PERENNIAL VALUE MANAGEMENT

Perennial Value Smaller Companies Trust

Monthly Report
31 October 2014

	Month	Quarter	FYTD	1 year	3 years	5 years	Since Inception^
	%	%	%	%	% p.a.	% p.a.	% p.a.
Perennial Value Smaller Companies Trust*	-5.4	-7.7	-2.2	-1.5	3.0	4.9	10.1
S&P/ASX Small Ordinaries Accum. Index	-0.5	-3.8	0.9	-3.3	-1.0	-0.1	5.2
Value Added (Detracted)	**-4.9**	**-3.9**	**-3.1**	**1.8**	**4.0**	**5.0**	**4.9**

*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 October 2014):
AUD111.3 million

Income distribution frequency:
Half yearly

Minimum initial investment:
$25,000

Trust inception date:
March 2002

APIR code:
IOF0214AU

- **The Trust underperformed the Index in October in what was a tough month for small caps stocks.**
- **Better performing stocks within the Trust included Fairfax Media, M2 Telecommunications, and eBet.**
- **During the month, we visited Swick Mining Services in WA and were pleased to see that their research and development on their enhanced underground drill rigs will be deployed into operation imminently.**

October was a tough month with the benchmark S&P/ASX Small Ordinaries Accumulation Index returning -0.5%. The Perennial Value Smaller Companies Trust (the Trust) declined 5.4% after all fees, thereby underperforming by a net 4.9%.

The Trust's underperformance can best be decomposed into a couple of stock specific events impacting WDS Limited and BC Iron, which we discuss below, combined with general weakness across a number of our holdings during the month. Despite ongoing unrest in the Middle East and Eastern Europe, the oil price declined further, negatively impacting our energy exposure. Additionally, strong performance from index-heavy (but in our view expensive) stocks, namely TPG Telecom, Domino's Pizza, Sirtex Medical, Invocare, Magellan Financial Group and Platinum Asset Management, impacted our relative performance.

The strongest performing sectors were telecommunication services (up 4.9%) and property trusts (up 4.1%) as demand for defensive yield stocks returned given bond yields remained largely unchanged near record lows. The weakest sectors were energy (down 8.0%) following a 9% decline in the spot Brent crude oil price, followed by materials (down 7.8%) largely due to weakness in gold, nickel and iron ore stocks.

Domestically, economic data was mixed. Building approvals for August rose 3.0% month on month and business confidence for September slipped three points. Retail sales and consumer confidence edged slightly higher, increasing 0.1% and 0.9% month on month respectively. The Reserve Bank of Australia (RBA) left the cash rate unchanged at 2.5% and the AUD ended the month up one cent at US88c.

The worst performing stock in the Trust was WDS Limited (down 69.4%) after announcing the fatality of one of their workers on the APLNG project in Queensland. This incident interrupted a previously impressive safety record (4 years lost time injury free) and had a significant financial impact as the large workforce was stood down while the incident was investigated. In light of this incident, WDS was also unsuccessful in extending the APLNG contract. We will continue to monitor the situation closely in particular the safety performance of WDS and any flow-on impacts with other clients. At this stage we believe an investment in WDS remains justified given the large multi-year pipeline of work in the coal seam space, the net cash on the balance sheet at the end of FY14 and the large discount to NTA of 64c (versus the 24.5c month end share price).

BC Iron (down 33.4%) had informed the market of issues the company was experiencing with clay material in some ore from its Nullagine mine ahead of the issuance of the September report. However, the quarterly report revealed an impact that was greater than initially indicated. This, combined with the company announcing its move to compulsory acquisition of Iron Ore Holdings, saw the share price aggressively sold off. Iron Ore is now entering a re-stock period (ahead of cyclone season in the Pilbara and shutting of mines in China due to winter and Chinese new-year holidays) with upside risk for price as steel mills increase iron ore inventories.

Despite pervasive bearishness in the iron ore space, the seasonal reasons for the re-stock and inventory levels at steel mills indicate a re-stock should take place.

Other detractors included Austex Oil (down 26.7%) where the weakness was oil price related and copper producer Hillgrove Resources (down 11.3%) which reported a solid third quarter production report, yet the market sold down this undervalued company despite a firmer copper price during the month.

During the month, we visited Swick Mining Services (down 1.8%) in South Guildford, Western Australia and were pleased to see that their research and development on their enhanced underground drill rigs (picture below) will be deployed into operation imminently. The company just delivered a positive 1Q FY15 operations report and we are of the view that the market will eventually reward them as the new technology deployed on their rigs will see them offer clients a lower cost per metre drilled versus. competitors, during which time Swick will enjoy higher margins given the increased efficiency and productivity their differentiated rigs will offer. Readers should be aware that Swick's main operations are focussed on underground drilling for mining companies in the production stage, which is less risky than those companies still at exploration stage, and Swick's tender pipeline looks promising.

Kent Swick (Managing Director Swick Mining Services Ltd) flanked by Perennial Value's small cap portfolio managers

Better performing stocks within the Trust included Fairfax Media (up 5.2%), M2 Telecommunications (up 5.1%), gaming systems provider eBet (up 4.8%) and mortgage broker Mortgage Choice (up 4.3%). We were also fortunate not to hold Vocation, which was down 62.4% during October, closing at 91.5c. Readers will recall we exited the stock in late May 2014 at an average price of $2.87 on valuation grounds, coupled with funding risks over FY15. Note when we participated in the IPO in late 2014 at $1.89, funding for FY14 had been secured from Government.

In terms of portfolio activity, we took profits and exited our position in Mantra Group on valuation grounds. Proceeds were used to re-establish a position in Oroton Group following a share price retracement to $3.80, which provided a more compelling valuation and risk-return investment, having previously sold out at an average price of $7.00 in May 2013.

At month end, stock numbers were 58 and cash was 2.8%.

Asset Allocation

Sector	Trust weight %	Index weight %
Energy	12.0	6.9
Materials	13.5	14.0
Industrials	18.1	15.6
Consumer Discretionary	24.7	23.8
Consumer Staples	0.0	3.8
Health Care	0.6	6.2
Financials-x-Real Estate	8.2	7.3
Real Estate	13.0	10.5
Information Technology	3.9	4.6
Telecommunication Services	1.7	6.6
Utilities	1.5	0.7
Other	2.8	-

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