Highly Recommended
Recommended
Approved
Not Rated
Redeem

Product Assessment

Rating issued on 21 Oct 2014

Perpetual Equity Investment Company Limited

VIEWPOINT & RATING

Perpetual Equity Investment Company Limited (ASX:PIC) is a newly incorporated Listed Investment Company (LIC). While PIC will predominantly invest in a diversified portfolio of Australian stocks, to increase flexibility and opportunity set, management may also invest up to 25% in global shares and 25% in cash. The portfolio will be managed by Sydney-based fund manager, Perpetual Limited (Perpetual), utilising its long standing and successful value orientated investment style. Zenith sees PIC as a LIC with solid potential as part of a diversified equities portfolio. **Zenith rates Perpetual Equity Investment Company Limited RECOMMENDED.**

Perpetual is an ASX listed investment company that consists of three core business units - Perpetual Investments; Perpetual Private; and Perpetual Corporate Trust. The Perpetual Investment division has approximately $29.8 billion in funds under management, as at 30 June 2014.

Perpetual has an experienced and well-resourced Australian equities team comprising 18 investment professionals including six portfolio managers and 12 investment analysts. Zenith views Perpetual's domestic equities team to be one of the strongest within the Australian market.

The Perpetual team employs a fundamentally driven, bottom-up research effort to identify investment opportunities. The process exhibits a value bias investment style and Zenith views the rigour of the process and experienced team as the key factors contributing to the team's long-term historical outperformance across their suite of funds.

Perpetual's investment process is based on the philosophy that investment markets are semi-efficient and that this provides opportunities to add value through the identification of and investment in high quality companies that are trading at attractive prices. Perpetual believes that the best way to identify such opportunities is through an internal, fundamentally driven, bottom-up research process.

PIC's Portfolio Manager is Vince Pezzullo who retains total responsibility for investment decisions for the LIC, however the portfolio construction process leverages off the rigorous company research undertaken by Perpetual's analysts. The process seeks to produce a portfolio reflective of the analysts' best ideas. This will be particularly relevant to PIC as it will be very much a high conviction, concentrated vehicle with more of an absolute return focus than many of their other equities funds. Perpetual does not permit analysts to assign a hold rating to a security believing that this promotes conviction in analyst recommendations. Zenith has a high level of confidence in the investment process and believes that that PIC will generate excess returns for its investors over the medium to long-term.

PIC is seeking to raise a minimum $150m and maximum $600m under the Offer (includes oversubscriptions with free attaching Options on a one-for-one base exercisable before 10 June 2016, no dividend entitlement). Upon listing PIC expects the shares to have a NAV of $0.983 (based on min. $150m raised). PIC will pay the Joint Lead Managers a management fee of 1.0% (excluding GST) of the total proceeds of the Offer.

LIC FACTS

- Access to Perpetual's strong quality and valuation focused investment process in a LIC structure.
- Concentrated exposure of between 20 and 40 securities, typically with a mid-cap bias.
- Capacity to hold up to 25% in each of international securities and cash.
- Expected portfolio turnover of between 30% p.a. to 50% p.a. (not targeted).

ABSOLUTE RISK (SECTOR)

VERY HIGH
HIGH
MODERATE
LOW
VERY LOW

RELATIVE RISK (FUND WITHIN SECTOR)

Active Derivatives - Net Mkt Exp > 1
Active Derivatives - Net Mkt Exp <= 1
Active - High Conviction
Active - Benchmark Aware
Index - Enhanced/Fundamental
Index

INCOME DISTRIBUTIONS PER

MONTH QUARTER 6 MONTH ANNUM

INVESTMENT TIMEFRAME

1-2 YRS 3-4 YRS 5-6 YRS 7+ YRS

APIR Code
ASX:PIC

Asset Class
Australian Shares

Sub-Asset Class
Listed Investment Companies - LICs

Investment Style
Value

Investment Objective
To generate a growing income stream and long-term capital growth in excess of the S&P/ASX 300 Accumulation Index over rolling 5 year periods.

Zenith Assigned Benchmark
S&P / ASX 300 (Accum) Index

Key People
Vince Pezzullo
Portfolio Manager

Investment Team Size
18

Fees (% p.a.)
Management Fee: 1.00%
Performance Fee: Nil

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APPLICATIONS OF INVESTMENT

SECTOR CHARACTERISTICS

Listed Investment Companies

In assessing the performance of the LIC sector, it is vital to understand how their structure affects the final performance figures as it is materially different to unlisted funds. As listed companies, the portfolio returns generated are exposed to additional volatility from share price movements and can trade at significant premiums or discounts to the NTA.

In addition, the impact of pre and post-tax returns needs to be considered because LICs distribute returns net of company tax, whilst benchmark index returns are quoted on a pre-tax basis. Accordingly it is difficult to accurately compare shareholder returns to either benchmarks which do not account for tax or realised peer group LICs where the timing of company tax on realised gains differs.

As an indication however, a series of return data can be viewed on the basis of the returns generated by:

- share price and dividends:
- change in pre-tax NTA value and dividends; and
- returns generated internally by the investment portfolio.

For comparison purposes, the use of the internal portfolio returns vs. the benchmark gives the closest measure of the skill of the investment manager in generating returns. However these returns may not be able to be fully crystallised to shareholders given the potential for share price movements. Caution should be used in too close a comparison of these figures as share price and pre-tax asset NTA are measures which take into account company tax paid on realised capital gains and unfranked income, whereas benchmark performance is a wholly untaxed measure.

At various times when assessed on a purely quantitative basis, a LIC can trade away from its longer term average discount or premium to NTA which may represent a period of good buying opportunity. While these can be periods to boost investment returns when buying at a deeper discount, there is no guarantee that any gain through positive movement in the discount to NTA can be crystallised. Potential investors must keep in mind that while discount opportunities may frequently present themselves there is no guarantee that management will be able to close the price to NTA gap.

Australian Equities

The sector incorporates both benchmark aware and benchmark unaware strategies but the funds focus is predominantly on large capitalisation stocks. The sector is one of the most competitive in the investment landscape, based on the number of managers and strategies available to investors. Despite the competitiveness of the sector, the Australian share market has historically provided many opportunities for active management, with the median active manager outperforming a passive index over the longer term.

The Australian share market, as represented by the S&P/ASX 300 Accumulation Index, is highly concentrated and narrow. Technically, a company is assigned the large cap moniker if it falls within the S&P/ASX 50, with those companies falling between the S&P/ASX 50 and S&P/ASX 100 assigned to the mid cap category. All stocks below the top 100 are considered small capitalisation stocks.

As at 31 January 2014, the Financials and Resources sectors combined represented a significant portion of the S&P/ASX 300 Accumulation Index, with the Financials sector accounting for close to 45% of the index, and Resources approximately 25%. The split between Industrials and Resources stocks was approximately 75%/25%. The top 10 stocks represented over 50% of the weighting of the index, and the top 20 stocks represented over 65% of the index.

International Equities

International equities offer Australian investors the ability to access a broader opportunity set, with the potential to invest in sectors not represented or not well represented in the Australian market. Given international markets are not perfectly correlated with the Australian market, International equities also affords portfolio diversification benefits.

Although global equities have disappointed over the past decade in terms of absolute performance, Zenith believes active management, particularly those less benchmark unaware managers, have the ability to add significant alpha above a passive index over the longer-term.

The MSCI World Index ex-Australia (Hedged), is the benchmark employed by the majority of funds in this space. The index is market-capitalisation weighted, resulting in those companies with the largest market capitalisations receiving the heaviest weightings. The index consists of approximately 1,500 securities listed in 22 developed markets, with the United States currently representing approximately 50% of the index; the United Kingdom and Japan being the next largest constituents, with approximately 10% each. The index excludes emerging and frontier markets but many managers retain the mandate flexibility to invest in emerging markets.

The global share market is far more diverse, in terms of sector exposures, than the Australian market. Although the Financials sector represents the largest sector index weight, many sectors not well represented in the Australian market, such as Information Technology and Healthcare, are well represented in the global index, each with approximately a 10% weighting. Despite the market capitalisation weighting methodology, the top 10 index stocks represent only approximately 10% of the weighting of the index, reflecting the larger universe and less top heavy nature of the universe.

PORTFOLIO APPLICATIONS

In general, compared to most other asset classes, equities offer investors the opportunity for higher capital growth over the longer-term with some income. However, this higher growth is also often associated with higher volatility. Therefore, it is recommended that investors adopt a longer time frame when investing in equities.

Investors should also be cognisant of the fact that the Australian equity market only represents approximately 1% of global equity markets (in terms of market capitalisation). While PIC has the flexibility to hold up to 25% in global equities, Zenith would recommend blending with a higher allocation to global equities for those seeking broader portfolio diversification.

PIC should suit investors seeking an Australian focussed equities exposure while Perpetual's strong value bias should provide resilience in falling markets along with a steady dividend income. As PIC is intended to be highly concentrated, Zenith believes the portfolio would blend well with growth orientated and/or style neutral products to achieve a diversified exposure to the Australian equity sector. Although Zenith would prefer PIC be held as part of a more diversified, style neutral, blended portfolio, for investors with small investment amounts seeking strong dividends and the willingness to accept underperformance against market benchmarks in strongly rising markets, PIC could potentially be held as a standalone exposure to equities. Such investors should however be cognisant of the risks associated with holding PIC as a single exposure given the associated single style and manager risk.

Portfolio turnover is expected to be approximately 30% to 50% p.a., which Zenith considers to be moderate to high. Given the expected portfolio turnover, we expect performance to be delivered through a combination of both capital appreciation in the share price and the realisation of capital gains which may be distributed as dividends. While Perpetual is cognisant of the tax impacts of capital gain realisation when making investment decisions, the Fund primarily seeks to increase total performance and does not factor in individual tax situations.

PIC intends to pay dividends twice a year with a current policy that all dividends will be franked to 100% or the maximum possible. Many of the domestic equity LIC's have proven attractive to SMSF clients due to a solid dividend income stream and high level franking. Zenith expects PIC to continue this trend with Perpetual's domestic focussed equities managed funds having historically delivered yields of 3.5% - 4.0% p.a.

RISKS OF THE INVESTMENT

SECTOR RISKS

Funds within the “Australian Equities/Listed Investment Company” sector are exposed to the following broad risks:

MARKET RISK: A sustained downturn in the Australian equity market could lead to negative performance. Furthermore, in market downturns, generally the mid and small cap sector tends to underperform the large cap sector due to its higher "beta" characteristic. While some of this high beta is delivered via the small resource sector, which is a sector the Manager tends to avoid, we do expect a portfolio with mid and small cap exposure to underperform a pure large cap portfolio in bear markets due to the "flight to quality and size" phenomenon.

LIC SECTOR / SENTIMENT RISK: the LIC sector is certainly “flavour of the month” with the sector having raised in excess of $500m during the second half of CY2013, taking it to levels not seen since 2003 / 04 when the likes of Magellan and Ellerston debut on the ASX. While many commentators are saying “but this time it's different” for a variety of reasons including FOFA reforms, investors need to be acutely aware that the sector can just as easily trade at a discount to its NTA as it can a premium.

While the LIC sector dates back to 1920's (oldest LIC is Whitfield Ltd), it is a sector (outside those LIC's with stock broking links) which has struggled to gain broader appeal in the Australian marketplace unlike its managed fund colleagues. On the flip side working in the favour of the LIC sector is a change to the Corporations Act allowing companies to pay a dividend if solvent (previous requirement was an accounting profit), which will appeal to many investors who seek a growing and consistent income stream, and recent FOFA legislation which should see more financial advisers consider LIC's as an alternative to managed funds.

STYLE BIAS RISK: Australian equity managers will either employ a Growth, Value or Neutral (combination of Value & Growth) styled approach to investing. Each style is conducive to certain market conditions, i.e. Growth should outperform Value in an upward trending market and vice versa in a downward trending market. As with Market Risk, investors should adhere to the fund's investment time frame to avoid short-term market movements and style impact.

LIQUIDITY RISK: This is the risk that a security in the portfolio cannot be traded quickly enough, due to insufficient trading volumes in the market.

FUND RISKS

Zenith has identified the following risks associated with PIC; this is not intended to highlight all possible risks:

MANAGER RISK: The success and profitability of PIC in part depends upon Perpetual's ability to deliver on its stated investment objective. Failure to do so will have a meaningful impact on the returns of PIC.

KEY PERSON RISK: As PM, the departure of Vince Pezzullo for the PIC would be a material loss for Perpetual. However this risk is mitigated in part by Perpetual's historically strong succession planning and overall team depth. Zenith also believes that the structured and robust nature of Perpetual's underlying investment process is readily transferable and is not strictly contingent on the continued presence of key individuals.

CURRENCY RISK: Given the capacity to invest in internationally listed companies, PIC may be exposed to fluctuations in the relevant price of the currency relative to the Australian dollar. Currency hedges may be undertaken, however these will only be implemented at the discretion of the PM.

TEAM STABILITY RISK: Over the past three years, there has been a high level of investment staff turnover, which may affect team dynamics and raises questions about Perpertual's ability to retain staff. Zenith believes it is now important for Perpetual's investment team to experience a period of stability.

PREMIUM / DISCOUNT TO NTA: The appetite for LIC's is cyclical and sentiment driven and this can result in inefficiencies with LIC's trading at either a greater (premium) or lesser (discount) value relative to the value of the underlying assets. Investors should excercise caution around trading patterns with some LIC's trading at large discounts (value traps) and large premiums (investors over paying for assets) which should be avoided.

PORTFOLIO RISK: PIC applies a concentrated, high conviction, benchmark unaware approach with a strong value bias. As such its returns may differ from other Australian equity funds or LIC's.

NET EXPOSURE RISK: it may take sometime for the portfolio to "get set" and fully exposed to the market. The fund manager has given an indication of up to 6 months. During this time investors may not be fully invested. Furthermore over the longer term, PIC has the ability within the mandate to hold up to a maximum 25% in cash if it can't see value in the market.

LISTING RISK: As a newly incorporated entity yet to be listed, there is a risk that PIC does not raise its minimum required $150 million. While PIC isn't leaning as heavily as some previous LIC's on its joint lead managers, Zenith has sensed some investor fatigue on capital raisings in the LIC sector and PIC has set a higher minimum than recent LIC IPOs (recent LIC's generally done at $50 million minimums).

QUALITATIVE DUE DILIGENCE

ORGANISATION

Perpetual Limited

Perpetual Limited (Perpetual) is an Australian listed investment company (ASX stock code: PPT) that consists of three core business units - Perpetual Investments; Perpetual Private; and Perpetual Corporate Trust. Within the Perpetual Investment division the business manages approximately $29.8 billion (as at 30 June 2014) across the following asset classes: Australian Equities, Fixed Income and Multi-Sector. The majority of this FUM is Australian Equities (approximately 73%) and this does create some single asset class concentration risk for the Perpetual Investments division.

Zenith has previously raised the issue of high turnover at the CEO level. Given the current CEO, Geoff Lloyd, has been in the position since February 2012, having led a transformation strategy, Zenith is comfortable with the current direction of the broader organisation.

Perpetual Equity Investment Company Limited

PIC has no paid employees.

The Board consists of the following individuals:

- Peter Scott, Not Independant Chairman, appointed 25 August 2014;
- Michael Gordon, Executive Director, appointed 25 August 2014;
- Virgina Malley, Independant, Non-Executive Director, appointed 25 August 2014;
- John Edstein, Independant, Non-Executive Director, appointed 26 September 2014; and
- Christine Feldmanis, Independant, Non-Executive Director, appointed 26 September 2014.

Peter Scott was appointed Chairman of Perpetual in 2010 and has a very strong finance and economic background. He has over 20 years of experience in corporate management in Australia, most recently as the CEO of MLC and previously as the Executive General Manager at National Australia Bank.

Michael Gordon was appointed as an Executive Director of Perpetual in 2013 and has over 30 years experience in financial services. Most recently he was Chief Investment Officer for Equities at BNP Paribas Investment Partners and has also had senior positions with Fidelity Investments International and Schroder Investment Management.

The three independent directors; Virgina Malley, John Edstein and Christine Feldmanis all bring a wealth of experience to the PIC Board. The composition of the Board complies with ASX corporate governance principles.

Annual remuneration for the Chairman is $50,000 and non-executive directors (NED's) is set at $40,000 per annum for the year ending 30 June 2015. No equity-based remuneration is in place for NED's. Executive Director Michael Gordon will receive no remuneration from PIC, instead being paid by Perpetual.

Zenith is currently comfortable with the composition of Board. Engagement by key investment personnel with shareholders is vital and has historically been a key driver of investor sentiment and can be a trigger for share price to NTA premiums or discounts. Zenith takes comfort from the fact that Perpetual's own listed status makes the awareness of these requirements ingrained inthe business.

INVESTMENT PERSONNEL

Name	Title	Tenure
Vince Pezzullo	Portfolio Manager	7 Yr(s)

The Perpetual equity investment team is led by Matt Williams, Head of Equities, who joined the Group in 1993. Zenith believes that Perpetual has successfully created a culture that promotes individual accountability but also spreads the portfolio management workload between the portfolio management team. In addition, we believe the team is one of the strongest in the Australian marketplace.

PIC's Portfolio Manager (PM) is Vince Pezzullo who is also a PM for the Perpetual Industrial Fund (50% of the portfolio) and Perpetual's Direct Equity Alpha Separately Managed Account (SMA). Pezzullo joined Perpetual in 2007, having previously worked as a senior portfolio manager at Deutsche Asset Management.

Perpetual's investment team consists of 18 investment professionals: six portfolio managers and 12 analysts. With the exception of two of the portfolio managers, each team member has specified stock and sector responsibilities, with the number of stocks each team member covers varying based on the individual's portfolio management responsibilities. Zenith believes that Perpetual has successfully created a culture that promotes individual accountability, whilst still providing analysts with the ability to leverage off the expertise of the broader Perpetual team.

While Perpetual's long running domestic equities capability is extremely well entrenched, the business has recently released their own global equities capability following a three year internal incubation period. This strategy (Perpetual Global Share Fund - PGSF) is currently expected to operate in parallel with the Perpetual Wholesale International Share Fund (managed by Wellington Management Company, LLP). The PGSF utilses the same investment process as Perpetual's domestic funds and has five of the equity team members focussed on its operation.

The level of resources under Pezzullo provides Zenith with a high level of confidence in Perpetual's ability to consistently cover its investment universe, and to continually add value for investors in the Fund.

Portfolio management and analyst remuneration pools are generally based on the performance of the investment team, but are also linked with the individual achievements of each team member. Bonus payments (for analysts), are generally based 50% on Fund performance, 40% on stock selection and 10% discretionary, with a substantial portion vested over three years to encourage team stability. Bonuses for portfolio managers has a greater weight to fund performance. Performance is assessed over one, two and three year periods.

The team has experienced some key changes over the past three years, most significantly the December 2011 announcement that John Sevior (prior Head of Equities and Portfolio Manager) would not be returning from long service leave.

Perpetual's investment team departures over the last four years are as follows:

- Simon Bridger, Portfolio Manager, resigned in September 2011. Bridger's responsibilities were transferred to Parkin for the Ethical SRI Strategy and Lanchester for the Sustainability Strategy.
- James Bruce, a Resources Portfolio Manager, departed in April 2012. Zenith views his departure as significant, however, we are confident the remaining two resources analysts are capable of providing analytical support for the resources sector for this Fund.
- Charlie Lanchester, previous Deputy Head of Australian Equities and portfolio manager for 70% of the ISF and the sustainable mandate, departed in September 2013.
- In May 2014, Sean Cunningham, the portfolio manager of the Pure Equity Yield Fund, left Perpetual after 18 years with the firm. Cunningham had no formal stock coverage responsibilities.

Perpetual have also added six equities analysts to the team over the past three years, bolstering the team depth. In terms of depth and experience, Zenith rates Perpetual highly. The team has an average of 15 years in the industry and an average tenure of 8 years with Perpetual. The investment team is also supported by well-resourced dealing and administration teams.

INVESTMENT PROCESS

PIC's investment objective is to provide investors with a growing income stream and long-term capital growth in excess of the S&P/ASX 300 Accumulation Index (net of fees), over rolling 5 year periods. Perpetual have stated that while they intend to hold global equities, they will use the S&P/ASX 300 Index as a informal benchmark as a measure of 'opportunity cost' when deploying funds offshore.

PIC is fundamentally a high conviction, benchmark unaware strategy. The investment mandate gives the flexibility to add additional alpha via exposure to offshore markets by allowing international securities up to 25%. PIC may also hold cash up to 25% to provide downside protection against equity market risk and flexibility where opportunities fail to meet their investment selection criteria.

Perpetual's investment process is based on the view that equity markets are semi-efficient and that this provides opportunities for the team to add value through the selection of high quality stocks trading at attractive prices. Perpetual believes the best way to identify such opportunities is through in-depth, fundamental, bottom-up research conducted internally.

The output of this fundamental research is a portfolio that tends to have a bias towards stocks with traditional "value" characteristics such as a low Price/Earnings or Price/Book ratios, as well as higher yielding companies.

Zenith views Perpetual's investment process as conceptually sound, rigorous and repeatable. Zenith takes confidence from the fact the process has consistently achieved its objectives over the long-term.

SECURITY SELECTION

As Perpetual operates a comprehensive suite of managed funds covering both Australian and Global equities markets, the bulk of the security selection process is undertaken by the analyst team as part of their coverage relevant to these other funds. PIC is ultimately a 'best ideas' vehicle, drawing from the stock selection and analysis undertaken by the wider team and overlaid with additional analysis from PM Vince Pezzullo to conform to PIC's strategy.

PIC's eligible universe includes all securities listed on the Australian Securities Exchange or an exchange outside Australia; however some potential investments are omitted due to size or liquidity issues.

Perpetual's standard stock selection process (for funds with global capacity), starts with a global screen which implements filters for valuation, size and quality to reduce the universe to a concentrated pool. The team then applies a quality filter which all potential candidates must pass. These tests include:

- *Quality of business* - a subjective call focusing on Porter factor analysis including the: barriers to entry; industry structure; competitive advantage.
- *Conservative debt* - net debt / equity ratio should be less than 50%, if not then the following is considered: interest cover must be three times or greater and debt payback period is a maximum of five years. For the banks the Tier 1 Capital ratio is used.
- *Sound management* - a subjective call focusing on factors such as: management's track record; capital management; ability to maximise shareholder value; and board of directors.
- *Recurring earnings* - a preference for companies that have a three year track record of generating earnings, or a demonstrated ability to provide visible earnings in the future.

Examples of stocks which fail this screen include highly levered companies. This screening process is undertaken using both internal data and consensus numbers. In addition to the screening filter, a formal report is prepared on the company. This report outlines how the company meets the set test criteria and also identifies any key risks associated with the company which may impact its balance sheet or the profit and loss statement. Analyst reports are then escalated to Matt Williams or Paul Skamvougeras, whose approval is needed before a stock is included into Perpetual's investment universe. Stocks in Perpetual's investment universe are monitored for adverse changes on a monthly basis. If breaches occur, they are brought to the attention of the investment team.

Stocks in Perpetual's investment universe are subject to a relative valuation process, which is designed to be flexible. For example, cyclical stocks may be valued using an assessment of potential P/E (Price to Earnings ratio) based on normalised market conditions, whilst growth companies may be valued using current price vs. future growth prospects, NPV and historic and forecast P/E. Whilst this flexibility in valuation techniques may generate inconsistencies in certain cases, Zenith is confident that Perpetual has the depth and experience of personnel, as well as an appropriate level of peer review to undertake this approach successfully.

The output from the fundamental research process is an analyst score which indicates the analyst's conviction in the stock and the expected level of outperformance that the stock will provide. The rating is used as one of the primary communication tools between the analyst and portfolio manager. Each stock is ranked from 1 to 5:

- *1*: Strong overweight - substantial outperformance
- *2*: Overweight - strong outperformance
- *4*: Underweight - underperformance / relative pricing too high
- *5*: Sell - fails the stock selection criteria step or is substantially overpriced

To promote the conviction of analyst recommendations, Perpetual analysts are not permitted to rate a stock 3 (hold), which is a structure that Zenith endorses. Ratings are then updated on an ongoing basis and are distributed to all members of the investment team.

Zenith believes Perpetual’s robust and transparent stock selection process provides a strong input for the construction of the Fund.

PORTFOLIO CONSTRUCTION

Although Portfolio Managers are ultimately responsible for all investment decisions, portfolio construction strongly leverages off the inputs of the stock selection process. PIC is generally built through the use of the analysts' best stock ideas. However, this is subject to the Portfolio Manager's qualitative view which considers:

- The stock’s availability
- Liquidity
- Portfolio constraints
- Any portfolio bias implications

Analysts construct their own hypothetical portfolios, which act as a guide for the portfolio managers in assessing the analyst’s level of conviction in a security. Despite the rigorous and structured process, the subjective input of the portfolio managers remain the key determinant of any portfolio construction decision.

Position sizing is relatively unconstrained with the only limits being a 15% single stock limit. Zenith considers these restrictions to be prudent, and highlights Perpetual's commitment to ensuring that the high levels of FUM across the business will not inhibit the performance of the individual funds.

PIC is expected to hold between 20 and 40 securities. Portfolio turnover is not targeted, however, it is expected to range between 30% p.a. and 50% p.a. PIC has the ability to hold up to 25% of the portfolio in cash to protect against downside equity market risk. While the global portion of the portfolio is unconstrained by sector and country, Zenith expects it to be highly US centric given the stock selection process and limitations on holdings. Investors should be cognisant that the portfolio construction strategy will result in additional concentration risk and portfolio returns substantially different to many more traditional benchmark aware strategies.

Perpetual employs a strong and consistent sell discipline, whereby securities will be sold down if the company fails the quality selection criteria, or if the stock’s current market price reaches an excessive and unsustainable level.

Given the size and reputation of Perpetual, it is typically one of the first managers sought out by brokers and company management. Zenith believes this is a competitive advantage for Perpetual as they are privy to public information and favourable transactions which many competitors may not have access to. Zenith notes that the individual fund portfolio managers ultimately decide whether their fund participates in particular Initial Public Offerings (IPOs) and placements. Where multiple funds have decided to participate, allocations will be distributed proportionately based on original order size. Zenith sees this as a positive as this was previously done on a dollar weighted basis which may have arguably placed funds with smaller FUM at a disadvantage.

Overall, Zenith is positive on Perpetual's portfolio construction process, as we believe it is structured to ensure a close connection between analyst research and the final portfolio.

OPERATIONAL DUE DILIGENCE

RISK MANAGEMENT

Portfolio Constraints	Description
Stock limits (%)	max: 15%
Cash (%)	max: 25%
No. of securities	20 to 40
- Australia	50 to 100
- International	0 to 25
Geographic Limits (%)	
Short selling (%)	
Unlisted Securities (%)	max: 10%

PIC's portfolio is significantly less constrained than its managed funds, being strongly benchmark unaware. There are no sector and geographic limitations to the portfolio with stock selection focussing heavily on what each brings to the portfolio rather than managing within hard risk constraints. Perpetual monitors for unintended and significant exposures to BARRA risk factors.

Standard portfolio monitoring occurs in a formal sense primarily through a monthly risk management report that outlines performance and risk factors. Examples of factors considered and analysed in the report include; fund performance attribution, individual analyst performance, portfolio and ranking changes, and BARRA analysis (ex-ante Tracking Error, risk decomposition, factor exposures, and stock contribution to active risk).

Zenith believes that the fundamental assessment conducted on the quality of a business is an important form of risk management, as the focus on the quality of a company minimises the stock specific downside risk in the portfolio.

Zenith is comfortable that Perpetual has strong risk management frameworks present throughout the business and that these are strictly adhered to at all stages of the investment process. While PIC represents the least constrained investment vehicle in their funds management business, Zenith is confident that their strong risk management focus will adequately manage the portfolio.

Zenith has continuously been impressed at the level of due diligence undertaken on each company that is represented in the portfolio, as well as the constraints placed on the portfolio, which we consider to be adequate in controlling the portfolio's exposures without constraining the ability to add value.

ADMINISTRATION & OPERATIONS

Dividend Policy

The Board intends to pay a dividend to shareholders twice a year. The amount of the dividend will be at the discretion of the Board and will depend on a number of factors, including future earnings, capital requirements, financial conditions, future prospects and other factors that the Board deem relevant.

It is the current Board policy that all dividends paid to shareholders will be franked to 100% or to the maximum extent possible.

INVESTMENT FEES

PIC will pay the Manager a management fee of 1.0% per annum on the furst $1bn and 0.85% p.a. thereafter. Fees are calculated and paid monthly in arrears. No performance fee is payable to the Manager.

LICs can broadly be categorised into two groups from a management and fee standpoint. Typically, those launched before 2003 have lower management costs (often not operating under an IMA) while those launched past this point tend to have base management fees more in-line with unlisted managed funds.

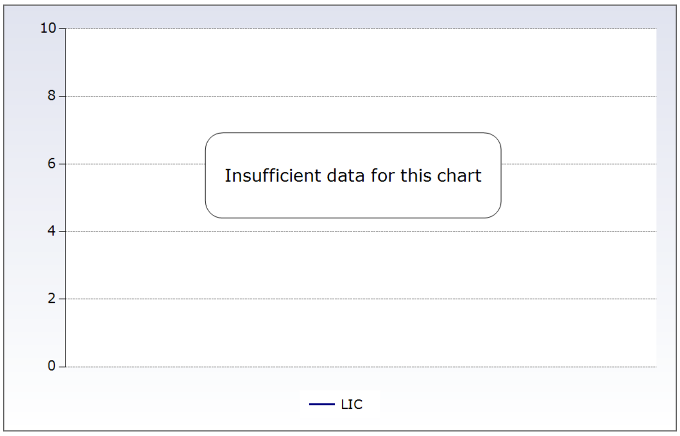
PIC's base management fee is broadly in-line with its peers in 'modern LICs' (IPO's from 2003 onward), which average 1.01% (Australian Equities).

It should be understood that the management fee only forms part of the overall cost of operating a LIC and the total attributable cost. This can only be accurately measured once PIC has at least its first years operations behind it.

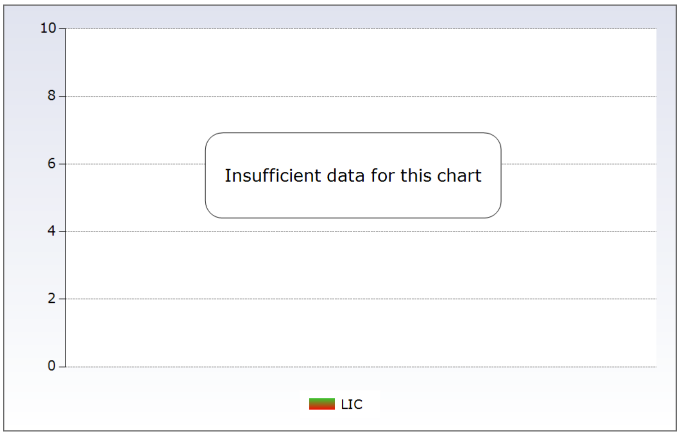
PERFORMANCE ANALYSIS

Monthly Performance History (%, net of fees)

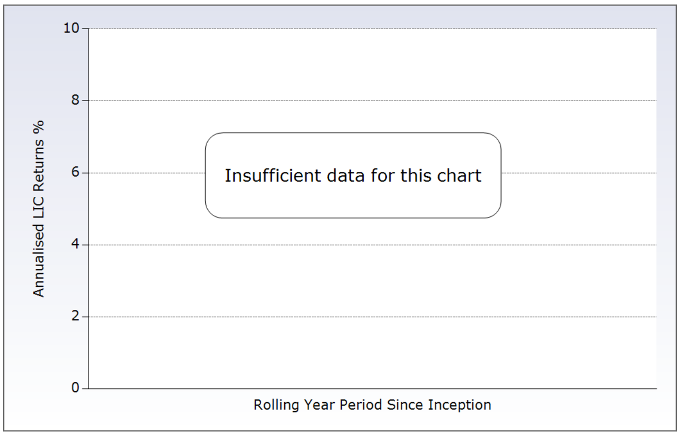
1 Yr % Rolling Excess Return



1 Yr % Rolling Return Range (Date range as above)



Minimum and Maximum Returns (% p.a.)



ABSOLUTE PERFORMANCE ANALYSIS

As at the date this rating was released, PIC has no performance track record.

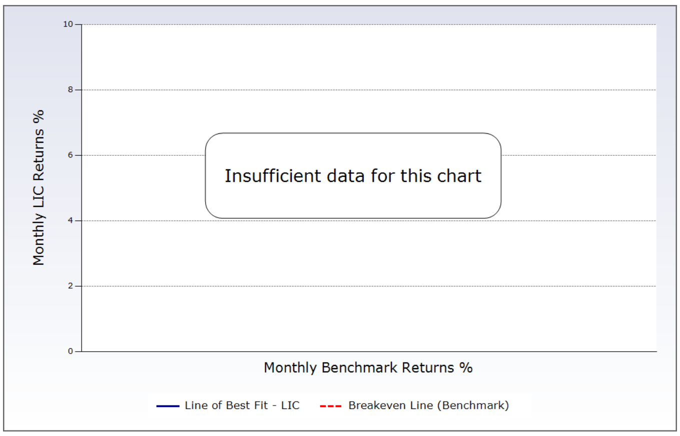
RELATIVE PERFORMANCE ANALYSIS

As at the date this rating was released, PIC has no performance track record. Given the unconstrained, high conviction nature of the strategy, along with the allocation to cash and global stocks, PIC's portfolio is expected to show a high level of tracking error in comparision to the benchmark index. The listed nature of the fund will also impact tracking error where investor sentiment moves the portfolio value away from the share price.

Monthly Return Scattergram

The following Monthly Return Scattergram Chart provides an insight into the skill of the manager, the risk profile of the manager (both absolute and relative) and the market conditions which favour the manager. The dot points represent the monthly returns of the fund (y-axis) and benchmark (x-axis) since inception or the past five years for funds with long histories. As a guide:

- A green dot point indicates the fund has outperformed in that month. A red dot indicates the fund has underperformed in that month.
- The blue line is a line of best fit of the fund returns and the red line is the breakeven line or benchmark line of best fit. The blue line crossing the y-axis above zero indicates investment outperformance (and vice versa)
- The slope of these lines provides an indication of the beta (market risk) of the investment and benchmark. The greater the slope the greater the risk.
- Often the blue line will cross with the red line at some point and this indicates that investment outperformance is better in certain market conditions (and vice versa).



While a specific level of income is not targeted, PIC is designed to deliver solid dividends. the LIC structure will also aid flexibility to dividend delivery and franking in comparison to managed funds given the inherent differences between the company and trust structures.

REPORT CERTIFICATION

Date of issue: 21 Oct 2014

Role	Analyst	Title
Author	Dugald Higgins	Senior Investment Analyst
Sector Lead	Dugald Higgins	Senior Investment Analyst
Authoriser	Bronwen Moncrieff	Head of Research

RATING HISTORY

As At	Rating
21 Oct 2014	Recommended
Last 5 years only displayed. Longer histories available on request.	

ZENITH RESEARCH METHODOLOGY & REGULATORY COMPLIANCE

Zenith Investment Partners ("Zenith") ABN 60 322 047 314 provides the following guidelines on Zenith's processes and procedures relating to research services, research methodologies and conflict of interest management. Detailed information on Zenith's Research Methodology & Regulatory Compliance can be accessed via the Zenith website.

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The Zenith rating referred to in this document is limited to "General Advice" (as defined by section 766B of Corporations Act 2001) for Wholesale clients and based solely on the assessment of the investment merits of the financial product on this basis. This advice has been prepared without taking into account the objectives, financial situation or needs of any specific person who may read it. It is not a specific recommendation to purchase, sell or hold the relevant product(s). Zenith advises that investors should seek their own independent financial advice before making an investment decision and should consider the appropriateness of this advice in light of their own objectives, financial situation or needs. Investors should obtain a copy of, and consider, the product PDS before making any decision. This report is prepared exclusively for clients of Zenith. The material contained in this report is subject to copyright and may not be reproduced without the consent of the copyright owner. The information contained in the report is believed to be reliable, but its completeness and accuracy is not guaranteed. Zenith accepts no liability, whether direct or indirect arising from the use of information contained in this report.

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Zenith is the holder of Australian Financial Services License No. 226872 which was issued by the Australian Securities & Investments Commission (ASIC) on 10 April 2003 for the purposes of providing ***General Advice*** as defined under the Corporations Act 2001. Further information on the services we are licensed to provide and our expertise can be found on the Research Methodology & Regulatory Compliance page of the Zenith website.

CURRENCY OF RATING

This Research Report and Rating is current as at the date it is issued and is valid until it is updated, replaced or withdrawn. Research Reports will be subject to future updates on an ongoing basis unless the Rating is Withdrawn. The Rating may be subject to change without notice and clients are advised to check currency via the Zenith website. Further information on Currency of Ratings is available on the Zenith website.

COVERAGE POLICY

Zenith's coverage policy defines the investment universe of products which are potentially eligible to receive an investment rating. This universe primarily focuses on those products available to financial advisers via the major wrap platforms and master trusts. Products predominantly encompass Unlisted Managed Funds and Listed Managed Investments available via the ASX.

Zenith also includes in its coverage policy products in several asset classes which are traditionally only available directly 'off-platform'. These asset classes include sectors such as Unlisted Direct Property Funds and products in the Alternatives asset class including Hedge Funds and Private Equity Funds. Detailed information on Zenith's coverage policy, processes, sector classifications and current coverage list can be found on the Research Methodology & Regulatory Compliance page of the Zenith website.

CONFLICT POLICY

Zenith maintains a Conflict Management Policy regarding the provision of non-research services to Product Issuer's, Fund Managers or other related parties relevant to the investment being rated. This policy relates to the provision of;

- Underwriting, managerial, consultancy or market making services to such parties;
- Whether such parties are a corporate client of Zenith;
- Whether such parties are related or otherwise associated with Zenith.

Any conflicts relating to these issues will be prominently disclosed on the relevant Zenith Product Assessment Report. Further details on Zenith's Conflict Policy can be found on the Research Methodology & Regulatory Compliance page of the Zenith website.

FEE FOR SERVICE

Zenith charges an upfront flat fee to the Product Issuer, Fund Manager or other related parties to produce research on funds that conform to our Research Methodology (Direct business model). This fee is to compensate Zenith for the work required to undertake the process and is not linked to the rating outcome. Fees are generally standardised within each sector however a small number of sectors (typically those dealing with real assets) are charged based on individual complexity. Further details on how the fee for service arrangement is managed can be found on the Research Methodology & Regulatory Compliance page of the Zenith website and also in Zenith's Financial Services Guide (FSG).

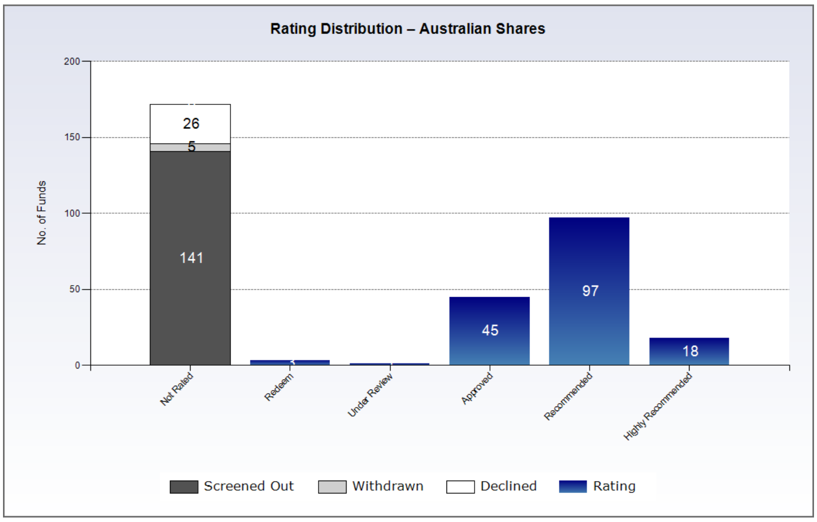
Zenith has charged Perpetual Investment Management Limited a fee to produce this report.

ANALYST CERTIFICATION & DISCLOSURE

Analyst remuneration is not linked to the rating outcome. Analysts holdings in investment products must be non-material and done in accordance with Zenith's Trading Policy. The Analyst certifies that the views expressed in the Product Assessment accurately reflect their personal, professional opinion about the financial product to which this report refers.

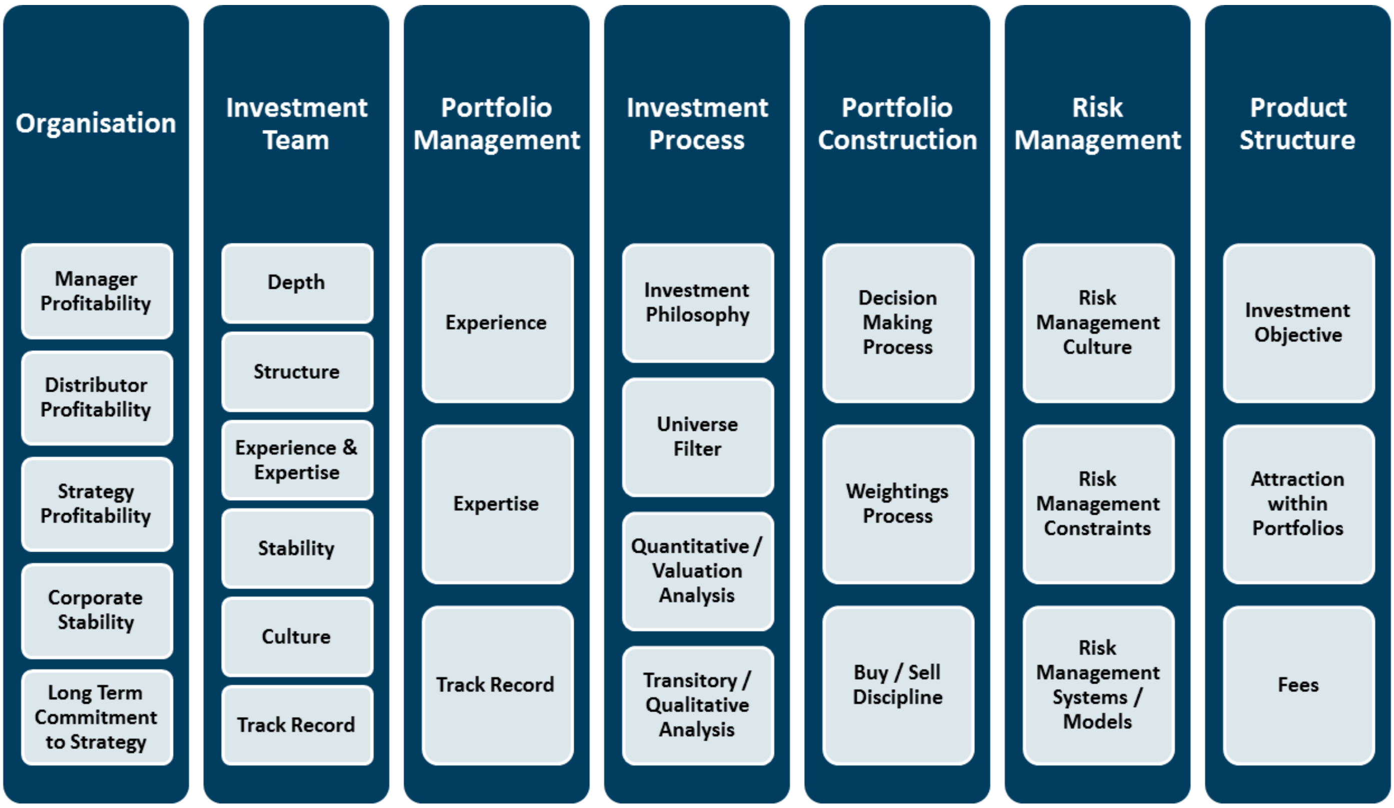
ZENITH RATING DISTRIBUTION

The following chart shows the current breakdown of Zenith's ratings as at the date of viewing. Ratings are based on the relevant fund peer group as determined by Zenith and include Parent funds only. Users can access more detailed information on ratings spreads on the Research Methodology & Regulatory Compliance page of the Zenith website.



Ratings Methodology

Zenith's ratings are based on the output of a proprietary scoring model. This model and its broad factors are shown in the following diagram. Please note we do not disclose the weightings of factors and sub-factors change for each sector. This information should be used as a guide only.



Ratings Bands

Based on the scores assigned by Zenith's analysts for the above mentioned proprietary scoring model, a rating of Highly Recommended, Recommended, Approved or Not Approved is applied to all funds that have undergone full due diligence by the Zenith research team. As shown in the following table the ratings are determined based on the overall score out of 100. Funds may also be screened prior to conducting full due diligence based on qualitative or quantitative concerns as Zenith's research model aims to focus on the best investments in each sector.

Rating	Scoring Output (%)	Confidence in Meeting Objectives	Zenith Approved List
Highly Recommended	>= 80	Very High	YES
Recommended	>= 70 - 79	High	YES
Approved	>= 55 - 69	Moderate	YES
Not Rated - Declined	N/A	No previous rating held. The fund has passed Zenith's preliminary screen however the issuer has declined to participate in a full due diligence review.	
Not Rated - Withdrawn	N/A	Previous Zenith rating withdrawn due to either: Zenith downgrading the rating to below investment grade; the issuer electing to cease ongoing coverage; the fund has been closed to investment; or the fund has been terminated and wound up.	
Not Rated - Screened Out	< 55	No previous rating held. The fund has either passed Zenith's preliminary screen but failed the full due diligence process; failed Zenith's preliminary screen making it ineligible for a full due diligence review; or is yet to be included in Zenith's preliminary screen or sector review process.	
Redeem	N/A	Previous rating removed where there has been a significant event that Zenith strongly believes will severely impacts the product to such an extent that investors are advised to redeem (withdraw) their investment.	

The performance of the investment in this report is not a representation as to future performance or likely return.

ABSOLUTE RISK RATING

The Absolute risk rankings should be viewed as a guide to potential capital volatility (in both gains and losses) of the relevant investment strategy (Zenith Asset Class / Sub Asset Class classification) of this product. A number of factors have been considered in setting this risk level. For liquid asset classes, we have typically used the underlying historical return volatility of the product's benchmark if the benchmark is a reasonable proxy for returns for this strategy. Where the risk of an investment cannot be reasonably estimated by historical benchmark return analysis, we have made a qualitative assessment of absolute risk and considered factors such as illiquidity risk, transparency, strategy risk, operational risk etc.

VERY HIGH	Funds classified as Very High risk are exposed to sectors with very high historical absolute volatility (typically a 16+% p.a. plus standard deviation over a rolling 20 year period). Where the risk of an investment cannot be reasonably estimated by historical return analysis, we have considered a range of qualitative risks in assigning a Very High absolute risk level.
HIGH	Funds classified as High risk are exposed to sectors with high historical absolute volatility (typically a 8-16% p.a. standard deviation over a rolling 20 year period). Where the risk of an investment cannot be reasonably estimated by historical return analysis, we have considered a range of qualitative risks in assigning a High absolute risk level.
MODERATE	Funds classified as Moderate risk are exposed to sectors with moderate historical absolute volatility (typically a 4-8% p.a. standard deviation over a rolling 20 year period). Where the risk of an investment cannot be reasonably estimated by historical return analysis, we have considered a range of qualitative risks in assigning a Moderate absolute risk level.
LOW	Funds classified as Low risk are exposed to sectors with low historical absolute volatility (typically a 2-4% p.a. standard deviation over a rolling 20 year period). Where the risk of an investment cannot be reasonably estimated by historical return analysis, we have considered a range of qualitative risks in assigning a Low absolute risk level.
VERY LOW	Funds classified as Very Low risk are exposed to sectors with very low historical absolute volatility (typically a <2% p.a. standard deviation over a rolling 20 year period). Where the risk of an investment cannot be reasonably estimated by historical return analysis, we have considered a range of qualitative risks in assigning a Very Low absolute risk level.

RELATIVE RISK RATING

The relative risk rankings should be viewed as a guide to the relative risk of a product within its sector. The relative risk levels are listed from high to low and are intended to provide some insight into the potential divergence of the investment's return profile relative to its assigned benchmark.