Highly Recommended
Recommended
Approved
Not Rated
Redeem

Product Assessment

Perpetual Equity Investment Company Limited

Report data as at 30 Apr 2018
Rating issued on 05 Jun 2018

APIR Code
ASX:PIC

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)
PIC Net Portfolio Returns

Net Returns (% p.a.)

	3 yrs	2 yrs	1 yr
LIC	8.91	15.57	17.49
Benchmark	5.80	11.45	5.71

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

VIEWPOINT

The Company is a Listed Investment Company (LIC) managed by Sydney-based fund manager, Perpetual Limited (Perpetual). The Company employs a fundamentally driven research effort to identify investment opportunities across predominately domestic but also internationally listed stocks. The process exhibits a value bias investment style, seeking to identify high quality stocks trading at attractive prices. Zenith has a high regard for the senior investment professionals at Perpetual and its rigorous investment process believing them to be key strengths for the Company.

Perpetual Limited (Perpetual) is an ASX listed company (ASX stock code: PPT) that consists of three core business units - Perpetual Investments; Perpetual Private; and Perpetual Corporate Trust. The Perpetual Investments division had approximately $30.2 billion in funds under management, as at 31 March 2018.

The Perpetual equity investment team is led by Paul Skamvougeras, who assumed responsibility for the team in February 2015. Skamvougeras is supported by Vince Pezzullo who assumed the Deputy Head of Equities role in December 2016 following the departure of Nathan Parkin. The investment team focused on domestic equities consists of 17 investment professionals: 6 portfolio managers, 1 deputy portfolio manager and 10 analysts. Zenith believes the investment team is sufficiently resourced to continue to provide high levels of analytical research.

Pezzullo retains ultimate responsibility for investment decisions within the Company. Pezzullo joined Perpetual in 2007, having previously worked as a senior portfolio manager at Deutsche Asset Management. He also retains responsibility for Perpetual's Australian Share, Geared Australian Share and Direct Equity Alpha (SMA) strategies. Zenith believes Pezzullo has the required experience and expertise to successfully manage the Company however, Zenith believes Pezzullo's other portfolio management responsibilities may dilute his attention towards this Company.

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.

Whilst Pezzullo retains total responsibility for the investment decisions of the Company, the portfolio construction process leverages off the rigorous company research undertaken by Perpetual’s analysts. The process aims to produce a portfolio reflective of the analysts’ best ideas. Analysts rank stocks under their coverage from 1 to 5 (with 1 being the highest). However, under the Perpetual model analysts cannot assign a ranking score of 3, which would normally be regarded as "hold". The removal of this ranking is designed to encourage the analyst to have conviction in their view on a company. 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.

COMPANY FACTS

- Concentrated exposure of between 20 and 40 securities
- Flexibility to invest up to 25% of the Company in international securities as well as up to 25% in cash
- Portfolio turnover is expected to be approximately 30% p.a. to 50% p.a.

ABSOLUTE RISK (SECTOR)

VERY HIGH
HIGH
MODERATE
LOW
VERY LOW

RELATIVE RISK (FUND WITHIN SECTOR)

Geared
Active - Benchmark Unaware
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 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 strategies 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 Index, is highly concentrated and narrow. Technically, a company is considered large cap if it falls within the S&P/ASX 50 Index, with companies falling between the S&P/ASX 50 and S&P/ASX 100 considered mid cap. All stocks outside of the S&P/ASX 100 Index are considered small capitalisation stocks.

As at 30 April 2018, the Financials and Resources sectors combined represented a significant portion of the S&P/ASX 300 Accumulation Index, with the Financials sector accounting for approximately 30% of the index, and Materials approximately 25%. The split between Industrials and Resources stocks was approximately 80%/20%. The top 10 stocks represented approximately 47% of the weighting of the Index, and the top 20 stocks represented over 59% of the Index.

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 in investing in equities.

Investors should also be cognisant of the fact that the Australian equity market is relatively concentrated, with the Materials and Financials sectors dominating the market; the market also only represents approximately 1% of global equity markets (in terms of market capitalisation). While the Company has the flexibility to hold up to 25% in global equities, Zenith would recommend blending with other global equities funds for broader portfolio diversification.

Given the value style approach, the Company would complement a growth orientated Australian equities strategy, resulting in a diversified equities exposure, avoiding any style bias. In Zenith's view, investors should be cautious with holding the Company as a single exposure given the associated single style and manager risk.

The Company can invest up to 25% in International equities. Although Zenith believes this feature of the Company will ultimately be beneficial in the Company achieving its objectives, investors need to be aware of this when blending this Company with International equities funds.

The Company's mandate constraints are considered relatively wide when assessed against peers that are more sensitive to benchmark composition. Operating within a relatively generous risk budget, it is feasible that the Company's risk/return profile materially deviates from that of its performance benchmark.

Investors also need to be aware that as a Listed Investment Company (LIC), the Company's shares will have their own trading patterns and may trade away from their Net Tangible Assets (NTA) which at times may impact the effectiveness of the Perpetual's investment process or expected risk-return profile.

The Company 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 the Company to continue this trend. However, Zenith would like to see the delineation of a specific dividend yield target, as opposed to a descriptive, qualitative objective as Zenith believes this will provide investors with greater transparency with regards to the expected dividends to be paid by the Company.

RISKS OF THE INVESTMENT

SECTOR RISKS

Companies 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): Investors need to be aware that as a LIC, the Company's shares will have their own trading patterns and may trade away from their Net Tangible Assets (NTA) which at times may impact the effectiveness of the Company's investment process and/or expected risk-return profile.

COMPANY RISKS

Zenith has identified the following key risks of the Company. Although Zenith believes the risks noted are all significant, we have listed them in order of importance. In addition, we have not intended to highlight all possible risks.

CAPACITY/LIQUIDITY RISK: Perpetual had approximately $20.9 billion (as at 31 March 2018) 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 high FUM 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.

In addition, Zenith notes that whilst remaining open, Perpetual is managing flows into their main large cap Australian equity strategies. Zenith will continue to monitor Perpetual's FUM closely, to ensure that excessive FUM does not impact the Company's performance.

KEY PERSON RISK: As with most fund managers, Perpetual is subject to a level of key person risk. This risk is mitigated in part by the size of the Australian equity team however, the departure of Vince Pezzullo would trigger a review of the Company's rating.

With regard to the broader Perpetual team, the departure of Paul Skamvougeras would be regarded as a considerable loss.

CONCENTRATION RISK: The Company is relatively concentrated, holding approximately 20 to 40 stocks. Zenith believes concentrated portfolios may potentially lead to periods of relatively high volatility. However, Zenith acknowledges that the Company has historically demonstrated a level of volatility consistent with or below the benchmark.

CURRENCY RISK: Given the Company's capacity to invest in internationally listed companies, the Company may be exposed to fluctuations in the relevant price of the currency relative to the Australian dollar. The Company allows for currency hedges to be undertaken, however these will only be implemented at the discretion of Pezzullo.

PORTFOLIO MANAGER FOCUS RISK: In addition to the Company, Pezzullo is responsible for the Australian Share, Geared Australian Share and Direct Equity Alpha (SMA) strategies which hold substantially more FUM. While Zenith acknowledges that there is some overlap in holdings between the funds, we believe that Pezzullo's other commitments have the potential to draw his focus away from the Company.

QUALITATIVE DUE DILIGENCE

ORGANISATION

Perpetual Equity Investment Company Limited

The Company was listed on the ASX on 18 December 2014 and provides investors with a concentrated, fundamentally driven exposure to predominatly domestic but also internationally listed stocks.

The Company has no employees.

The Board consists of the following individuals:

- Nancy Fox, Non-Independent Chairman, Non-Executive Director and Chairman, appointed 1 July 2017
- Virginia 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 Lane, Executive Director, appointed 20 November 2017

Zenith notes that Geoff Lloyd resigned from his role as an Executive Director of the Company in November 2017. He was replaced on the Board by David Lane. Zenith recognises that a modest amount of turnover in company boards tends to be healthy as new directors bring fresh perspectives and new skills, and new directors can show a propensity to challenge on key issues more than than long serving incumbents. However, there is a balance to Board turnover which also needs to be considered.

The Company's directors all bring a wealth of experience to the Board. In terms of the ASX Corporate Governance Principles and Recommendations, Zenith notes that whilst these aren't mandatory, the Company complies with all Principles except one, as Chairman Nancy Fox is not considered independent as she is also a Director of Perpetual Limited. The Board considers Nancy Fox to be best placed to undertake the role of Chairman, given her wealth of experience as company director and in financial services and risk management. While acknowledging that Fox is a Non-Executive Director of Perpetual, Zenith would prefer that LICs conform to ASX guidelines in this matter.

Zenith is generally comfortable with the composition of the 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.

Under a long-term investment management agreement (IMA) the Company accesses the skills and capabilities of Perpetual. Perpetual has managed domestic and global strategies with the same underlying philosophy utilised by the Company.

Perpetual Limited

Perpetual Limited (Perpetual) is an Australian listed company (ASX: PPT) that consists of three core business units: Perpetual Investments; Perpetual Private; and Perpetual Corporate Trust. The Perpetual Investments division managed approximately $A 30.2 billion in funds under management (FUM) as at 31 March 2018. The majority of Perpetual's FUM is in Australian Equities, creating some single asset class concentration risk for the Perpetual Investments division.

As at 30 April 2018, the Company had a market capitalisation of $A 290 million.

INVESTMENT PERSONNEL

Name	Title	Tenure
Paul Skamvougeras	Head of Equities	14 Yr(s)
Vince Pezzullo	Portfolio Manager	10 Yr(s)

The Perpetual equity investment team is led by Paul Skamvougeras, who assumed responsibility in February 2015. Skamvougeras is supported by Vince Pezzullo who assumed the Deputy Head of Equities role in December 2016 following the departure of Nathan Parkin. Pezzullo is also the Portfolio Manager of the Company.

Pezzullo joined Perpetual in 2007, having previously worked as a senior portfolio manager at Deutsche Asset Management. He also retains responsibility for Perpetual's Australian Share, Geared Share and Direct Equity Alpha (SMA) strategies. Zenith acknowledges that there is some overlap with these strategies however, Zenith believes Pezzullo's increased portfolio management responsibilities may dilute his attention towards this Company.

The investment team focused on domestic equities consists of 17 investment professionals: 6 portfolio managers, 1 deputy portfolio manager and 10 analysts. Zenith believes the investment team is sufficiently resourced to continue to provide high levels of analytical research.

Pezzullo also draws on Perpetual's global equities team led by Garry Laurence, who is supported by eight dedicated global equities analysts who have specified stock and sector responsibilities. Prior to the formation of this dedicated internal capability in 2011, Zenith notes that since 2006, global equities were opportunistically covered as part of the management of Australian equities at Perpetual 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.

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, 30% on stock selection and 20% discretionary, with a substantial portion vested over three years to encourage team stability. Portfolio manager bonuses will typically be based 90% on the outperformance of the Fund and a 10% discretionary component.

In terms of experience, Perpetual rates highly. The domestic equities team has an average of 16 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 OBJECTIVE, PHILOSOPHY AND PROCESS

The Company'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 has 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.

Zenith would prefer to see the delineation of a specific outperformance target, as opposed to a descriptive, qualitative objective. Zenith believes this will provide investors with greater transparency with regards to returns expectations and to the level of risk imbedded in the Company.

The Company is a high conviction, fundamentally driven benchmark unaware strategy. The Company will predominantly invest in domestic securities however, the investment mandate allows the Company to hold up to 25% of the Company in international securities. 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 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.

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, the portfolios, also tend to exhibit lower net Debt/Equity ratios and higher interest cover relative to the broad equities benchmark.

Zenith notes that the Company's investment mandate does not allow the short selling of individual securities however, we note it is permitted to implement derivatives or stock positions which can provide a similar exposure to that of a short sale on a stock or index. Whilst Zenith acknowledges that this is not expected to be material part of the investment process and does not contravene a breach of the Company's investment mandate, we believe the use of an instrument to create a short exposure is inconsistent with the Company's long-only mandate.

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 majority of the security selection process is undertaken by the analyst team as part of their coverage relevant to particular strategies. The Company 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 the Company's strategy.

The Company's initial investment universe consists of all ASX listed securities, however, some potential investments are omitted due to size or liquidity issues. In addition, the Company has the ability to invest 25% of the portfolio in stocks that are listed on registered global exchanges.

Perpetual's stock selection process starts with a quality screen, which the investment universe is subject to. Companies must pass all four quality tests. 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 Vince Pezzullo, whose approval is needed before a stock is included in Perpetual's investment universe (PU). The Company can only take positions in stocks in PU, which contains approximately 280 stocks. 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.

Investment in international companies will only be considered when it is deemed that the offshore opportunity offers significantly better value, and the analyst holds a high degree of conviction in the investment case of the stock. Given Perpetual's analysts consider a number of globally listed stocks in determining a reference point for Australian securities within the same industry, Zenith believes that Perpetual's ability to invest in international securities will not compromise its domestic research effort. Furthermore, Perpetual has an internal team which focuses purely on global equities which Zenith believes will contribute the majority of global ideas to the Company.

Zenith notes that the Fund will not take on international exposure based on a macroeconomic theme, which is consistent with Perpetual's goal of adding value exclusively through fundamental stock analysis. Responsibility for international stock coverage rests with the dedicated global equities investment team. Hedging the currency risk for any international exposures is at the discretion of Pezzullo.

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. 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, however, to promote conviction in recommendations, analysts are not permitted to rate a stock 3 (hold), which is a structure that Zenith endorses. Interpretations or stock rankings are as follows:

- *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

Ratings are then updated on an ongoing basis and are distributed to all members of the investment team. Stocks held in the portfolio must be in PU and typically ranked 1 or 2.

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

PORTFOLIO CONSTRUCTION

Pezzullo is ultimately responsible for all investment decisions, although portfolio construction strongly leverages off the inputs of the stock selection process. The Company 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

Zenith is comfortable with the subjective overlay provided by Pezzullo to the process, believing that he has the experience and insight to add value to the fundamental research conducted by the analysts.

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.

The Company 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 the Company's high conviction and concentrated approach.

The Company 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.

Perpetual's participation in an Initial Public Offering (IPO) requires the Head or Deputy Head of Equities to sign off on a stock within PU. It is then the responsibility of each portfolio manager to determine whether the IPO is suitable for their individual portfolios. Perpetual will then submit an aggregated order for the stock. In the event that Perpetual's order is not filled in its entirety, the order will be allocated proportionately to each fund based on the original order size of each portfolio. Zenith believes this approach results in an equitable outcome for all investors.

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
Security Numbers	20 to 40
Single Stock Limit (%)	max: 15%
International Stock Exposure (%)	max: 25%
Australian Stock Exposure (%)	50% to 100%
Unlisted Securities (%)	max: 10%
Cash (%)	max: 25%

The Company'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.

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 notes that the Company's investment mandate does not allow the short selling of individual securities however, we note it is permitted to implement derivatives or stock positions which can provide a similar exposure to that of a short sale on a stock or index. Whilst Zenith acknowledges that this is not expected to be material part of the investment process and does not contravene a breach of the Company's investment mandate, we believe the use of an instrument to create a short exposure is inconsistent with the Company's long-only mandate.

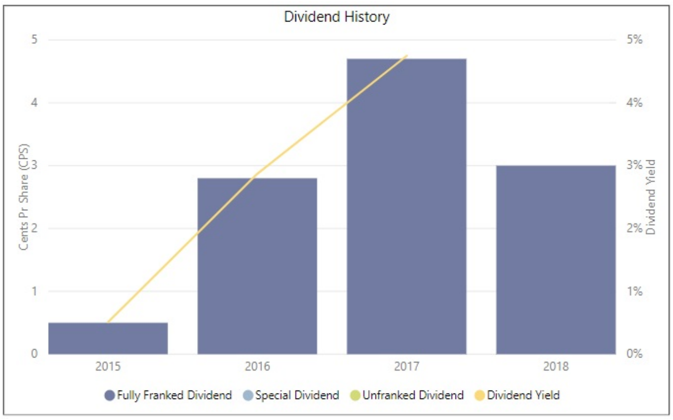
Zenith is comfortable that Perpetual's risk management framework is strictly adhered to at all stages of the investment process. Zenith is impressed at the level of due diligence undertaken on each company that is represented in the portfolio, as well as the constraints placed on the portfolio, which 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.

The Company paid its maiden dividend in August 2015 and has managed to steadily increased its dividend each half year. Zenith expects the Company to continue this trend. In addition, Zenith would like to see the delineation of a specific dividend yield target, as opposed to a descriptive, qualitative objective as Zenith believes this will provide investors with greater transparency with regards to the expected dividends to be paid by the Company.



INVESTMENT FEES

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. The Company's management cost is broadly in-line with externally managed LICs.

The Company 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.

Zenith considers the fees to be inline with peers.

Investment Fees		
Product		Perpetual Equity Investment Company Limited
Asset Class		Australian Equities
Sub-Asset Class		Aust. Equities - Large Companies
Management Structure		Externally Managed
Management Fee		1.10%
Performance Fee		Nil.
Annual Management Fee Comparision		**% p.a.**
Australian Equities	Peers - LICs/LITs (Internally Managed) [1]	N/A
	Peers - LICs/LITs (Externally Managed)	1.05%

[1] Internally Managed LICs/LITs data use published Management Cost as at 31 December 2017 and are ex-GST. All other fees are inclusive of GST, less Reduced Input Tax Credits where available. Source: ASX, Zenith.

PERFORMANCE ANALYSIS

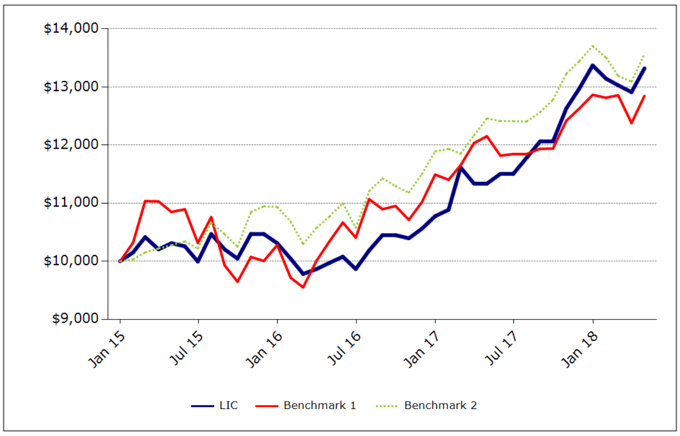
Report data: 30 Apr 2018, product inception: Jan 2015

Monthly Performance History (%, net of fees)

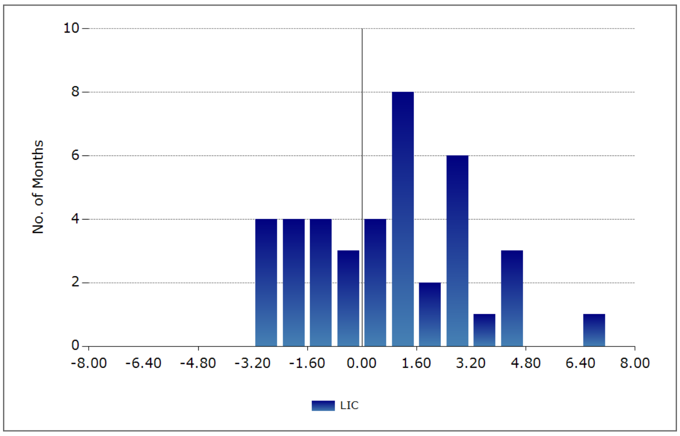
	JAN	FEB	MAR	APR	MAY	JUN	JUL	AUG	SEP	OCT	NOV	DEC	LIC YTD	BM1 YTD	BM2 YTD
2018	-1.70	-0.87	-0.91	3.17									-0.38	-0.14	-1.00
2017	1.01	6.70	-2.39	0.00	1.47	0.00	2.42	2.38	0.00	4.72	2.70	3.07	24.07	11.95	15.23
2016	-2.56	-2.63	0.86	1.08	1.07	-2.12	3.24	2.60	0.00	-0.52	1.57	2.06	4.52	11.80	8.75
2015	1.53	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	9.35

Benchmark 1: S&P/ASX 300 (Accum), Benchmark 2: PIC Net Portfolio Returns

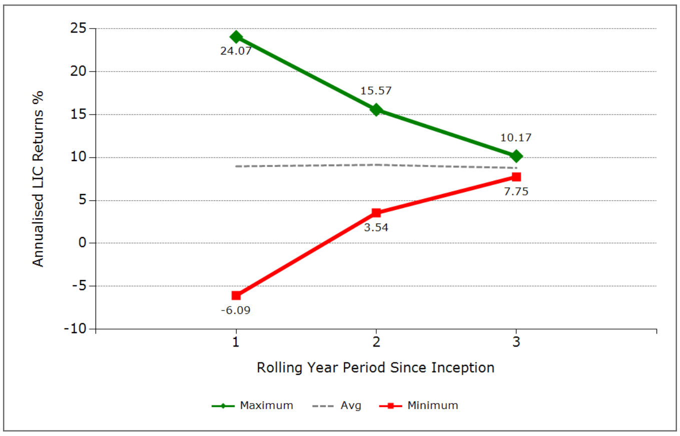
Growth of $10,000



Monthly Histogram



Minimum and Maximum Returns (% p.a.)



ABSOLUTE PERFORMANCE ANALYSIS

Return	Incpt.	3 yr	2 yr	1 yr
LIC (% p.a.)	8.98	8.91	15.57	17.49
Benchmark 1 (% p.a.)	7.80	5.80	11.45	5.71
Benchmark 2 (% p.a.)	9.58	9.70	12.23	8.88
Median (% p.a.)	5.17	4.73	7.81	5.20
Ranking within Sector	**Incpt.**	**3 yr**	**2 yr**	**1 yr**
Fund Ranking	8 / 40	8 / 41	7 / 48	3 / 49
Quartile	1st	1st	1st	1st
Standard Deviation	**Incpt.**	**3 yr**	**2 yr**	**1 yr**
LIC (% p.a.)	8.01	8.21	7.48	6.68
Benchmark 1 (% p.a.)	11.19	11.04	8.53	7.50
Median (% p.a.)	15.51	11.12	10.39	9.29
Downside Deviation	**Incpt.**	**3 yr**	**2 yr**	**1 yr**
LIC (% p.a.)	3.27	3.29	2.44	1.86
Benchmark 1 (% p.a.)	6.21	6.46	3.70	4.20
Median (% p.a.)	8.65	5.82	5.26	4.99
Risk/Return	**Incpt.**	**3 yr**	**2 yr**	**1 yr**
Sharpe Ratio - LIC	0.87	0.85	1.84	2.36
Sortino Ratio - LIC	2.13	2.11	5.63	8.46

Readers should note that unless otherwise indicated, all performance, consistency and risk/return data is referenced to the Zenith assigned benchmark (as represented by Benchmark 1 in the above table) with the LIC returns representing those attributable to shareholders (i.e. share price + dividends). For comparison purposes, Zenith has also included the net returns of the investment portfolio (as represented by Benchmark 2 in the above table) as Zenith believes this is the best measure of the investment managers skill. However, investors should note that whilst we expect the portfolio returns to be a key driver of the share price over the longer-term, due to the LIC structure, these returns may not be able to be fully realised by shareholders at various points in time.

All commentary below is as at 30 April 2018.

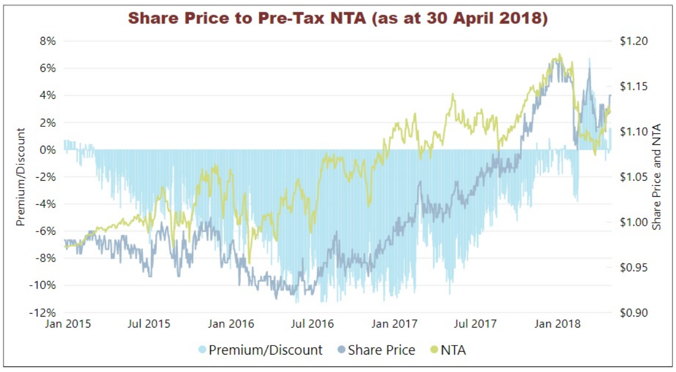
The Company's investment objective is to provide investors with a growing income stream and long-term capital growth in excess of the S&P/ASX 300 Accumulation Index (net of fees), over rolling five year periods. The Company has achieved its performance objective since inception.

Over all periods of assessment, the Company's performance volatility, as measured by Standard Deviation, has been lower than that of the benchmark and median manager.

Share Price vs. NTA

The Company was trading at 1.1% premium to NTA as at 30 April 2018.

The following chart shows the Company's premium/discount since inception.



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.	3 yr	2 yr	1 yr
Excess Return (% p.a.)	1.18	3.12	4.12	11.78
% Monthly Excess (All Mkts)	47.50	50.00	50.00	58.33
% Monthly Excess (Up Mkts)	28.00	30.43	35.29	55.56
% Monthly Excess (Down Mkts)	80.00	84.62	85.71	66.67
Beta Statistics	**Incpt.**	**3 yr**	**2 yr**	**1 yr**
Beta	0.45	0.47	0.42	0.62
R-Squared	0.39	0.40	0.22	0.48
Tracking Error (% p.a.)	8.77	8.61	8.26	5.60
Correlation	0.63	0.64	0.47	0.69
Risk/Return	**Incpt.**	**3 yr**	**2 yr**	**1 yr**
Information Ratio	0.13	0.36	0.50	2.10

All commentary below is as at 30 April 2018.

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

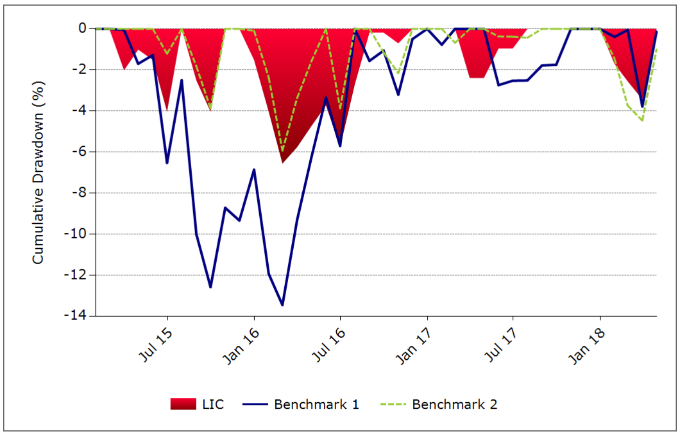
Zenith seeks to identify funds that can outperform in over 50% of months in all market conditions, as we believe this represents consistency of manager skill. The Company's consistency statistics both at the portfolio and shareholder level, illustrate strong historical outperformance above benchmark in falling market conditions.

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	BM1	BM2
Max Drawdown (%)	-6.57	-13.46	-5.93
Months in Max Drawdown	3	12	3
Months to Recover	9	5	3

Worst Drawdowns	LIC	Benchmark 1	Benchmark 2
1	-6.57	-13.46	-5.93
2	-4.04	-3.78	-4.47
3	-4.03	-3.20	-3.87
4	-3.44	-2.74	-3.87
5	-2.39	-0.77	-2.16



All commentary below is as at 30 April 2018.

Consistent with the Company's capital preservation focus, drawdowns have been smaller than that of the benchmark. Zenith expects stronger drawdown protection during periods of significant market corrections.

Investors should be aware that accessing a strategy via a LIC will mean that the effectiveness of the strategy may be significantly diminished due to the Company's own trading movements. That is, investors may not be able to benefit from the portfolio's performance, as the performance of the Company is driven by market sentiment.

REPORT CERTIFICATION

Date of issue: 5 Jun 2018

Role	Analyst	Title
Author	Jacob Smart	Investment Analyst
Sector Lead	Dugald Higgins	Head of Property & Listed Strategies
Authoriser	Bronwen Moncrieff	Head of Research

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RATING HISTORY

As At	Rating
5 Jun 2018	Recommended
18 Jul 2017	Recommended
21 Dec 2016	Recommended
16 Dec 2016	Under Review
6 Jun 2016	Recommended
20 Mar 2015	Recommended
2 Feb 2015	Recommended
21 Oct 2014	Recommended

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

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