PERENNIAL VALUE MANAGEMENT

Perennial Value Smaller Companies Trust

Monthly Report
30 June 2017

	Month	Quarter	FYTD	1 year	3 years	5 years	Since Inception^
	%	%	%	%	% p.a.	% p.a.	% p.a.
Perennial Value Smaller Companies Trust*	3.7	1.9	16.9	16.9	6.9	7.7	9.9
S&P/ASX Small Ordinaries Accum. Index	2.0	-0.3	7.0	7.0	7.1	5.7	5.6
Value Added (Detracted)	**1.7**	**2.2**	**9.9**	**9.9**	**-0.2**	**2.0**	**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 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
AUD $110 million

Distribution frequency
Half yearly

Minimum initial investment
$25,000

Trust inception date
March 2002

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- **For the financial year the Perennial Value Smaller Companies Trust (the Trust) has delivered a net return of 16.9%, compared to the S&P/ASX Small Ordinaries Index (the Index) return of 7.0%**
- **The Trust remains attractively priced compared to the Index with a price to earnings ratio of 11.5 times for FY18 and a gross yield of 5.2% - the Index valuation is 15.1 times with a yield of 4.7%**

Trust performance

For FY17 the Trust was up 16.9% well ahead of the Index which was up only 7.0%. The final distribution from the Trust is 5.2 cents per unit, a healthy cash yield of 5.5% on the month end unit price.

Global markets were generally stronger in June, with the S&P500 up 0.5%, Nikkei 225 up 1.9% and Shanghai Composite up 2.4%, while the FTSE100 declined 2.8%, following the outcome of the UK election. As widely expected, the US Federal Reserve raised interest rates by 25 basis points, moving the target rate to between 1.00% and 1.25%. Commodity prices were mainly stronger, with iron ore rallying strongly 14.0%, thermal coal up 6.0%, copper up 5.0% and coking coal flat. However, oil sold off 5.0% and gold fell 2.0%. The Reserve Bank of Australia left the cash rate steady at 1.5% and the Australian Dollar finished the month up three cents at 77 US cents.

During June, the best performing sector was consumer staples (up 7.6%) followed by healthcare (up 3.8%) and consumer discretionary (up 3.3%). The worst performing sector was utilities (down 13.5%) followed by property trusts (down 3.0%) and Energy (down 2.9%).

The strong performance of the Trust during June reflected a broad based rally in many stocks we hold- as an indication 13 stocks held in the Trust were up over 10.0% for the month.

The largest gain was from **Austin Engineering** (up 37.5%) with investors increasingly confident in the earnings turnaround first seen at the 1H17 result in February. Data from industry leader **Caterpillar** gave further support showing the strong recovery in equipment demand across the Asia Pacific has continued.

Prime TV (up 20.6%) reiterated underlying earnings guidance and also outlined the benefit from the reduced license fees. While the reduction in license fees is a positive, we await progress on the government's attempts to remove cross media ownership restrictions, something that would further enhance the corporate value of Prime TV. Another positive is the likely weakness in competitor Channel 10 as they face funding issues. HT1 (up 12.8%) also benefited from reduced licence fees as well as data which showed an improvement in the metropolitan radio market after several months of decline.

Other strong performers included: **Thorn Group** (up 18.3%) as several directors bought stock on market post the FY17 result reported in May, **Imdex** (up 18.0%) after a presentation at a Morgan Stanley conference showed continued growth in tool rental and a strong earnings recovery as well as **Integrated Diagnostics** (up 16.1%) after competitor Capital Health moved earnings guidance to the top of the range and divested an asset at an attractive multiple.

The main detractor from performance was **Metals X** (down 13.5%) this move was at odds with their main commodity exposure of copper which was up 4.6% in USD. Our conviction in this name remains high post a recent site tour, hence we added to the position on weakness.

Gateway (down 7.1% after factoring in the dividend) was lower after they reduced their settlement forecast for FY17. While downgrades are never positive, we did take comfort from the healthy sales rates (settlements just pushed into FY18 given poor weather) as well as the implied rental growth and lower corporate costs in the 2H17.

Trust activity

We exited **Tassal Group** during the month, with our preference being **Huon Aquaculture** given the current environmental disputes in Macquarie Harbour which provide some uncertainty for Tassal.

We added a new position in **Synlait** (a dual listed NZ stock), which manufactures infant formula for A2 Milk and others. The valuation is much more compelling than the brand exposures and with the changes in Chinese regulations the manufacturing sites are becoming more strategic (as evidenced by A2 Milk acquiring a stake in Synlait). As part of our due diligence we toured the key site in Christchurch NZ during the month, as seen below.

Source: Perennial Value Management Site Tour to Christchurch, New Zealand July 2017

We added several stocks which were overly impacted by tax-loss selling in June. One example is **Baby Bunting**, a specialty retailer and market leader of baby goods. This stock had been drifting lower due to general weakness in the consumer discretionary sector combined with fears of disruption from Amazon's entry into the Australian market. When this selling accelerated in June we used the weakness to add it to the Trust at an average entry price of $1.61 (versus month end price $1.95).

At month end the Trust held 56 stocks and cash of 6.1%.

Outlook

The Trust offers considerable value trading on an FY18 price to earnings of 11.5 times (24.0% discount to the ex-100 market) and a gross yield of 5.2% (10.0% premium to the ex-100 market).

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	3.4	5.6
Materials	13.7	16.3
Industrials	12.2	9.6
Consumer Discretionary	24.2	21.4
Consumer Staples	2.6	9.3
Health Care	7.0	6.8
Financials-x-Real Estate	10.7	7.5
Real Estate	5.2	14.4
Information Technology	7.1	6.5
Telecommunication Services	4.6	2.0
Utilities	3.2	0.6
Cash & Other	6.1	-

Rounding accounts for small +/- from 100%.