

# Microcaps Sector Update

Teleconference  
25 August 2010



ACORN CAPITAL



Australian Unity

# Who is Acorn Capital?

- Joint venture partner of Australian Unity
- Melbourne based boutique investment manager established in 1998
- First investment manager to exclusively target the Australian microcap sector
- Largest specialist microcap investor in the Australian market
- Track record of consistent long term performance
- Highly experienced team following a research driven investment process
- Manager of two microcap investment products

# The Microcap Sector

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# What is the Microcap sector?

- All stocks outside the largest 250 by market capitalisation
- Has total market capitalisation of \$89B (30 June 2010)
- Has over 1,700 companies
- Largest company \$420M
- Average company size \$52M

Data as at 30 June 2010

- Provide exposure to different sectors of the general economy
- More companies at early stage of corporate development (R&D and exploration type companies)
- Smaller exposure to banks, insurance and media companies
- Larger exposure to industrials, IT, healthcare & biotech and resource sectors
- Higher volatility
- Reduced liquidity
- Source of stars (and almost all failures)
- Less than 1% under-performance vs AllOrds over 35 years

- The microcap landscape has altered significantly over past 10 years
- Challenge to maintain competitive advantage

## Change in Microcap Sector Landscape

	2000	2010
<b>Number of Investment Managers</b>		
Small Caps	17	42
Microcaps	1	7
<b>Microcap Sector</b>		
Capitalisation	\$32.3 billion	\$99.0 billion
Number of Companies	1,019	1,691
% of Total ASX Capitalisation	5.0%	6.8%
Largest company	\$194 million	\$451 million
<b>Financial Data</b>		
Reliability	High error rate (20% +)	Accurate
Availability	Limited to hard copy	Electronic download
<b>Acorn Capital</b>		
Total Staff	7	15
Investment Team	4	11
<b>ESG Issues</b>		
Relevance	Low	Significant

## Turnover

- Healthy levels late CY09 early CY10
- Very low past 2 months

## Volatility

- Remains above long term levels

## Primary Markets

- Capital raising activity still low, expected to increase over the coming year

# The Acorn Microcap Trust

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- The focus of Acorn Capital's dealing is to minimise market impact
- For calendar 2009, 51% of all investments were made via primary market deals

## Analysis of Transactions: 2 Years to June 2010

<u>Transaction Type</u>	<u>Buys</u>	<u>Sells</u>
Block Trades		
Placements, IPOs, Takeovers etc	45%	25%
Uninitiated Trades	18%	10%
On Line purchases/sales	22%	32%
Orders through Broker	15%	33%
	<u>100%</u>	<u>100%</u>

Uninitiated trades are those instigated by brokers / companies  
Source: Acorn Capital

- Capturing alpha by exploiting market inefficiencies
  - Under-researched
  - Poor information flow
  - Lack of liquidity
  - Large number of stocks
- Can add significant alpha by finding future stars

- Proprietary database enabling customised quant ranking
- Conventional analytical framework, no black box
  - The company's business
  - Competitive position
  - Business strategy
  - Management assessment
  - Strength of balance sheet and cash flow
  - Historical financial analysis
  - Scope for improving return on funds and margins
  - Earnings and cash flow estimates
- Report on each company
- Final ranking, selection for approved list, preferred portfolio and stock weights
- On-going review of relative valuation

# General risks of investing in Microcaps

- Large number of stocks to choose from
- Higher volatility
- Reduced liquidity and higher transaction costs (crossing bid-ask spread)
- Large % of developing companies
- Source of almost all failures
- Treacherous place for uninformed investors

# How Acorn Capital mitigates the risk

- Diversified portfolio (of up to 80 stocks) across all sectors
- Long term investment horizon to ride out volatility, diversified portfolio
- Low turnover of diversified long-term portfolio (averaged low 20%), very active in primary market, large active broker network and patient anonymous dealing
- Style neutral – allow investments in developing companies; long term investment horizon to allow companies to develop/mature; and diversified portfolio to capture potential stars
- Sector neutral, style neutral, diversified portfolio, maximum investment 5%, maximum holding 7.5% and a research driven stock selection process - to minimize impact of failures
- Research driven investment process by large dedicated in-house research team

- The top 10 holdings account for approximately 35% of the portfolio

## Major Portfolio Holdings

Holding	Sector	GIC Sectors	%
Perseus Mining	Top250	Materials - Resources	4.77%
Extract Resources	Top 250	Energy	4.56%
The Reject Shop	Microcaps	Consumer Discretionary	4.11%
Sphere Minerals	Microcaps	Materials - Resources	3.52%
IMF (Australia)	Microcaps	Financials – ex AREITs	3.30%
Indophil Resources	Top 250	Materials - Resources	3.07%
St Barbara	Top 250	Materials - Resources	2.94%
Mermaid Marine	Top 250	Industrials	2.92%
Retail Food Group	Microcaps	Consumer Discretionary	2.72%
Grange Resources	Microcaps	Materials - Resources	2.58%

Holdings as at 30 June 2010

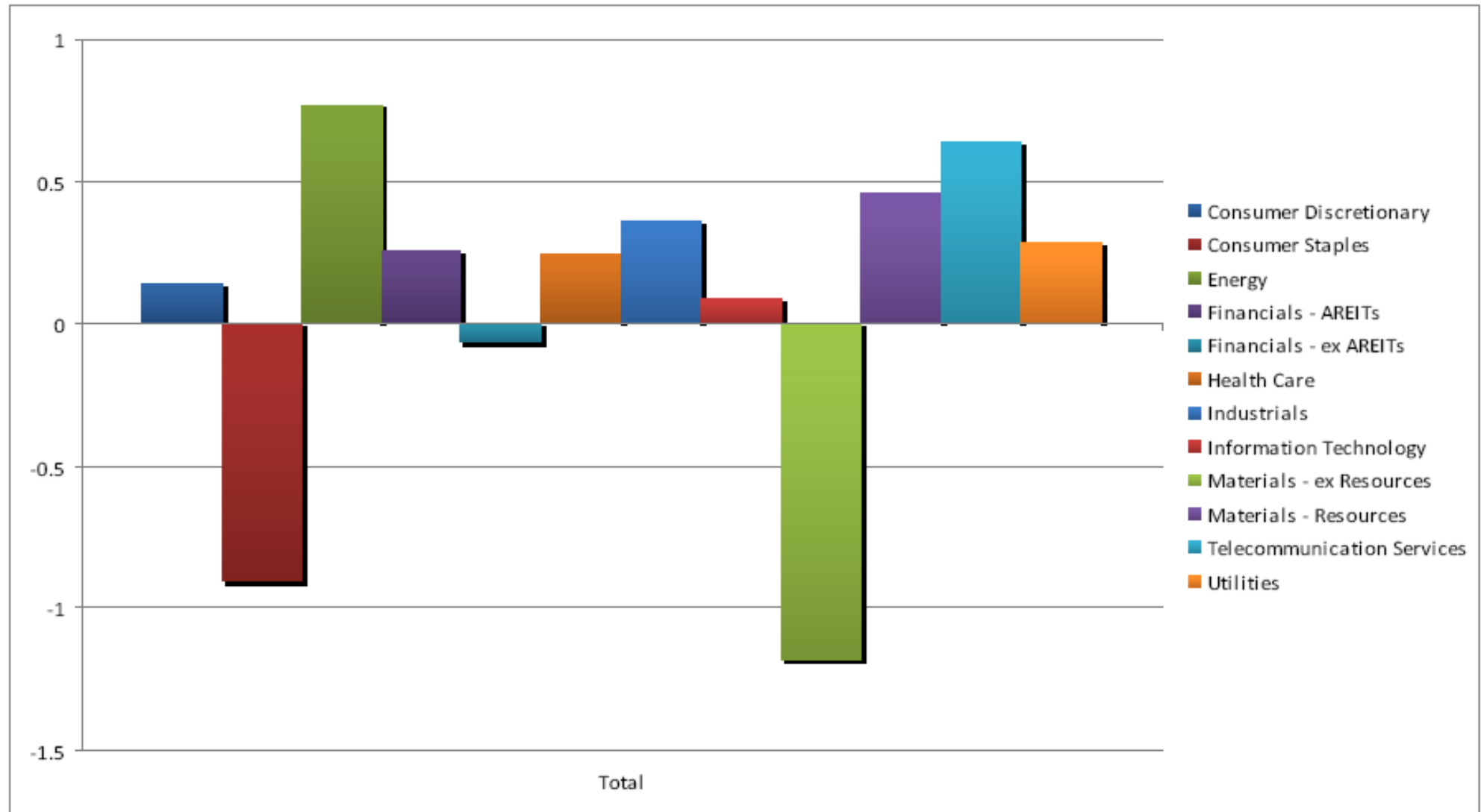
## FUM to 30 June 2010: \$991M

- By product: \$799M in listed product & \$192M in hybrid product
- By sector: \$671M in Microcaps (0.76% of Microcap Sector), \$273M in Top250 , \$47M in cash
- By source: \$808M institutional, \$183M retail, Top 5 Institutions account for 61% of Total FUM

## Track record to 30 June 2010

- Composite portfolio returned 14.14% p.a. (pre fees) since inception\*
- Benchmark returned 6.80% p.a. and AllOrds returned 7.18% p.a. over the same period
- On average 25% to 30% of the portfolio graduates into Top 250

- Average excess return per month – 5 years to 30 June 2010



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