

Australian Smaller Companies

Period to 30 June 2010	1 Year (%)	3 Years (% p.a.)	5 Years (% p.a.)	Since Inception (% p.a.)
Perennial Value Smaller Companies Trust	38.4	0.1	12.2	14.2
S&P/ASX Small Ordinaries Index	11.2	-14.2	2.7	7.1
Value Added/Detracted against S&P/ASX Small Ordinaries Index	27.2	14.3	9.5	7.1
Net Performance	32.8	-2.5	10.1	12.4

Source: Perennial Investment Partners. Trust Inception: March 2002. Past performance is not reliable indicator of future performance.

Gross performance does not include any applicable management fees. Net performance is based on redemption price for the period and assumes that all distributions are reinvested. Fees indicated reflect the maximum applicable.

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What is a small cap?

Traditionally, a smaller company (small cap) is one with a market cap of between \$100 million and \$1.5 billion. Market capitalisation (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.

Benefits of investing in small caps:

- **Small caps offer high growth opportunities.** Many Small caps are relatively young companies. This can result in a greater earnings growth potential than larger, more established stocks.
- **Small caps typically have more focused management, given they would likely have a significant equity stake in the business.** This results in a clear alignment of interests between shareholders and management.
- **Investing in small caps can be a way of obtaining exposure to a specific industry or market.** A small cap will likely focus its operations and expertise on more specific products or services (as per the Metcash Limited case study below), where as a larger stock may diversify across a broader range of operations.
- **Small caps are more agile than their large cap counterparts** and can react more quickly to changes in their business environment and circumstances.

Today's successful small caps can grow into tomorrow's successful large caps

Case study: Metcash Limited

Metcash is a distribution and marketing company which operates in the Food and Fast Moving Consumer Goods sectors. Metcash comprises of three different businesses: IGA Distribution, Campbells Cash & Carry and Australian Liquor Marketers. With a market share of circa 19%, Metcash is a significant competitor to the major supermarket chains. The charts below show the performance of its share price (**Chart 1**) and the growth of the company's market cap (**Chart 2**).

Chart 1: Share price



Chart 2: Market cap



Source: IRESS / Perennial.

The company's market cap has grown from \$169 million in June 2000 to over \$3 billion.

Metcash was held in the Perennial Value Smaller Companies Trust from the Trust's inception in March 2002 until July 2009. During that time, Metcash returned 225% compared to a return of 58% by the large cap S&P/ASX 100.

Sector performance

It is generally accepted that the small cap sector typically outperforms the large cap sector during a recovering market. This is shown by the following table.

Table 1: Small cap and large cap performance during the first 12 months of a market recovery.

Trough	0-12 months of recovery		
	Small Caps	Large Caps	Differential
31-Jan-93	77.1%	51.2%	+17.1%
31-Mar-95	25.3%	21.2%	+3.4%
28-Feb-03	38.8%	24.8%	+11.2%
6-Mar-09 (to 30-Sept-09)	74.3%	49.7%	+24.6%

Source: Credit Suisse First Boston Securities

Liquidity

There is a greater perceived liquidity risk involved in investing in small caps. In other words, once you own a small cap share it can be hard to sell. Therefore, small cap investing is more conducive to longer-term investing than it is to a short or medium-term investment timeframe. It is possible that it could take a significant amount of time for the market to realise the true value of a small cap.

However, there are ways of eliminating low-liquidity stocks. For example, a fund manager may choose to invest in stocks above a minimum market cap, on the assumption that the greater the market cap the greater the liquidity. Alternatively, screens can be put in place to determine those stocks which are not regularly traded. For

example, if a stock is not traded on 50% of trading days in year a fund manager may chose to exclude it from the portfolio.

Perennial Value Smaller Companies does not invest in companies with a market cap less than \$50 million, given low liquidity levels.

Research availability

Due to the large volume of research carried out on large and mid cap stocks, large and mid cap markets tend to be more efficient. The discrepancy between the volume of research done on large cap stocks when compared with small caps is vast. This creates an inefficient small cap market which creates a greater opportunity for a 'stock picking' style fund manager.

For the most part, the perceived risk associated with investing in smaller companies comes from a lack of research carried out on the smaller companies sector. As such, it is widely accepted that small cap investing is usually well suited to a boutique or specialist fund manager. Due to the lack of external research conducted by brokers and analysts, a dedicated in-house team is required to carry out the necessary pre-investment research. Perennial Value has this capability.

Accessing small caps

In addition to the above, a boutique structure tends to be well suited to smaller cap investing due to the greater agility and flexibility that comes with a low level of funds under management. The ability to control when to close a fund to new business is an important aspect in determining the success of a smaller cap fund. Large funds under management would either result in an exceptionally diluted portfolio of many stocks, or in significant stakes in the businesses of a more concentrated portfolio. Neither of these are ideal outcomes for a small cap manager who requires the ability to move easily in and out of stocks.

Why access smaller companies via a managed fund

The research, time and associated costs required to successfully invest in small caps dictates that it is not always a feasible option for a direct investor. Investing through a managed pooled fund results in the fund manager carrying the cost of the research and transaction cost. It also gives investors access to a diversified portfolio of small caps – a vital element of successful small cap investing.

Why the Perennial Value Smaller Companies Trust?

Results: Consistently outperforming both the Index and large caps. Table 2 below shows that the Perennial Value Smaller Companies Trust (the Trust) has outperformed not only its Index, the S&P/ASX Small Ordinaries, but also large caps, as measured by the S&P/ASX 100 Accumulation Index.

Table 2

Period to 30 June 2010	3 months (%)	1 Year (%)	3 Years (% p.a.)	5 Years (% p.a.)	Since Inception (% p.a.)
Perennial Value Smaller Companies Trust	-7.6	38.4	0.1	12.2	14.2
S&P/ASX Small Ordinaries Index	-11.6	11.2	-14.2	2.7	7.1
S&P/ASX 100 Accumulation Index	-11.2	13.3	-7.2	4.7	7.4
Value Added vs S&P/ASX Small Ordinaries Index	4.0	27.2	14.3	9.5	7.1

A high quality portfolio

The table below highlights that the Trust offers more value and a greater dividend yield than the market, whilst offering superior growth.

Table 3

Prospective FY11 As at 1 July 2010	Price to Earnings (times)	Price to free cashflow (times)	Gross Yield (%)	Price to NTA (times)	Net Interest Cover (times)	3 Year EPS growth (% p.a.)
Market Average (ASX Small Ords)	10.9	10.2	6.7	2.0	24.1	13.1
Perennial Value Smaller Companies	8.5	7.7	7.5	1.3	28.8	17.3
Premium/(Discount) to Market	(22%)	(25%)	12%	(35%)	20%	32%

Source: Perennial Investment Partners

Capital preservation

As well as offering strong historical returns, the Trust has a strong capital preservation element:

- Zero exposure to highly geared, complex structures i.e. RAMS, Allco, MFS.
- As at 30 June 2010, 38% of the Perennial Value Smaller Companies Trust is exposed to companies with debt-free balance sheets.
- The Trust has a strong net interest cover (based on FY10 forecasts) of 28 times.

Risk Limits

The Trust is constructed taking into account the following parameters:

- Min market cap \$50 million
- Maximum cash = 10%
- Individual stocks
 - = Max 10% of portfolio
 - = Max 12.5% of issued capital
 - = Max 15% in mid-cap stocks
- No. of stocks 20-70
- Tracking error (ex-ante) 5% – 8% (soft limit only)

Conclusion

- The Perennial Value Smaller Companies Trust offers investors exposure to a high quality portfolio of small cap companies.
- The Trust has a proven track record over all time frames (as shown in **Table 2**), against both small cap and large cap indices.
- The investment staff's direct equity stake in the business results in a clear alignment of interests between investors and the dedicated Perennial Value Smaller Companies Team.

For more information, please contact Perennial Investment Partners on 1300 730 032 or click here for a Product Disclosure Statement.

Investment Manager: Perennial Investment Partners Ltd ABN 59 087 901 620. AFSL: 238763. Sub Managers: Perennial Value Management Limited, ABN 22 090 879 904, AFSL: 247293. Perennial Fixed Interest Partners Pty Limited ABN 35 099 336 357, Perennial International Equities Management Pty Limited ACN 099 336 375, Perennial Growth Management Pty Limited ABN 41 099 336 384, Perennial Investment Partners Asia Limited ABN 38 082 790 047 and Perennial Real Estate Investments Pty Ltd ABN 35 117 913 685 are Subsidiaries and Authorised Representatives of Perennial Investment Partners Limited. Responsible Entity: IOOF Investment Management Limited ABN 53 006 695 021, AFSL: 230524. This paper is provided for information purposes only. Accordingly, reliance should not be placed on this document as the basis for making an investment, financial or other decisions. This information does not take into account your investment objectives, particular needs or financial situation. Whilst every effort to ensure the information in this report 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 funds must be accompanied by the application form attached to the current offer document. Past performance is not a guarantee of future returns.