



# Perennial Value Microcap Opportunities Trust

June 2017



The Perennial Value Microcap Opportunities Trust (the Trust) provides actively managed exposure to a portfolio of Australian smaller and microcap companies shares, employing a value style investment process.

The Trust invests in Australian microcap companies with a market capitalisation less than \$500 million. An investment in the Trust can complement an allocation to Australian large cap shares and provide the diversification benefits associated with focusing on the stocks in the broader universe.

## What is a Microcap?

The microcap companies sector of the Australian listed market is very dynamic. With a mix of up and coming technologies through to long-term very successful businesses in varied sector exposures.

Traditionally, a microcap company has a market capitalisation (market cap) of less than \$500 million. Market cap is a way of measuring the size of a company. It is calculated by multiplying the number of shares issued by a company by the current value of a single share. The Trust is also capable of investing in pre-IPO stage companies (unlisted) with the ability to invest up to 20% of assets in such companies.

### Benefits of investing in microcap companies

- ▶ **Microcaps have considerable potential and can deliver significant value to shareholders.** Many small & micro caps are relatively young companies. This can result in a greater earnings growth potential than larger, more established stocks.
- ▶ **Microcaps typically have more focused management, given they are likely to have a significant equity stake in the business.** This results in a clear alignment of interests between shareholders and management.
- ▶ **Investing in microcaps can be a way of obtaining exposure to a specific industry or market.** A micro cap will likely focus its operations and expertise on more specific products or services, whereas a larger stock may diversify across a broader range of operations.
- ▶ **Microcaps are more agile than their large cap counterparts** and can react more quickly to changes in their business environment and circumstances.
- ▶ **The microcap universe is large and there is limited research coverage.** The lack of research coverage means that the market is less efficient and this creates more opportunities to outperform the market.

## How the Trust works

Perennial Value is a specialist active Australian equities manager, whose investment process is based on a 'value' stockpicking investment style. The team holds the belief that investment markets are not fully efficient, as asset prices are sometimes driven by irrational influences. With an investment process based on 'value' stockpicking, the Trust invests in a range of smaller listed companies with a maximum market cap of \$500m, which Perennial Value believes have sustainable operations and whose share price offers good value.

## Key features of the Trust

### Proven long-term track record of the Manager

Since inception in March 2002, the team has been successfully managing a Smaller Companies Portfolio. Whilst the Microcap Opportunities portfolio is newly established, it is based on a similar investment process as the successful Smaller Companies portfolio.

Period to 30 June 2017	3 mths %	1 year %	3 years % p.a.	5 years % p.a.	Since Inception % p.a.
Perennial Value Microcap Opportunities Trust	7.0	-	-	-	7.9
S&P/ASX Small Ordinaries Accumulation Index	-0.3	-	-	-	3.6
Value Added/ Detracted	7.3	-	-	-	4.3

Source: Perennial Value Management. Perennial Value Microcap Opportunities Trust inception date is February 2017. Past performance is not reliable indicator of future performance. Net of fees performance shown.

### Research capability

The cornerstone of Perennial Value's approach is a strong emphasis on company research, with the aim of developing a detailed understanding of each company before committing investors' funds. The research effort includes sifting through annual reports, building company models and meeting with company executives as well as competitors and suppliers.

As the Small and Microcap team sits within the larger Perennial Value team, it is able to leverage the considerable expertise and experience of a combined fifteen investment professionals.

### Equity ownership

Equity participation is a key element of Perennial's business model. The investment staff's equity stake in the business means the team are single minded in ensuring delivery of performance ahead of benchmark. At the heart of Perennial's equity ownership structure is the philosophy of aligning our investment professionals' interests with that of our clients.

### Focus on capital preservation

The Trust has a strong capital preservation element based on the following parameters:

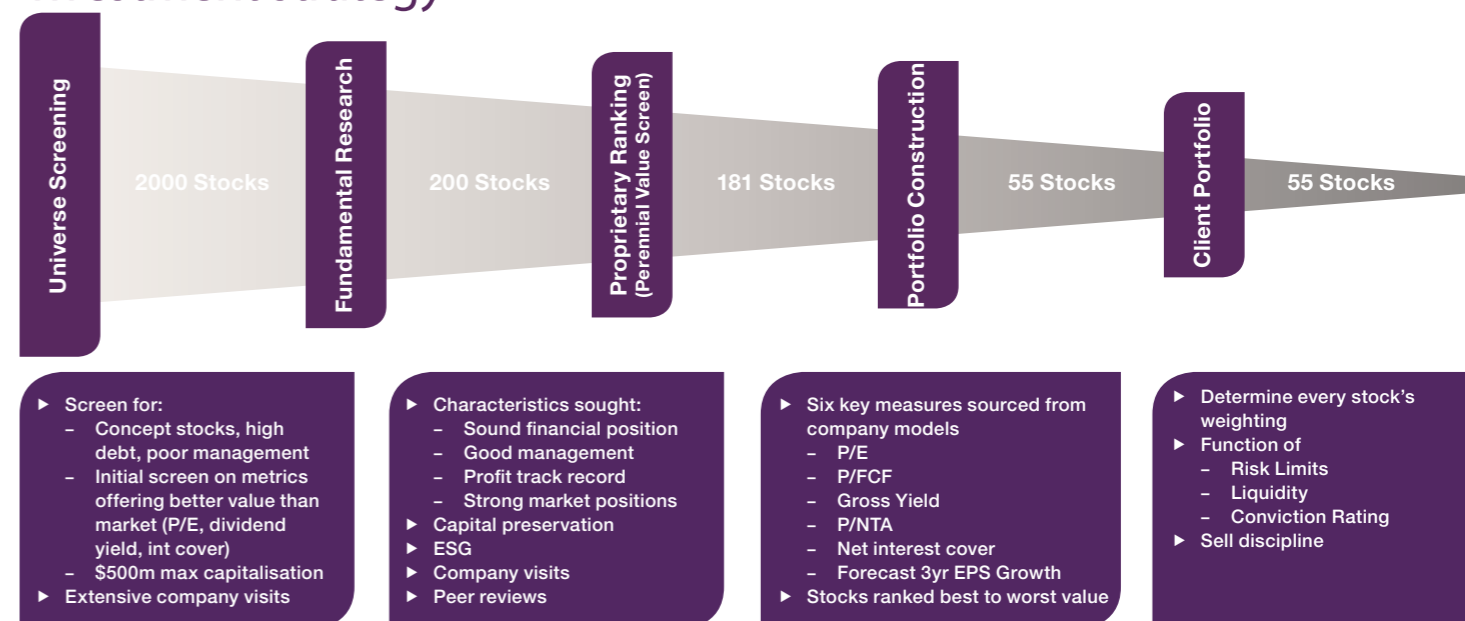
- ▶ Zero exposure to highly geared, complex structures.
- ▶ Strong balance sheets with limited debt.
- ▶ Strong net interest cover.
- ▶ The Portfolio offers better value than the market.

### Risk limits

Risk management is key to Perennial Value's investment approach and the construction of a high quality portfolio. The following parameters are factored into the investment process.

Maximum market cap	\$500 million
Maximum cash allocation	20%
For individual stocks	Maximum allocation of 10% of the portfolio. Maximum 15% of issued capital. Maximum 20% investment in unlisted companies.
Number of stocks in the portfolio	The Trust will typically hold approximately 55 stocks with a minimum stock holding of 30 and a maximum of 70.
Tracking error (ex-ante)	10% to 12% (soft limit only)

## Investment strategy



For the team, the key characteristic in any stock is value. This is crucial in ensuring that at all times the Trust is always better value than the market.

The Trust invests in stocks with a market cap of less than \$500m. In managing liquidity risk, the Trust can invest up to 20% to cash. Perennial Value's investment process begins with screening approximately 2000 stocks. Stocks are then eliminated based on factors such as expensive P/Es and high debt. Detailed modelling and research is then conducted on approximately 200 companies. To qualify for investment, stocks must have sustainable businesses (qualitative) and offer good value at the current share price (quantitative). Every potential investment opportunity is assessed on its key qualitative and quantitative criteria, including sound financial position (low debt), good management, demonstrable track record of profit or a clear path to this, as well as a strong market position.

Direct company and industry contacts are an integral part of the stock selection process. Relative value is measured by Perennial Value's proprietary stock ranking model, known as the Perennial Value Screen. Having ratified the numbers in the company models, six key financial measures are downloaded from each company model into the Value Screen:

- 1 Price to earnings.
- 2 Price to free cash flow (a more rigorous measure than gross cash flow).
- 3 Gross dividend yield.
- 4 Price to net tangible assets.
- 5 Net interest cover (to measure financial strength).
- 6 Earnings growth.

For each of the six measures, stocks are assigned a ranking, with each measure evenly weighted. Each stock is then assigned a final score, which determines its final ranking. The outcome of this detailed research process is a list of stocks that are eligible for portfolio inclusion.

The next phase of Perennial Value's process is portfolio construction. The major driver of portfolio construction is Perennial Value's desire to deliver a true to label value portfolio at all times. This means that the portfolio has a strong bias towards the best ranking, or best value, stocks in the Perennial Value Screen.

Having built the investment case for each stock through a detailed understanding of the industry, suppliers, technology and competitors, the passion and conviction of the investment analysts and portfolio managers is key to stock selection and ultimately performance. With over 10 years' average industry experience the team's considerable expertise, knowledge and skill have enabled them to construct and manage the portfolio to deliver strong and sustained outperformance for investors.

Trust snapshot	
Suggested investment time horizon	Five years
Number of securities	50
Unit pricing	Daily
Income distribution	Annually
Minimum initial investment amount	\$25,000
Minimum additional investment amount	\$5,000
Risk/Return profile	High
Investment management fee	1.20% p.a.
Performance fee	Yes
Buy/Sell spread	0.30/0.30

## Trust characteristics

Prospective FY19	Price to earnings (times)	EV/ EBIT (times)	3yr EPS growth (% p.a)
Perennial Value Microcap Opportunities Trust**	12.0	6.9	24.3
Market Average Ex-100*	13.8	11.6	12.9
Premium/(Discount) to Market	(13%)	(40%)	88%

Source: \*Macquarie Securities, Goldman Sachs and UBS as at 30 June 2017.

\*\*Perennial as at 30 June 2017.

## Perennial Value Microcap Opportunities team

The Microcap Opportunities team sits within Perennial Value and is able to leverage the experience and expertise of a further twelve investment professionals in the Perennial Value team.

### Portfolio Managers



Andrew Smith

Portfolio Manager



Sam Berridge

Portfolio Manager



Damian Cottier

Portfolio Manager

### For more information, please contact your Investment Specialist:

**Charles Magro** (NSW/QLD/WA)

0416 211 270

**George Katopis** (VIC/TAS/SA)

0401 151 665

**Cesar Farfarn** (NSW/ACT)

0405 964 960

### Perennial Client Services

1300 730 032 [invest@perennial.net.au](mailto:invest@perennial.net.au)

For up to date information on the Trust, including the latest performance data, unit prices and commentaries please visit [www.perennial.net.au](http://www.perennial.net.au)

Issued by: The Investment Manager, Perennial Value Management Limited, ABN 22 090 879 904, AFSL: 247293. Responsible Entity: Perennial Investment Management Limited ABN 13 108 747 637, AFSL: 271501. This promotional statement is provided for information purposes only. Accordingly, reliance should not be placed on this promotional statement as the basis for making an investment, financial or other decision. This promotional statement does not take into account your investment objectives, particular needs or financial situation. While every effort has been made to ensure the information in this promotional statement is accurate; its accuracy, reliability or completeness is not guaranteed. Past performance is not a reliable indicator of future performance. Gross performance does not include any applicable management fees or expenses. Net performance is based on redemption price for the period and assumes that all distributions are reinvested. Fees indicated reflect the maximum applicable. Contractual arrangements, including any applicable management fee, may be negotiated with certain large investors. Investments in the Trusts must be accompanied by an application form. The current relevant product disclosure statements, Additional Information Booklet, and application forms can be found on Perennial's website [www.perennial.net.au](http://www.perennial.net.au).