

Item 1 - Cover Page

# Penn Capital Management Company, Inc.

March 31, 2019

Navy Yard Corporate Center  
1200 Intrepid Avenue, Suite 400  
Philadelphia, PA 19112  
215-302-1500  
[www.penncapital.com](http://www.penncapital.com)

---

This Brochure provides information about the qualifications and business practices of Penn Capital Management Company, Inc. ("Penn Capital"). If you have any questions about the contents of this Brochure, please contact Penn Capital at (215) 302-1500. The information in this Brochure has not been approved or verified by the United States Securities and Exchange Commission ("SEC") or by any state securities authority.

Additional information about Penn Capital is also available on the SEC's website at [www.adviserinfo.sec.gov](http://www.adviserinfo.sec.gov).

Penn Capital is an investment adviser registered with the SEC under the Investment Advisers Act of 1940, as amended ("Advisers Act"). Registration does not imply a certain level of skill or training.

---



## **Item 2 - Material Changes Since the Last Annual Update**

There have been material and non-material changes to this Brochure since the last annual update on March 30, 2018. Item 5: Fees and Compensation has been amended to describe the asset-based sales compensation of Penn Capital employees who are registered representatives. Item 12: Brokerage Practices has been materially amended to include additional explanatory disclosure regarding the firm's selection of broker-dealers, including the factors considered and the commissions paid for the different types of brokerage services. Disclosure has been expanded regarding Penn Capital's receipt of soft dollars, its policies and processes, including the use of a third-party aggregator for collection and payment of soft dollars, and the related conflicts of interest involved in that process. Disclosure has also been added regarding the roles and responsibilities of the firm's Best Execution Committee. Item 16: Investment Discretion has been materially amended to provide additional detail regarding the specific types of clients for which Penn Capital provides either discretionary or non-discretionary investment advisory services. Numerous other non-material additions, deletions, changes, and elaborations, as well as additional explanatory enhancements and clarifications, have been made throughout this year's Brochure.

Penn Capital will provide you with other interim disclosures about material changes as required.

Upon written request, Penn Capital will provide a copy of this Brochure.

### Item 3 - Table of Contents

#### Table of Contents

Item 1 - Cover Page.....	1
Item 3 - Table of Contents .....	3
Item 4 - Advisory Business .....	4
Item 5 - Fees and Compensation.....	9
Item 6 - Performance Fees & Side-by-Side Management .....	12
Item 7 - Types of Clients.....	12
Item 8 - Methods of Analysis, Investment Strategies and Risk of Loss .....	13
Item 9 - Disciplinary Information.....	17
Item 10 - Other Financial Industry Activities and Affiliations .....	18
Item 11 - Code of Ethics, Participation or Interest in Client Transactions, and Personal Trading.....	18
Item 12 - Brokerage Practices .....	19
Item 13 - Review of Accounts .....	29
Item 14 - Client Referrals and Other Compensation .....	30
Item 15 - Custody .....	31
Item 16 - Investment Discretion.....	31
Item 17 - Voting Client Securities .....	32
Item 18 - Financial Information .....	33

#### **Item 4 - Advisory Business**

Penn Capital Management Company, Inc. ("Penn Capital"), is an independent boutique investment management firm based in Philadelphia, Pennsylvania. Penn Capital was founded by Richard A. Hocker in 1987 with a primary focus on capital structure investing through proprietary research and high-quality client service. Richard A. Hocker and Marcia A. Hocker are the principal owners of Penn Capital. Penn Capital has remained 100% employee-owned since its inception and is dedicated to employee development and community service.

For over thirty years, Penn Capital has followed its core belief that understanding a company's entire capital structure is the best way to identify investment opportunities with the most value. In fact, the portfolio managers and research analysts (the "Investment Team") have found that managing fixed income portfolios makes Penn Capital a better equity manager and managing equity portfolios makes Penn Capital a better fixed income manager. Integrating credit and equity research allows Penn Capital's team to construct a more comprehensive mosaic and identify inefficient security pricing. The process is called Complete Capital Structure Analysis®.

Through Complete Capital Structure Analysis®, Penn Capital's investment professionals are capital structure generalists, meaning they are responsible for understanding the entire capital structure of the companies they follow. All ideas are vetted through Penn Capital's investment process and investment decisions are made by senior investment professionals. Penn Capital seeks to select for its portfolios those securities with the greatest potential to provide the risk-adjusted returns that clients expect.

As of December 31, 2018, Penn Capital managed approximately \$3 billion in regulatory assets under management, of which approximately \$2.6 billion was held in discretionary investment accounts, and approximately \$300 million was held in non-discretionary accounts.

Investment Strategies:

Penn Capital's investment strategies focus on micro-to mid-cap equity securities, fixed income and high yield securities, and bank loans. The investment strategies are:

Micro Cap Equity	Defensive Floating Rate Income
Micro to Small Cap Equity	Defensive High Income
Small Cap Equity	Defensive Short Duration High Income
Small Cap Value Equity	Ultra Short Duration Corporate Income
Small Cap Growth Equity	Multi-Sector Spectrum Income
Small to Mid Cap Equity	Opportunistic High Yield
Mid Cap Equity	Defensive High Yield
Financial Services	Double B High Yield
Energy Opportunities (Credit and Equity)	Ultra Equity High Yield
	Capital Structure Total Return
	Distressed Total Return

Penn Capital provides investment advisory services primarily through the following investment vehicles: registered mutual funds, private investment funds, separately managed accounts, and investment advisory programs offered through wrap fee programs or model portfolio distribution channels. Each of these is described in more detail below.

Registered Mutual Funds:

Penn Capital serves as either the adviser or sub-adviser to mutual funds registered under the Investment Company Act of 1940, as amended ("Investment Company Act"). As adviser or sub-adviser, Penn Capital's responsibility is to manage fund assets according to the investment strategy described in each fund's prospectus and statement of additional information. For the non-affiliated registered funds Penn Capital sub-advises, Penn Capital does not perform any sales, custodial, or administrative functions on behalf of those funds. Penn Capital also provides non-discretionary investment sub-advisory services to registered mutual funds.

Penn Capital is the discretionary investment adviser to the series funds of PENN Capital Funds Trust (the "Trust"), an affiliated investment company registered under the Investment Company Act.

Private Investment Funds:

Penn Capital serves as the general partner and investment adviser for private investment funds that are organized as limited partnerships. Penn Capital's private investment funds are available to accredited or qualified investors, and other persons as allowable by SEC rules. The minimum size of a limited partnership interest varies, as noted in the below chart, and Penn Capital reserves the right to waive these minimums for certain clients.

As of the date of this Brochure Penn Capital offers the following private investment funds:

<b><u>Fund</u></b>	<b><u>Investment Minimum</u></b>
Penn Capital Defensive High Yield Fund, L.P.	\$1,000,000
Penn Capital Multi-Sector Spectrum Income Fund, L.P.	\$1,000,000
Penn Capital Structure Total Return Fund, L.P.	\$1,000,000
Penn Core High Yield Bond Fund, L.P.	\$ 100,000
Penn Institutional Loan Common Master Fund, L.P.	\$5,000,000
Penn Short Duration High Yield Fund, L.P.*	\$1,000,000

\*Penn Capital is the investment adviser and its affiliate, Penn Capital Funds Group, LLC, acts as general partner.

**Separately Managed Accounts (“SMAs”):**

SMAs are primarily available to private and public retirement and pension plans, foundations, endowments, banks, institutional investors, insurance companies, and high net-worth individuals. Penn Capital is an approved SMA manager on a number of banking and brokerage platforms. The minimum account size for Penn Capital strategies, typically, is \$1 million for equity portfolios and \$10 million for fixed income/bond and bank loan portfolios. Penn Capital reserves the right to waive the account size minimums. SMA clients have the option to negotiate individualized investment guidelines or directives. If agreed to in advance, some SMA clients also are permitted to impose allocation and/or security-specific restrictions to either individual securities, asset classes, industries, or types of securities. Certain SMA clients also can engage Penn Capital to provide non-discretionary investment advisory services.

**Wrap Fee Program Accounts:**

Penn Capital serves as the investment adviser to wrap fee programs that are sponsored by third parties (typically, broker-dealers). Wrap fee programs are advisory programs in which the underlying clients pay a single fee to the wrap fee program sponsor for access to the investment advisory services of multiple investment advisers such as Penn Capital. Wrap fee program clients typically are high net worth individuals. The sponsors of wrap fee programs have the primary responsibility for the underlying clients’ servicing, communications, custody, and conduct some (or all, depending upon the program) of the trading for client accounts. In wrap fee programs, clients enter into agreements either directly with both the sponsor and Penn Capital (“dual contract” agreements) or solely with the wrap fee program sponsor (“single contract” agreements). Typically, underlying wrap fee program clients do not pay Penn Capital directly for advisory services. Instead, Penn Capital receives a (separately negotiated) portion of the wrap fee program sponsor’s fee for managing those wrap fee program account assets that are invested in a Penn Capital investment strategy.

For single contract agreements, Penn Capital makes no determination of the suitability of the sponsor's wrap fee program product for such sponsor's underlying clients. Penn Capital is responsible only for managing the client's wrap fee program account assets in the specified investment strategy. Unless specific program or account restrictions are imposed, Penn Capital manages wrap fee program accounts in a similar manner as Penn Capital's other clients in the same investment strategy. On a limited basis, Penn Capital permits wrap fee program account underlying clients and/or the program sponsor to impose restrictions or limits on certain individual securities or types of securities. Any restrictions or limits imposed would likely affect the performance of those accounts so that such account's performance will likely differ (e.g., it could be either higher or lower) than the performance obtained by Penn Capital's other clients investing in the same strategy.

Penn Capital is not responsible for overseeing the provision of services by a wrap fee program sponsor and cannot assure the quality of such services. Wrap fee program clients should review all materials relating to their program (including the program brochure) regarding the wrap fee program's terms, conditions and fees, and consider the advantages, disadvantages and overall appropriateness of the program in light of the client's particular circumstances.

Model Accounts:

Penn Capital provides non-discretionary investment advisory services to certain clients who in turn offer Penn Capital's investment strategies to their own underlying clients ("Model Accounts"). Penn Capital provides model portfolios to a number of Model Accounts, including, but not limited to, unified management account sponsors ("UMA"), SMA clients, and unaffiliated registered mutual funds. Penn Capital provides its Model Accounts with a model portfolio for the applicable investment strategy, subject to negotiated fees. Penn Capital constructs the model portfolio for the applicable strategy once the model portfolio's allocations, investments and weightings have been established, which typically occurs at the end of the trading day. Once completed, the model portfolio generally is provided to Model Accounts prior to the next day's market open. Model Accounts also can request alternative (e.g., weekly, rather than daily), delivery of a model portfolio. For Model Accounts, Penn Capital provides only the model portfolio, but does not assume responsibility for executing trades, performing recordkeeping, accessing performance data, or providing underlying client reporting. Model Accounts, in their sole discretion, choose to act or to not act upon any or all of Penn Capital's model portfolio recommendations. The recommendations in the model portfolios typically reflect the recommendations being made to Penn Capital's discretionary accounts, unless the Model Accounts have negotiated restrictions or other limitations on securities or asset classes or industries. Penn Capital typically delivers the model portfolios to the Model Accounts through the various proprietary systems of each Model Account.

Since Penn Capital generally provides Model Accounts with the relevant model portfolios prior to the next day's market open, Penn Capital will have already traded on its recommendations during the prior trading day, which trading was used to establish the model portfolio's actual weightings and holdings that are then communicated to the Model Accounts prior to the next day's market open (or at such time as may have been separately negotiated). In the instances where the Model Accounts choose to act upon Penn Capital's model portfolio recommendations, Penn Capital will likely be trading in the same securities for its other discretionary client accounts before, concurrently, or after the Model Accounts determine to act on Penn Capital's recommendations. In this way, and because of intra-day price movements, particularly with large orders or thinly traded securities, timing delays, or other operational factors associated with the implementation of trades, the trades executed by Model Accounts could result in the Model Accounts' underlying clients receiving prices that are materially different (i.e., at prices that are either higher or lower) than the prices obtained by Penn Capital's discretionary account clients. Because it does not trade on behalf of Model Accounts, Penn Capital cannot seek to manage through its trading strategy the market impact (including such factors as liquidity and price) of securities transactions for Model Accounts in the same way that it seeks to manage market impact for its discretionary client accounts on whose behalf Penn Capital trades. Since Model Accounts exercise investment and trading discretion, the investment performance experienced by the underlying clients of Model Accounts could be higher or lower than the investment performance experienced by Penn Capital's discretionary clients with the same or similar investment mandates.

Penn Capital generally has no direct advisory relationship with any underlying retail clients of the Model Accounts. Penn Capital is not responsible for the underlying client accounts as part of the investment programs operated by Model Accounts for which Penn Capital provides model portfolios and therefore cannot assess or guarantee the quality of those services or the investment performance experienced by such underlying clients of Model Accounts. Since Penn Capital does not have investment discretion, Penn Capital does not consider itself to have an advisory relationship with underlying clients of the Model Accounts or the sponsor programs of Model Accounts. To the extent that this Brochure is delivered to the underlying clients of Model Accounts with whom Penn Capital has no such advisory relationship, or under circumstances where it is not legally required to be delivered, this Brochure is provided solely for informational purposes. Furthermore, because Model Accounts either directly or through an overlay manager generally exercise investment discretion and, in many cases, brokerage discretion, any performance or other information relating to Penn Capital's services for which it exercises investment and/or brokerage discretion should be considered to have been provided for informational purposes only, and likely would not be representative of any Model Account's underlying clients' results or experience.



Penn Capital is not responsible for overseeing the provision by Model Accounts of brokerage or client services to their underlying clients and therefore Penn Capital cannot ensure the quality of such services. Underlying clients of Model Accounts should review all materials relating to their Model Account program (including the relevant program brochure or other documentation) regarding the Model Account program's terms, conditions and fees, and consider the advantages, disadvantages, and overall appropriateness of the Model Account in light of the client's particular circumstances.

## **Item 5 - Fees and Compensation**

Penn Capital investment advisory clients pay fees that typically vary from client to client depending on the type, size, complexity of the client account, or the vehicle in which a client invests (e.g., mutual funds, private investment funds, SMAs, wrap fee programs, Model Accounts). Fees for products other than registered mutual funds typically are individually negotiated and generally reflect, among other considerations: specific investment mandate(s), service needs, history with Penn Capital, account size, including related accounts under management, and reporting requirements. From time to time Penn Capital will give certain investors in private investment funds or certain SMA clients more favorable economic terms than other investors in the same investment vehicle or within the same or similar investment strategy, including with respect to both management and performance-based fees, which terms generally take into account certain factors, including but not limited to the timing and aggregate size of investments with Penn Capital of such client. Penn Capital does not require the prepayment of fees.

### PENN Capital Funds Trust (the "Trust"):

The fees payable on assets, including SMA assets, invested in the affiliated registered mutual funds of the Trust are paid by the investor in accordance with the fees and expenses identified in each registered fund's prospectus. Shares of funds in the Trust can be purchased through various distribution channels (i.e., mutual fund supermarket platforms, and other investment advisers' separate account models) that are not affiliated with Penn Capital.

Investment advisory fees payable to Penn Capital by each registered mutual fund in the Trust are stated in each fund's Prospectus.

### Private Investment Funds:

Fees for private investment funds are charged based on a percentage of the total asset value of the account and deducted on a monthly basis. Penn Capital does not require the prepayment of fees. Investors and prospective investors should review the confidential private placement memorandum, limited partnership agreement, and other governing documents of each private investment fund in conjunction with this Brochure for complete information on the fees and compensation payable with respect to investment in that

particular private investment fund. If permitted by an SMA client's stated investment guidelines, or as appropriate to the client's investment strategy, Penn Capital will invest a portion of SMA client assets in the private investment funds for which Penn Capital acts as General Partner and investment adviser. The investment advisory fee payable on SMA assets invested in any such private investment funds are paid through the SMA, but the operating costs of the private investment funds are payable on a pro-rata basis by all such private fund investors, including any SMA clients.

The fee schedule below shows the maximum annual investment advisory fee for private investment funds that do not charge a performance-based fee. Investment advisory fees are also subject to negotiation based on a number of factors and generally reflect, among other considerations: service needs, history with Penn Capital, account size, including related accounts under management, and reporting requirements. For private investment funds that charge a performance-based fee, please refer to *Item 6: Performance Fees and Side-by-Side Management* below. Investment advisory fees charged by the private investment funds are negotiable based upon the size of investment and other factors, but the private investment fund's operating expenses are paid on a pro-rata basis by all private investment fund investors.

The maximum investment advisory fee charged by the private investment funds are shown below:

<u>Fund</u>	<u>Max Investment Advisory Fee % of total market value</u>
Penn Capital Defensive High Yield Fund, L.P.	1.25%
Penn Capital Multi-Sector Spectrum Income Fund, L.P.	0.70%
Penn Core High Yield Bond Fund, L.P.	1.25%
Penn Short Duration High Yield Fund, L.P.	1.50%

SMA's:

Generally, SMA fees are calculated and paid quarterly in arrears and are prorated, if necessary, based on the period the assets were under management, including adjustments for significant additions or partial withdrawals. Penn Capital typically invoices clients on a monthly or quarterly basis, unless otherwise negotiated by a client.

Penn Capital's standard investment advisory fees generally have a maximum fee between 0.90% and 1.10% of assets depending upon the specific equity strategy, and a maximum between 0.45% to 1.25% depending upon the specific fixed income, alternative investment, or bank loan strategy. Fee breakpoints are also available depending upon total assets invested with Penn Capital. Generally, fees are based upon the market value of the account at the end of each calendar quarter, calculated on a 360-day year; although clients are

permitted to request other arrangements. If the account uses margin (borrowed assets), the fee is charged on the total assets.

Wrap Fee Program Accounts, Model Accounts and Unaffiliated Registered Mutual Funds:

Penn Capital does not determine the fee that investors pay to unaffiliated registered mutual funds for which Penn Capital acts as sub-adviser, Model Accounts, or wrap fee program accounts. Penn Capital separately negotiates its fees for its sub-advisory services to these products. Typically, the mutual fund investment adviser, Model Account sponsor, or wrap fee program sponsor pays Penn Capital from the mutual fund adviser's or program sponsor's own management fees. Where Penn Capital does not exercise investment trading discretion, (e.g., Model Accounts), the negotiated fee could be lower than those negotiated for discretionary advisory services, depending upon the circumstances. Underlying clients of Model Account or wrap fee programs should contact the sponsors of such programs directly for information about the investor's total costs to participate in such programs.

Trading and Other Costs:

All accounts incur ongoing expenses, including custodial and other administrative expenses. Clients also incur trading costs such as brokerage or transaction fees for services provided by entities other than Penn Capital and which are not reflected in Penn Capital's advisory fee. For more information regarding brokerage practices and related costs, please refer to *Item 12: Brokerage Practices* below. On a limited basis, Penn Capital has the ability to invest in exchange-traded funds or closed-end investment companies. Penn Capital's advisory fee is in addition to, and does not include the internal management, operating, or distribution fees or other expenses incurred by these other products.

Compensation of Supervised Persons:

A number of Penn Capital employees are registered representatives of Foreside Fund Services, LLC. ("Foreside"), an unaffiliated FINRA registered broker-dealer. These registered representatives receive compensation for the sale of securities, including asset-based sales compensation from the sale of Penn Capital affiliated mutual funds in the Trust, and Penn Capital's private investment funds. This presents a conflict of interest in which a Penn Capital employee has an incentive to recommend Penn Capital's products and services based on the compensation such employee receives, rather than the client's individual investment goals. Despite this incentive, each registered representative is subject to Penn Capital's Code of Ethics and Business Conduct ("Code"), which is designed to ensure the activities of Penn Capital and its employees are conducted in a manner that is consistent with their fiduciary obligations as a registered investment adviser under the Advisers Act. The Code contains procedures reasonably designed to prevent Penn Capital's employees from engaging in fraudulent, manipulative or deceptive conduct. Under the Code, Penn Capital has a duty to exercise its authority and responsibility for the benefit of its clients, to place the interests of its clients first, and to refrain from activities that conflict with the interests of its clients.

Furthermore, each registered representative must adhere to Foreside's Registered Representative Compliance and Supervisory Procedures, and is subject to oversight by the Penn Capital designated supervising principals and by Foreside. Foreside is also the distributor of Penn Capital's affiliated mutual funds and private investment funds.

#### **Item 6 - Performance Fees & Side-by-Side Management**

Penn Capital has entered into performance fee arrangements with a private investment fund and certain qualified clients, as defined by Rule 205-3 of the Advisers Act. Performance fees are subject to individualized negotiations. Penn Capital will structure a performance or incentive fee arrangement in accordance with applicable laws and related exemptions. The base fee is calculated based upon the market value of the account, while the incentive fees generally are paid annually, or upon liquidation of a client's account. Fees on investments in private investment funds are negotiable based upon the size of investment and other factors.

The Penn Capital Structure Total Return Fund, L.P. (the "Fund") has a maximum investment advisory fee of 1.50% of the total market value of the investor's assets, plus a performance fee of 20% of the Fund's net profits, as defined by the Fund, subject to high watermark. Please refer to the Fund's offering documents and governing agreements for a complete description of the performance fee and the manner in which it is calculated.

Performance based fee arrangements have the potential to create an incentive to recommend investments that are riskier or more speculative than those that would be recommended under a different fee arrangement. Performance based fee arrangements also have the potential to create an incentive to favor accounts paying higher fees over other accounts in the allocation of investment opportunities. Penn Capital has implemented controls to manage the inherent risks associated with incentive fees. As part of the Compliance Program, Penn Capital has adopted and implemented policies and procedures reasonably designed to prevent violation of the Advisers Act by Penn Capital or any of Penn Capital's supervised persons and to ensure that investment opportunities are allocated to clients fairly and equitably. Penn Capital does not consider an account's fee structure during any part of the investment process. Investment opportunities are allocated on either a pro rata or rotation basis across the clients in each respective investment strategy.

#### **Item 7 - Types of Clients**

Penn Capital offers investment advisory services to: corporate retirement, pension, and profit-sharing plans; Taft-Hartley plans; registered mutual funds; US and international pooled investment vehicles and private investment funds; insurance companies; charitable institutions; foundations; endowments; municipalities; banking or thrift institutions;

corporations; non-US funds; and other institutions, investment advisers, individuals, and high net worth individuals.

## **Item 8 - Methods of Analysis, Investment Strategies and Risk of Loss**

This section provides an overview of Penn Capital's investment advisory methods, strategies, and risks.

### **Complete Capital Structure Analysis®**

Penn Capital strategies employ a private approach to the public market with a Complete Capital Structure Analysis®. Through Complete Capital Structure Analysis®, Penn Capital's investment professionals are capital structure generalists, meaning they are responsible for understanding the entire capital structure of the companies they follow. All ideas are vetted through Penn Capital's investment process and investment decisions are made by senior investment professionals. Stocks or high yield debt securities are selected with the greatest potential to provide the risk-adjusted returns that clients expect. Penn Capital's research process and Complete Capital Structure Analysis® are designed to be used across of all the firm's investment strategies.

Penn Capital believes that independent, fundamental bottom-up research can add significant value when investing in inefficient asset classes. Penn Capital looks beyond a company's income statement, emphasizing balance sheet research and in-depth evaluation of management. The research team looks for companies with consistent earnings before interest, taxes, depreciation, and amortization ("EBITDA"), attractive relative EBITDA multiples, and catalysts for growth. Penn Capital applies its fully integrated credit and equity research process. This approach uncovers companies that are improving their capital structures and enhancing equity value.

### ***Portfolio Risk Management***

Penn Capital assesses security risk at the company level by understanding the fundamentals driving a particular business. As part of the security selection process, the analysts are responsible for identifying the risks inherent in their idea within the specific sector/industry they cover and the risk that the security potentially introduces to the portfolio.

The Investment Team completes a comprehensive liquidity analysis on the company's balance sheet and projects the company's cash flow. Penn Capital's process requires understanding the liquidity of the security within the market and the ability to enter and exit a position. The Investment Team reviews overall firm holdings within a security to understand the time needed to liquidate the entire position. Additionally, price targets are monitored for individual security risk and opportunity is adjusted on a real time basis within

the portfolio. The rolling bond prices of the entire capital structure of a company are reviewed to understand what the credit markets are implying for the risks of that company. At the portfolio level, the size of the position is reviewed and correlation with other positions is measured to understand industry exposure risk.

### **Credit Investment Process**

#### *Bottom-Up Focused Investment Process*

Penn Capital executes a team-driven investment process that is anchored by daily Investment Team meetings. Outside of that meeting structure, the process is led by the portfolio managers of a particular strategy. The initial universe includes all domestic, corporate, US dollar denominated debt issues that have spread-to-treasury and yield characteristics that represent value relative to company fundamentals and credit metrics. Penn Capital's bottom-up fundamental research is a critical tool used to identify improving credit situations that are not yet reflected in a company's security prices. Penn Capital invests only in credit securities that trade at a discount to Penn Capital's proprietary assessment of an investment's intrinsic value.

#### *Identification of Relative Value*

##### **Quantitative Screening**

The research team runs quantitative screens to identify companies with higher spreads relative to comparable companies, industry averages, and historical averages.

##### **Proprietary Sources of Research and Idea Generation**

The presence and reputation of Penn Capital's research team in the institutional marketplace allows the Investment Team to source ideas by leveraging direct access to company management and road shows, institutional equity relationships, conferences, IPO and competitive intelligence, industry experts, and former government officials.

##### **Macroeconomic Outlook**

Penn Capital focuses on the economic cycle and business environment, analyzes sector performance, and evaluates interest rates and macroeconomic conditions to determine industries with potential relative value.

##### **Confirmation of Relative Value**

##### **Improving Fundamentals**

Companies are further screened for improving fundamental metrics.

### Liquidity Outlook

Companies are also screened for liquidity issues, emphasizing potential weaknesses in an issuer's liquidity profile. Analysts also research and consider an issuer's covenant compliance, ability to incur additional debt, and asset value analysis.

### Qualitative Research

Penn Capital's qualitative research process encompasses meetings with company management, discussions with company stakeholders, and industry experts. The research team looks to support its assessment of strong fundamentals and to identify positive catalysts.

### *Investment Recommendation*

#### Penn Risk Rating ("PRR")

Every security in a company's capital structure is assigned a proprietary risk rating that encompasses forward looking estimates of credit quality, quantitative and qualitative factors, and rating agencies. A PRR is used to identify the appropriate discount rate to assign to a security and thereby arrive at its intrinsic value.

### Review and Formal Recommendation

Daily research meetings are primary forums for discussion. A consensus at team level is required prior to moving a recommendation on the Credit Strategy Committee.

### Credit Strategy Committee Approval

The Credit Strategy Committee is presented with the comprehensive analysis, investment thesis, and PRR rationale. The portfolio manager considers the impact of a new investment on portfolio construction and determines where funds will be sourced to fund the recommendation. The recommendation is either approved for portfolio inclusion or dismissed to the company watch list.

### *Investment Decisions and Implementation*

Once a name is approved for the portfolio, the Credit Strategy Committee sets a maximum weighting based upon capital at risk downside assessment. The portfolio manager is responsible for sizing the initial investment and timing the purchase and sale of the security within the maximum range.

### Equity Investment Process

Penn Capital's equity investment philosophy is based on the belief that credit leads equity at both a micro and macro level, and independent, fundamental bottom-up research can add significant value in inefficient markets. Penn Capital believes that long-term sustainable alpha is generated from uncovering capital structure catalysts, where

deleveraging opportunities can enhance enterprise value. Penn Capital's investment process is designed to uncover a company's optimal capital structure. Participating in both credit and equity markets, along with an integrated research process, provides Penn Capital's Investment Team with an informational advantage in the equity markets.

The Investment Team seeks to find companies that trade at attractive valuations, primarily focused on enterprise value/EBITDA, have proven management teams, and sound prospects for growth. Through Penn Capital's fully integrated, proprietary research process, the Investment Team attempts to identify companies with "capital structure catalysts" and strategies intended to lower overall cost of capital, thus creating equity value. Penn Capital believes the credit markets provide early identification of these opportunities.

The Investment Team follows a six-step process for approval of a stock to be considered for purchase in the portfolio. The initial universe is narrowed by screening for companies that have the potential to create equity value through both traditional and non-traditional sources.

*Step 1 – Fundamental Financial Analysis*

The Investment Team screens for companies with improving financial metrics to determine relative value.

*Step 2 – Qualitative Research*

The Investment Team performs qualitative research to confirm relative value.

*Step 3 – Liquidity Outlook/Covenant Analysis*

The Investment Team screens for liquidity issues and performs covenant analysis, bank loan availability and asset value analysis.

*Step 4 – Recommendation*

The researchers present the best new ideas to the Investment Team for evaluation and consideration.

*Step 5 – Decision Making*

A two-step approval process requires approval first by the strategy portfolio manager, and second by either the Director of Research or the Chief Investment Officer.

*Step 6 – Portfolio Construction*

The Equity Strategy Committee meets weekly to discuss macro-view and to determine sector allocations.



### *Investment Decisions and Implementation*

After the decision to buy a new security has been made, the strategy's lead portfolio manager and the primary analyst are responsible for determining the appropriate sizing, or weighting, in the portfolio. Penn Capital's portfolio managers work closely with the analysts and their counterparts on the Equity Strategy Committee to execute on these factors. On a weekly basis, the analyst recommends any changes to the weighting (add, hold, trim and price target) as information changes regarding positions in the market. The portfolio manager takes into consideration all analyst recommendations and is ultimately responsible for guiding the weighting of a security in the portfolio.

### **Risks of Investing**

Past performance is not indicative of future results. Purchasing investment products, including those outlined in this Brochure, involves risk. Stock and bond markets can fluctuate substantially over time with changes in the economy and demand for particular products or services. You should be aware that the purchase of securities involves the possibility of financial loss including the loss of principal. Penn Capital makes no assurances that its investment strategies will meet any particular investment return and Penn Capital does not guarantee any level of investment performance. Investors should consult their own financial, tax, or legal adviser to discuss their particular circumstances, objectives, and risk tolerance before investing with Penn Capital. The primary risks of investing will vary greatly depending on the individual investment objective, strategy, and/or investment product.

Investors should carefully review the relevant private placement memorandum, prospectus, or their own investment guidelines for additional risks specific to their particular investments.

Risks of investing generally will include, but are not limited to, one or more of the following: ADR risk, agent insolvency risk, bank loan risk, convertible securities risk, credit risk, debt/fixed income securities risk, diversification risk, dividend-paying securities risk, ETF risk, focused investment risk, financials sector risk, foreign currency risk, foreign securities risk, high yield securities risk, interest rate risk, income risk, investment in other investment companies risk, leveraged companies risk, limited operating history risk, liquidity risk, margin risk, management risk, market risk, maturity risk, micro, small and mid-capitalization company risk, portfolio turnover risk, payment-in-kind securities risk, prepayment risk, preferred stock risk, private placement risk, rating agencies risk, redemption risk, REIT risk, sector risk, short selling risk, unregistered securities risk, algorithmic risk, cybersecurity risk, and volatility risk.

### **Item 9 - Disciplinary Information**

Penn Capital has no material legal or disciplinary information or events to disclose.

### **Item 10 - Other Financial Industry Activities and Affiliations**

Penn Capital's affiliate, Penn Capital Funds Group, LLC, acts as General Partner for a private investment fund.

Penn Capital serves as the investment adviser to the PENN Capital Funds Trust, which offers a series of mutual funds registered under the Investment Company Act.

A number of Penn Capital employees are registered representatives of Foreside Fund Services, LLC. ("Foreside"), an unaffiliated FINRA registered broker-dealer. Penn Capital, at its expense, pays Foreside, a fee for certain distribution related services for certain registered mutual funds and private investment funds. Penn Capital employees who serve as registered representatives of Foreside facilitate the distribution or marketing of fund shares. Foreside, a limited purpose broker-dealer, supervises registered representative marketing activities related to fund shares pursuant to its policies and procedures and applicable FINRA rules and securities laws.

Penn Capital is not a broker-dealer nor is it affiliated with any broker-dealer. Penn Capital does not have affiliations with any other investment advisers.

### **Item 11 - Code of Ethics, Participation or Interest in Client Transactions, and Personal Trading**

#### Code of Ethics:

Penn Capital has adopted a written Code of Ethics and Business Conduct ("Code") pursuant to the requirements of Rule 204A-1 under the Advisers Act and in accordance with Rule 17j-1 under the Investment Company Act designed to comply with applicable regulations. The Code is designed to ensure the activities of Penn Capital and its employees are conducted in a manner that is consistent with their fiduciary obligations as a registered investment adviser under the Advisers Act. The Code contains procedures reasonably designed to prevent Penn Capital's employees from engaging in fraudulent, manipulative or deceptive conduct. Under the Code, Penn Capital has a duty to exercise its authority and responsibility for the benefit of its clients and to place the interests of its clients first, to comply with applicable federal securities laws, and to refrain from activities that create an actual or potential conflict with the interests of its clients. The Code is available free of charge upon written request to the following address:

Compliance Department  
Penn Capital Management Company, Inc.  
Navy Yard Corporate Center  
1200 Intrepid Avenue, Suite 400  
Philadelphia, PA 19112

Participation in Client Transactions:

Penn Capital recommends clients purchase or sell interests in the registered mutual funds or private investment funds described in this Brochure and in which Penn Capital has a financial interest. As with all investments, Penn Capital selects investments for clients primarily based on the aforementioned investment analysis process and agreed upon investment strategy and client-specific guidelines, if applicable. In addition, Penn Capital's financial interest in each such registered mutual fund or private investment fund is disclosed in the mutual funds' prospectus and statement of additional information, and in each private investment fund's private placement memorandum, or other related offering materials.

Penn Capital is permitted to purchase securities of an issuer that has retained Penn Capital as its investment manager. These purchases are solely based on the investment merits of the security and Penn Capital's relationship will have no impact on the investment decision. Penn Capital does not invest in the securities of an issuer for the issuer's account, but is permitted to buy them for other accounts.

Personal Trading:

Penn Capital's Code includes policies and procedures governing Personal Securities Transactions that applies to all employees and is designed to prevent any actual or perceived conflicts of interest with the firm's activities on behalf of its clients. Employees are required to maintain accounts at designated brokerage firms and to disclose those accounts to the Compliance Department. All employees must obtain written approval prior to placing certain personal transactions conducted by them or their immediate family members. Purchases or sales of registered mutual funds do not require prior approval unless the fund is advised or sub-advised by Penn Capital, although this pre-approval is not required for employees who invest in Penn Capital's affiliated mutual funds through their Penn Capital non-brokerage retirement plan, and automatic investment programs are permitted after initial authorization. An "Authorizing Person" must approve the requested transaction before the transaction is executed. The personal securities transaction will be approved if the requested security is not subject to a blackout period due to, for example: (i) Penn Capital's possession of material non-public information, (ii) certain client account activity, and (iii) an investment decision to trade the security in client accounts within seven (7) calendar days, including trade date. If a security is held in an employee's account and also in a client account, the employee is not permitted to sell any portion of the position within 180 days of the purchase. If Penn Capital sells its entire position in a security for all client accounts, the 7- and 180-day rules no longer apply to the employee's holding(s).

**Item 12 - Brokerage Practices**

Penn Capital provides discretionary investment advisory services to clients, subject to overall review by the client or named fiduciaries of the client, and subject to any limitations in the

investment management agreements that are individually negotiated. Penn Capital typically has the discretionary authority to determine, without obtaining specific client consent, the securities to be bought and sold for client accounts, including the amounts of such securities. In a discretionary advisory account, Penn Capital also typically has the authority to select broker-dealers to execute transactions. This authority is subject to the imposition of any specific investment restrictions, directed brokerage restrictions, or other requirements for certain accounts.

Selection of Broker-Dealers:

Penn Capital has adopted policies and procedures designed to seek best execution for all of its clients. Penn Capital selects broker-dealers to execute transactions based upon its assessment of their capability to provide best execution. Generally speaking, the duty of best execution requires an investment adviser to seek to execute securities transactions for clients in such a manner that each transaction is the most favorable under the circumstances, taking into account all relevant factors. The lowest possible commission, therefore, is not the only consideration. Best execution typically refers to the ability to obtain, based on a number of factors, favorable price, commissions, promptness and reliability of execution, confidentiality, and placement accorded the trade order. Penn Capital does not adhere to any quantitative formula but instead considers from among the following factors in reviewing broker-dealers for best execution: the broker-dealer's capability to execute the size of the order that needs to be executed; the broker's financial condition; the broker's responsiveness; the execution difficulty of the transaction; availability of technology; liquidity of the security; market and exchange conditions; company-specific market considerations; speed of execution; the bid/ask spreads; the market price impact; macro-economic conditions; order flow of information; ability or inability of electronic communication network to handle transactions; ability to time a trade or trade a block with minimal market impact; and commission costs. Penn Capital's determination of what is a reasonable commission rate is based upon its Trading Department's knowledge regarding competitive rates paid and charged for similar transactions. Penn Capital believes best execution consists of obtaining the most favorable result, considering the full range of services provided, under the prevailing market conditions. Accordingly, best execution is not necessarily measured by the circumstances surrounding a single transaction, but should be measured over time through consideration and analysis of multiple transactions. For Penn Capital, the determinative factor is not the lowest possible commission cost, but whether the transaction represents the best qualitative execution under the circumstances. Penn Capital generally seeks reasonably competitive execution rates but is not required to pay the lowest spread or commission available in effecting transactions.

Penn Capital also can make arrangements with certain executing broker-dealers to receive credits for commissions generated on client securities transactions (i.e., "soft dollars"). Soft dollars are used by Penn Capital to purchase research and brokerage products or other

services that are eligible under the “safe harbor” of Section 28(e) of the Securities Exchange Act of 1934 (“Exchange Act”). A more detailed description of Penn Capital’s use of soft dollars can be found under the *Research and Brokerage Services* section below.

Penn Capital is permitted, but not required, to use algorithmic trading venues to execute when, in its judgment, the use of an such algorithmic trading venues could result in equal or more favorable overall executions for the transactions. In conducting its analysis, Penn Capital consults comparative trading cost data and analytics provided by a third-party.

Penn Capital also will use execution-only broker-dealers, algorithmic tools and other electronic order routing products offered by broker-dealers to execute on various exchanges if doing so is believed to be consistent with the effort to seek best execution. Increasing the use of non-full service alternatives can reduce overall commission costs to clients, even though commission rates are only one component of a best execution analysis. Penn Capital will use these trading methods when it believes that doing so achieves the best execution for a particular order.

Due to the nature of the marketplace, certain securities are more likely to be available in sufficient quantity through non-full service alternatives than others. As a result, depending on the investment service and other factors such as the timing of orders, the percentage of a client’s transactions executed through non-full service alternatives will vary. Therefore, certain clients could receive the benefit of these lower transaction costs more often than other clients and thus would experience lower overall transaction costs. Although commission rates paid to full service broker-dealers are substantially higher than non-full service alternatives, Penn Capital believes that the fees paid to full service broker-dealers are reasonable in relation to the value of the brokerage and research services provided. Trading through these alternative platforms at certain commission rates can also generate credits that can be used to acquire research services.

On a quarterly basis, the Best Execution Committee reviews both equity and fixed income trading. The Best Execution Committee reviews or discusses, among other things: (i) third-party reporting that quantitatively analyzes Penn Capital’s trade cost analysis (“TCA”) of equity securities trades (“TCA Reports”); (ii) an analysis of a statistically meaningful amount of fixed income trades made by Penn Capital by comparing the actual prices received against competitive bids or offers received on such securities by other broker-dealers; (iii) issues relating to a broker-dealer’s efficiency of execution, settlement and error resolution, financial stability, research, responsiveness, quality of service, reputation and any of the other factors that are deemed relevant; and (iv) volume of trades directed to each broker-dealer, including algorithmic trading venues.

The provider of the TCA Reports is also a broker-dealer that executes trades for Penn Capital during the periods covered by the TCA Reports. Penn Capital also receives soft dollar credits generated from trading with that broker. This creates a conflict of interest because the provider of the TCA Reports has an incentive to favorably report its execution quality for Penn Capital's trades in order to obtain additional brokerage from Penn Capital. Penn Capital believes this conflict is mitigated by the fact that the broker-dealer is itself a FINRA registered and regulated broker-dealer and accordingly has a legal obligation not to misrepresent its execution quality.

The Best Execution Committee will analyze relevant data in light of the relevant factors used to select broker-dealers to determine whether: (i) a broker-dealer should continue to be approved; (ii) whether any limitations should be set on the volume of trades to be sent to a particular broker-dealer; (iii) whether a broker-dealer should receive heightened supervision for a period of time; and (iv) whether Penn Capital is directing an appropriate volume of trades to algorithmic trading venues. In analyzing the data, the Best Execution Committee is permitted, but is not required, to engage other members of the firm or third-parties to assist in evaluating fixed income and/or equity transactions, and the broker-dealers with whom Penn Capital places trades.

Directed Brokerage:

Although Penn Capital generally has full discretion to place orders, some clients direct the use of specific broker-dealers. These client-directed brokerage requests must be in writing and indicate that the request is properly authorized. Certain wrap fee program sponsors also require Penn Capital to trade through their affiliated broker-dealers for underlying wrap fee program client accounts. Penn Capital makes no guarantee that it can obtain best execution when clients and wrap fee program sponsors direct their account's brokerage. Clients who direct brokerage risk receiving less favorable prices on transactions. On any given trade or trades, clients could pay higher or lower commissions when trades are placed through directed brokerage. Typically wrap fee program trades that are placed through affiliated broker-dealers are not charged brokerage commissions. Directing Penn Capital to use a particular broker-dealer might also affect the timing of a client's transaction. There likely will be times when Penn Capital will not trade with a client's directed broker-dealer until all non-directed brokerage orders are complete. In addition, not all broker-dealers have the systems or expertise to effectively process transactions in a manner that is beneficial for a client's account. Where clients and wrap fee program sponsors who instruct Penn Capital to direct brokerage to particular broker-dealers are executed after transactions for clients who have not so instructed Penn Capital, the price paid or received by one group of accounts likely will differ, and could be more or less favorable, from that paid or received by the remaining accounts due to, among other factors, trade execution efficiency and market activity.

In certain SMAs, Penn Capital clients direct Penn Capital to place all or certain trades with specified broker-dealers that have commission recapture arrangements. When Penn Capital combines such clients' orders with other orders for execution by these specified broker-dealers, only the portion of the commission generated for the directed SMA account is credited to the SMA.

"Trading Away" Transactions in Wrap Fee Program Accounts:

When Penn Capital places trade orders with a broker-dealer firm other than a wrap fee program sponsor or the sponsor's affiliated broker-dealer, the resulting transaction is commonly referred to as either "trading away" or "stepping out," because the transaction is executed "away" from the wrap fee program's sponsor or affiliate.

When permitted by wrap fee program sponsors, Penn Capital often seeks to execute large trades with selected broker-dealers other than the wrap fee program sponsor or its affiliates to the extent that trading away from the wrap fee program sponsor will, in Penn Capital's opinion, achieve best execution *over time*. Trading away from the wrap fee program sponsor enables Penn Capital to aggregate wrap fee program client trades in large blocks with trades in the same securities being made for other clients. Penn Capital believes this will generally result in the best overall execution for accounts across multiple product lines and over time. Best overall execution includes favorable pricing, promptness and reliability of execution, confidentiality, and placement accorded the trade order, as well as the amount of the commission charged. Large block trading has the potential to benefit all clients involved. However, trading away will often result in clients in so-called "bundled" wrap fee programs incurring transaction and other costs that are in addition to their wrap fee program fees and that would not have been incurred if the trades were instead executed with the relevant wrap fee program sponsor. This is because, in a "bundled" wrap fee program, the typical wrap fee program sponsor's fee is agreed to cover any commissions on trades executed by the sponsor, but does not cover commissions charged by other broker-dealers. Penn Capital has the authority to determine whether, notwithstanding the absence of an incremental commission, the sponsor can provide best overall execution of any given trade, considering all of the factors described above.

Penn Capital generally determines that client specific or "account maintenance" trades (i.e., trades effected to invest a new wrap fee program account, to divest a closing wrap fee program account, to invest account contributions, to conduct withdrawals, or to conduct tax loss harvesting) are best executed by the wrap fee program sponsor. Trades placed directly with wrap fee program sponsors are commission free for that sponsor's underlying wrap fee program accounts, but Penn Capital cannot ensure that such trades receive the same price or execution that they would have received if the order was placed with an institutional broker-dealer as part of a larger trading block. By contrast, Penn Capital typically seeks to execute in large blocks with a single broker-dealer those trades that result from investment

management decisions, and that are also being implemented for other Penn Capital clients in the same strategy.

The commissions, if any, paid on trades executed away from the wrap fee program sponsors typically are reflected in the transaction price at which the securities are bought or sold (rather than being separately stated or charged). Penn Capital provides to wrap fee program sponsors the names of the broker-dealers who execute trades at Penn Capital's direction for such sponsor's clients as well as the specific commissions, if any, paid to such broker-dealers. Each wrap fee program sponsor in turn is responsible for the content of the trade confirmations sent to its customers, including the extent of trading information (e.g., the broker-dealers selected and commissions charged). To the extent trading away in a block reduces a wrap fee program sponsor's own trading costs, a wrap fee program sponsor could have an incentive to recommend Penn Capital over a manager that does not trade away.

Certain wrap fee program sponsors require their accounts to be traded only through the wrap fee program sponsor's proprietary trading system. Trades placed directly with wrap fee program sponsors are commission free for that sponsor's underlying wrap fee program accounts, but Penn Capital cannot ensure that such trades receive the same price or execution that they would have received if the order was placed with an institutional broker-dealer as part of a larger trading block. The availability of a wrap fee program sponsor's proprietary system is beyond Penn Capital's control or oversight and Penn Capital is not responsible for any costs or performance disparities that result. To the extent that such a system is unavailable for trading, Penn Capital would be unable to execute orders for such wrap fee program sponsor's accounts at the time Penn Capital seeks to place the order with the wrap fee program sponsor.

Aggregation:

Penn Capital has adopted policies and procedures designed to treat all of its clients fairly and equitably. Where possible, multiple orders are combined in an effort to seek best execution. In some instances, clients will pay a higher transaction cost based upon the degree of difficulty of execution and whether broker-dealers provide either a capital commitment to complete the trade, research, or other services. Penn Capital seeks to limit brokerage commissions to no more than five cents per share on equity transactions. Under certain circumstances, an account would pay in excess of five cents per share due to special situations. Fixed income trades are made on a net basis. There is no separate commission charged on a fixed income trade, but there is a bid/ask spread that operates as the equivalent of a commission.

Penn Capital will place a combined order for multiple accounts for the same security if, in its judgment, the execution is believed to be in the best interest of each participant and is



expected to result in best execution. Transactions involving combined orders are allocated in a manner that Penn Capital believes will be equitable over time to all of its accounts.

Block trading can help limit the impact to a security's market price over the course of a day's trading. This is in part because block trading reduces the number of buyers (or sellers) in the marketplace due to the fact that fewer orders are placed through block trading compared to the numerous orders that would have to be sent through multiple clients and/or wrap fee program sponsor traders. Block trading also has the advantage of involving fewer broker-dealers in the market place competing with each other to execute trades in the same securities at the same time, or conversely, avoiding the need to allocate separate orders to multiple broker-dealers in a sequence such that one broker-dealer does not receive and commence executing its order until one or more others have already filled theirs, often after the market price has moved adversely. By contrast, a block order allows the executing broker-dealer to either find a substantial counterparty or parties to trade the block or to "work" the order for all clients together on a pro rata basis over the course of the trading day as needed and to give all such clients the average price of the day's order. Block orders can also serve to limit the marketplace's knowledge of who exactly is trading in a specific security, which reduces information leakage and the ensuing impact to a security's price. This is particularly true in the case of the small and micro and mid cap stocks, which tend to have lower trading volumes. For these reasons Penn Capital believes that block trading on behalf of multiple clients and/or wrap fee program accounts, where permissible or available, aids in Penn Capital's efforts to seek best execution for all of its clients, including wrap fee program clients.

Although Penn Capital believes aggregating trades of wrap fee program clients with larger trades in the same securities being made for institutional clients generally will result in better overall execution for wrap fee program clients rather than separating wrap fee program trades into smaller units and executing them with the relevant wrap fee program sponsors on a rotating basis, this aggregation is not always possible. In such instances, Penn Capital would not be able to place wrap fee program accounts in a block with some or all trades placed on behalf of other institutional clients. To the extent that wrap fee program clients' investments are traded directly with wrap fee program sponsors, Penn Capital cannot ensure that such wrap fee program clients receive the same price or execution as the institutional clients, and as a result wrap fee program clients' performance will likely be different, and can be either higher or lower, than that of Penn Capital's institutional clients for whom Penn Capital trades in a block order.

Trade Placement for Institutional, Wrap Fee Program, and Directed Accounts:

Penn Capital's traders are permitted to use discretion when seeking best execution. The methodology Penn Capital uses to execute for its various clients is based on criteria including, but not limited to: stock liquidity, volatility, complexity, volume, best execution,

and trader experience. Due to the types of securities that Penn Capital trades, and based on the experience and knowledge of the Penn Capital traders, trades are typically placed on a discretionary order basis. In the discretionary order, the Penn Capital trader has discretion to place orders with broker-dealers in an order that the trader expects to be the most beneficial for overall execution. Penn Capital uses market data, among other factors, to assist in making reasonable determinations regarding how to best execute each order via discretionary order placement. Traders are permitted to use discretion when seeking best execution and will select the specific order in which certain wrap fee program sponsors that require directed brokerage are traded. The methodology chosen initially is subject to change throughout the duration of the order because the market landscape during the trading day can be inconsistent, and Penn Capital seeks to ensure certain account guideline restrictions are met on a daily basis (e.g., cash insufficiencies or limitations).

If permitted to do so by the wrap fee program sponsor, wrap fee program accounts can be traded as a step-out trade as part of an institutional trading block together with Penn Capital's other discretionary institutional clients. In a step-out trade, the trader sends a block order to one broker-dealer that works the entire order and steps out the trades for one average price for all institutional clients as well as wrap fee program accounts. However, Penn Capital also reserves the right to place wrap fee program account trades directly with a wrap fee program sponsor's trading desk solely in the trader's discretion, even if not required to do so by the wrap fee program sponsor. Wrap fee program accounts that are not part of a block trade are traded directly with the respective wrap fee program sponsor's trading desk, and such trades are accordingly put into a discretionary trading rotation order with Penn Capital's other clients.

Depending on the investment mandate, it is possible that Penn Capital will trade identical securities in the opposite direction for multiple client accounts. This typically occurs in accounts that have different investment mandates. In some instances, opposite direction trades can occur in accounts with similar investment mandates due to differing cash inflows and outflows in client accounts.

Research and Brokerage Services:

Unless otherwise instructed by a client, Penn Capital has discretionary authority to select the brokerage firms used to execute trades. Penn Capital has arrangements with certain executing broker-dealers to receive credits for commissions generated on client securities transactions (i.e., "soft dollars"). Soft dollars are used by Penn Capital to purchase those research and brokerage products or services that are considered eligible under the "safe harbor" of Section 28(e) of the Exchange Act. These research and brokerage services include, but are not limited to: advice, either directly or through publications or writings, as to the value of securities, industry and company analyses, the advisability of investing in, purchasing or selling securities; information about the availability of securities or purchasers

or sellers of securities; furnishing analysis and reports concerning issuers, securities or industries; providing information on economic factors and trends; quantitative data and market information systems; assistance in determining portfolio strategy; providing seminars and conferences; providing computer software used in securities analysis; and providing quotation services from certain stock exchanges. Eligible services and products include functions incidental to effecting securities transactions, such as clearance, settlement, custody, and related communications. Trading software used to route orders and algorithmic trading software are also considered to be eligible brokerage services. During the last fiscal year, Penn Capital received a number of research products and services through soft dollar arrangements, including but not limited to: FactSet Research Systems Inc. ("FactSet"), and Bloomberg L.P., FactSet provides global financial and economic information, including fundamental financial data on thousands of companies. Bloomberg L.P. provides a financial information platform, which includes, global financial data, equity trading platforms, and portfolio analytical tools. Research and brokerage services are designed to enhance Penn Capital's internal research and investment strategy capabilities.

Soft dollar arrangements are managed at Penn Capital's discretion without requiring any prior agreement or approval by clients. The commissions charged by broker-dealers with whom Penn Capital has soft dollar arrangements will likely be higher than those charged by other broker-dealers. Penn Capital will effect transactions through broker-dealers providing soft dollars if the commissions charged by such broker-dealers are believed by Penn Capital to be reasonable in relation to the value of the research provided. Penn Capital has adopted policies and procedures designed to oversee implementation of soft dollar arrangements. Penn Capital receives an economic benefit because Penn Capital does not have to produce or pay for the research and brokerage services obtained with soft dollars. Research and brokerage services received through soft dollar arrangements are in addition to, and not in lieu of, Penn Capital's investment advisory services; the investment advisory fee is not reduced as a consequence of the receipt of such supplemental research information.

Certain broker-dealers that effect transactions for Penn Capital's clients allocate a portion of their commissions to a pool of soft dollar credits. At Penn Capital's direction, independent research providers (including other broker-dealers) will be paid for research products and services from this pool of soft dollar credits. This type of arrangement is called a commission sharing arrangement because an independent research provider will be paid for its research products and services from the commissions generated by other executing broker-dealers. Commission sharing arrangements are used to pay for proprietary and third-party research products and services. For example, some broker-dealers who are considered "introducing" broker-dealers can offer access to a network of many executing broker-dealers through which Penn Capital trades. In this case, rather than paying the individual broker-dealer for research and services by placing trades, Penn Capital can direct the trade to the introducing broker-dealer and request that the

introducing broker-dealer (or a soft dollar administrator) pay the research provider from the pool of "credits" accumulated. Because commission sharing arrangements help separate the execution decision from the research decision, Penn Capital believes that commission sharing arrangements can help achieve best execution for its clients.

Penn Capital has engaged Westminster Research Associates, LLC ("Westminster"), a FINRA registered broker-dealer to provide commission aggregation and third party research payments in connection with Penn Capital's use of soft dollars. The soft dollar credits that have been generated by Penn Capital's trading are credited to a pooled account that is administered by Westminster. These pooled credits are then used to purchase research and brokerage services at Penn Capital's direction.

Westminster, the provider of the third-party commission aggregation tool is also a broker-dealer that executes trades for Penn Capital. The aggregation tool, considered an eligible brokerage service under Section 28(e) of the Exchange Act, is paid for through a commission sharing arrangement. Penn Capital also receives soft dollar credits generated from trading with Westminster. This creates a conflict of interest because Westminster is responsible for managing the pool of credits received from certain executing broker-dealers from whom Penn Capital receives credits for commissions generated on client securities transactions. Penn Capital believes this conflict is mitigated by the fact that Westminster is a FINRA registered and regulated broker-dealer and accordingly has a legal obligation to conduct its activities in accordance with Section 28(e) of the Exchange Act.

There are other benefits to Penn Capital that are provided by broker-dealers who do not have soft dollar arrangements with Penn Capital. These benefits include research, opportunities to attend conferences sponsored by such broker-dealer, or assistance with coordinating meetings with the management of issuers. Typically, these types of services are made available to all institutional investors doing business with such broker-dealer and are not uniquely provided to Penn Capital. Soft dollar transactions are not effected pursuant to any binding agreement or understanding with any broker-dealer regarding a specific dollar amount of commissions to be paid to that broker. However, Penn Capital does in some instances request a particular broker-dealer to provide a specific research service, which might be proprietary to that firm, or produced by a third party and made available by that firm. In such instances, the broker, in agreeing to provide the research service, frequently will indicate to Penn Capital a specific or minimum amount of commissions, which it expects to receive by reason of its provision of the particular research service. Although Penn Capital does not agree, and is not required by the broker-dealer, to direct a specific or minimum commission amount in that circumstance, Penn Capital does internally identify those broker-dealers who provide such research services and the value of such research services, and endeavors to direct sufficient commissions to ensure the continued receipt of research services that Penn Capital believes are important to the Penn Capital research process.

Certain items obtainable with soft dollars might not be used exclusively for either execution or research services. A broker-dealer might also furnish Penn Capital with a "mixed-use" product or service that is used for both making investment decisions for managed accounts and for marketing, performing compliance, administrative or other investment decision making functions. Where this occurs, Penn Capital makes a good faith effort to determine the allocation of the portion of the product or service that assists in the investment decision-making process is obtained with soft dollars and the allocation of the portion of the product or service that provides non-research assistance is paid for directly by Penn Capital from its own assets. Penn Capital therefore has an incentive to select a broker-dealer based on its own interest in receiving the research or other products or services, rather than on its clients' interest in receiving the lowest possible price or the most favorable execution.

Research and other services used in connection with Penn Capital's investment decision-making process are not used exclusively for the account(s) generating the brokerage commissions. Penn Capital does not allocate among its client accounts the relative costs or benefits of various research or other brokerage services, believing that these are, in the aggregate, of assistance in fulfilling overall responsibilities to clients. Accordingly, any research or brokerage services received for a particular client's brokerage commissions could be useful to that client, but also might be useful in the management of other client accounts. Similarly, that client could also benefit from the research or brokerage services received for the commissions of other client accounts. Although Penn Capital sends orders to broker-dealers who provide soft dollars and/or brokerage and research services, Penn Capital believes that the commissions (or their equivalent) paid to such broker-dealers are reasonable in relation to the value of the services received. Penn Capital believes that receipt of research and brokerage services provides a benefit to all clients, regardless of whether it is direct or indirect, by assisting Penn Capital in its overall investment decision-making process.

Allocations:

Penn Capital will participate in an equity IPO for eligible client accounts when Penn Capital believes that it presents a valuable investment opportunity. Penn Capital has adopted procedures designed to ensure fairness in the allocation of IPO opportunities among eligible clients.

Penn Capital will, on occasion and with client consent, cross bonds or, as necessary, equities from one client account to another using an unaffiliated broker. "Cross Trade" transactions are usually made for the following reasons: (1) an account liquidation; (2) an account needs to raise cash; (3) an account is overweight the security due to asset withdrawals; or (4) the holding is no longer appropriate for the account's strategy. Because the Department of Labor's view that cross trades give rise to an ERISA 406(b)(2) prohibited transaction due to

the inherent conflicts of interest when an adviser has discretion over both sides of the transaction, Penn Capital does not engage in Cross Trades for ERISA accounts.

### **Item 13 - Review of Accounts**

The Investment Team reviews and discusses investment decisions and the reason(s) for such action(s) at daily meetings. In addition, the Investment Team reviews the securities each portfolio holds at least weekly. At these meetings, they review earnings projections, risk/reward parameters, and, as appropriate, recent research information. In addition, the Equity Strategy Committee and the Credit Strategy Committees each meet weekly to review top-down strategy positioning such as sector and industry concentrations in the portfolios, both on an absolute basis and relative to the applicable benchmark. Performance for accounts other than registered mutual funds is computed and reviewed monthly.

The frequency, depth and nature of a specific client's account review are often determined by negotiation with individual clients pursuant to the terms of each client's written investment management agreement, or by the mandate selected by the client, taking into account the particular needs of each client. Reviews of accounts also occur when investment strategies and objectives are changed. Reviews are conducted by the relevant Investment Team members and client service personnel that are responsible for the particular account(s). Typically, on a quarterly basis, or as frequently as individually negotiated, Penn Capital provides written client reports that detail a client's performance, accounts holdings, transactions, and other related metrics. SMA clients should reconcile these reports with the records provided by such client's custodian. Limited partners invested in Penn Capital private investment funds receive written monthly statements.

### **Item 14 - Client Referrals and Other Compensation**

Penn Capital and its affiliates compensate individuals, corporations or other entities for soliciting Penn Capital's advisory services, proprietary affiliated mutual funds in the Trust, and private investment funds. Pursuant to these agreements, Penn Capital or its affiliates pay the referring party a percentage of the investment advisory fee and/or performance-based fee collected by Penn Capital from the client. Clients referred through such arrangements receive from the solicitor a copy of this Brochure and a copy of a disclosure document describing the terms and conditions of the solicitation arrangement, including the compensation paid to the solicitor. Generally, the compensation paid to the solicitor is based upon the revenue generated by client accounts referred by the solicitor. Solicitors have an incentive to recommend Penn Capital's investment management services because of the ongoing fees they receive from Penn Capital. The arrangements have no effect on the gross fee charged to the client and comply with all relevant federal and state securities laws, including Rule 206(4)-3 under the Advisers Act.

## **Item 15 - Custody**

### Registered Mutual Funds and Wrap Fee Programs:

Penn Capital does not have custody of client assets in its capacity as (1) a discretionary investment adviser to affiliated registered mutual funds, (2) discretionary sub-adviser to unaffiliated registered mutual funds, or (3) discretionary sub-adviser to unaffiliated broker-dealers' investment programs (e.g., wrap fee programs). For more information about custodial matters on such accounts, investors in such funds and programs should refer directly to the relevant mutual fund's prospectus, or to the documentation provided by the wrap fee program sponsor.

### Private Investment Funds:

As General Partner of a number of private investment funds, Penn Capital is considered to have custody. Limited partners invested in those private investment funds receive monthly statements. Each private investment fund is audited annually by an independent registered public accounting firm. Penn Capital encourages each limited partner investor to carefully review the private investment fund's audited financial reports.

### SMA Accounts:

Penn Capital does not have custody of SMA account assets. Penn Capital does not select or recommend custodians for its clients' SMA holdings. Although Penn Capital provides performance and transaction information to clients on (typically) a monthly or quarterly basis, this information should be cross referenced with the client's custodian to ensure accuracy. Penn Capital's account statements can vary from the account's custodial statements based on a number of potential factors including accounting procedures, reporting dates, or valuation methodologies of certain securities.

### Model Accounts:

Penn Capital does not have custody of the accounts for which Penn Capital provides non-discretionary investment advisory services.

## **Item 16 - Investment Discretion**

Penn Capital provides both discretionary and non-discretionary investment management services, depending on the type of account or client.

### Registered Mutual Funds:

Penn Capital's discretionary authority is set forth in each fund's prospectus. The investment advisory or sub-advisory agreement entered into between Penn Capital and the advisor and/or the registered mutual fund outlines the extent to which Penn Capital does or does not have discretionary management authority. Discretionary authority, if any, is governed by the

terms contained in such agreement, as well as applicable federal securities laws and tax laws. Penn Capital has discretionary authority for its affiliated registered mutual funds.

Private Investment Funds:

Under the terms of the offering documents, Penn Capital is the investment manager with discretionary authority to invest the private investment fund's assets, which reflect the assets invested by the limited partners in the private investment fund.

SMA Accounts:

Penn Capital generally has discretionary authority pursuant to an investment management agreement. Under the investment management agreement, unless instructed otherwise, Penn Capital will direct the investment and reinvestment of assets on the client's behalf and at the client's risk. This discretionary authority is subject to any investment guidelines or limitations negotiated with the individual client.

Wrap Fee Programs:

Participants in wrap fee programs generally enter into an agreement with the program sponsor that outlines the services to be provided under the specific wrap fee program. Typically, a program sponsor has discretionary authority to engage a third-party investment adviser (such as Penn Capital) to provide investment advisory services for the participant's account(s) under the wrap fee program. The program sponsor generally enters into a separate agreement with Penn Capital pursuant to which Penn Capital provides investment management services to the underlying clients of the wrap fee program sponsor. In this way, Penn Capital has discretionary authority, subject to individually negotiated limitations or other guidelines. In some wrap fee programs, underlying clients are able to enter into agreements directly with Penn Capital, as well as with the program sponsor (i.e. a "dual contract" account).

Model Accounts:

Penn Capital does not have investment discretion over Model Accounts. Instead, Penn Capital is responsible solely for providing model portfolios to the various Model Accounts, which then chose to invest, or not invest, on the recommendations provided in the model portfolios. Penn Capital delivers to a number of Model Accounts the model portfolios on a daily or weekly basis (depending upon individual client negotiations).

**Item 17 - Voting Client Securities**

Penn Capital has adopted a written proxy voting policy (the "Proxy Policy") as required under the Advisers Act. For clients that give Penn Capital the right to vote proxies, Penn Capital will vote proxies in accordance with its Proxy Voting Policy, which is designed to vote proxies in a manner consistent with what Penn Capital believes is in the client's best interest. Some



clients contractually reserve the right to either vote their own proxies or direct Penn Capital to vote their proxies in a certain manner. Penn Capital votes proxies based on a client's instruction, or a client's legal structure (e.g., an ERISA-covered pension plan).

Penn Capital uses Glass Lewis & Co. ("Glass Lewis"), an independent third-party proxy research firm, to provide proxy research and voting recommendations based on objective analysis. Penn Capital will consider recommendations from Glass Lewis as part of its ultimate decision-making process, but will exercise its independent judgment in making voting decisions. Penn Capital reserves the right to vote contrary to Glass Lewis recommendations in the event that Penn Capital determines that such vote is in the client's best interest. By following the Proxy Policy and the guidelines of Glass-Lewis, an independent third party, Penn Capital seeks to mitigate potential conflicts of interest Penn Capital may have with respect to voting proxies

Broadridge Proxy Edge, an automated voting system provided by Broadridge, is used to vote proxy ballots electronically. Broadridge also maintains records on proxy votes for each client, or group of clients. Additionally, Penn Capital manually votes proxies in certain limited situations. Penn Capital can determine to not vote a proxy if it is not practicable to do so or if it determines that the potential costs involved with voting a proxy outweigh the potential benefits to the client whose account owns the underlying security. Furthermore, there could be times when refraining from voting a proxy is believed to be in a client's best interest.

Clients can submit a written request for a copy of Penn Capital's "Proxy Voting Policy" or the proxy-voting history for their account(s), free of charge, to the following address:

Investor Services Department  
Penn Capital Management Company, Inc.  
Navy Yard Corporate Center  
1200 Intrepid Avenue, Suite 400  
Philadelphia, PA 19112

#### **Item 18 - Financial Information**

Penn Capital has no financial commitment that impairs its ability to meet the contractual and fiduciary commitments that have been made to clients.