

Defining Value

Many institutional investors use third party benchmarks to determine how “value” is defined. For example, Russell Investments uses “price-to-book” as the central characteristic, followed by growth for its “value” style benchmarks. Other benchmark providers add in “forward price-earnings ratios” and “dividend yields” as indicators of value. There appears to be some explanatory power in these attributes, as there are many periods when the entire groupings tend to be in favor or out of favor. In fact, despite the obvious flaws in some of these items, academic research continues to support that they do have significance.

In our meetings with clients, we are often asked, “What is a value stock?” At Pacific Ridge, we look for good companies at cheap prices, which means we define a value stock as follows:

1. It should have a low multiple on current earnings relative to the market. That just means for a given return of profit, the market is paying less for Stock A than it is in for Stock B. All things being equal, an investor would prefer to buy A instead of B. (Of course, all things are rarely equal.)
2. If the stock price of a particular company does not satisfy Point 1, the stock should have a low multiple on future expected earnings relative to the market. This means that the current earnings are not reflective of what the company should normally be expected to do (recognizing that the term “normally expected” is based on our judgment). Put another way, from our expectations of the economy, the industry, and/or the company trends, we would expect the company to produce a certain set of results, and the market should be paying a relatively low multiple for those results. Hence, if stock A has a lower multiple than stock B, it’s the value stock of the two, all things being equal.
3. If the company’s stock price doesn’t satisfy either Point 1 or Point 2, the company must have some other undervalued asset on the balance sheet (tangible or intangible) that can be turned into earnings for shareholders. This might be excess cash, undervalued real estate, intellectual property, brand names, or a range of other factors that we have noted over the years.

It is difficult for us to think of any other way to define a good investment.

Simply stated, when we buy shares in a company, we expect the earnings or the multiple paid for the earnings to go up—or both. Our forecast horizon is typically three to five years, which happens to correspond to our annual turnover of 20-35%.

Prices are higher for stocks today than they were a year ago. However, in any market environment, there will always be a collection of oversold, neglected, and earnings-turnaround companies that can be very attractive investments. Our daily practice is to find those companies and buy them. This deliberate and patient process should continue to provide excess returns to our clients who have entrusted their funds to our care. It’s a job that we take quite seriously.

Sincerely,

Pacific Ridge Capital Partners

**Small Cap Value
Portfolio Statistics
December 31, 2013**

	PRCP Small Cap Value	Russell 2000® Value
Number of Holdings	111	1,394
Weighted Average Market Cap (\$M)	649	1,517
Average Market Cap (\$M)	627	883
Median Market Cap (\$M)	474	613
Price/Earnings (FY1)	17.7	17.0
Price/Earnings (FY2)	14.9	16.1
Price/Book	1.7	1.5
Dividend Yield	0.9%	1.9%
Beta (vs Russell 3000)	1.3	1.2
L.T. Growth Forecast Median	12.0%	10.0%
Annual Turnover	26.5%	

**Micro Cap Value
Portfolio Statistics
December 31, 2013**

	PRCP Micro Cap Value	Russell Microcap® Value
Number of Holdings	64	1,089
Weighted Average Market Cap (\$M)	287	442
Average Market Cap (\$M)	271	278
Median Market Cap (\$M)	245	232
Price/Earnings (FY1)	19.5	16.1
Price/Earnings (FY2)	16.2	15.8
Price/Book	1.5	1.4
Dividend Yield	1.4%	1.7%
Beta (vs Russell 3000)	1.3	1.1
L.T. Growth Forecast Median	15.0%	10.0%
Annual Turnover	30.2%	

Composite Performance Tables

Small Cap Value

	Q4'13	YTD	1 Year	3 Year	Since Inception
PRCP Small Cap Value - Gross	10.9	45.7	45.7	16.7	21.1
PRCP Small Cap Value - Net	10.6	44.3	44.3	15.6	19.9
Russell 2000® Value	9.3	34.5	34.5	14.5	18.2

Micro Cap Value

	Q4'13	YTD	1 Year	3 Year	5 Year	Since Inception
PRCP Micro Cap Value - Gross	9.4	47.4	47.4	20.7	29.6	10.1
PRCP Micro Cap Value - Net	9.0	45.3	45.3	19.0	27.7	8.4
Russell Microcap® Value	10.6	41.2	41.2	15.8	18.6	4.1

The firm maintains composites on both its strategies. The Small Cap Value Composite inceptioned on August 1, 2010. The Micro Cap Value inceptioned on April 1, 2007. All returns greater than one year are annualized. The performance results of the Micro Cap Value strategy includes accounts managed at another advisor. The Firm maintains a complete list and description of composites and a presentation that complies with the requirements of GIPS® standards, which is available upon request by contacting Peter Trumbo, Chief Compliance Officer at (503) 886-8972 or Peter.Trumbo@PacificRidgeCapital.com. The portfolio statistics are shown as supplemental information only and complements the full disclosure presentation (fully compliant GIPS presentation).

About Pacific Ridge Capital Partners, LLC

Pacific Ridge Capital Partners is an employee-owned firm. We generate our own investment ideas using fundamental analysis and bottom-up stock picking. The investment team applies a consistent, patient and disciplined process that results in low turnover and stability. Our proven philosophy has performed well over many investment cycles and it is the consistent application of this strategy that makes Pacific Ridge unique.

The principals of Pacific Ridge Capital Partners are invested along with our clients in each of our strategies.

PRCP Small Cap Value – Our Small Cap Value strategy generally purchases stocks in the bottom three-quarters of the Russell 2000® Index. This smaller capitalization segment has a large number of underfollowed companies, providing us the greatest opportunity to exploit market inefficiencies. The typical range of holdings is between 110 and 160.

PRCP Micro Cap Value – Our Micro Cap Value strategy generally purchases stocks in the Russell Microcap® Index. This segment is widely underfollowed, providing us the greatest opportunity to exploit market inefficiencies. The typical range of holdings is between 50 and 80.

We believe these market cap segments offer great potential returns and additional diversification for our clients.

For further information about Pacific Ridge Capital Partners and our investment strategies, we invite you to contact Peter Trumbo via email at Peter.Trumbo@PacificRidgeCapital.com or by phone at (503) 886-8972.

Disclosures

Pacific Ridge Capital Partners, LLC (“Pacific Ridge”, “PRCP”, or “the Firm”) is an employee-owned investment advisor registered with the Securities and Exchange Commission under the Investment Advisor Act of 1940. The Firm was established in June 2010, and has one office located in Lake Oswego, Oregon. Pacific Ridge claims compliance with the Global Investment Performance Standards (GIPS®).

Sources: Pacific Ridge; FactSet Research Systems (“FactSet”); and Russell Investment Group (“Russell”) who is the source and owner of the Russell Index data.

The current annual investment advisory fees for the portfolios managed in the Firm’s Small and Micro Cap Value strategies are 1.00% and 1.50% of assets, respectively. Returns for the composites are presented gross and net of management fees and other expenses and includes realized and unrealized gains and losses, cash and cash equivalents and related interest income, and accrued based dividends. The Firm calculates time weighted rates of return by geometrically linking portfolio simple rates of return at least monthly, with adjustments made for significant external cash flows. The composite returns are calculated by asset weighting the individual portfolio returns using beginning of the period values. All returns are calculated after the deduction of the actual trading expenses incurred during the period.

The information provided should not be considered a recommendation to purchase or sell any particular security. There is no assurance that any securities discussed herein will remain in our strategy at the time you receive this report or that securities sold have not been repurchased. It should not be assumed that any of the holdings discussed herein were or will be profitable or that the investment recommendations or decisions we make in the future will be profitable or will equal the investment performance of the securities discussed herein. Past performance is no guarantee of future results.

Although the statements of fact and data in this report have been obtained from, and are based upon, sources that the Firm believes to be reliable, we do not guarantee their accuracy, and any such information may be incomplete or condensed. All opinions included in this report constitute the Firm’s judgment as of the date of this report and are subject to change without notice. This report is for informational purposes only and is not intended as an offer or solicitation with respect to the purchase or sale of any security.

The Russell 2000® Value Index measures the performance of the Russell 2000 companies with lower price-to-book ratios and lower forecasted growth values. For comparison purposes, the index is fully invested, which includes the reinvestment of income. The return for the index does not include any transaction costs, management fees or other costs.

The Russell Microcap® Value Index measures the performance of the microcap segment of the U.S. equity market. For comparison purposes, the index is fully invested, which includes the reinvestment of income. The return for the index does not include any transaction costs, management fees or other costs.

Returns and asset values are stated in US dollars.