PERENNIAL VALUE MANAGEMENT

Perennial Value Smaller Companies Trust

Quarterly Report
31 December 2014

	Quarter	FYTD	1 year	3 years	5 years	Since Inception^
	%	%	%	% p.a.	% p.a.	% p.a.
Perennial Value Smaller Companies Trust*	-10.6	-7.5	-3.9	3.9	2.7	9.5
S&P/ASX Small Ordinaries Accum. Index	-3.9	-2.4	-3.8	0.6	-2.0	4.8
Value Added (Detracted)	**-6.7**	**-5.1**	**-0.1**	**3.3**	**4.7**	**4.7**

*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 and tax effective income 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 2014):

AUD105.6 million

Income distribution frequency:

Half yearly

Minimum initial investment:

$25,000

Trust inception date:

March 2002

APIR code:

IOF0214AU

- **Relative performance for the Trust was impacted by the continued strength of a range of expensive momentum stocks which are not held in the Trust as we remain true to our value style of investing.**
- **Positive contributions were made by Thorn Group (up 26.9%), AMA Group (up 19.1%) and Regis Resources (up 24.1%)**
- **The Trust benefited from the strong float of the patent attorneys IPH Limited (up 66.6% from issue price).**

During the quarter, the Perennial Value Smaller Companies Trust (the Trust) generated a return (net of all fees) of -10.6% compared to the benchmark S&P/ASX Small Ordinaries Accumulation Index return of -3.9%, resulting in underperformance of 6.7%. For the 2014 calendar year the Trust delivered -3.9% after all fees compared to the benchmark of -3.8%, thereby marginally underperforming by a net 0.1%.

Relative performance for the Trust was impacted by the continued strength of a range of expensive momentum stocks which are large index constituents (for example, 20 key stocks are on a 1-year forward P/E multiple of 21x-43x based on IBES consensus data). These stocks are not held in the Trust as we remain true to our value style of investing, as evidenced by the attractive value of the portfolio relative to the market as shown below.

Prospective FY15	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 Ex-100*	16.1	14.6	4.9	1.6	8.0	7.5
Perennial Value Smaller Companies Trust**	12.5	10.8	5.4	1.1	25.0	28.8
Premium/ (Discount) to Market	(22%)	(26%)	11%	(33%)	212%	284%

Source: *Macquarie Securities, Goldman Sachs and UBS as at 29 December 2014. **Perennial as at 31 December 2014

Global markets finished a volatile December quarter mixed, with the S&P500 (up 4.4%) and Nikkei 225 (up 7.9%) up, while the FTSE 100 (down 0.9%) and Euro Stoxx 50 (down 2.5%) declined. The major event during the quarter was the sharp decline in oil prices, which undermined confidence in the global economy as well as impacting the share prices of energy producers. However, there was further evidence that global growth is improving. In particular, the data for the US was positive, with the revised Q3 GDP data showing the firmest rate of growth since 2003 and non-farm payrolls growing 321,000, well above expectations. In other regions, key German data improved, there were positive signs that Japan's economy is emerging from recession in the current quarter and China's data was consistent with a growth rate close to 7% in Q4, although a key manufacturing PMI dropped below 50. Global inflation continued to fall suggesting a prolonged period of low interest rates.

In Australia, GDP growth was unexpectedly weak in the September quarter, with real disposable income falling again, however, the partial data for the fourth quarter pointed to improvement. Retail sales for October were soft, albeit better than expected and home building approvals boomed, as did employment for November.

The jobless rate, however, rose to a new 12-year high of 6.3%, and business and consumer sentiment fell, with the mid-year economic update revealing further deterioration in the budget deficit, largely due to lower commodity prices. The RBA left interest rates unchanged at 2.5% and the AUD continued to fall, reaching a four-year low of 81 US cents.
This quarter saw significant divergence in the performance of some sectors. Energy was the worst performing sector down 36.0%, followed by Materials down 13.9%. Telecommunication Services and Property Trusts were the best performers up 7.7% and 7.6% respectively. The relative performance of the Trust was impacted by holdings in the Energy and Materials sector, as well as some stock specific factors.

Key detractors during the quarter were Sundance Energy (down 57.1%) and Austex Oil (down 44.4%) in response to the large sell-off in oil markets (Brent Crude was down 39.1%. for the quarter). Despite the weakness, we remain comfortable with these holdings given costs for Sundance Energy of US$20.40/barrel of oil equivalent (BOE) in the September quarter and in the case of Austex Oil a hedge position of 80% of their production above US$80/barrel for the next two years – in time the relative quality and positioning of these companies should be reflected in stronger share prices despite the prospect of continued weak oil markets. Iron ore prices were also weaker and this had a significant impact on BC Iron which was down 67.2% for the quarter.

As touched on in the October monthly, WDS Limited was a key detractor (down 68.8% over the quarter) after being heavily impacted following the fatality of one of their workers on the APLNG project in Queensland which also led to the subsequent loss of future APLNG opportunities. We spent considerable time assessing the impact of this event and discussing any issues with the safety procedures (which previously resulted in 4 years lost time injury free) with the board and management. We gained some comfort that there has been a limited flow on effect to other contracts after the award of a new contract with Santos GLNG in November. This combined with stable outlook for coal seam related work and an NTA of 64c (versus 24.5c share price at end of the quarter) justifies holding the position in WDS at this time.

Positive contributions were made by Thorn Group (up 26.9%) following a strong interim result which showed continued growth in their core rental business, as well as AMA Group (up 19.1%) after announcing an expansion into the Queensland smash repair market. Regis Resources (up 24.1%) benefited from an improvement in the $A gold price while Global Construction (up 12.8%) reacted positively after Brookfield Asset Management acquired a 15% stake. Fairfax (up 12.9%) also performed well after announcing the merger of its radio business with Macquarie Radio Networks.

In addition the Trust benefited from the strong float of the patent attorneys IPH Limited (up 66.6% from issue price). IPH has a strong presence in Australia and Singapore with a growing business in other parts of Asia.

During the quarter, we exited our position in Mantra Group on valuation grounds. We also sold out of Karoon Gas post a positive drill result and to reduce energy exposure ahead of the OPEC meeting. After the recovery in the gold sector during the quarter we sold out of Alacer Gold and reduced the position in Regis Resources.

The proceeds were used to re-establish a position in Oroton Group following recent share price weakness (bought at an average of $3.80 compared to our exit price of $7.00 in May 2013). We also added to our positions in Super Retail Group, Fantastic Furniture, Life Healthcare, Tower and GDI Property Group.

Perennial Value Management remains alert to Environmental, Social and Corporate Governance (ES&G) issues in the portfolio. Pacific Energy is a remote power operator for mine sites as well as the owner of 6MW of Hydro capacity. They are making considerable progress in reducing the diesel fuel intensity of their power stations for the benefit of both their clients and the environment. At their recent AGM they announced progress with their waste heat recovery technology (with Regis Resources a foundation client) as well as their dual fuel technology which enables their clients, such as the Tropicana mine, to switch from diesel to gas.

At month end, stock numbers were 54 and cash was 4.0%.

Asset Allocation

Sector	Trust weight %	Index weight %
Energy	9.2	5.1
Materials	9.3	14.5
Industrials	18.3	15.1
Consumer Discretionary	28.1	24.5
Consumer Staples	0.0	4.2
Health Care	1.5	6.6
Financials-x-Real Estate	10.2	7.9
Real Estate	13.3	11.4
Information Technology	3.2	4.8
Telecommunication Services	1.7	5.2
Utilities	1.3	0.7
Other	3.9	-

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