the team is satisfied with the assessment of loan level data, cashflow waterfall analysis of the asset backed structure is undertaken using proprietary models which track the frequency of loan repayments. These models allow the team to stress test various scenarios that may affect repayment rates of the loan pool and erode value of the various tranches. Once the team is satisfied with the relative value on offer, the balance of collateral in the underlying pool and results of stress tests they will present the issue for consideration at the IC meeting. Each issue that is considered must have an Underwrite report, Collateral Stratifications report and Large Loan Review report. Throughout the process, Fleming and Burtenshaw, with the assistance of Stanton, overlay a qualitative view considering macro influences on the domestic economy and long-term knowledge of the asset class.
- GCI does not intend to actively trade in the secondary market on a regular basis. They will choose to trade if their relative value view on an issue changes, they see an opportunity to lock in solid gains for the portfolio or are concerned the issue may be vulnerable to a credit rating downgrade.
- The IC meets formally once a week. A structured IC pack is provided which looks at various macroeconomic factors (global and domestic) including; RMBS delinquency rates and house price analysis. The IC will also discuss and debate new investment opportunities that have been evaluated using the GCI research process.
- GCI's investment philosophy and process are solely focused on securitised assets making their offering distinct from most other fixed income funds covered by Lonsec. Other Funds will often be permitted to invest in securitised assets as a sleeve of a more broadly diversified portfolio. Lonsec considers that investing in securitised assets requires a specialised skill set and the ability to filter and analyse large volumes of data on a regular basis. Another key challenge for investors is the lack of standard off the shelf systems available for use in analysing data. To this end, the onus is on managers to build and maintain in-house models to collate data and allow analysis to take place. Lonsec notes GCI has developed various methods of analysis over many years including proprietary models which are considered good quality and reasonably robust. However, Lonsec maintains the view that ongoing maintenance and review of internal systems is necessary which is an additional drain on the investment teams time. Lonsec also notes there has been no external auditing or review of proprietary systems to date. Lonsec takes some comfort that the analytical and monitoring spreadsheets include a cashflow reconciliation.
- The largest shareholder in the Trust with 15,500,000 securities (approximately 10.5%) is Loannet Pty Ltd. Loannet Pty Ltd is a related party to Liberty Financial Pty Ltd, a significant issuer in non-prime mortgages (a sector in which this Trust invests into) and an entity Gryphon has had a long standing relationship with. Gryphon has reaffirmed each issuer and individual issue must undergo the same analysis and risk assessment prior to investment and each opportunity is assessed at "arms-length". Gryphon employees must comply at all times with its Code of Business Conduct and Ethics Policy which includes a policy on dealing with Related Parties. At this point in time, Lonsec is satisfied with this approach but will continue to closely monitor portfolio allocations going forward and the underlying shareholder base.

Gryphon Capital Income Trust

Risk management

- Lonsec believes that in-depth analysis of securitised assets requires both vast amounts of data and sophisticated modelling approaches to fully ascertain risk and relative value. Pleasingly GCI displays a keen awareness of risk within the portfolio and demonstrates a deep level of knowledge of the asset class which has built up over time. GCI does not believe they can time markets and instead focus on using their in-depth knowledge to drive investment decisions. GCI believes that an allocation to securitised assets for investors, in particular, RMBS, can provide investors with a degree of capital preservation, a steady income stream, superior investment returns and diversification benefits when invested as part of an overall fixed income portfolio.
- Once an investment is made GCI undertake regular monitoring by accessing ongoing loan level data on a monthly basis. Stanton, and now Singh, are key to this process, responsible for sourcing data, cleaning the data to improve quality and undertaking regular risk assessments via the cashflow models.

Funds under management

- GCI currently has approximately $X.XXbn funds under management (August 2019). Considering the current team size of five, Lonsec continues to be supportive of any additional resourcing being added, particularly in regards to the data gathering and analysis of loan pools.
- Lonsec acknowledges that the securitised market in Australia is substantial and continues to grow. The growth of the domestic securitised market has increased rapidly over the last few years with large volumes of issuance, the current market size is in excess of $100bn with $36bn of RMBS issued in 2017 and approximately $26bn in 2018. Lonsec considers the securitised market, although large, is subject to every growing demand from investors. The challenge with this type of product is successfully sourcing investments to match GCI's required criteria. Over the past year, GCI has successfully deployed the majority of capital raised in the IPO into desired allocations. With the completion of the entitlement offer which raised $108,000,000 million (with an additional placement of $14,000,000 million to be offered shortly) the challenge is once again to source the appropriate securities for investment. Lonsec will continue to closely monitor this over time. GCI remains confident they can allocate FUM raised given the size of the market, their long-standing participation in it and existing relationships within the industry.

Performance

- The portfolio is yielding 4.84% (since inception anualised to June 2019) and the target is RBA Cash Rate plus 3.50% per annum net of fees. GCI previously had not run any other strategies for retail or wholesale investors. However, the team manages three mandates for institutional clients which provide a track record of performance over recent years.
- The High Grade Securitised strategy, since inception January 2010 to June 2019 has delivered an annualised return of 5.30% (net). More relevant to the LIT under review is the return of the Secured Opportunities and Investment Grade strategies of which the portfolio design will be modelled on based on a 50%/50% split. The Secured Opportunities strategy since inception April 2015 to June 2019 has delivered an annualised return of 6.67% (net). The Investment Grade strategy since inception September 2016 to June 2019 has delivered an annualised return of 4.89% (net).
- Lonsec cautions investors to remain mindful the two strategies most relevant for assessment have reasonably short track histories and largely enjoyed favourable market conditions which may not be repeated in the years to come.
- The Trust paid its first distribution for June 2018 in early July and has paid regular monthly distributions since then.

Overall

- Lonsec has assigned the Gryphon Capital Income Trust (GCI) a rating of **'Investment Grade'**. This rating is supported by the deep level of experience and expertise of Fleming and Burtenshaw coupled with a rigorous and disciplined research and portfolio monitoring process. The proprietary systems and site visits to servicers as well as the deep understanding of the issuance market are considered key strengths of the offering.
- However, Lonsec considers the team to be quite lean for such a data-intensive (and at times necessarily manual) process, exposing some vulnerability to key person risk. In addition, Lonsec highlights the vulnerability of the Trust to adverse macroeconomic conditions in the domestic market.

People and Resources

Corporate overview

Gryphon Capital Investments is an asset management firm focused on investments in the structured finance and less liquid credit markets in both Europe and Australia. The three founding Partners maintain full ownership of the firm. GCI is the investment manager of the Trust.

The investment team is split across two locations. Fleming, Burtenshaw, Stanton and Singh are in Brisbane. Podzorov is based in Sydney. Henry Cooke the third managing partner is based in London.

Corporate Structure

GCI is the investment manager of the Trust and was founded in 2014 by Steven Fleming, Ashley Burtenshaw and Henry Cooke. The three founding Partners maintain full ownership of the firm. The managing partners combined equity is held in the Gryphon Capital Partners Limited holdings vehicle.

Board of Directors

One Managed Investment Fund Limited is the Responsible Entity of the Trust. The Responsible Entity is a member of One Investment Group (OIG) which is a funds management business. A Board of Directors is appointed by OIG. The OIG Board consists of two Executive Directors; Frank Tearle and Sarah Wiesener, and one non-Executive Director, Justin Epstein. The OIG Board does not have visibility into the firm's investments but is responsible for ensuring that corporate strategy is executed optimally and that the Trust is strictly compliant.

Key events

FUNDS RAISED IPO	$175,000,000
UNITS ALLOTTED 25TH MAY 2018	87,650,000
NTA AT ALLOTTMENT 25TH MAY 2018	2.00/UNIT
FUNDS RAISED PRIVATE PLACEMENT OFFER	$11,822,000
UNITS ALLOTTED 3 MAY 2019	5,911,000
NTA AT ALLOTTMENT	2.00/UNIT
FUNDS RAISED SECOND CAPITAL RAISING	$108,000,000
UNITS ALLOTTED 2 AUGUST 2019	19,000,000
UNITS ALLOTTED 13 AUGUST 2019	35,000,000
MANAGER LOAN DRAWDOWN AMOUNT	$8,341,000
JULY DISTRIBUTION (PAID 8 AUGUST 2019)	$0.0084/UNIT
31 JULY NTA	2.0105 /UNIT

Size and experience

NAME	POSITION	EXPERIENCE INDUSTRY / FIRM
STEVEN FLEMING*	MANAGING PARTNER/ CEO	24 / 5
ASHLEY BURTENSHAW*	MANAGING PARTNER/CIO	23 / 5
SHANE STANTON*	ANALYST	13 / 5
SERGEY PODZOROV*	ANALYST	24 / 5
VIJAY SINGH	ANALYST	5 / >1

* The team has longer co-tenure together including time at Threadneedle

The investment committee is comprised of Fleming and Burtenshaw.

Steven Fleming has 24 years of industry experience. He has worked in a variety of roles across in investment banking and funds management, including principal finance, structured finance, property and project finance transactions in London, New York and Australia. Fleming has held senior positions in several large highly regarded companies including Threadneedle International Limited, Babcock & Brown and Nomura. Pleasingly Fleming's previous roles were focused on the management of securitized assets.

Ashley Burtenshaw has 23 years of industry experience with a background in trading credit across domestic and international markets. Burtenshaw also held senior positions at Threadneedle International Limited in the mortgage business, and at Credit Suisse First Boston where he was hired to establish their Structured Credit and ABS business in 2004. He commenced his career at Nomura London and also spent time at Babcock & Brown managing ABS.

Shane Stanton has 13 years industry experience across securitization, derivatives, funds management and structured finance. Stanton previously worked with Fleming and Burtenshaw at Threadneedle Investments.

Sergey Podzorov has 24 years of industry experience in financial markets in areas including securitisation, structured finance and funds management. Podzorov was also previously employed at Threadneedle.

Vijay Singh has five years industry experience in securitisation and covered bonds. Prior to joining Gryphon Singh was employed at the Bank of Queensland.

Investment team remuneration

Lonsec believes that there is a strong alignment of interests between the two senior team members, Fleming and Burtenshaw, and the Trust. Both Fleming and Burtenshaw as Managing Partners each own a 40% equity stake in the business. The remaining 20% is held by Henry Cooke their London based colleague. The three do not draw any fixed compensation.

The remaining employees are paid a fixed salary, which is determined based on market analysis and contribution to overall business outcomes. There is also a variable short term incentive which is discretionary and may be in the range of 0%-100% of the fixed compensation amount. GCI believes this remuneration structure incentivises employees to achieve agreed objectives which align with long term business outcomes. GCI does not offer a compensation deferral policy at present.

Research Approach

Overview

GCI applies a blend of top down and bottom up research to construct a portfolio that is diversified across various risk buckets. GCI invests in securitised assets only, predominantly residential mortgage backed securities and to a lesser degree asset backed securities. The investible assets for this Trust will be predominantly Australian domiciled securities, however, mandate guidelines allow exposure to foreign denominated securities. Any such exposures would be fully hedged.

GCI undertakes macroeconomic analysis on a regular basis to assess how changes in the global and domestic economy could impact the portfolio of assets. The IC receives a weekly information pack outlining key economic indicators which are combined into a macro summary dashboard. Factors assessed include data on; market volatility, treasury yield curves, employment rates, wage earnings, and shipping and trade data. Of particular importance is data pertaining to the domestic housing market such as; housing affordability statistics, house prices analysis and mortgage delinquency rates. The team also analyses spread comparison reports across various global markets versus Australian securitised sectors.

The team then uses the broad-based macro view to guide their in-depth fundamental analysis of securities. First, the Portfolio Managers assess if a security offers good relative value and is appropriate for inclusion in the portfolio. Once the initial decision is made to consider the security for analysis a formal underwrite report is undertaken. The reports assess the following factors:

1. Deal Structure – amortization/step down conditions, liquidity support, hedging
2. The form of credit enhancement - LMI, Excess spread, Subordination
3. Risk Analysis – default risk, performance risk, downgrade risk, loan arrears deterioration, non-call risk
4. Provision of reporting and underlying loan data
5. Cashflow modelling – analysing credit protection, stress testing and scenario analysis

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A collateral stratification report is generated by breaking down the loan pool data into sub-sectors allowing the team to assess the level of risk held within the issue and whether they are comfortable with the underlying constituents. The loan pool is broken down into bands including LVR, security type (e.g. residential luxury), loan classification residential or investment, loan purpose, employment type of borrowers, locality, loan type (fixed or variable), current loan balances, LMI provider or none and repayment type, seasoning of loans, arrears data and percentage of properties situated in a flood postcode.

Next, a report is generated to analyse large loans in the underlying pool. This report provides individual loan line assessment looking at the loan balance, loan type, loan purpose, loan classification, employment type of borrower, arrears (if any), the location of a property, indexed LVR, loan type. GCI prefer to avoid loan pools that a barbelled in terms of large loans, particularly those with high LVR's. Lonsec is supportive of this approach.

Once the documentation is completed the team provides a formal IC paper with a recommendation for investment across the various tranches of the issue. A formal recommendation must also be drafted for IC consideration if a security is sold on the secondary market.

Portfolio Construction

Overview

The Trust is constructed using a bottom up approach as outlined above. GCI have a strong focus on capital preservation which drives security selection, the team estimate losses on the underlying portfolio based on each security's individual characteristics, then compares this to the available credit protection built into the transaction.

All investment actions must be approved by the investment committee consisting of Fleming and Burtenshaw. There is no formal requirement for both to agree on an investment, however, it would be highly unlikely to proceed if one disagreed with the recommendation. If this was to occur, it would be a sign that more analysis and discussion is needed before a final decision is made.

GCI aims to diversify the portfolio across rating bands, geographical allocations, and originators. Underlying that broad-based approach GCI aims to balance the portfolio in terms of seasoning of underlying loans, LVR's, cashflow frequency and maturity profile.

Ultimately GCI's ability to access the deal sizes and favoured tranches is dependent upon market demand. GCI may not always receive what they bid for, with demand from competitors high. GCI believe their long-standing tenure within the industry allows them some favourable treatment. Lonsec believes this could be eroded as the market heats up and new investors enter the auction process in the future.

Risk Management

Risk limits

RMBS EXPOSURE	70-100%
ABS EXPOSURE	0-30%
MAXIMUM GROSS EXPOSURE TO SINGLE ORIGINATOR	30%
MAXIMUM INDIVIDUAL SECURITY WEIGHT	10%
MAXIMUM PORTFOLIO WEIGHT AVERAGE LIFE	LESS THAN 5.5 YEARS
CURRENCY EXPOSURE	100% FULLY HEDGED
DERIVATIVES	YES
MAXIMUM SUB-INVESTMENT GRADE ALLOCATION	50%
MINIMUM CREDIT RATING	UNRATED
LEVERAGE	MAX 25% NAV (FOR USE IN FUTURE CAPITAL RAISES, SHORT TERM PURPOSES ONLY)
SEPARATE RISK MONITORING	NO

GCI actively monitors portfolio risk and endeavours to optimise the balance between risk exposure and risk mitigation. GCI utilise in-house proprietary risk systems to stress test investments prior to investing and on an ongoing basis. A qualitative opinion of what is the appropriate risk in the portfolio at any given time is part of the team's ongoing assessment. The LIT is authorised to invest in RMBS, non-conforming RMBS and ABS.

The LIT mandate guidelines also provide the risk limits outlined above. Lonsec notes the limits go some way in diversifying the portfolio in terms of exposures to originators, individual securities and sub-investment grade assets. Regardless of these limits, the portfolio has the ability to be 100% exposed to RMBS.

Risk monitoring

As part of their ongoing risk management, the investment team monitor maturity profiles, monthly cash flows and arrears statistics.

The Trust will have no unhedged currency. Derivatives are permitted for efficient portfolio management only and not for market speculative purposes to increase returns

Risks

An investment in the Trust carries a number of standard investment risks associated with domestic and international investment markets. These include economic, political, legal, tax and regulatory risks. These and other risks are outlined in the PDS and should be read in full and understood by investors. Lonsec considers major risks to be:

Investment risk

Being a LIT, its securities may trade on the ASX at a discount to its NTA for extended periods of time.

ASX Related Market risk

Given that the Trust's units are traded on the ASX, investors may be exposed to risks including, but not limited to, Unit trading price risk, volatility of Units risk, ASX liquidity risk, and ASX counterparty risk.

The **trading price** of any listed security may change, related to performance and matters inherent to the investment performance of the securities, but also due to external factors such as market sentiment, or a range of other factors including the presence of larger buying or selling interest in the Units.

Volatility risk may arise when Units in the Trust are **thinly** or **heavily** traded, which could make the Unit

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prices very volatile, irrespective of any changes in the underlying value of the investments held by the Trust.

Although liquidity is generally expected to exist in this secondary market for Units in the Trust, there are **no guarantees that an active trading market** with sufficient liquidity will develop, or should it develop after listing, that such a secondary market will sustain a price representative of the NAV per Unit.

The Units may also be exposed to ASX counterparty risk. This describes the risk that when a Unitholder sells their Units on market they are relying on CHESS, the central system for clearing and settling trades on the ASX, to ensure they receive their settlement proceeds as well as the risk that arises as a result of Unitholders relying on the creditworthiness of their broker when making trades on ASX.

Asset backed securities risk

The value of an RMBS and ABS can be affected by a number of factors, including--

(i) changes in the market's perception of the underlying assets backing the security (for example, RMBS are particularly at risk from a decline in the housing market)

(ii) economic and political factors such as interest rates and levels of unemployment and taxation which can have an impact on the arrears, foreclosures and losses incurred with respect to the pool of assets backing the security

(iii) changes in the market's perception of the adequacy of credit support built into the security's structure to protect against losses caused by arrears and foreclosures

(iv) changes in the perceived creditworthiness of the originator, of the underlying security or any other third parties to the transaction, and

(v) the speed at which mortgages or loans within the pool are repaid by the underlying borrowers (whether voluntary or due to arrears or foreclosures).

At times of rapid changes in market conditions, it may be difficult to value certain RMBS and ABS and values may fluctuate considerably, with market prices quickly becoming out of date and not reflecting the value which would be realised on a sale of the relevant investments in such market conditions. The value of the Portfolio will be determined regularly based on prices at which its investments trade in the wholesale market and, accordingly, falls in the market price will result in a corresponding fall in the Trust's NAV and the Units.

The investment characteristics of RMBS and ABS differ from traditional debt securities. Among the major differences are that interest and principal payments are made more frequently, very often monthly or quarterly, and that principal may be prepaid at any time because the underlying loans are often capable of being prepaid at any time.

Credit risk

The Trust may invest in high yield RMBS and ABS that are rated less than an Investment Grade. High yield RMBS and ABS have an increased risk of capital erosion due to a higher probability of default by the issuer. Changing market conditions and interest rate levels can also have a larger impact on the values of high yielding RMBS and ABS.

The Trust is also exposed to the credit risk associated with the Gryphon Group as an entity through the provision of the manager loan. The Manager Loan is an unsecured loan, which means the Trust's right to recover the loan will rank behind the secured creditors of Gryphon Capital Management (GCM). If GCM is unable to meet its contractual obligations under the Manager Loan, then the Trust may incur a loss and this would have an adverse effect on the value of the Trust.

Interest rate risk

The Manager will primarily invest the Trust in floating rate loans meaning that as the underlying base rate rises and falls, the relative attractiveness to other instruments may change.

Liquidity risk

The Trust is exposed to liquidity risk in relation to the investments within its Portfolio. If a security cannot be bought or sold quickly enough to minimise potential loss, the value of the Portfolio may be adversely affected. The Trust's investments are not liquid securities and the ability of the Manager to dispose of an investment will depend on the market liquidity prevailing at that time.

Leverage risk

The Manager does not intend to use long-term debt to enhance returns, but may use debt in limited circumstances. For example, the Manager does not intend to use debt unless it has also planned to raise new capital from the issue of new Units which will be used to repay any borrowings. If a proposed capital raise is not successful, then any leverage can magnify the gains and losses achieved in the Portfolio.

The use of leverage may magnify the Fund's losses and gains.

Valuation risk

ABSs will be valued in accordance with the Trust's valuation policy which includes wherever possible using independent security pricing sourced from third parties. However, estimates of the fair value of such securities are inherently difficult to establish and are the subject of substantial uncertainty.

Market disruption risk

As a lender, GCI is exposed to market disruption risk. A market disruption event occurs in relation to a loan if a borrower or borrowers are unable to refinance.

Service provider risk

The operation of the Trust relies on the successful performance of the Responsible Entity's contracts with service providers. There is also a risk of manager change, that is GGI being replaced due to unforeseen circumstances. This is a risk considering the complexity of this niche asset class, where specialist skills are required for the management of this type of asset class.

Manager loan

The Trust assets will be used to make the Manager Loan. Over the life of the Investment Management Agreement, the Manager will use its part of its management fee to repay the Manager Loan, including payment of interest on the Manager Loan which will be interest income to the Trust. The repayments are structured such that the final payment of principal and interest will be paid at the end of the initial 10-year term of the Investment Management Agreement. The Responsible Entity it entitled to deduct loan repayments (including interest) from the Manager's fee each month until the Manager Loan plus interest is repaid in full.

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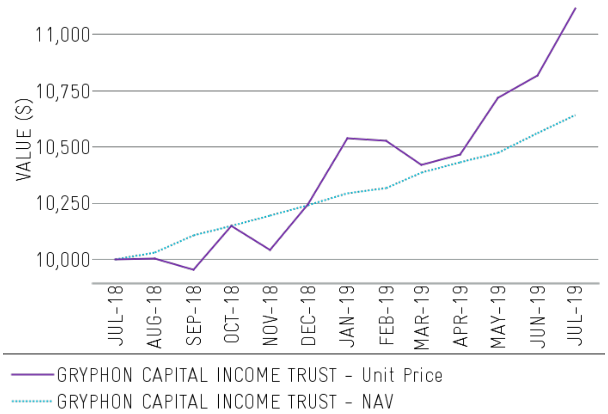
Quantitative Performance Analysis - annualised after-fee % returns (at 31-7-2019)

Performance metrics

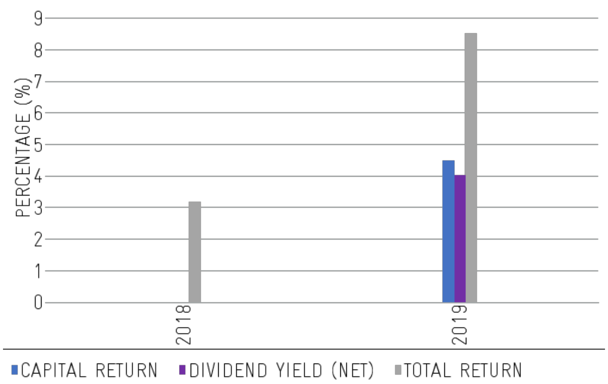
	3 MTH	6 MTH	9 MTH	12 MTH
TOTAL RETURN (% PA)	6.23	5.47	9.52	11.17
STANDARD DEVIATION (% PA) *	-	-	-	5.09
EXCESS RETURN (% PA)	5.05	3.07	5.86	6.23
WORST DRAWDOWN (%)	0.00	-1.13	-1.13	-1.13
TIME TO RECOVERY (MTHS)	-	2	2	2
TRACKING ERROR (% PA) *	-	-	-	5.10

FUND: GRYPHON CAPITAL INCOME TRUST
BENCHMARK USED: RBA CASH RATE + 3.50%
* PERIODS LESS THAN 12 MONTHS ARE NOT CALCULATED
TIME TO RECOVERY: NR - NOT RECOVERED, DASH - NO DRAWDOWN DURING PERIOD

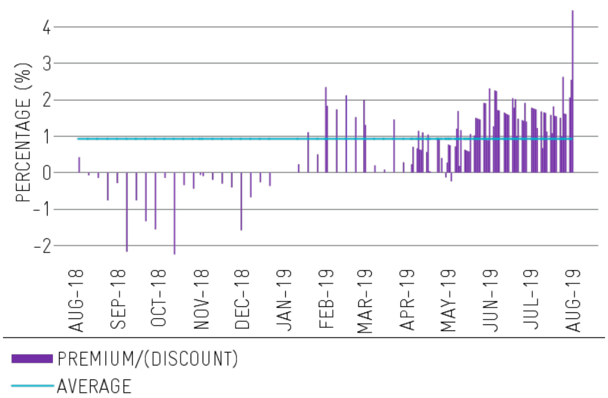
Growth of $10,000 over one year



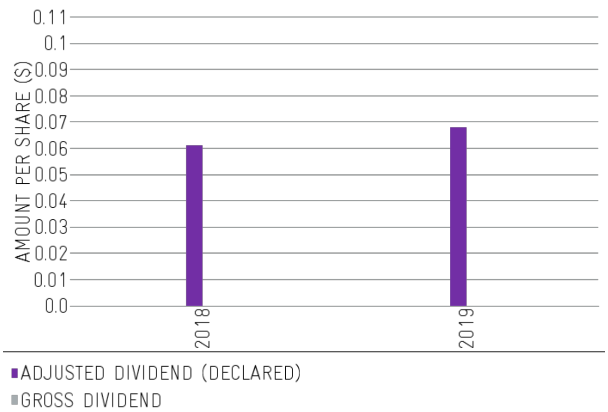
Calendar Year Returns over two years



Unit Price Premium/Discount to NAV over one year



Dividend Record over two years



ANALYST: JUDE MCDONNELL | APPROVED BY: PRASANKA RAJAPAKSHA

Gryphon Capital Income Trust

Glossary

Click here for the glossary of terms.

About Lonsec

Lonsec Research Pty Ltd (Lonsec) is an investment research house with specialist areas of expertise, that was originally established in 1994 and the current entity was registered on 23 June 2011. From 1 July 2011, Lonsec became a fully owned subsidiary of Lonsec Fiscal Holdings Pty Ltd, a privately owned entity with a multi-brand strategy of providing leading financial services research and investment execution. Lonsec believes that professional financial advisers need informed opinions on the best investment strategies and financial products to provide real value for their clients. To meet this need, Lonsec has in place an experienced research team, which draws on a robust research process to undertake in-depth assessment of managed fund products.

Analyst Disclosure and Certification

Analyst remuneration is not linked to the research or rating outcome. Where financial products are mentioned, the Analyst(s) may hold the financial product(s) referred to in this document, but Lonsec considers such holdings not to be sufficiently material to compromise the rating or advice. Analyst holdings may change during the life of this document. The Analyst(s) certify that the views expressed in this document accurately reflect their personal, professional opinion about the matters and financial product(s) to which this document refers.