Perennial Value Smaller Companies Trust

Monthly Report
31 January 2016

	Month	Quarter	FYTD	1 year	3 years	5 years	Since Inception^
	%	%	%	%	% p.a.	% p.a.	% p.a.
Perennial Value Smaller Companies Trust*	-7.3	-5.8	-1.2	6.6	-2.5	-0.1	9.1
S&P/ASX Small Ordinaries Accum. Index	-5.1	-1.4	1.5	3.6	-1.4	-3.1	4.8
Value Added (Detracted)	**-2.2**	**-4.4**	**-2.7**	**3.0**	**-1.1**	**3.0**	**4.3**

*Net performance (including performance fee). ^Since inception: March 2002. Past performance is not a reliable indicator of future performance.

Perennial Value Smaller Companies Trust

The Trust aims to grow the value of your investment over the long term via a combination of capital growth by investing in a diversified portfolio of Australian shares predominantly outside the S&P/ASX 100 Index, and to provide a total return (after fees*) that exceeds the S&P/ASX Small Ordinaries Accumulation Index measured on a rolling three year basis.

Portfolio managers:
Grant Oshry and Andrew Smith

Risk profile:
High

Trust FUM (as at 31 January 2016):
AUD 112 million

Income distribution frequency:
Half yearly

Minimum initial investment:
$25,000

Trust inception date:
March 2002

APIR code:
IOF0214AU

- **In January the Index was down 5.1% and the Trust was down 7.3%.**
- **The sell-off occurred in most global markets in conjunction with continued weakness in materials and energy reflecting concerns on the global growth outlook.**
- **February reporting season will focus the market back on domestic issues and company reports.**

Trust performance

January was a particularly weak month, with the S&P/ASX Small Ordinaries Index (the Index) down 9% at one stage before a late recovery to finish down 5.1% over the month. The Perennial Value Smaller Companies Trust (the Trust) was down 7.3%, underperforming by 2.2% net of all fees.

Over the last 12 months the Index is up 3.6% with the Trust up 6.6%, delivering 3.0% outperformance net of all fees.

Globally, markets were dominated by concerns around growth, particularly the slowing Chinese economy and the falling oil price. This led to a broad based sell-off with the S&P500 down 5.1%, FTSE100 down 2.5%, Nikkei225 down 8.0% and the Shanghai Composite down 22.6%. In Australia, there was another decent job number, with the unemployment rate steady at 5.8% in December. This provides further evidence of the economy successfully transitioning post the resources boom. The cash rate remained at 2% (the Reserve Bank of Australia (RBA) does not meet in January) and the Australian Dollar (AUD) fell 2 cents to close at 70.9 US cents.

The weakest sector by far was energy (down 19.8%) followed by financials (down 8.9%) and consumer discretionary (down 6.8%). The only positive sector was telecommunications services (up 5.2%) with the next best sector utilities (down 0.1%).

Tourism stocks, such as Skydive the Beach (up 22.2%), continued to gain attention, and was the best performer during the month. While there was no company announcements, we did note that the company had two of their drop zones included in the Forbes top 11 skydiving destinations for 2016 – their Cairns location as well as the recently acquired NZONE which operates in Queenstown.

Source: Analyst William Wu in Queenstown November 2015

Our other tourism holdings also did well in a weak market: Sealink Travel (up 4.7%) and Skycity Entertainment (up 3.2%) which updated the market during the month reporting strong revenue growth in their key asset, the Auckland Casino.

In other company news, Fantastic Furniture (down 11.8%) announced strong 1H16 results ahead of market expectations, unfortunately this was overshadowed by the resignations of their respected Chief Financial Officer and Chief Executive Officer earlier in the month. We are clearly disappointed with these developments in light of the strong turnaround being achieved by this outgoing management team. We have expressed our concerns to the Board and remain in dialogue with them.

M2 Group (up 10.0%) closed higher as their merger with Vocus was approved by shareholders towards the end of the month. The Trust took advantage of this late spike in the share price to lock in some profits.

The key detraction from performance was energy stocks reflecting weaker oil prices as well as general concerns about energy demand – be it coal, gas or oil. Whitehaven Coal (down 41.4%) was sold off on coal weakness despite an impressive quarterly in which they proved they were getting a premium price for their Maules Creek product. Sino Gas (down 57.7%) was aggressively sold off after announcing some delays in payment from their Chinese partners. The stock is now trading at close to cash backing and thus any resolution on the outstanding payments will be material to the share price. Sundance Energy (down 29.4%) sold off with the oil price despite announcing a cut in capex, which will now be more than covered by cashflow this year.

Simonds Group (down 54.3%) was weaker after announcing 1H16 results which were 30% lower than analyst expectations. The issue is around margins, rather than demand, which remains strong. Some of the issues appear timing related reflecting an aggressive push into Queensland and New South Wales with costs incurred ahead of revenues. We await the appointment of the new Managing Director to determine our confidence in a margin recovery, however, even on conservative assessments, the sell-off looks over sold.

Trust Activity

In terms of portfolio activity the Trust took advantage of weakness in several stocks to add to our positions: namely Thorn Group, Sundance Energy, Pulse Health and G8 Education. These positions were funded by existing cash as well as selling down outperformers such as Melbourne IT and Lifehealthcare Group.

The Trust ended the month with 49 stocks and cash of 4.7%.

Outlook

We continue to see attractive valuations in only a select number of small companies as the Index is relatively expensive with a weighted average FY16 PE (Price to Earnings) of 15.3x FY16. Our portfolio, by contrast has a FY16 PE of 13.5x FY16, being a 12% discount to the market.

In the defensive sectors, we have investments in healthcare, retirement and gaming where we see a combination of growth and attractive valuations. We also remain attracted to industries benefitting from a weaker AUD, in particular tourism. We believe there will be continued growth in detached housing construction despite signs of over-heating in other areas such as apartments. Valuations look attractive in domestic media and the likelihood of government policy changes to cross media ownership rules provides a potential catalyst in 2016.

In resources, there are some good valuation opportunities in our preferred commodity exposures (copper and nickel) however the gold sector looks expensive and is the main reason for our underweight position in materials. We have close to a benchmark position in energy.

As always, our focus will continue to be on investing in quality companies which are offering attractive valuations.

Asset Allocation

Sector	Trust weight %	Index weight %
Energy	4.0	2.1
Materials	7.8	14.6
Industrials	9.1	12.6
Consumer Discretionary	35.9	22.2
Consumer Staples	3.6	8.9
Health Care	5.2	7.3
Financials-x-Real Estate	9.4	8.9
Real Estate	12.8	12.3
Information Technology	4.2	6.4
Telecommunication Services	2.2	4.1
Utilities	1.2	0.7
Cash & Other	4.7	-

Rounding accounts for small +/- from 100%.

For all other enquiries, please contact us on 1300 730 032
or visit www.perennial.net.au

Signatory of:

PRI Principles for Responsible Investment