Perennial Value Smaller Companies Trust

Monthly Report
31 December 2015

	Month	Quarter	FYTD	1 year	3 years	5 years	Since Inception^
	%	%	%	%	% p.a.	% p.a.	% p.a.
Perennial Value Smaller Companies Trust*	2.1	7.7	6.5	13.5	1.7	1.6	9.8
S&P/ASX Small Ordinaries Accum. Index	3.9	11.3	7.0	10.2	1.7	-2.5	5.2
Value Added (Detracted)	**-1.8**	**-3.6**	**-0.5**	**3.3**	**0.0**	**4.1**	**4.6**

*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 December 2015):
AUD 122 million

Income distribution frequency:
Half yearly

Minimum initial investment:
$25,000

Trust inception date:
March 2002

APIR code:
IOF0214AU

- **In December 2015, the Trust delivered a return of 2.1% net of all fees, underperforming the index by 1.8%.**
- **For the calendar year the Trust was up 13.5% net of all fees, outperforming the index by 3.3%.**
- **The Trust announced a December 2015 half-yearly distribution of 1.03 cents per unit (CPU), up 2% on the prior corresponding period.**

Trust performance

December was another strong month for the S&P/ASX Small Ordinaries Index (the Index) up 3.9%. The Perennial Value Smaller Companies Trust (The Trust) delivered a return of 2.1% net of all fees, underperforming the index by 1.8%. The strong index return was driven by several large index stocks (Blackmores up 18.7% and Bellamy's Australia up 27.8%) which are not held in the Trust on valuation grounds. In addition Broadspectrum was up 63.7% after receiving a takeover bid, this was not held by the Trust given the policy and reputational risk from their management of government detention centres.

The Index was up 10.2% for the calendar year 2015, well ahead of the S&P/ASX 100 Index which was up only 2.1%. Pleasingly the Trust was up 13.5% net of all fees over the same period delivering 3.3% outperformance compared to the Small Ordinaries Index.

Globally, markets were dominated by the US Federal Reserve's decision to finally lift interest rates by 0.25%. Markets were generally softer with the S&P 500 down 1.8%, FTSE 100 down 1.8% and Nikkei 225 down 3.6%, while the Shanghai Composite rose 2.7%. In Australia, strong job growth continued, with 71,000 jobs created in November and the unemployment rate falling to 5.8%. This provides further evidence of the economy successfully transitioning post the resources boom. The Reserve Bank of Australia (RBA) left the cash rate steady at 2% and the Australian Dollar (AUD) drifted slightly higher over the month to close at 72.9 US cents.

Better performing sectors over the month included consumer staples (up 9.6%) and materials (up 6.9%) while energy (down 11.3%) was the worst performer followed by utilities (down 7.4%).

Smartgroup Corporation (up 42.3% to $5.11) was a strong contributor to performance after delivering another profit upgrade (now targeting a 46% lift in earnings per share). In addition they announced the accretive acquisition of Advantage Salary Packaging funded by debt and the issue of shares to the vendor. The Trust first invested in Smartgroup via the initial public offering (IPO) in mid-2014 at $1.60 and used the subsequent weakness to further increase our position in what is now one of the more successful IPO's of recent years.

Other sizeable positions which benefitted performance include Emerchants (up 18.0%) after signing contracts with both William Hill and bet365 in Australia for their cash load technology. QMS Media (up 14.0%) was also stronger following the accretive acquisition of I-Site in New Zealand. Below is a screenshot of a digital billboard owned by QMS just one of many examples of conversion from static screens to digital which is boosting revenue for the outdoor industry.

Source: QMS Media website, 2015

Some smaller positions, which have looked oversold for much of the year, recovered strongly following encouraging news during the month. Mint Payments (up 51.5%) announced a partnership with a large US listed payments provider to use Mint's technology for their Australian customer base. Swick Mining (up 25.0%) announced the renewal and expansion of their drilling contract with Newmont, their biggest customer.

The key detraction from performance was energy stocks which came under significant pressure during the month as Crude Oil fell a further 11.1%. This impacted oil exposed stocks such as Sundance Energy (down 40.4%), Austex Oil (down 31.0%) as well as oil service company Matrix C & E (down 26.8%). Whitehaven Coal (down 22.7%) was also caught up in the energy sell-off.

While the energy exposure of the Trust has reduced over the last 12 months we believe it prudent to maintain some exposure to the sector given the attractive valuations on offer and prospect of improving prices in the 2H16 as supply begins to fall as a result of recent industry wide capex cuts.

Trust Activity

In terms of Trust activity we exited several small positions in recent IPO's (IDP Education, PWR Holdings and PSC Insurance) which have performed strongly and therefore no longer met our valuation requirements. Proceeds were used to increase cash holdings and participate in the rights issue of both QMS Media and Pulse Health. The Trust ended the month with 48 stocks and cash of 5.6%.

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 of 15.6x FY16. The Trust, by contrast, has a FY16 PE of 12.3x FY16, a 21% 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 an index 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	4.5	2.5
Materials	7.9	14.2
Industrials	8.9	12.5
Consumer Discretionary	34.7	22.6
Consumer Staples	3.0	8.9
Health Care	5.2	7.3
Financials-x-Real Estate	8.6	9.3
Real Estate	12.4	12.0
Information Technology	4.6	6.3
Telecommunication Services	3.5	3.7
Utilities	1.1	0.6
Cash & Other	5.6	-

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

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