PERPETUAL EQUITY INVESTMENT COMPANY LIMITED
ACN 601 406 419

PERPETUAL EQUITY INVESTMENT COMPANY LIMITED (ASX: PIC)
UNDERSTANDING THE LISTED INVESTMENT COMPANY STRUCTURE

Listed investment companies (LICs) have been around for nearly a century with the first LIC listing on the ASX in 1923[1]. LICs aim to provide investors with an efficient way to invest in a diversified portfolio of assets which are managed by a professional investment team. Investors can buy and sell shares in a LIC on the ASX and have all their investment holdings consolidated under their CHESS Holder Identification Number (HIN).

Let's explore in more detail what LICs are and how PIC utilises this structure.

The Perpetual Equity Investment Company Limited (ASX: PIC, the Company) has operated as a LIC since listing on the ASX in December 2014. PIC seeks to offer investors access to a concentrated portfolio of high quality Australian and global listed securities and its 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 (benchmark) over minimum 5-year investment periods.

HAVE YOU CONSIDERED LISTED INVESTMENT COMPANIES?

LICs are designed for investors who:

- Use managed accounts
- Have an SMSF
- Seek an actively managed, diversified portfolio
- Want transparency and simplicity, or
- Look for administrative efficiency of their investment portfolio.

1 Whitefield Limited (ASX: WHF) listed on the ASX in 1923 and is the oldest listed investment company that is now listed.

KEY FEATURES OF A LIC

- ABILITY TO PAY FRANKED DIVIDENDS
- DIVERSE INVESTMENT STRATEGY
- CLOSED-END STRUCTURE
- GOVERNANCE
- ROBUST PRICING AND CALCULATION OF NTA
- ASX SHARE PRICE

Perpetual

KEY FEATURES OF A LIC

ABILITY TO PAY FRANKED DIVIDENDS

A key feature of the LIC structure is the ability for the Board to declare and pay franked dividends. The Board has the discretion to pay dividends that can be partially franked or fully franked. To the extent that the dividends are franked, generally the assessable income of the investor will include the amount of the dividend plus the value of the franking credits attached to the dividend.

Investors will generally be entitled to a tax offset equal to the amount of franking credits attached to the dividends (i.e. investors will effectively get a tax credit for the company tax paid by the LIC which is imputed to investors in the form of franking credits).

LICs can earn franking credits from the payment of company tax on income they earn including from the realisation of profits on the sale of assets, dividend income earned from their assets and other income such as interest. A key benefit of the LIC structure is the flexibility of when and how much income it returns to investors.

A LIC is able to retain earnings and reinvest them into the portfolio or pay dividends out of profits. Where a company can build up both its profits and its franking credit balance, it provides the opportunity for the Board of the company to declare consistent dividend amounts to investors. This contrasts to a trust structure which includes a listed investment trust (LIT), ETF or managed fund. Trusts may either pay a distribution and/or attribute their earnings including both income and realised capital gains. Franking credits and other tax credits received by the trust will also flow through to investors as part of the distribution. This income is distributed to investors and forms part of their assessable income taxed at their own marginal tax rate.

The frequency of dividends paid and the operation of a dividend reinvestment plan will be determined by the Board of a LIC. For example, the Board of PIC may declare dividends twice a year at the half year and full year results of the Company. The Board has established a dividend reinvestment plan whereby investors are able to reinvest their dividends to purchase more shares in the company without transaction costs.

DIVERSE INVESTMENT STRATEGY

The LIC structure provides investors exposure to an actively managed portfolio which may be across a range of asset classes, sectors and geographies by purchasing shares in just one company. It also provides investors the opportunity to access the expertise of a professional investment manager who may have experience investing through various market conditions and market cycles with access to deep research and analysis.

The Company has appointed Perpetual Investment Management Limited (Manager) as investment manager of PIC. The investment strategy of PIC is focused on investing in quality companies that are trading at attractive valuations both in Australia and offshore under the Manager's investment criteria. This includes investing in securities that may be difficult to access for retail investors. For example, global listed securities may be more expensive for investors to access or the opportunity to participate in capital raisings may be limited to institutional, sophisticated or professional investors. The Manager's assessment of high quality and attractively valued companies is underpinned by its investment process to assess companies based on fundamentals such as the balance sheet, cashflow and operating leverage. The Manager also speaks regularly to the board and management of the companies included in the portfolio. This includes receiving updates on how the company is being managed as well as how the company is impacted by economic conditions or regulatory or technology changes. The Manager may also advocate ideas on the direction of the company.

Importantly, the Manager has the flexibility to diversify the portfolio across industry sectors and markets by investing offshore. The Manager may also take steps with the objective of protecting investments in volatile market conditions or protecting against currency exposure by purchasing derivatives.

CLOSED-END STRUCTURE

A key feature of a LIC is the closed-end structure which means the Manager has a fixed amount of capital to invest, as the number of shares issued to investors and capital raised is fixed. This usually starts with an Initial Public Offer (IPO) as PIC did in December 2014, raising approximately $250 million. If the board of the company wants to issue new shares to increase the size of the investment pool, then it must launch another capital raising such as a placement or entitlement offer. PIC conducted a secondary capital raising via a non-renounceable entitlement offer in August 2018, raising approximately $101m. This increased the size and scale of PIC, providing the Manager with additional capital to invest and further opportunity to diversify the portfolio.

Importantly, the closed-end structure means that the Manager is not a forced buyer or seller. The benefit of a LIC is that where markets are strong and assets may be considered expensive, the Manager is not required to buy assets to satisfy an application of new shares as is the case in vehicles with an open-end structure such as an exchange traded fund (ETF) or traditional managed fund. Similarly, where markets are weak, the Manager does not need to satisfy redemptions but rather has the ability to take advantage of investing opportunities at good value.

GOVERNANCE

LICs use a company structure which require the appointment of a Board. The role of the Board is to act in the best interests of the investors of the company with responsibilities including providing strategic direction and governance and oversight of the company. The LIC structure requires adherence to strict corporate governance requirements including compliance with the ASX Listing Rules and Corporations Act. It also requires companies to hold Annual General Meetings (AGMs) every year or general meetings where necessary to discuss matters outside day to day operations of the company.

These meetings provide a forum for companies to provide an update to their investors (e.g. on the financial performance of the company) and investors to express their views to the company's board and management.

PIC has a highly experienced Board that undertakes rigorous governance processes over the year to provide oversight of the Company's activity and performance. The Manager is required to report to the Board regularly on investment performance and the composition of the underlying portfolio.

ROBUST PRICING AND CALCULATION OF THE NET TANGIBLE ASSET VALUE

LICs are required to lodge their net tangible assets (NTA) with ASX at least monthly. PIC provides more frequent disclosures, lodging the estimated NTA for the Company with the ASX daily. This provides transparency to investors to understand the current value of the underlying assets held in the Company.

The NTA reflects the fair value of the LIC's underlying portfolio. The valuation of the underlying assets underpinning the NTA may differ across LICs depending on the pricing methodology and source. For example, the assets in PIC are generally readily tradeable securities in active markets with an available external pricing source.

ASX SHARE PRICE

The listed nature of a LIC also means that its share price may be different to the value of the underlying assets held in the portfolio. The share price on the ASX is determined by the demand and supply of the market with a range of factors including investor sentiment or performance potentially leading to the share price trading at a premium or discount to the NTA.

In contrast, the issuer of ETFs are required to appoint a market maker to ensure that the vehicle trades at or around its net asset value (NAV). While this seeks to provide investors with certainty that the ETF should trade close to its NAV, the NAV may be impacted by the ETF being a forced buyer or seller to satisfy applications and redemptions.

ETFs and LICs may be affected by market volatility or corporate activity from the underlying investments in the portfolio. For example, change in company management or the default of an issuer of an underlying asset can impact the NTA/NAV. The ability of an investor to sell their shares in a LIC or ETF on the ASX will also depend on the turnover or liquidity of the units at the time of sale. Therefore, investors may not be able to sell their shares at the time, in the volumes or at the price they desire.

DECIDING WHETHER A LISTED INVESTMENT COMPANY IS THE RIGHT INVESTMENT FOR YOU

When choosing investment options, there's a range of factors to consider. We have compared LICs to three common alternate investment options that also provide investors with a diversified portfolio – LITs, managed funds and ETFs.

LISTED INVESTMENT COMPANIES	LISTED INVESTMENT TRUST	MANAGED FUNDS	EXCHANGE TRADED FUNDS
Pay a dividend which is generally fully franked	Pay a distribution that may include income and capital gains; may include franking credits	Pay a distribution that may include income and capital gains; may include franking credits	Pay a distribution that may include income and capital gains; may include franking credits
Listed on the ASX and have price transparency	Listed on the ASX and have price transparency	Unlisted – application via Product Disclosure Statement (PDS) – cannot see buy and sell price until it is struck for the transaction date – generally the following business day	Listed on the ASX and have price transparency
Active portfolio management by experienced professionals	Active portfolio management by experienced professionals	Active portfolio management by experienced professionals	Most ETFs are passive and replicate a specific market index or adopt a rules-based approach to investing
Because there is a finite number of shares issued, fund flows do not impact the investment strategy	Because there is a finite number of units issued, fund flows do not impact the investment strategy	Significant fund flows, particularly large withdrawals, can necessitate selling investments – this can impact all investors through realising capital gains or losses	Significant fund flows, particularly large withdrawals, can necessitate selling investments – this can impact all investors through realising capital gains or losses
Investors may receive returns that are higher or lower than the relevant market	Investors may receive returns that are higher or lower than the relevant market	Investors may receive returns that are higher or lower than the relevant market	Investors receive market returns, less fees
May trade at a premium or discount to their NTA (net tangible assets)	May trade at a premium or discount to NAV	Generally trade close to their NAV	Generally trade close to their NAV
Closed-end – shares can only be bought if there is a seller or the company issues new shares	Closed-end – units can only be bought if there is a seller or the trust issues new units	Open-ended – units can generally be bought and sold at any time	Open-ended – units can generally be bought and sold at any time; market makers ensure liquidity in the ETF
Must abide by the ASX's continuous disclosure rules	Must abide by the ASX's continuous disclosure rules	Portfolio composition is generally made available to investors on a quarterly basis	Must abide by the ASX's continuous disclosure rules, which enables investors to see the composition of the ETF's portfolio in real time
Operate under a company structure and issue shares	Operate under a trust structure and issue units	Operate under a trust structure and issue units	Operate under a trust structure and issue units

MORE INFORMATION

www.perpetualequity.com.au

Perpetual