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Perritt MicroCap Opportunities  
 Perritt Emerging Opportunities

## Numbers Don't Lie: A Disappointing Quarter, Compelling Opportunity?

If we believe that numbers don't lie, then our words shouldn't either: we are disappointed with our recent performance. Yet cold, hard numbers can teach us a lot, especially in an environment being dominated by emotion. In this commentary we will keep the words short and focus on the data. What can it tell us about the recent downturn? And where is the opportunity?

**The extreme volatility in the micro-cap space was caused by a rush to liquidity by investors of all kinds.** Fearful investors shunned the stocks that were less likely to be able to provide them with short term cash and they placed a premium valuation on more liquid, defensive names. The result

was that poor performance has been most pronounced in the lower market-cap stocks, as seen in the adjacent table. Because we invest primarily in the sub-\$500 million market cap range, the companies that we invest in were adversely affected.

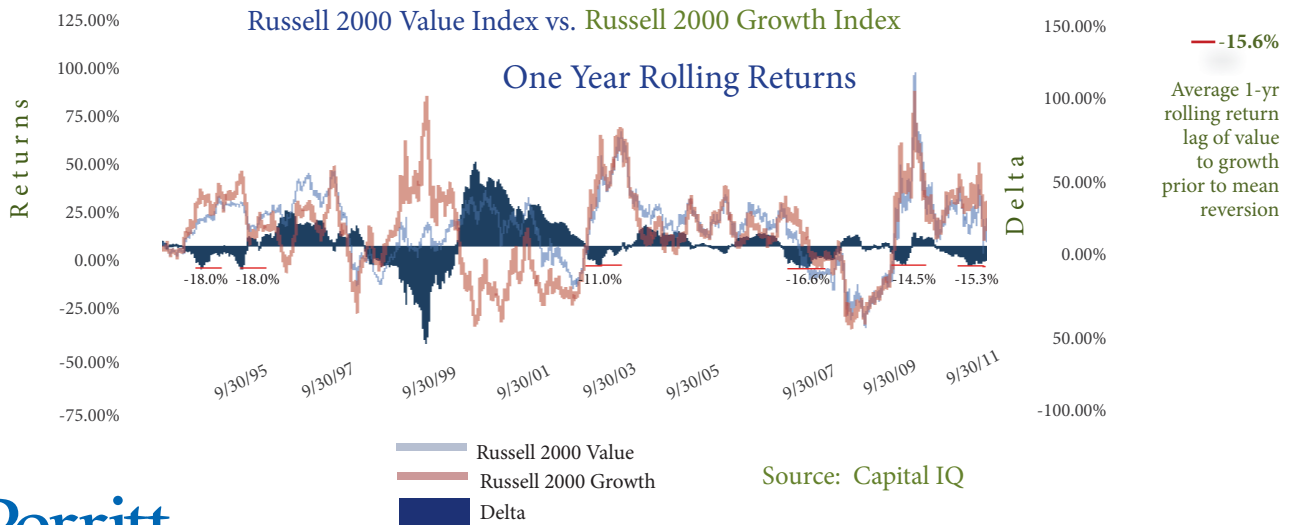
Value stocks have lagged growth stocks in the small-cap space this year, although this trend has been slightly reversing. In the past twenty years, The Russell 2000 Value Index has lagged the Russell 2000 Growth Index in seven distinct periods outside of the Technology Boom of the late 90's, which can be viewed as somewhat of an anomaly. In each of the seven periods, the Value Index lagged the Growth Index by an average of 15.6% on a one-year basis before a predictable reversion to the mean occurred. In April of this year, the one-year return of the Value index lagged the Growth Index by 15.8%. As expected, since that time small-cap value stocks have outperformed. We tend to invest with an emphasis on solid fundamentals and clean balance sheets and we prefer to not pay for a price-to-earnings growth (PEG) ratio of over 1.0 for a growing company. Because of this, the relative out performance of growth stocks has hurt our portfolio on a year-to-date and one-year basis, although it is encouraging that this trend is slightly reversing as might be expected.

## In Rush to Liquidity, Larger Market Caps Outperform

December 31, 2010 to September 30, 2011	Russell 2000 Index*	
	Median Return	Number Of Stocks
\$150MM.....	-23.87%	149
\$150MM-\$500MM.....	-26.24%	799
\$500MM-\$2Bil. + .....	-19.72%	924
\$2Bil. + .....	-14.47%	102

Source: Capital IQ

## Value Lagging Growth... Reversion to the Mean Looms?

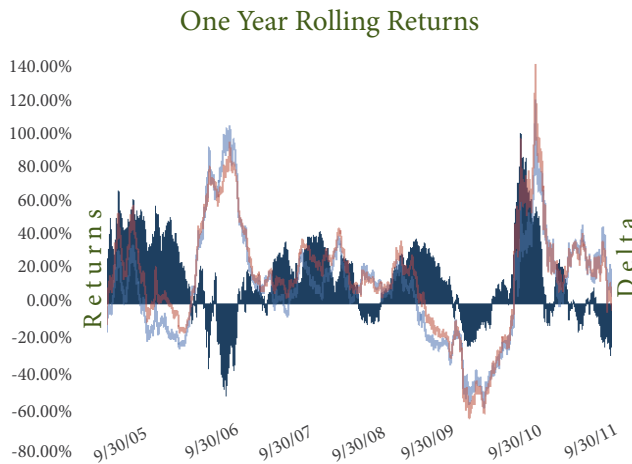


\* Data represents companies listed in the Index on 12/31/10 and does not reflect rebalance of Index on 9/30/11

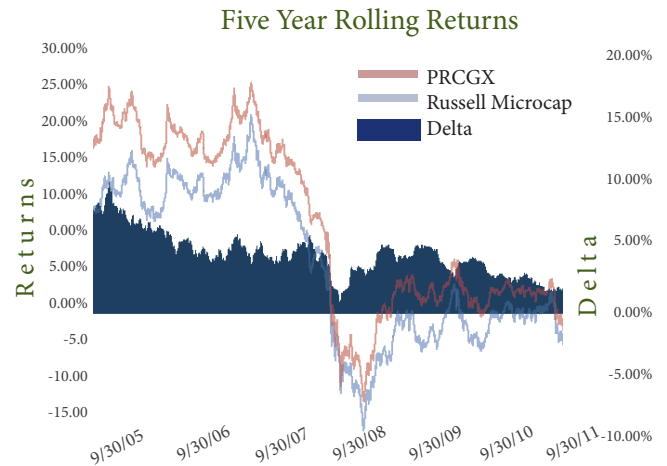
## Short Term Volatility... Long Term Track Record

We know that the best way to measure performance is over a full market cycle. Despite being disappointed with our recent short-term performance, we do remember that we have been here before. We are confident about the future because our five-year rolling returns (shown below) confirm that our shareholders have profited relative to the Index despite short term volatility.

Perritt Micro Cap Fund vs. Russell MicroCap Index



Perritt Micro Cap Fund vs. Russell MicroCap Index



Source: Capital IQ

Our twenty years of experience investing over multiple market cycles has taught us that it is difficult – if not impossible – to predict the moment when a short-term trend in under-performance of a market segment or a skilled manager reverses itself. However, portfolio valuations have often provided a good forecast. Many of the stocks in our portfolio have been a victim of indiscriminate selling regardless of balance sheet fundamentals or business performance. We hope that the valuation data and examples that follow will give you an insight into the earnings power and upside opportunity in our portfolios that are currently being ignored by Wall Street.

### Opportunity Now: Compelling Valuations

	PRCGX*		PREOX*		
	#	% of Portfolio	#	% of Portfolio	
Holdings	125	-	126	-	
Companies Below TBV	44	35.2%	43	34.1%	
Companies Below 1x Revenue	86	68.8%	92	73.0%	
Companies Below 7x OCF	35	28.0%	36	28.8%	
No Debt	35	28.0%	37	29.4%	
	Mkt. Cap	Price to Tangible Book	Price To Sales	Price To Earnings (Trailing 12 Months)	Price To Operating Cash Flow
PRCGX	151.0	1.0	0.6	14.8	8.6
PREOX	49.5	1.0	0.6	12.9	6.3
RMC Index	123.1	1.2	1.3	9.9	5.0
R2000 Index.	401.5	1.6	1.3	16.5	7.4

As of 9/30/11

(Annualized %)

PRCGX

PREOX

	PRCGX	PREOX
YTD	-24.02%	-14.90%
1-YR	-11.05%	-1.15%
3-YR	-0.62%	5.97%
5-YR	-2.66%	-2.52%
10-YR	9.49%	N/A
15-YR	8.12%	N/A
Inception	8.16% (4/11/1988)	3.16% (8/30/2004)
	Expense Ratio 1.27%	Expense Ratio 1.72%

Performance data quoted represents past performance; past performance does not guarantee future results. The investment return and principal value of an investment will fluctuate so that an investor's shares, when redeemed, may be worth more or less than their original cost. Current performance of the fund may be lower or higher than the performance quoted. Performance data current to the most recent month end may be obtained by calling 1-800-331-8936. The funds impose a 2% redemption fee for shares held less than 90 days. Performance data quoted does not reflect the redemption fee. If reflected, total return would be reduced.

\*PRCGX - Perritt Microcap Opportunities Fund  
\*PREOX - Perritt Emerging Opportunities Fund

## More Strength In Numbers: A Few Examples Typical of Portfolio

### Michael Baker (BKR)

Over-reaction to Lowered Guidance

Market Capitalization.....	190MM
Revenue .....	\$475 MM
Cash.....	\$90 MM
P/B.....	1.4
P/E 2011.....	12.4
P/E net cash.....	6.0

- **Provides engineering design** and program management for the construction industry
- **Management recently lowered** business projections by 10% due to project delays, market reaction brought stock down over 30%
- **Despite this, business backlog** of more than \$1.5 billion & financially strong balance sheet including more than \$10.00/share in cash and no debt.
- **Removing \$10.00/share in cash**, trading at 6x 2011 earnings

### Medical Action (MDCI)

Growing Top line Sold Off by Market

Market Capitalization.....	\$97.2 MM
Revenue 12/31/10.....	\$328 MM
Revenue 9/16/11.....	4.0
Price to P/EBITA(P/EBITA) 5yr. Avg.....	8.4
P/B.....	0.6

- **Develops disposable medical products** such as operating room sterilization products
- **Recent margin contraction** due to higher input costs
- **Growing top line**; recently implemented price increases and announced acquisition of AVID Medical
- **Trading at 4x ttm EBITA**. Over past 5 years, traded at average of 8.4x EBITA, presenting 100% up-side opportunity before consideration of long term growth prospects

### John B. Sanfilippo and Sons (JBSS)

03x Sales; 0.5x Book

Market Capitalization.....	\$85 MM
Revenue.....	\$674 Bil.
P/B.....	0.5

- **Processes and markets tree nuts and peanuts** under private labels including Fisher nuts.
- **Stock sold off 36% YTD as earnings** have lagged due to volatile raw nut prices
- **Top line has grown each year since 2007**; management has implemented price increases and indicates that margins are likely at a trough
- **Stock trading is 0.3x sales and 0.5x book**. Management actions to increase prices and trim operations to single facility lead us to project eps at \$1.95, equaling a P/E of 4.6.

### Systemax (SYX)

Fundamentals & Stock Price

Market Capitalization.....	\$468 MM
Revenue .....	\$3.7 Bil.
Cash.....	\$92 MM
P/E forward est. (net cash).....	6.0
P/B.....	1.1

- **Direct marketer of brand name** products in both technology and industrial segments
- **Severe disconnect between fundamentals** and stock price: since 2010, stock price has declined 50% while revenues increased 10%, with stable margins
- **Systemax has grown revenue year-over-year** in all but 2 of 16 years as a public company with the same management team
- **As margins continue to improve** we believe Systemax is capable of \$2.00+/share in earnings. Net of \$2.70 cash per share (no debt), Systemax trades at 6x 2011 EPS and 4.6x our projected earnings power.

## Attribution Analysis

During the third quarter both the sector allocation and the stock selection hurt the performance of the Microcap Opportunities Fund. Much of the under performance was due to our significant underweight in Financials relative to the benchmark. The Fund has historically been significantly underweight in Financials and we expect that trend will continue as the number of high-quality financial companies in the micro-cap space is limited. However, despite our large underweight to the sector, we have lately increased our allocation to Financials as we have seen several attractively priced and compelling opportunities in the sector lately, mainly in asset managers and some regional banks.

Year-to-date, over half of the MicroCap Opportunities Fund's relative under performance was due to our selection in the Technology sector. As explained in the beginning of this commentary, much of this had to do with a general flight to liquidity as investors abandoned micro-cap stocks. There was a large amount of selling focused on the more volatile Technology space, and on our lower market caps names in particular. We remain convinced about the long-term prospects of many micro-cap companies in the technology space because the strength of balance sheets in relation to stock prices is as attractive as we have seen in many years.

Stock selection was the reason that The Emerging Opportunities Fund outperformed its benchmark in the quarter as well as on a year-to-date basis. The Fund was driven by outperformance in stocks of nearly every sector. Selection was particularly strong in the Health Care sector, aided by the buy-out of two companies (American Medical Alert Corp. and Allied Healthcare International) at a significant return. Whether lucky or good, we are well-aware of the kinds of "nano-cap" companies we invest in do march to the beat of their own drum and that making short-term comparisons to a benchmark can be something of a ridiculous exercise. As our clients know, we have good reason to believe this Fund is a truly distinctive offering which gives investors exposure to the very smallest of the small companies.

The information provided herein represents the opinion of Perritt Capital Management and is not intended to be a forecast of future events, a guarantee of future results, nor investment advice.

Price to Earnings ratio is calculated by dividing current price of the stock by the company's trailing 12 months' earnings per share. Earnings per share is calculated by taking the total earnings divided by the number of shares outstanding. The Russell 2000 Index consists of the smallest 2,000 companies in a group of 3,000 U.S. companies in the Russell 3000 Index, as ranked by market capitalization. The Russell Microcap Growth Index includes those Russell Microcap Index companies with higher price-to-book ratios and higher forecasted growth values. The Russell Microcap Value Index includes those Russell Microcap Index companies with lower price-to-book ratios and lower forecasted growth values. The Russell 2000 Growth Index includes those Russell 2000 Index companies with higher price-to-book ratios and higher forecasted growth values. The Russell 2000 Value Index includes those Russell 2000 Index companies with lower price-to-book ratios and lower forecasted growth values. You cannot invest directly in an index. Price/earnings to growth (PEG) ratio is a ratio used to determine a stock's value while taking into account earnings growth. The Russell MicroCap Index is a capitalization weighted index of 2,000 small cap and micro cap stocks that captures the smallest 1,000 companies in the Russell 2000, plus 1,000 smaller U.S.-based listed stocks. Book value is the net asset value of a company, calculated by subtracting total liabilities from total assets. Cash flow measures the cash generating capability of a company by adding non-cash charges (e.g. depreciation) and interest expense to pretax income. Market Cap is the market price of an entire company, calculated by multiplying the number of shares outstanding by the price per share. The Price to Book ratio compares a stock's market value to the value of total assets less total liabilities. Price to sales ratio is a tool for calculating a stock's valuation relative to other companies, calculated by dividing a stock's current price by its revenue per share. Price to EBITDA is the ratio of a company's stock price to its per share Earnings Before Interest, Taxes, Depreciation and Amortization."

As of 9/30/11, the Perritt Microcap Opportunities Fund held a 0.54% position in BKR, a 0.58% position in MDCl, a 0.45% position in SYX, and no position in American Medical Alert Corp., Allied Healthcare International, JBSS and AVID Medical. As of 9/30/11, the Perritt Emerging Opportunities Fund held a 0.81% position in JBSS, and no position in American Medical Alert Corp., a Allied Healthcare International, BKR, MDCl, SYX and AVID Medical. Fund holdings are subject to change and are not recommendations to buy or sell any security.

Earnings growth for a Fund holding does not guarantee a corresponding increase in the market value of the holding of the Fund.

*The fund's investment objectives, risks, charges and expenses must be considered carefully before investing. The statutory and summary prospectuses contain this and other important information about the investment company, and may be obtained by calling 800-331-8936 or by visiting [www.perrittmutualfunds.com](http://www.perrittmutualfunds.com). Read carefully before investing.*

**Mutual fund investing involves risk. Principal loss is possible. The Funds invest in smaller companies, which involve additional risks such as limited liquidity and greater volatility than larger companies. The Funds invest in micro cap companies which tend to perform poorly during times of economic stress. The Emerging Opportunities Fund may invest in early stage companies which tend to be more volatile and somewhat more speculative than investments in more established companies. Growth stocks typically are more volatile than value stocks; however, value stocks have a lower expected growth rate in earnings and sales.**

The Perritt Funds are distributed by Quasar Distributors, LLC