

Item 1 - Cover Page

# Penn Capital Management Company, Inc.

March 31, 2020

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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. Registration does not imply a certain level of skill or training.

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## **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 29, 2019. Material changes include the following: Item 4: removed references to limited partnerships and strategies that are no longer available; Item 5: revisions to the full range of advisory fees charged by Penn Capital for all strategies, and the clarification of the ability to negotiate fees, and the resulting potential for conflicts of interest; Item 6: additional disclosure designed to further clarify the conflicts of interest inherent in performance fees and side-by-side management of different investment vehicles and the allocation of investment opportunities; Item 8: the disclosure of additional risks inherent to certain of Penn Capital's investment strategies; Item 10: disclosure regarding affiliated entities and the potential for conflicts of interest among and between those entities, Penn Capital employees, and Penn Capital; Item 11: additional disclosure relating to conflicts of interest with respect to the management of proprietary mutual funds and investment in those funds by Penn Capital employees; and Item 12: expanded disclosure of Penn Capital's IPO allocation policy. Generally, the material changes made have sought to expand disclosure of potential and actual conflicts of interest inherent in Penn Capital's business. A number of other non-material additions, deletions, changes, and elaborations, as well as additional explanatory enhancements and clarifications, have been made throughout this updated Brochure.

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

Upon written request and without charge, Penn Capital will provide a copy of this Brochure.

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#### **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 and controlled 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. This process is called Complete Capital Structure Analysis®.

Through Complete Capital Structure Analysis®, Penn Capital's Investment Team is comprised of 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 Team 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, 2019, Penn Capital managed approximately \$3 billion in regulatory assets under management, of which approximately \$2.7 billion was managed for discretionary investment accounts, and approximately \$300 million was managed for non-discretionary accounts.

Investment Strategies:

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

Micro Cap Equity	Defensive Floating Rate Income
Small to Micro Cap Equity	Ultra Short Duration Corporate Income
Small Cap Equity	Defensive Short Duration High Income
Small Cap Value Equity	Defensive High Yield
Small to Mid Cap Equity	Opportunistic High Yield
Mid Cap Equity	Multi-Sector Spectrum Income
FinTech Catalyst	Multi-Credit High Income

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

Penn Capital is the discretionary investment adviser to the series funds ("funds") of PENN Capital Funds Trust (the "Trust"), an affiliated investment company registered under the Investment Company Act. Penn Capital will recommend the funds as an investment option for its clients. Penn Capital has an incentive and inherent conflict of interest to recommend and favor the funds because the firm receives advisory fees from the funds. These fees are described in *Item 5—Fees and Compensation* below and are detailed in each fund's prospectus. Increases in the funds' assets will result in increases in the advisory fees paid to Penn Capital.

Private Investment Funds:

Penn Capital serves as the general partner and investment adviser for private investment funds organized as limited partnerships. Penn Capital also serves as the sub-adviser to private funds managed by unaffiliated third parties. 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.

Penn Capital offers the following private investment funds:

<u>Fund</u>	<u>Investment Minimum</u>
Penn Capital Defensive High Yield Fund, L.P.	\$1,000,000
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: 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, institutional investors, individuals, 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 \$250,000 equity, fixed income/bond and/or 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 unaffiliated 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 investment 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. The availability of such proprietary systems is beyond the control of Penn Capital. To the extent such system is unavailable, Penn Capital likely would be unable to deliver the model portfolio to such Model Accounts timely.

Since Penn Capital provides Model Accounts with the relevant model portfolios prior to the next day's market open (or at such time as has been separately negotiated), 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 has 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 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. Most Model Accounts are unable to participate in secondary (IPO) offerings so to the extent that Penn Capital's discretionary clients participate in IPOs, such participation likely will result in better performance than that of the Model Accounts that did not participate in the IPO. 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 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 and sub-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 either private investment funds or SMAs 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 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 investment fund investors, including any SMA clients.

The fee schedule below shows the maximum annual investment advisory fee for the affiliated private investment funds that charge an investment advisory 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. Penn Capital has the absolute discretion to waive or modify the application of any provision of a limited partnership agreement (including, but not limited to, those relating to liquidity, investment capacity, fees, and transparency). Penn Capital is permitted to negotiate side letters with certain private investment fund limited partners and in some instances, side letters will grant materially favorable terms relating to, among other things, liquidity, investment capacity, economic rights, fees, information and reporting rights, and certain rights or terms necessary in light of particular legal, regulatory or policy requirements of a particular investor. In addition, Penn Capital reserves the right to waive or rebate all or a portion of its management fees and/or performance fees with respect to a limited partner. Prospective investors should consider these possible conflicts of interest in making their decision to invest or remain invested in a private investment fund, as certain side letters result in favoring certain limited partners. 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 following private investment funds charge a maximum investment advisory fee as shown below:

<b><u>Private Investment Fund</u></b>	<b><u>Max Investment Advisory Fee as % of total market value</u></b>
Penn Capital Defensive High Yield 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 quarterly basis, unless otherwise negotiated by a client.

Penn Capital's standard investment advisory fees generally range from 0.45% to 1.25% depending upon the specific investment 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, 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 advisory fees for its sub-advisory services provided 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.

Other Costs and Expenses:

In addition to the advisory fees described above, clients typically bear other costs associated with investments or accounts including but not limited to, and only as applicable for the client's specific situation: (i) custodial charges, brokerage fees, exchange fees, mutual market access fees, commissions and related costs (see *Item 12 – Brokerage Practices* for more information); (ii) interest expenses; (iii) taxes, duties and other governmental charges; (iv) transfer and registration fees or other similar expenses; and (v) costs associated with foreign exchange transactions. With respect to such services (which typically include, but are not limited to, custodial, securities lending, brokerage, banking, consulting or third-party advisory services) SMA clients are required to establish business relationships with relevant service providers or other counterparties.

Registered mutual funds and private investment funds bear the fees and expenses listed above as part of each fund's operating and other expenses, as well as any relevant (i) legal expenses; (ii) external accounting fees; and (iii) audit and tax preparation 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 other non-affiliated pooled investment vehicles (e.g., 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 and the distributor of Penn Capital's affiliated mutual funds and private investment funds. These registered representatives receive bonuses for sales of Penn Capital strategies purchased by clients through SMAs, and 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 and risk tolerance. A conflict of interest also can arise where the financial or other benefits available to a portfolio manager differ among the funds and/or accounts that he or she manages. If the structure of Penn Capital's management fee and/or the portfolio manager's compensation differs among funds and/or accounts (such as where certain funds or accounts pay higher management fees or performance-based management fees), the portfolio manager might be motivated to help certain funds and/or accounts over others. To mitigate these potential conflicts inherent in compensation, all Penn Capital employees, including registered representatives, are 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 Investment Advisers Act of 1940, as amended ("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. Please refer to *Item 11 – Code of Ethics, Participation or Interest in Client Transactions and Personal Trading* for more detail about the Code and how you can obtain a free copy. Registered representatives must also adhere to Foreside's Registered Representative Compliance and Supervisory Procedures and are subject to oversight by the Penn Capital designated supervising principal and by Foreside.

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

Penn Capital has entered into performance fee arrangements with 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.

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.

Side-by-side management of various types of accounts raises the possibility of favorable or preferential treatment of a client account or a group of accounts arising from differences in fee arrangements. Penn Capital manages all client accounts in the same strategy in line with a model account for that strategy, which will generally prevent such preferential treatment. On a monthly basis, Penn Capital verifies that all accounts in the same strategy perform similarly and will review any significant performance dispersion. Furthermore, Penn Capital has designed and implemented procedures in an effort to seek to treat all clients fairly and equitably over time. Through these procedures, Penn Capital believes that clients that are subject to side-by-side management alongside other accounts are receiving fair and equitable treatment over time.

Penn Capital simultaneously manages multiple types of investment vehicles, including the affiliated and non-affiliated mutual funds, private investment funds, wrap fee and model delivery programs, and SMAs, in many instances according to the same or a similar investment strategy (*i.e.*, side-by-side management). The simultaneous management of these different investment vehicles gives rise to the types of conflicts described above, as the fees for the management of certain types of investment vehicles could be higher than for others. Nevertheless, Penn Capital has an affirmative duty to treat all clients fairly and equitably over time.

Although Penn Capital has a duty to treat all clients fairly and equitably over time, there is no requirement that Penn Capital use the same investment practices consistently or at the same time across all clients. In addition, different account guidelines, applicable laws and regulations, and/or differences within particular investment strategies leads, in some cases, to the use of different investment practices for accounts with a similar investment strategy or investing in the same securities. Portfolio managers know the size, timing and possible market impact of client trades. A conflict of interest exists where portfolio managers could use this information to the advantage of certain accounts they manage and to the possible detriment of other accounts. Penn Capital will not necessarily purchase or sell the same securities at the same time, in the same direction, or in the same proportionate amounts for all eligible accounts, particularly if different accounts have different amounts of investable cash available, different existing exposures, different liquidity requirements, different strategies, or different risk tolerances. As a result, although Penn Capital manages numerous accounts with similar or identical investment objectives, or could manage accounts with different objectives or strategies that trade in the same, similar or related securities, the portfolio decisions relating to these accounts, and the performance resulting from such decisions, likely will differ from account to account and, accordingly, from client to client. In certain circumstances, investment opportunities that are in limited supply and/or have limited return potential in light of administrative costs of pursuing such investments (*e.g.*, IPOs) are only allocated to clients where the given opportunity is more closely aligned with the applicable strategy and/or trading approach.

Side-by-side management also affects instances in which Penn Capital provides model portfolio recommendations to Model Accounts. Since Penn Capital provides Model Accounts with the relevant model portfolios prior to the next day's market open (or at such time as has been separately negotiated), 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 has been separately negotiated). Penn Capital will likely be trading in the same securities for its 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 Penn Capital does not control the execution of transactions related to a model portfolio, Penn Capital cannot attempt to control the market impact of such transactions to the same extent that it would for its discretionary clients. Please see *Item 12 – Brokerage Practices* below for a more detailed discussion of trade allocation and aggregation policy and procedures.

## **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.

**Frequent Trading Risk.** Penn Capital's tactical investment process, particularly for its equity strategies, is expected to result in frequent trading, which increases an account's portfolio turnover rate and its transaction costs, such as brokerage commissions, dealer mark-ups and taxes. Increased transaction costs detract from an account's overall performance.

Certain Penn Capital strategies involve investment in senior floating rate bank loans, which has specific bank loan risks as well as liquidity risk.

**Bank Loan Risk.** There are a number of risks associated with an investment in floating rate senior secured bank loans, including credit risk, interest rate risk, liquidity risk and prepayment risk. Lack of an active trading market, restrictions on resale, irregular trading activity, wide bid/ask spreads and extended trade settlement periods in excess of seven days all would likely impair the ability to sell bank loans within its desired time frame or at an acceptable price and its ability to accurately value existing and prospective investments. Extended trade settlement periods may result in cash not being immediately available to the account. As a result of such illiquidity, the account may have to sell other investments or engage in borrowing transactions to raise cash to meet its obligations.

Bank loans in which the account invests have similar risks to below investment grade fixed income securities. Changes in the financial condition of the borrower or economic conditions or other circumstances could reduce the capacity of the borrower to make principal and interest payments on such instruments and may lead to defaults. Secured bank loans are supported by collateral; however, the value of the collateral may be insufficient to cover the amount owed to the account. If the account relies on a third party to administer a loan, the account is subject to the risk that the third party will fail to perform its obligations. In addition, if the account holds only a participation interest in a loan made by a third party, the account's receipt of payments on the loan will be dependent on the third party's willingness and ability to make those payments to the account.

Loans generally are subject to legal or contractual restrictions on resale. The liquidity of loans, including the volume and frequency of secondary market trading in such loans, varies significantly over time and among individual loans. For example, if the credit quality of a loan unexpectedly declines significantly, secondary market trading in that loan can also decline for a period of time. During periods of infrequent trading, valuing a loan can be more difficult and buying and selling a loan at an acceptable price can be more difficult and delayed. Difficulty in selling a loan can result in a loss. Due to their subordination in the borrower's capital structure, subordinated loans involve a higher degree of overall risk than senior bank loans of the same borrower.

**Liquidity Risk.** Certain securities may be difficult (or impossible) to sell at the time and at the price the Advisor would like. As a result, the account may have to hold these securities longer

than it would like and may forego other investment opportunities. There is the possibility that the account may lose money or be prevented from realizing capital gains if it cannot sell a security at a particular time and price. Liquid portfolio investments may become illiquid or less liquid after purchase by the account due to low trading volume, adverse investor perceptions and/or other market developments. Liquidity risk includes the risk that the account will experience significant net redemptions at a time when it cannot find willing buyers for its portfolio securities or can only sell its portfolio securities at a material loss. Liquidity risk can be more pronounced in periods of market turmoil. It may be more difficult for the account to determine an accurate good faith fair value of an illiquid investment than that of a more liquid comparable investment. If the account sells investments with extended settlement times, such as loans, the settlement proceeds from the sales may not be available to meet the account's redemption obligations for a substantial period of time.

#### **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 PENN Short Duration High Yield Fund, L.P.

Penn Capital serves as the investment adviser to the PENN Capital Funds Trust ("Trust"), which offers a series of mutual funds ("funds") registered under the Investment Company Act. As discussed in Items 4, 5 and 7, Penn Capital provides investment advice to each fund, and could be deemed to be a related person of the funds through common control by Richard Hocker who is a Trustee and the President of the Trust, and a portfolio manager of the funds. Penn Capital and its employees have significant interests in the funds, and investors in the funds also include SMA clients of Penn Capital, including in circumstances where Penn Capital recommended such investments. Please see Items 11 and 12 for discussion of related conflicts and the policies and procedures that Penn Capital has adopted to address these conflicts.

A number of Penn Capital employees are registered representatives associated with Foreside Fund Services, LLC. ("Foreside"), an unaffiliated FINRA registered limited purpose broker-dealer that also serves as distributor to the affiliated mutual funds and private investment funds. Penn Capital and/or the funds pay Foreside a fee for the distribution related services for the affiliated mutual funds and private investment funds. Foreside, together with Penn Capital's supervising principal, supervises the registered representative activities related to marketing and distribution of affiliated mutual funds and private investment funds 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.

The Ethel Mae Hocker Foundation, Inc. ("EMH Foundation") was founded in 2005 and is privately funded by Marcia A. Hocker (President of Penn Capital and a Trustee of the EMH Foundation) and Richard A. Hocker (Chairman of the Board of the EMH Foundation, as well as Penn Capital's Founder, Chairman of the Board, CEO, and CIO, and Trustee of the PENN Capital Funds Trust). The EMH Foundation provides educational opportunities to elementary and high school students. The EMH Foundation also is a client of Penn Capital and invests in Penn Capital's investment strategies and products. The persons responsible for the investment decisions of the EMH Foundation are Access Persons and employees of Penn Capital.

The Penn Capital Foundation, Inc. ("Penn Capital Foundation") was founded in 2019 by Penn Capital to oversee Penn Capital's philanthropic ventures. The Penn Capital Foundation expects to receive its funding initially from Penn Capital, but seeks to have the majority of its assets result from independent fundraising efforts. Once funded, the Penn Capital Foundation expects to invest in Penn Capital's investment strategies and products. The persons responsible for the investment decisions of the Penn Capital Foundation are Access Persons and employees of Penn Capital. The EMH Foundation and the Penn Capital Foundation collectively are referred to hereinafter as "the Foundations".

Richard and Marcia Hocker have certain other business interests and own or are partners in a number of other investment and non-investment related entities, which are collectively referred to herein as the "Hocker Entities." Certain of the Hocker Entities receive a nominal fee from Penn Capital in exchange for providing storage facilities for some of Penn Capital's books and records. Richard and Marcia Hocker have investment decision-making authority for the Hocker Entities' investments.

Richard and Marcia Hocker devote only as much of their time to the Hocker Entities and the Foundations as they deem to be reasonably necessary. Certain Penn Capital employees also devote a portion of their time to the Hocker Entities and the Foundations, but do not receive additional remuneration from the Hocker Entities and the Foundations for their time.

A conflict of interest could be presumed to exist between Penn Capital and each of the Hocker Entities and the Foundations because Richard and Marcia Hocker own controlling interests in Penn Capital and as such personally benefit to the extent that the Hocker Entities and the Foundations engage the investment advisory services of, or otherwise support, Penn Capital. In addition, the Foundations have access to investments and investment strategies at Penn Capital that are not currently offered to the public.

Certain senior Penn Capital employees, Penn Capital, and the EMH Foundation also participate in a private entity formed for the purpose of making investments in other businesses. There are no unaffiliated clients in this private entity and the private entity does not invest in any issuers of securities held by Penn Capital clients.

Employees of Penn Capital could have family members and/or friends that are employed with, or are otherwise affiliated with, vendors that provide services to or engage in business transactions with Penn Capital. To manage this potential conflict of interest, all employees are required to promptly report these types of relationships to the CCO.

Penn Capital has also adopted compliance policies and procedures that are designed to address various other conflicts of interest that may arise for the firm and the individuals that it employs. For example, Penn Capital seeks to minimize the effects of competing interests for the time and attention of portfolio managers by assigning portfolio managers to manage funds and accounts that share a similar investment style. Penn Capital has also adopted trade allocation procedures that are designed to facilitate the fair and equitable allocation of limited investment opportunities over time among multiple funds and accounts. There is no guarantee, however, that these policies, procedures and internal controls will be effective for detecting and/or preventing every situation in which an actual or potential conflict occurs.

#### **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 affiliated mutual funds or private investment funds described in this Brochure and in which Penn Capital, its affiliates and employees have a financial interest. Penn Capital, employees, or other related persons invest in these affiliated mutual funds and private investment funds. In some cases, such investments could constitute the majority of the assets in the investment vehicle. These investments, therefore, could provide an incentive for Penn Capital to favor accounts in which it has such an interest over accounts or funds where it does not. Penn Capital, from time to time, also recommends to clients that they buy or sell securities in which employees or other related persons also have a financial interest. These types of transactions present a conflict of interest in that employees or related persons might benefit from market activity by a client in a security held by an employee. In order to reasonably prevent conflicts of interest between Penn Capital and its clients, employee trading is monitored under Penn Capital's Code. 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 is disclosed in the mutual funds' prospectus and statement of additional information, and where Penn Capital is the General Partner, investment adviser, and a seed investor, its interest is disclosed 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:

Richard and Marcia Hocker invest a significant portion of their personal securities investments, as well as the entities or trusts over which they have investment discretion in Penn Capital strategies and products. Penn Capital employees are permitted to hold direct investment in securities owned by or recommended to Penn Capital's clients. To manage the potential conflicts of interest inherent in personal trading, Penn Capital has adopted procedures that are designed to identify potential conflicts of interest, to prevent or mitigate actual conflicts of interest, and to resolve such conflicts appropriately if they do occur.

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).

*Conflicts Related to the Registered Mutual Funds*

Penn Capital recommends that clients consider an investment in one or more of the registered mutual funds in the Trust, which is advised by Penn Capital. Before investing, clients should consider the information provided in a fund's prospectus and statement of additional information, including the fact that funds have additional or different risks than other securities and that Penn Capital receives advisory fees from the funds that could exceed the fees that would have been paid had the assets been invested in other securities or investment vehicles. Additionally, incidental expenses associated with a fund could exceed those associated with SMAs. Penn Capital's employees, including portfolio managers, have significant investments in the funds. These interests could create an incentive to favor a fund over other client accounts when, for example, placing trades or aggregating orders. Penn Capital maintains policies and procedures, including the trading and allocation policies described in *Item 12—Brokerage Practices*, so that Penn Capital manages all client accounts in a manner consistent with the duties an adviser owes to its clients and applicable law, and without considering such persons' ownership, compensatory, or other pecuniary or financial interests.

**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) the fixed income trading department's analytics regarding broker volumes and relationships; comparative new issue allocations; and industry trends; (iii) the equity and fixed income broker-dealers approved for use by the Trading Department; (iv) 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; (v) volume of trades directed to each broker-dealer, including algorithmic trading venues; (vi) trade errors, if any, and their remediation; (vii) soft dollar and commission sharing arrangements; and (viii) allocation of limited investment opportunities.

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) any limitations should be set on the volume of trades to be sent to a particular broker-dealer; (iii) a broker-dealer should receive heightened supervision for a period of time; and (iv) 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 and non-wrap clients also risk paying higher commissions than would be the case without such directed brokerage. 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. Under this aggregation procedure, transactions will generally be averaged as to price and allocated among clients pro rata, based on original allocation to the purchase and sale orders placed for each client on any given day. To the extent that Penn Capital determines to aggregate client orders for the purchase or sale of investments, Penn Capital shall seek to do so in a fair and equitable manner. In the event that Penn Capital determines not to aggregate client orders, clients would be subject to different

prices and commissions or other transaction costs compared to what they would have obtained had such orders been placed on an aggregate basis.

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 believes will 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 seeks 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. Mixed-use allocations give rise to a conflict of interest because Penn Capital has an incentive to make those allocations in such a way as to minimize the amount of out-of-pocket expenses incurred by Penn Capital. 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. 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. 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.

IPO Allocations:

Penn Capital will participate in initial public offerings, restricted securities, secondary offerings and other limited issues (collectively, "IPOs") for eligible client accounts, (excluding wrap fee program accounts, directed brokerage accounts, and accounts of Penn Capital's Access Persons) when Penn Capital believes that such IPO presents a valuable investment opportunity for eligible clients. Wrap fee program accounts and directed brokerage accounts are excluded from participating in IPOs because securities for wrap fee program accounts are purchased through either the sponsor's or a step out broker's desk and directed

brokerage accounts are purchased through a client's designated broker's desk, none of which meet the conditions described below that are required for Penn Capital's trading desk to be able to purchase IPO shares for these accounts. Due to the inherent conflicts of interest, Penn Capital's Code of Ethics and Business Conduct prohibits Access Persons from participating directly in IPOs, but Access Persons can gain exposure to IPO investments by virtue of their investment in an affiliated mutual fund advised by Penn Capital and which such fund is eligible to participate in IPOs.

Penn Capital's policy is to treat all clients fairly and not favor one account over another. To that end, Penn Capital's procedures have been designed to allocate IPO opportunities among eligible client accounts in a fair and equitable manner over time, taking into consideration factors described herein. Penn Capital will not intentionally favor or disfavor any account or type of account or client over another. Accordingly, we seek to allocate trades in a manner that does not allow any particular client account or group of client accounts to systematically receive more favorable treatment than other client accounts.

Penn Capital will ensure each eligible equity client account is included in Penn Capital's IPO rotation and will purchase IPOs provided the following conditions are met:

- The client has authorized in writing its ability to participate in IPOs, which will be maintained in the client's file
- The account has sufficient cash or margin available to buy the IPO, including ticket charges and custodial fees
- The account guidelines do not contain a prohibition or restriction that would prevent the account's participation in the IPO
- The portfolio manager believes the IPO is suitable for the account after having considered:
  - the liquidity of the issue
  - whether the market cap of the issuer is within the account's primary market cap range
  - whether the issue fits within the sector and style classification of the account

Penn Capital is not always able to obtain access to a sufficient number of IPO shares to make a material allocation of such shares among all of its client accounts for which such investments might be appropriate. If a client account selected to receive an IPO allocation would not receive at least 0.10% of such client account's total market value, Penn Capital will employ a rotational methodology designed to allocate the offering, with non-participating clients receiving positions in subsequent IPOs if such future allocations exceed 0.10% of such client account's total market value. The portfolio manager is responsible for determining the allocation of investment opportunities and will take into consideration factors such as client account objectives and preferences, investment restrictions, account sizes, cash availability, and current specific needs. These factors can impact investment decisions and result in

different performance across accounts within the same strategy. As a result of the considerations by the portfolio managers, the IPO allocation methodology, and the participation in either more or fewer allocations than other clients, not all accounts are treated identically. However, investment opportunities are to be allocated among client accounts in a manner that treats all client accounts in a fair and equitable manner such that no account or type of account should be favored over another, over time. Fair treatment does not necessitate that all accounts are managed exactly the same.

Penn Capital, as a general practice, allocates the IPOs shares pro rata among eligible accounts where the portfolio manager seeks an allocation. However, one or more eligible accounts would not receive an allocation for a variety of reasons, including: because they lack available cash, are restricted from making certain investments, pays a performance fee, or is so large that the allocation is determined by the portfolio manager to not be meaningful to the account's overall performance. When a pro rata allocation of limited availability investments is not possible or is not appropriate, Penn Capital considers the following factors, among others, to determine an appropriate allocation:

- Penn Capital's good faith assessment of the best use of such limited opportunities relative to the investment objectives, investment limitations and requirements of the accounts
- Suitability requirements and the nature of the investment opportunity, including relative attractiveness of a security to different accounts
- Relative sizes of applicable accounts
- Impact on overall performance an allocation of such securities would have on an account
- Cash and liquidity considerations, including without limitation, availability of cash for investment
- Account investment horizons and guidelines
- Client-specific investment guidelines and restrictions
- An account's risk tolerance and/or risk parameters
- Tax sensitivity of accounts
- Concentration of positions in an account
- Appropriateness of a security for the account given the benchmark and benchmark sensitivity of an account
- Use of the opportunity as a replacement for another security Penn Capital believes to be attractive for an account or the availability of other appropriate investment opportunities
- Considerations related to giving a subset of accounts exposure to an industry
- Account turnover guidelines
- Whether the allocation of an IPO to a client account will exceed 3% of the value of the account's assets (measured at the time the allocation is made). Any excess

amount that cannot be allocated to a particular account as a result of this percentage restriction will be allocated to the next eligible account on the list.

In some circumstances, it is possible that the application of these factors could result in certain accounts receiving an allocation when other accounts do not. Moreover, accounts in which Penn Capital and/or its Employees have interests (e.g., investment in affiliated Penn Capital mutual funds), might receive an allocation or an opportunity not allocated to other accounts. Penn Capital acknowledges the potential conflicts of interest that could arise in certain situations, for example, when an account: (i) has higher immediately available cash or buying power and is allocated IPO shares in a preferential manner; (ii) is given preference based on the size of the account and the overall effectiveness of an IPO allocation on the performance of that account; (3) includes Penn Capital, its officers and Employees who have a financial interest, such as the affiliated mutual funds, and there could be a conflict of interest to the extent IPOs are allocated to these accounts and not allocated to other client accounts.

To mitigate these potential conflicts of interest, Penn Capital seeks to allocate IPO shares on a pro rata basis among participating accounts within each investment strategy whose portfolio managers have elected to participate. The portfolio managers for each strategy have discretion to determine whether their accounts will participate in an IPO. In situations where Penn Capital is not allocating an IPO to all IPO-eligible accounts, Penn Capital will document, prior to or at the time of submitting an indication of interest, which accounts will participate in the IPO, how the decision was made, and why any accounts were omitted. Reasons for non-participation include but are not limited to: inappropriate sector or geographic exposure; inappropriate market capitalization; inappropriate asset class; inappropriate fit with client mandate; insufficient liquidity; or undesirable risk profile for the strategy. Although Penn Capital seeks to define reasons for non-participation in its documentation, it is possible that certain biases will exist. For example, portfolio managers of a strategy that is closing imminently could choose not to participate in an IPO for which the strategy is otherwise eligible, instead limiting participation in the IPO to other eligible Penn Capital strategies that will remain open.

If a portfolio manager deems an IPO unsuitable either based upon the portfolio managers consideration of the factors above or the client's account guidelines, the account will be excluded from participating in that IPO and the portfolio manager will provide a detailed explanation to the trader, who shall then include such documentation on the trader's IPO Trades spreadsheet.

Accounts participating in IPOs will have their shares allocated on the day Penn Capital receives notice of the allocation to Penn Capital. Portfolio managers are permitted to sell the

IPO holdings on the same day of their acquisition, or shortly thereafter upon the occurrence of any event the portfolio manager believes justifies such sale.

Each portfolio manager/trader shall seek to avoid any allocation of investment opportunities that would result in the front running of investments or any client being defrauded, such as through an inequitable allocation or disproportionately allocating hot IPOs, or other limited issues to: (i) "favored" funds and accounts, such as proprietary accounts, (ii) accounts that pay performance-based fees, (iii) personal accounts, (iv) accounts that have relatively poor performance, or (v) new accounts, including new investment companies (in an effort to seek to boost performance and subsequently to attract additional assets).

Penn Capital's Code of Ethics and Business Conduct prohibits Access Persons from participating in IPOs.

Cross Trading:

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 in the Trust.

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. Some clients contractually reserve the right to either vote their own proxies or direct Penn Capital to vote their proxies in a certain manner. If a client does not grant voting authority to Penn Capital and wishes to vote its own proxies, that client would be responsible for arranging delivery of proxy materials from the client's custodian or the relevant transfer agent. For clients that give Penn Capital the right to vote proxies, Penn Capital has adopted a Proxy Voting Policy and generally will exercise authority to vote proxies related to securities held in client accounts on behalf, and in the best interests, of its clients. 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.

Conflicts of interest will be resolved in favor of the clients' interests. The CCO is responsible for resolving potential conflicts of interest in the proxy voting process. Examples of potential conflicts of interest include: (1) Penn Capital or its principals have a business or personal relationship with participants in a proxy contest, corporate directories or candidates for

directorships; (2) Penn Capital or its principals have a material business relationship with a proponent of a proxy proposal and this business relationship could influence how the proxy vote is cast. When a potential material conflict of interest exists, Penn Capital will obtain client consent before voting. Penn Capital will provide the client with sufficient information regarding the potential conflict, so the client can make an informed decision whether to consent. 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 could 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.