Zenith Investment Partners

Highly Recommended
Recommended
Approved
Not Rated
Redeem

Product Assessment

Perpetual Equity Investment Company Limited

Report data as at 30 Apr 2016
Rating issued on 06 Jun 2016

APIR Code
ASX:PIC

Buy / Sell Price: 3-Jun-16
A$0.94 / A$0.95

Asset / Sub-Asset Class
Australian Shares
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)

Net Returns (% p.a.)

	1 yr	6 mth	3 mth
LIC	-3.28	-4.75	-0.74
Benchmark	-4.67	2.66	6.42

Fees (% p.a., Incl. GST)
Management Cost: 1.10%
Performance Fee: N/A

VIEWPOINT & RATING

Perpetual Equity Investment Company Limited (ASX:PIC) Listed Investment Company (LIC) managed by Sydney-based fund manager, Perpetual Limited (Perpetual). While PIC will predominantly invest in a diversified portfolio of Australian stocks, to increase flexibility and the opportunity set, Perpetual may also invest up to 25% in global shares and 25% in cash. PIC will be managed in accordance with Perpetual's long standing and successful quality and value orientated investment style. 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. **Zenith rates PIC RECOMMENDED.**

Sydney based, Perpetual Limited (Perpetual) is an ASX listed investment company (ASX stock code: PPT) that consists of three core business units - Perpetual Investments; Perpetual Private; and Perpetual Corporate Trust. The Perpetual Investment division had approximately $29.8 billion in funds under management, as at 31 March 2016.

The Perpetual equity investment team is led by Paul Skamvougeras, who assumed responsibility in April 2015. Nathan Parkin was also promoted to Deputy Head of Equities. Prior to this, the team was led by Matt Williams, who retired in September 2015.

Although Zenith held Williams in high regard, we believe Perpetual's strong investment process and succession planning has placed it in a solid position to manage his departure. In addition, Zenith rates Skamvougeras highly and believes he has the requisite skills to lead Perpetual's strong investment team of 23 investment professionals, which includes 7 portfolio managers and 16 analysts.

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 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.

Vince Pezzullo retains total responsibility for investment decisions for PIC, 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 is particularly relevant to PIC as a high conviction, concentrated vehicle with more of an absolute return focus than many of Perpetual's other equities funds. Perpetual does not permit analysts to assign a hold rating to a security, believing 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.

LIC FACTS

- Concentrated exposure of between 20 and 40 securities
- Mid-cap bias with capacity to hold up to 25% in each of international securities and cash
- Trading at a 8.8% discount to NTA as at 30 April 2016
- Market capitalisation of $235 million as at 30 April 2016

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

APPLICATIONS OF INVESTMENT

SECTOR CHARACTERISTICS

Listed Investment Companies (LIC)

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 Net Tangible Assets (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
- Returns generated internally by the investment portfolio

For comparison purposes, the use of the internal portfolio returns versus the benchmark gives the closest measure of the investment manager's skill 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 the 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 NTA which may represent good buying or selling opportunities. While these instances may boost investment returns, there is no guarantee that the discount or premium will converge to NTA, therefore, gains can not be crystallised.

Australian Equities

The sector incorporates both benchmark aware and benchmark unaware strategies but the funds focus 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.

Zenith benchmarks all funds in this space against the S&P/ASX 300 Accumulation Index, believing it is a fair representation of the investment universe for the underlying managers. However, many managers in this category benchmark their funds against the S&P/ASX 200 Accumulation Index. Both indices are market-capitalisation weighted, resulting in those companies with the largest market capitalisations receiving the heaviest weightings within the index. Over the longer-term, Zenith believes there will be minimal difference between the return profiles of these indices.

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

As at 30 April 2016, 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 15%. The split between Industrials and Resources stocks was approximately 85%/15%. The top 10 stocks represented approximately 45% of the weighting of the index, and the top 20 stocks represented over 60% 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.

Zenith benchmarks all funds in this sector against the MSCI World Index ex-Australia, which corresponds with 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 (Austria, Belgium, Canada, Denmark, Finland, France, Germany, Hong Kong, Ireland, Israel, Italy, Japan, Netherlands, New Zealand, Norway, Portugal, Singapore, Spain, Sweden, Switzerland, the United Kingdom, and the United States) 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, as represented by the MSCI World Index ex-Australia, 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 Health care, 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.

Zenith believes PIC may 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% p.a. to 50% p.a., which Zenith considers to be low to moderate. 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 cognisant of the tax impacts of capital gain realisation when making investment decisions, in the case of PIC, Perpetual 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 LICs have been 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% p.a. to 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 & ECONOMIC RISK: As is the case with all long only Australian Share funds, the biggest risk to performance is a sustained downturn across the Australian share market. In addition, changes in economic, social, technological or political conditions, as well as market sentiment could also lead to negative fund performance. This risk can be significantly reduced by investors adhering to the LIC's prescribed investment time frame.

SPECIFIC SECURITY RISK: This is the risk associated with an individual security. The price of shares in a company may be affected by unexpected changes in that company's operations such as changes in management or the loss of a significant customer.

LIQUIDITY RISK: This is the risk that a security or asset cannot be traded quickly enough, due to insufficient trading volumes in the market. When trading volumes are low, sellers can significantly impact the price of a security when attempting to quickly exit a material position.

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 LIC's investment time frame to avoid short-term market movements and style impact.

CAPACITY RISK: High levels of funds under management (FUM) can present additional challenges to an Australian equity manager, as high FUM has the potential to hamper the manager's ability to trade efficiently and/or be forced to disclose substantial shareholdings to the market (most common in smaller companies).

PREMIUM / DISCOUNT TO NET TANGIBLE ASSETS (NTA): The appetite for LICs can be cyclical and sentiment driven and this can result in inefficiencies with LICs trading at either a greater (premium) or lesser (discount) value relative to the value of the underlying assets. There continues to be several LICs trading at large discounts (value traps) and large premiums (investors over paying for assets) which should be avoided.

FUND RISKS

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

CAPACITY/LIQUIDITY RISK: Perpetual had approximately $21.5 billion (as at 31 March 2016) in Funds under Management (FUM) across its Australian equity suite of products and, as such, capacity and liquidity risk management is particularly important. Having high levels of FUM may present additional challenges to Perpetual, as it has the potential to hamper a fund manager's ability to trade efficiently. Whilst Zenith believes this level of FUM is at the upper end of what can reasonably be managed within Australian equities, we acknowledge that, to date, Perpetual has managed its significant level of FUM well, displaying a historical ability to consistently generate outperformance across its product suite.

Given that PIC exhibits a mid cap bias, Zenith believes the potential exists for Perpetual (across all strategies) to be holding a material portion of the available equity of a company, which has the potential to restrict Pezzullo's ability to effectively trade the portfolio. This risk is mitigated by Perpetual's limit in only holding 15% of the issued equity of a company (across all strategies).

In addition, Perpetual's main institutional large cap Australian shares strategies are closed to new institutional investors, with inflows coming solely from existing institutional investors and retail wrap platforms. Zenith will continue to monitor Perpetual's FUM closely, to ensure that excessive FUM does not impact the Fund's performance.

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 the portfolio manager for PIC, the departure of Vince Pezzullo would be a material loss. However, Zenith believes this risk is mitigated in part by Perpetual's historically strong succession planning and overall team depth. We also believe 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.

TRACK RECORD RISK: Zenith notes that the Fund's strategy was not run in simulation mode or incubated internally prior to its launch in January 2015. While Zenith acknowledges that there is a limited performance track record, we draw comfort from Pezzullo's track record managing Perpetual's Industrial Share Fund and Perpetual's prudent and long standing investment process.

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 Pezzullo's discretion.

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 Perpetual's ability to retain staff. Zenith believes it is now important for Perpetual's investment team to experience a period of stability.

PORTFOLIO MANAGER FOCUS: In addition to PIC, Pezzullo is responsible for Perpetual's Industrial Share Fund, which holds substantially more FUM. While Zenith acknowledges that there are some overlap in holdings between the funds, we believe that Pezzullo's other commitments have the potential to draw his focus away from this Fund.

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 and the benchmark.

QUALITATIVE DUE DILIGENCE

ORGANISATION

Perpetual Limited

Sydney based, 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 managed approximately A$29.8 billion (as at 31 March 2016) across the following asset classes: Australian Equities, Fixed Income and Multi-Sector. The majority of this FUM is in Australian Equities and this does create some single asset class concentration risk for the Perpetual Investments division.

Perpetual Equity Investment Company Limited

PIC has no paid employees.

The Board consists of the following individuals:

- Peter Scott, Not Independent Chairman, appointed 25 August 2014
- Virgina Malley, Independent, Non-Executive Director, appointed 25 August 2014
- John Edstein, Independent, Non-Executive Director, appointed 26 September 2014
- Christine Feldmanis, Independent, Non-Executive Director, appointed 26 September 2014
- David Kiddie, Executive Director, appointed 12 May 2016

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.

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 Net Tangible Assets (NTA) premiums or discounts. Zenith takes comfort from the fact that Perpetual's own listed status makes the awareness of these requirements ingrained in the business.

As at 30 April 2016, PIC had a market capitalisation of $235 million.

INVESTMENT PERSONNEL

Name	Title	Tenure
Vince Pezzullo	Portfolio Manager	8 Yr(s)

The Perpetual equity investment team is led by Paul Skamvougeras, who assumed responsibility in April 2015. Nathan Parkin was also promoted to Deputy Head of Equities. Prior to this, the team was led by Matt Williams, who retired in September 2015.

Although Zenith held Williams in high regard, we believe Perpetual's strong investment process and succession planning has placed it in a solid position to manage his departure. In addition, Zenith rates Skamvougeras highly and believes he has the requisite skills to lead Perpetual's strong investment team.

Including Skamvougeras, the investment team covering Australian equities consists of 15 investment professionals which include six portfolio managers and nine analysts. With the exception of two 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.

The global equities team is led by Garry Laurence who is supported by seven dedicated global equities analysts who have specified stock and sector responsibilities. While Australian equities is the focus of the broader team, Zenith notes that global equities have been opportunistically covered since 2006 with strong success. In addition, Zenith draws further comfort from the oversight of the investment process provided by senior members of Perpetual's equities team, who we rate highly.

Vince Pezzullo retains ultimate responsibility for investment decisions with regards to PIC. Pezzullo is also responsible for Perpetual's Industrial Fund and Direct Equity Alpha Separately Managed Account (SMA). Pezzullo has over 20 years investment management experience and joined Perpetual in 2007, having previously worked as a senior portfolio manager at Deutsche Asset Management.

The level of resources supporting 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 PIC.

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 portfolio managers are aligned to the performance of their funds. 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.

Whilst the team has experienced some key changes over recent times, Zenith draws considerable comfort from Perpetual's well-founded succession planning structure. This structure provides portfolio management experience to highly regarded internal candidates, through a progressive multi-portfolio manager structure. This practise has been in place for many years.

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 five 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 excess returns 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. In addition, Perpetual state that due to their quality filters, the equity portfolios also tend to have significantly lower net debt / equity ratios and higher interest cover than the broad equities benchmark.

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

SECURITY SELECTION

As Perpetual operates a comprehensive suite of strategies 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 particular strategies. 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 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 strategies 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 (five times for pre-production companies) and debt payback period is a maximum of five years. For the banks, the Tier 1 Capital ratio is used.
- *Sound management* - a subjective assessment 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. Pre-production companies are required to be expecting income within two years.

Examples of stocks which fail this screen include highly levered companies. The 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. The reports are then escalated to Paul Skamvougeras or Nathan Parkin, whose approval is needed before a stock is included in Perpetual's investment universe (PU). Stocks in PU are monitored for adverse changes on a monthly basis. If breaches occur, they are brought to the attention of the investment team.

Stocks in PU 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 Price to Earnings ratio (P/E) based on normalised market conditions, whilst growth companies may be valued using current price vs. future growth prospects, Net Present Value (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 PIC.

PORTFOLIO CONSTRUCTION

Although Pezzullo is 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 Pezzullo'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 Pezzullo in assessing the analyst's level of conviction in a security. Despite the rigorous and structured process, Pezzullo's subjective input remains the key determinant of any portfolio construction decision.

PIC is expected to hold between 20 and 40 securities. Position sizing is highly unconstrained with the only restriction being a 15% single stock limit. Although Zenith believes this constraint is very broad, we note that it is consistent with PIC's high conviction and concentrated approach.

PIC has the ability to hold up to 25% of the portfolio in cash to protect against downside equity market risk. Investors should be cognisant that the portfolio construction strategy will result in additional concentration risk and portfolio returns that are substantially different to the 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.

Portfolio turnover is not targeted, however, it is expected to range between 30% p.a. and 50% p.a.

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 portfolio managers ultimately decide whether their strategy participates in particular Initial Public Offerings (IPOs) and placements. Where multiple strategies 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 strategies 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.

RISK MANAGEMENT

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

PIC's portfolio constraints are listed in the table above. Consistent with its highly benchmark unaware approach, portfolio constraints are very broad. 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 risk factors identified by the BARRA risk system.

Standard portfolio monitoring occurs formally 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
- 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.

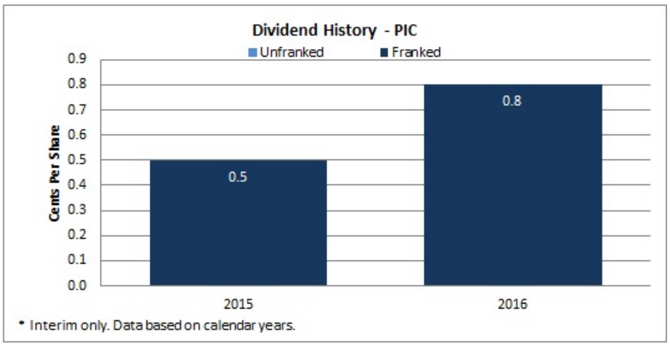
Zenith is comfortable that Perpetual has strong risk management frameworks present throughout the business and that these are strictly adhered to at all stages of the investment process. While PIC represents the least constrained investment vehicle in their funds management business, Zenith is confident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

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.

PIC paid its maiden dividend in August 2015, representing a net yield of 1.39% as at 30 April 2016.



INVESTMENT FEES

PIC will pay Perpetual a management cost of 1.1% p.a. inclusive of GST (1% p.a. exclusive of GST) on the first $1 billion and 0.935% p.a. inclusive of GST (0.85% p.a. exclusive of GST) thereafter. Fees are calculated and paid monthly in arrears. No performance fee is payable to Perpetual.

LICs can broadly be categorised into two groups from a management and fee standpoint on the basis of whether they are internally or externally managed (operating under an investment management agreement). Typically, internally managed LICs have lower proportional management costs due to a larger asset pool. Externally managed LICs tend to have management costs more in-line with unlisted managed funds. PIC's management cost is broadly in-line with externally managed LICs.

Fee Type	LIC / Peer Group	Fee %
Management Cost	Perpetual Equity Investment Company Limited	1.10%
Sector Average - Internally managed [1]	Australian Equities LICs	0.30%
Sector Average - Externally managed		1.11%
Performance Fee	Nil.	

[1] Internally Managed LICs data use published MER's as at 31 March 2016 and are ex-GST. All other fees are inclusive of GST. Source: ASX, Zenith.

PERFORMANCE ANALYSIS

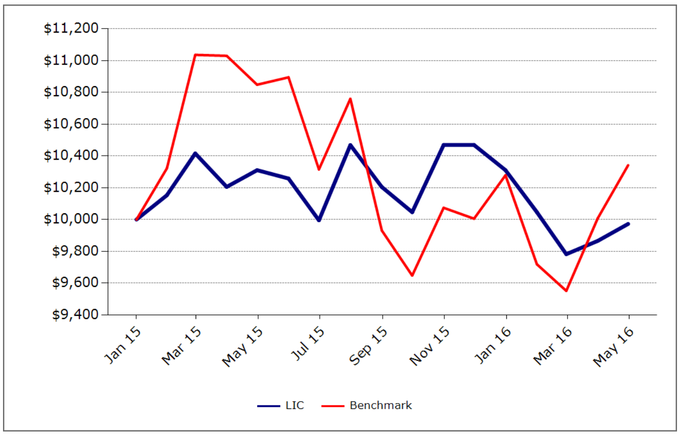
Report data: 30 Apr 2016, product inception: Jan 2015

Monthly Performance History (%, net of fees)

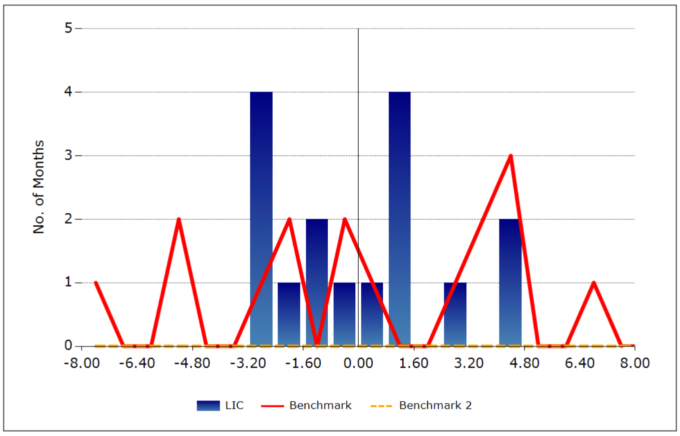
	JAN	FEB	MAR	APR	MAY	JUN	JUL	AUG	SEP	OCT	NOV	DEC	LIC YTD	BENCHMARK YTD
2016	-2.56	-2.63	0.86	1.08									-3.28	0.62
2015	1.53	2.59	-2.02	1.03	-0.51	-2.56	4.74	-2.52	-1.55	4.21	0.00	-1.52	3.11	2.79

Benchmark: S&P/ASX 300 (Accum)

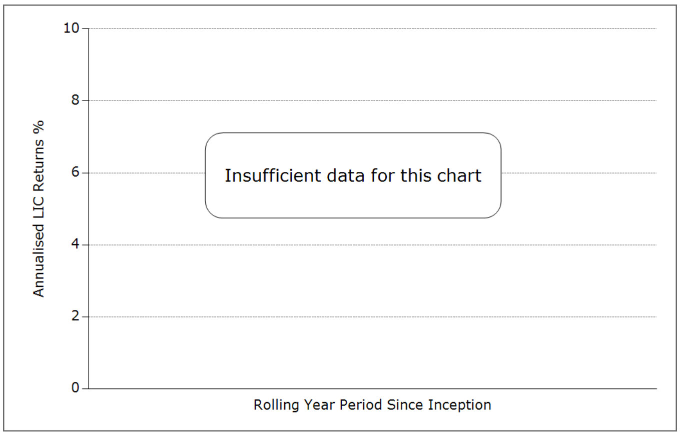
Growth of $10,000



Monthly Histogram



Minimum and Maximum Returns (% p.a.)



ABSOLUTE PERFORMANCE ANALYSIS

Return	Incpt.	1 yr	6 mth	3 mth
LIC (% p.a.)	-0.21	-3.28	-4.75	-0.74
Benchmark (% p.a.)	2.56	-4.67	2.66	6.42
Ranking within Sector	**Incpt.**	**1 yr**	**6 mth**	**3 mth**
Fund Ranking	21 / 38	21 / 39	39 / 43	28 / 44
Quartile	3rd	3rd	4th	3rd
Standard Deviation	**Incpt.**	**1 yr**	**6 mth**	**3 mth**
LIC (% p.a.)	8.11	8.53	5.27	5.89
Benchmark (% p.a.)	14.18	14.40	12.09	9.66
Downside Deviation	**Incpt.**	**1 yr**	**6 mth**	**3 mth**
LIC (% p.a.)	3.84	3.92	4.07	4.30
Benchmark (% p.a.)	8.27	9.05	6.76	2.81
Risk/Return	**Incpt.**	**1 yr**	**6 mth**	**3 mth**
Sharpe Ratio - LIC	-0.31	-0.65	-1.12	-0.22
Sortino Ratio - LIC	-0.66	-1.41	-1.45	-0.31

Readers should note that unless otherwise indicated, all performance, consistency and Risk/Return data is referenced to the Zenith assigned benchmark and returns are those to shareholders (i.e. share price + dividends).

All commentary below is at 30 April 2016.

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 five year periods. PIC has yet to gain a sufficient track record to determine its success in achieving these objectives.

LIC Specific Considerations

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 Net Tangible Assets (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:

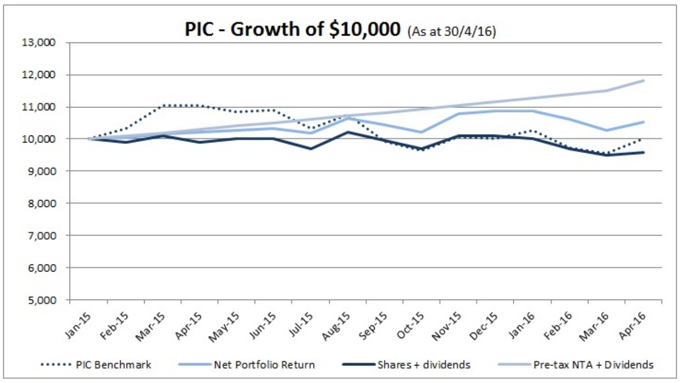
- Share price and dividends
- Change in pre-tax NTA value and dividends
- Returns generated internally by the investment portfolio

For comparison purposes, the use of the internal portfolio returns versus the benchmark gives the closest measure of the investment manager's skill 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 the 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 NTA which may represent good buying or selling opportunities. While these instances may boost investment returns, there is no guarantee that the discount or premium will converge to NTA, therefore, gains can not be crystallised.

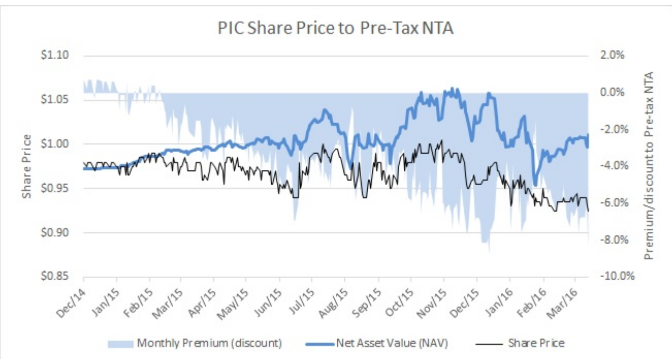
The key performance indicators in the chart below shows the performance of the PIC portfolio (net of fees).



Share Price vs. NTA

PIC was trading at 8.8% discount to NTA as at 30 April 2016.

The following chart shows PIC's premium/discount since inception. It should be noted that PIC currently has 249.6 million unexercised options on issue which if exercised may have a temporarily dilutionary effect (current shares on issue was 251 million as at 30 April 2016).



WARNING: Zenith ratings applied to LIC's do not explicitly take into account share prices vs. NTA and do not represent a buy/sell recommendation based on a LICs valuation. Potential investors should make their own determination of the appropriateness of prevailing premiums or discounts to NTA when acquiring or disposing of a LIC.

RELATIVE PERFORMANCE ANALYSIS

Alpha Statistics	Incpt.	1 yr	6 mth	3 mth
Excess Return (% p.a.)	-2.76	1.39	-7.41	-7.15
% Monthly Excess (All Mkts)	43.75	50.00	33.33	0.00
% Monthly Excess (Up Mkts)	12.50	16.67	0.00	0.00
% Monthly Excess (Down Mkts)	75.00	83.33	66.67	0.00
Beta Statistics	**Incpt.**	**1 yr**	**6 mth**	**3 mth**
Beta	0.45	0.47	0.33	0.59
R-Squared	0.61	0.63	0.59	0.93
Tracking Error (% p.a.)	9.36	9.24	8.73	4.27
Correlation	0.78	0.79	0.77	0.96
Risk/Return	**Incpt.**	**1 yr**	**6 mth**	**3 mth**
Information Ratio	-0.30	0.15	-0.85	-1.68

All commentary below is at 30 April 2016.

It is important to note that the Relative Performance Analysis shown above combines the LICs share price returns with dividends to give the reader detail on the investor experience.

In order to provide statistics that display the portfolio performance alone as an indicator of the manager's skill, we have also provided the same statistics below on the underlying investment portfolio. PIC is benchmarked against the S&P/ASX 300 Index.

PIC Portfolio Performance Statistics

Alpha Statistics	Incpt.	1 yr	6 mth	3 mth
Excess Return (% p.a.)	2.48	8.63	-3.80	-5.91
% Monthly Excess (All Mkts)	56.25	58.33	33.33	0.00
% Monthly Excess (Up Mkts)	25.00	33.33	0.00	0.00
% Monthly Excess (Down Mkts)	87.50	83.33	66.67	0.00
Beta Statistics	**Incpt.**	**1 yr**	**6 mth**	**3 mth**
Beta	0.41	0.51	0.48	0.91
R-Squared	0.55	0.65	0.67	1.00
Tracking Error (% p.a.)	9.87	8.86	7.49	0.92
Correlation	0.74	0.81	0.82	1.00
Risk/Return	**Incpt.**	**1 yr**	**6 mth**	**3 mth**
Information Ratio	0.25	0.97	-0.51	-6.42

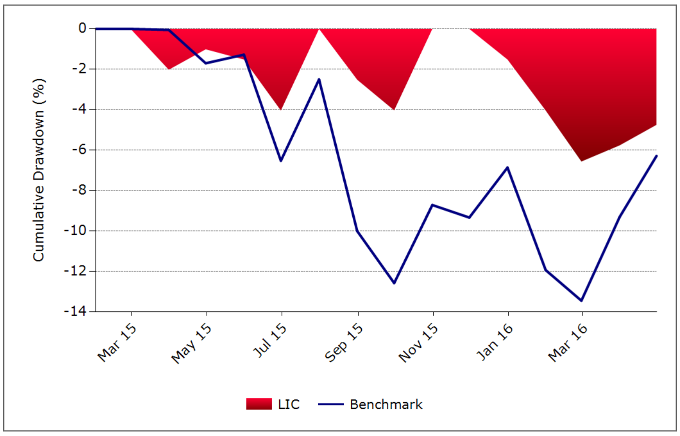
As at 30 April 2016. NOTE: Benchmark is the S&P/ASX 300 Accumulation Index. Unlike the Relative Performance Analysis table, the statistics for the PIC Portfolio are static.

DRAWDOWN ANALYSIS

Drawdown analysis assesses the relative riskiness of a Fund versus the benchmark, in reference to capital preservation. The maximum Drawdown is recorded as the percentage decline in the value of a portfolio from peak to trough (before a new peak is achieved). All Drawdown analysis is calculated commencing from the inception date of the Fund in question, and Drawdown analysis for the Fund and benchmark(s) are calculated independently. That is, the largest drawdown for the Fund and benchmark(s) will not always refer to the same time period.

Drawdown Analysis	LIC	Benchmark
Max Drawdown (%)	-6.57	-13.46
Months in Max Drawdown	3	12
Months to Recover	-	-

Worst Drawdowns	LIC	Benchmark
1	-6.57	-13.46
2	-4.04	
3	-4.03	
4		
5		



All commentary below is at 30 April 2016.

Given PIC's December 2014 inception, there is currently insufficient performance history to conduct meaningful analysis. However, consistent with the Fund's investment philosophy, drawdowns have been smaller than that of the benchmark.

REPORT CERTIFICATION

Date of issue: 6 Jun 2016

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

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RATING HISTORY

As At	Rating
6 Jun 2016	Recommended
20 Mar 2015	Recommended
2 Feb 2015	Recommended
21 Oct 2014	Recommended

As At	Rating

Last 5 years only displayed. Longer histories available on request.

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