



Key Points: Microequities Deep Value Microcap Fund

- ❑ The Microequities Deep Value Microcap Fund uses a fundamental, research-driven process to invest in companies valued below \$250m.
- ❑ Established in March 2009 by CIO Carlos Gil, who has over 15 years' experience in a range of asset management roles including senior management roles in Europe with BM Securities and Santander Group.
- ❑ Gil's philosophy is that companies in the microcap sector are often under-researched and under-valued which in turn provides opportunity for above market returns. The strategy has delivered performance well above the broader market since inception.
- ❑ The Fund is long only, does not short, use leverage or derivatives. The portfolio is concentrated, usually with 15 to 20 companies in the industrial sectors. Resource stocks are avoided.



Key Performance	Microequities Deep Value	ASX 200 Acc
Sep-14	-2.59	-5.38
Annualised Return	28.60	13.51
Latest 3 Months	2.03	-0.60
Latest 6 Months	3.39	0.33
Latest 12 Months	16.31	5.93
Latest 24 Months p.a.	26.36	14.71
Latest 36 Months p.a.	27.91	14.75
Latest 60 Months p.a.	19.60	6.81
% Positive Months	68.66	65.67
Best Month	19.68	7.98
Worst Month	-7.59	-7.51
Largest Drawdown	-10.86	-15.13
Average +ve Return	4.21	3.31
Average -ve Return	-2.18	-3.04
Annualised Standard Deviation	14.93	12.68
Downside Deviation (Since Inception)	6.15	7.94
Sharpe Ratio (Since Inception)	1.53	0.79
Sortino Ratio	3.56	1.16

Management Company Overview

The Microequities Deep Value Fund was launched in March 2009 by CIO Carlos Gil, and Senior Advisor, Sam Gutman to invest in microequities, which they define as companies with a market capitalization of \$A250m or less. The motivation for establishing the Fund was their belief that this sector held the most compelling value propositions. Gil had previously worked in range of capacities in asset management including stockbroking, funds management and investment research for over 15 years. Senior management roles have included Head of International Securities at BM Securities, and at Banesto Bank, owned by Santander Group, the largest bank in the Eurozone. On returning to Australia in 2005 he established Microequities to provide quality investment research on domestic listed microcap stocks, and then based on this research moved to establish the Fund. Gil has a Bachelor of Economics degree from the University of Sydney, and a Graduate Diploma in Applied Finance from FINSIA.

Sam Gutman has a range of business experience derived from a career in the IT industry. He has a BA with a major in Economics, and a Graduate Diploma in Applied Finance from FINSIA.

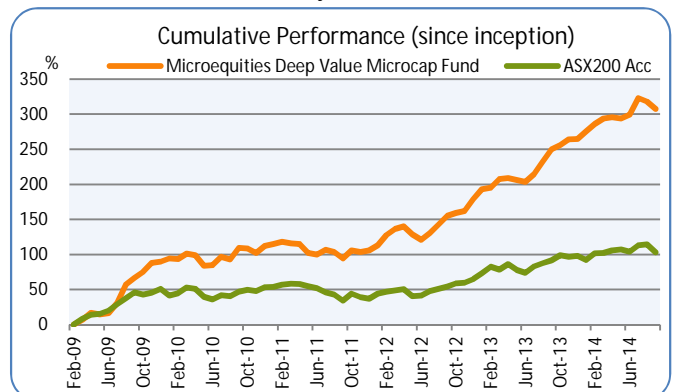
The investment team is supported by Shuo Yang who has a Bachelor of Commerce and Economics from UNSW. The management and staff are significant investors in the Fund, helping to provide an alignment of interests with outside investors.

Investment Approach

The Manager's core approach is that investments will benefit from both the market inefficiency of the microcap sector, and the underlying growth of each investment to drive intrinsic value. In addition the Managers see themselves as a long term investor and business partner in the underlying companies, rather than as a fund manager simply trading stocks.

Within the microequities space the Fund is first and foremost a value investor looking to invest in companies at a significant discount to the Manager's valuation. They define value as those companies whose shares have an upside of 50 to 100% before reaching their intrinsic or real value. The emphasis on buying stocks at a discount has two advantages; firstly it reduces the potential for loss, and secondly it provides a growth as the share price moves towards the intrinsic valuation over time.

*Statistics above for the ASX are adjusted to the Fund's start date



The Manager insists all companies in the portfolio have a driver that is likely to see profit grow above that of the market. In general, microcaps can have a higher growth profile as a result of a range of factors, including a new product or service, new market opportunities, an increasing market size, or company specific events.

This report qualifies Financial Advisors for 0.5 CPD points on completion of AFM's online test available at www.fundmonitors.com

The Microequities Deep Value Fund is listed on www.primselect.com and applications can be made online using OLIVIA123.

Performance - Net of Fees (%)

Year	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	YTD
2014	2.97	2.76	2.10	0.41	-0.46	1.39	5.94	-1.13	-2.59	-	-	-	11.70%
2013	5.02	0.83	4.08	0.54	-0.91	-0.90	3.63	5.58	5.46	1.60	2.40	0.08	30.73%
2012	3.55	6.76	3.90	1.50	-4.67	-3.40	4.20	5.33	5.12	1.65	0.94	6.57	35.44%
2011	1.28	1.61	-1.21	-0.44	-5.93	-1.03	3.34	-1.48	-4.38	5.76	-1.03	1.08	-2.94%
2010	2.56	-0.57	4.00	-1.08	-7.59	0.45	6.47	-1.72	8.37	-0.49	-2.88	4.83	11.88%
2009	-	-	6.77	9.62	-1.99	1.51	12.67	19.68	5.98	5.44	7.19	0.82	89.62%



The second reason for buying undervalued companies in the microcap sector is the general lack of research coverage by stockbrokers and research houses. This is caused by the economies of providing research for which there is limited return, and as a result often creates opportunities through the significant undervaluation of companies. The Fund is specifically designed to exploit these opportunities, although there are also risks of investing in thinly traded stocks.

Given the higher risks of investing in microcaps the Fund has three criteria before investing. First, the company must have a long term growth profile to drive the intrinsic value. Second, the intrinsic value, as calculated by the Manager, must be at least 50% above the entry share price. Thirdly, the company must have little or no debt, have positive cash flow from operations, and 2 years of operating profit. As such no research is conducted on loss-making companies, and there is also a strong preference for companies with high earnings visibility and disclosure.

In terms of valuation the Manager calculates intrinsic value through the use of a 10 year discounted cash flow model with a discount rate 7.5% above the current risk-free rate. The result is that a company's cash flows are discounted at rates of 11 to 17% when determining intrinsic value, with this higher discount rate designed to overcome some of the risks of investing in microcap companies.

Fundamental Research & Analysis

Given the Manager's emphasis on intrinsic value and growth drivers it specialises in companies in the industrial products or services sectors. The Fund does not invest in resource or property companies as the Manager does not believe that they have expertise in these sectors.

The fundamental research process requires meeting with senior management to assess both their competency and ethics. Specifically, the Manager is looking for their ability to manage the business, communicate the strategic vision and outlook, and display ethics towards shareholders. A view is formed whether the management can be trusted and their judgment. In researching a company the Manager will also contact competitors and suppliers to provide industry background information.

The Manager does not use broker research even where this available with all research conducted in house to leverage the initial origins of the business as a provider of research. The Manager prides itself on its ability to "cocoon" itself from market noise and the independence of its research views and conclusions.

The research process requires that the Manager build a detailed financial model with projections to value the company. Revenue forecasts towards the tail end of the DCF valuation model are typically conservatively forecast below nominal GDP growth rates.

The Manager estimates they make approximately 150 company visits per year and companies not in the portfolio are monitored for any changes that may lead to further research.

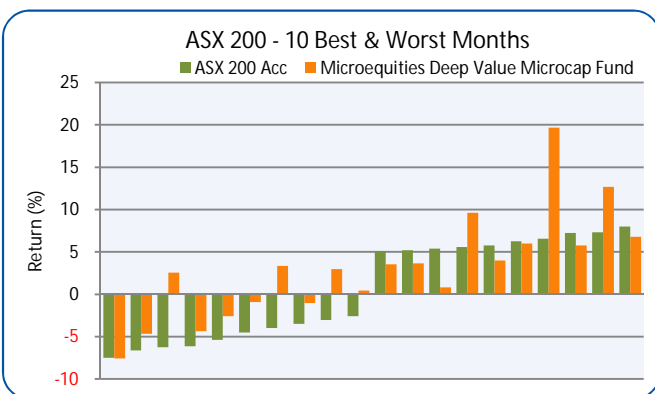
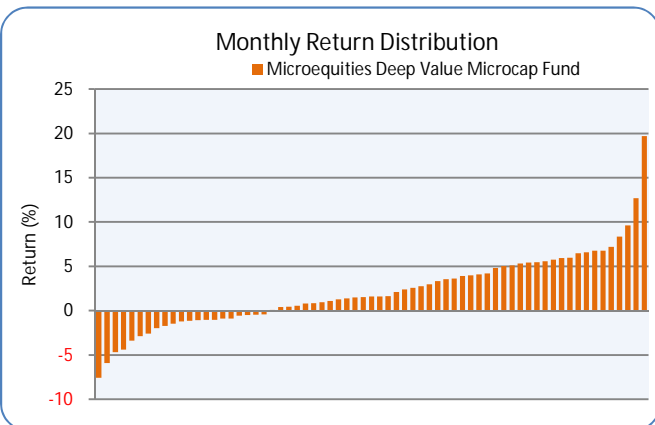
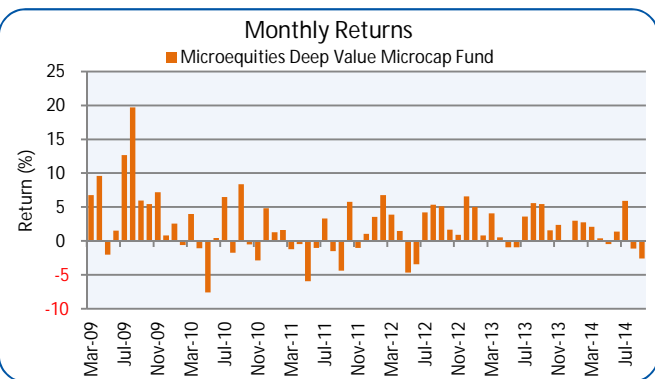
Investment Risk & Processes

The Fund will run a concentrated portfolio of around 20 stocks as the CIO has a view that professional managers should have a high conviction portfolio, backed by thorough research. There are no sector limits and the fund can have no more than 20% of the Fund's NAV in a single company and has a limit of 19.9% of the total equity of a single investment.

The Fund can have up to 20% of NAV in companies with a market cap above \$250m based on book value. This allows the Fund to benefit from the ongoing growth of companies when they exceed the \$250m cap limit. For example, one previous investment moved from a market cap of \$40m at the time of investment to \$600m when the Fund exited.

The Fund can invest in pre IPO opportunities due to be listed within 3-6 months, but these types of investments are limited to 10% of total NAV.

Microequities Deep Value Fund Fund Key Terms	
Strategy	Equity Long, Market cap under \$250m
Geographic Mandate	Australia
Domicile/Structure	Australia
Investor Type	Wholesale only
Min. Investment	A\$100,000
Additional Investment	A\$20,000
Management Fee	1.8% p.a
Performance Fee	20% p.a, with high water mark
Hurdle	Yes
Min. Term	1 Mth, 2% fee if exited under 1 year
Redemption	Monthly
Inception Date	Mar-09
Fund Size	A\$44 million
Manager's Total FUM	US\$75 million
Status	Open





The Fund does not use "stop losses" as the Manager's view is that positions should only be cut from the portfolio when the fundamentals of the business change, not when there are changes in share price or the markets perception of the business.

The major risk is the general illiquidity of microcaps. Across the sector some stocks will be more liquid than others, however some investments will be difficult to enter and exit. The Manager notes that given the size of the Fund the illiquidity is less of an issue than the general perception, and the Manager is comfortable to remain a buyer of stock for long periods of time to obtain the desired investment. In terms of selling, illiquidity is not a deterrent to exiting a stock when the fundamental case has altered. In this event Gil accepts that some capital may be lost in the sale process, but he does not believe in holding stocks which no longer meet their original investment thesis.

However Gil reiterates that the Manager takes a business partner approach to investing and therefore has a long term horizon, so turnover of investment is low and the cost of crossing the wide bid/offer spreads often found in microcaps is reduced.

The Fund does not borrow or use leverage. Derivatives and short selling (which are frequently not available in the microcap sector) are also not used and the Manager believes this also reduces the risk in the portfolio. A final factor reducing risk in terms of limiting downside is that the Fund can hold up to 80% in cash, but in most cases cash will range between 1-20%.

Performance Review

The Fund has delivered very strong performance since inception with a 28.60% annualised return compared to the ASX 200 Index Accum return of 13.51%. Volatility has been somewhat higher than the Index at 14.93% (ASX 200 Accum 12.68%) however the Sharpe ratio at 1.53 (Index 0.79) reflects the high incremental returns for taking on the extra volatility/risk. The Sortino ratio, which excludes the effects of upside volatility, is well above Index at 3.56 (Index 1.16). Up and Down capture ratios are 1.17 and 0.26. The risk and return statistics indicate that the Fund's value philosophy and sound fundamental research are reflected in the stocks and portfolio and the investment outcome.

However investors need to be aware that microequities can be seriously impacted in a significant market pullback. The S&P/ASX Small Ordinaries had a maximum drawdown of 65% during the GFC with a number of small cap funds falling 50% or more.

This example is not meant to indicate the Fund will necessarily fall to this extent in a weak market, but rather that the sector can be more volatile than the market in severe downturns.

Operational & Business Risk

The Manager's IT processes include all data being backed up on site, as well as in two separate cloud-based facilities.

The Manager conducts their own administration and monthly pricing of NAV, functions which are normally outsourced by boutique managers. While this is unusual in the industry Gil notes that they have 2 people checking and conducting entries and all functions, and he is comfortable with the accuracy of current processes. Establishing the Fund's monthly NAV is straightforward due to the absence of debt and derivatives. Fund valuations and unit prices are audited annually.

Structure, Terms & Compliance

Microequities Asset Management Pty Ltd ABN 96 134 984 768 is a subsidiary of Microequities Pty Ltd, holder of Australian Financial Services Licence (AFSL) Number 287526.

The Microequities Deep Value Microcap Fund is open to Wholesale Clients or Sophisticated Investors within the meaning of Sections 761G(7) and 761GA(7) of the Corporations Act 2001.

The minimum investment amount is \$100,000 with additional investments of \$20,000 subject to the discretion of the Manager.

Management fees are 1.8% per annum, with a performance fee of 20% of the out-performance above a hurdle of 5% before management fees and administrative costs. The performance fee is subject to a high water mark. There is a buy/sell spread of 0.40% on entry and exit, and if investments are held for less than 12 months the Fund will levy a 2% exit fee.

Distributions are made annually and are automatically re-invested in the Fund unless the Manager elects to make a cash distribution.

Currently the Manager has FUM of \$75m with \$44m in the Deep Value Fund. The remainder of the FUM is in special vehicles and the High Income Microcap Fund. The Manager has a view that the Fund has capacity to \$100m and will close at that point.

Service Providers

Trustee:	Microequities Asset Management Pty Ltd
Custodian:	Macquarie Bank
Prime Broker:	Macquarie Bank
Administrator:	In-house
Auditors:	BDO
Legal:	Clayton Utz

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Research Analyst: Sean Webster
Report valid until: November 14



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