

Perennial Value Smaller Companies Trust

2013



The Trust provides actively managed exposure to a portfolio of Australian smaller companies shares, employing a value style investment process.

The Trust invests outside the top 100 Australian listed companies with a market capitalisation greater than \$50 million. An investment in the Trust can complement an allocation to Australian large cap shares and provide the diversification benefits associated with focusing on the stocks in the broader universe.

What is a small cap?

Traditionally, a smaller company (small cap) has a market capitalisation (market cap) of between \$50 million and \$1.5 billion. Market cap is a way of measuring the size of a company. It is calculated by multiplying the number of shares issued by a company by the current value of a single share.

Benefits of investing in small caps:

- **Small caps have considerable potential and can deliver significant value to shareholders.** Many small caps are relatively young companies. This can result in a greater earnings growth potential than larger, more established stocks.
- **Small caps typically have more focused management, given they are likely to have a significant equity stake in the business.** This results in a clear alignment of interests between shareholders and management.
- **Investing in small caps can be a way of obtaining exposure to a specific industry or market.** A small cap will likely focus its operations and expertise on more specific products or services, whereas a larger stock may diversify across a broader range of operations. Recent examples of some of the Trust's many holdings are outlined in the 'Stock Case Study' insert.
- **Small caps are more agile than their large cap counterparts** and can react more quickly to changes in their business environment and circumstances.
- **The small caps universe is large and there is limited research coverage.** The lack of research coverage means that the market is less efficient and this creates more opportunities to outperform the market.

How the Trust works

The Perennial Value Smaller Companies team is a specialist active Australian equities manager, whose investment process is based on a 'value' stockpicking investment style. The team holds the belief that investment markets are not fully efficient, as asset prices are sometimes driven by irrational influences. With an investment process based on 'value' stockpicking, the Trust invests in a range of smaller listed companies predominantly outside the S&P/ASX 100 Index, which Perennial Value believes have sustainable operations and whose share price offers good value.

Key features of the Trust

Consistent outperformance

The Trust has a proven track record over all time frames. It has consistently outperformed not only its benchmark, the S&P/ASX Small Ordinaries Accumulation Index, but also large caps, as measured by the S&P/ASX 100 Accumulation Index over longer period.

Period ending 28 February 2013	1 year %	3 years % p.a.	5 years % p.a.	10 years % p.a.
Perennial Value Smaller Companies Trust	8.7	11.0	6.0	13.9
S&P/ASX Small Ordinaries Accumulation Index	-2.4	2.6	-3.8	9.0
S&P/ASX 100 Accumulation Index	26.1	8.3	3.4	11.1
Value Added/Detracted against S&P/ASX Small Ordinaries Index	11.1	8.4	9.8	4.9
Value Added/Detracted against S&P/ASX 100 Accumulation Index	-17.4	2.7	2.6	2.8

Source: Perennial Investment Partners Limited. Net performance. Trust inception: March 2002.

Research capability

The cornerstone of Perennial Value's approach is a strong emphasis on company research, with the aim of developing a detailed understanding of each company before committing investors' funds. The research effort includes sifting through annual reports, building company models and meeting with company executives as well as competitors and suppliers.

The Smaller Companies team sits within the Perennial Value team and is able to leverage the considerable expertise and experience of another eight investment professionals not available to traditional small cap boutique managers.

Boutique ownership

Equity participation is a key element of Perennial's business model. The investment staff's equity stake in the business means the team are single minded in ensuring delivery of performance ahead of benchmark. At the heart of Perennial's equity ownership structure is the philosophy of aligning our investment professionals' interests with that of our clients.

The Perennial Value Smaller Companies team attributes its success to:

- Rigidly sticking to the discipline of only buying good businesses for good value.
 - A very strong focus on in-depth, proprietary research. This includes sifting through annual reports, building company models and meeting with company executives as well as competitors and suppliers.
 - An experienced small cap investment team that leverages the strength and expertise of a further eight investment professionals in the Perennial Value team.
 - Key investment staff own direct equity in the business and are personally invested in the Trust, thereby aligning all stakeholders' interests.
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Focus on capital preservation

As well as offering strong historical returns, the Trust has a strong capital preservation element based on the following parameters.

- Zero exposure to highly geared, complex structures.
- Strong balance sheets with limited debt. As at 28 February 2013, 48% of the Trust was invested in companies with debt-free balance sheets.
- Strong net interest cover. As at 28 February 2013, (based on FY12 forecasts) net interest for the Trust cover was 33.9 times representing a 144% premium to market.

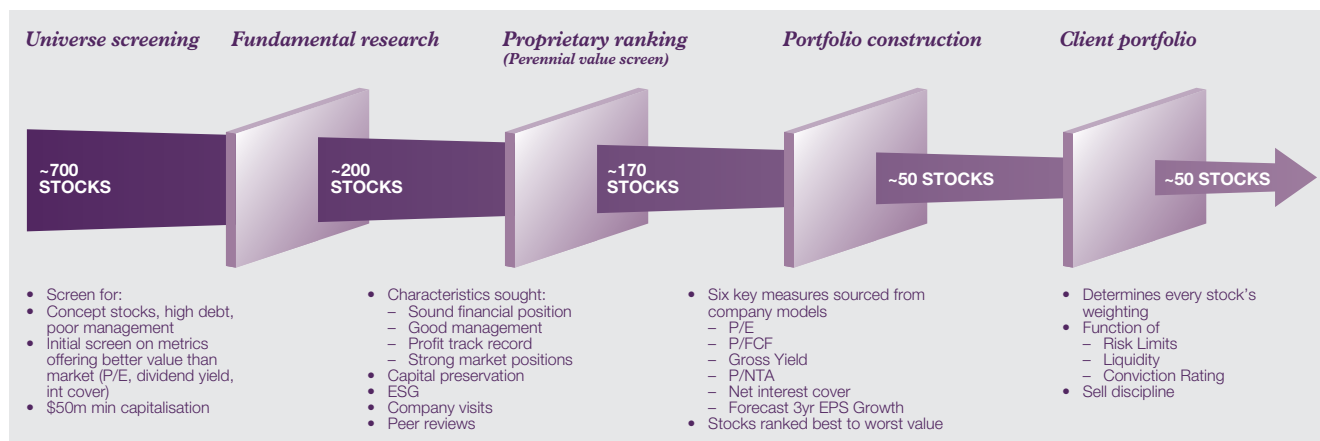
Risk limits

Risk management is key to Perennial Value's investment approach and the construction of a high quality portfolio. The following parameters are factored into the investment process.

Minimum market cap	\$50 million
Maximum cash allocation	10%
For individual stocks	Maximum allocation of 10% of the portfolio. Maximum 12.5% of issued capital. The Trust is permitted to invest up to 15% of the portfolio in mid-cap stocks.
Number of stocks in the portfolio	The Trust will typically hold approximately 50 stocks with a minimum stock holding of 30 and a maximum of 60.
Tracking error	(ex-ante) 5% to 8% (soft limit only)

Investment strategy

Investment process



For the team, the key characteristic in any stock is value. This is crucial in ensuring that at all times the Trust is always better value than the market.

The Trust predominantly invests in stocks outside the top 100. However, the Trust can invest up to 15% in stocks that are included in the mid-cap index. In managing liquidity risk, the Trust can invest in stocks with a market capitalisation greater than \$50 million at the time of acquisition. Perennial Value's investment process begins with screening approximately 700 stocks that are actively researched. Stocks are eliminated based on factors such as expensive P/Es, high debt and lack of earnings track record. Detailed modelling and research is then conducted on approximately 170 companies. To qualify for investment, stocks must have sustainable businesses (qualitative) and offer good value at the current share price (quantitative). Every potential investment opportunity is assessed on its key qualitative and quantitative criteria, including sound financial position (low debt), good management, demonstrable track record of profit and strong market positions.

Direct company and industry contacts are an integral part of the stock selection process. Relative value is measured by Perennial Value's proprietary stock ranking model, known as the Perennial Value Screen. Having ratified the numbers in the company models, six key financial measures are downloaded from each company model into the Value Screen:

1. Price to earnings.
2. Price to free cash flow (a more rigorous measure than gross cash flow).
3. Gross dividend yield.
4. Price to net tangible assets.
5. Net interest cover (to measure financial strength).
6. Earnings growth.

For each of the six measures, stocks are assigned a ranking, with each measure evenly weighted. Each stock is then assigned a weighted average final score, which determines its final ranking. The outcome of this detailed research process is a list of stocks that are eligible for portfolio inclusion.

The next phase of Perennial Value's process is portfolio construction. The major driver of portfolio construction is Perennial Value's desire to deliver a true to label value portfolio at all times. This means that the portfolio has a strong bias towards the best ranking, or best value, stocks in the Perennial Value Screen.

Having built the investment case for each stock through a detailed understanding of the industry, suppliers, technology and competitors, the passion and conviction of the investment analysts and portfolio managers is key to stock selection and ultimately performance. With over 10 years' average industry experience the team's considerable expertise, knowledge and skill have enabled them to construct and manage the portfolio to deliver strong and sustained outperformance for investors.

Trust snapshot	
Suggested investment time horizon	Five years
Number of securities	58
Unit pricing	Daily
Income distribution	Half yearly
Minimum initial investment amount	\$25,000
Minimum additional investment amount	\$5,000
Risk/Return profile	High
Investment management fee	1.20% p.a.
Performance fee	Yes
Buy/Sell spread	0.30/0.30

Current Trust characteristics

Prospective FY14	Price to Earnings (times)	Price to free cashflow (times)	Gross Yield (%)	Price to NTA (times)	Net Interest Cover (times)	3yr EPS growth (% p.a.)
Market Average (ASX 300)	13.0	12.7	6.2	2.1	13.9	11.8
Perennial Value Smaller Companies Trust	9.0	10.5	5.4	1.3	33.9	25.4
Premium/ (Discount) to Market	(31%)	(17%)	(13%)	(38%)	144%	115%*

Source: Perennial Investment Partners Limited. As at 28 February 2013. The above figures are forecasts only.
 * 165% Premium vs Ex-100 market. Macquarie Securities and UBS as at 28 February 2013.



Perennial Value Smaller Companies team

Portfolio Managers and Analysts:
Grant Oshry and Andrew Smith

Resource Equities Analyst:
Sam Berridge

Senior Equities Analyst:
Damian Cottier

The Smaller Companies team sits within Perennial Value and is able to leverage the experience and expertise of a further eight investment professionals in the Perennial Value team.

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For up to date information on the Trust, including the latest performance data and asset allocations, please visit www.perennial.net.au

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