

	Month	Quarter	FYTD	1 year	3 years	5 years	Since Inception <sup>^</sup>
	%	%	%	%	% p.a.	% p.a.	% p.a.
Perennial Value Smaller Companies Trust*	1.1	4.6	13.1	14.4	6.0	5.7	10.1
S&P/ASX Small Ordinaries Accum. Index	-4.7	-4.8	3.4	14.9	4.4	2.7	5.6
<b>Value Added (Deducted)</b>	<b>5.8</b>	<b>9.4</b>	<b>9.7</b>	<b>-0.5</b>	<b>1.6</b>	<b>3.0</b>	<b>4.5</b>

\*Net performance (including performance fee). <sup>^</sup>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 October 2016):

AUD \$116 million

### Income distribution frequency:

Half yearly

### Minimum initial investment:

\$25,000

### Trust inception date:

March 2002

### APIR code:

IOF0214AU

- ▶ The Perennial Value Smaller Companies Trust (the Trust) delivered strong outperformance for the month up 1.1%, net of all fees compared to a fall of 4.7% for the S&P/ASX Small Ordinaries Index (the Index).
- ▶ The Index return was impacted by growth stocks (not held in the Trust) which were sold off aggressively.
- ▶ The Trust also benefited from increased corporate activity with two takeover offers received during the month.

## Trust Performance

The Index fell 4.7% during the month. The Trust finished up 1.1%, net of all fees, outperforming by a net 5.8%.

The international markets were mixed with the S&P500 down 1.9%, while the Nikkei 225 (up 5.9%), Shanghai Composite (up 3.2%) and the FTSE 100 (up 0.8%) all rallied. The month saw strong rallies in iron ore (up 15.6%) and coal, with thermal coal up 33.0% and hard coking coal up 20.0%, while oil eased (down 1.5%) and gold declined 3.8%. The Federal Reserve left rates unchanged, as did the Reserve Bank of Australia, with the cash rate remaining steady at 1.5%, while the Australian Dollar finished the month down one cent at 76 US cents.

Sector performance for the Index was mixed with only utilities (up 14.6%) and energy (up 10.1%) in positive territory. Information technology (down 9.3%) and health care (down 9.2%) were the weakest.

There were two key drivers of the strong performance for the month:

- A continued swing back towards value investing (both in the Australian small cap sector as well as globally) with growth stocks underperforming (particularly if earnings disappointed) and cheaper stocks re-rating; and
- Increased corporate activity in our portfolio, with an agreed bid for one of our larger shareholdings Fantastic Furniture (up 43.2%) and a non-binding proposal for Pulse Health (up 26.5%).

The bid for Fantastic Furniture was particularly pleasing given the efforts by Perennial, as a 10.0% shareholder, to drive changes at the board level and ultimately realise value for shareholders. The bid that was announced during the month represented a 43.0% premium to the previous closing price. In addition to encouraging special dividends to release excess franking credits (a 15 cent per share special dividend was announced in August as well as an increased final dividend) we have been lobbying for board renewal after the poor handling of the incentive arrangements which led to the departure in January of the highly rated Managing Director. We agitated for the replacement of the Chairperson of the Remuneration Committee and nominated John Hughes to the board to represent our significant interest. We also suggested to the Chairman (who is the largest shareholder with 40.0%) that privatisation of the business could be the best way to realise value for all stakeholders given the illiquidity of the stock.



**Source:** Portfolio Manager Grant Oshry at Fantastic Furniture's modern manufacturing facility in Changzhou- May 2015.

The all cash proposal from Health Care for Pulse Health represented a 42.4% premium, but it remains non-binding and subject to due-diligence. We are pleased that an industry player has recognised the undervalued nature of Pulse Health and we will monitor the progress of the proposed scheme.

Other stocks that performed well were National Veterinary Care (up 12.7%) after expanding their debt facility, Capral (up 9.7%) following an anti-dumping decision that will improve their competitive positioning as well as Global Construction Services (up 8.9%) after divesting their SmartScaff joint venture for a good price.

Cheap stocks that had little news flow, but benefited from the rotation to value included Thorn Group (up 13.1%), LifeHealthcare Group (up 8.8%) and Gateway Lifestyle (up 8.4%).

By contrast several expensive stocks, not held in the Trust, were sold off aggressively during the month. For example Bega Cheese (down 25.8%) and SkyCity (down 16.2%) after earnings downgrades. Other high price to earnings stocks such as Netcomm Wireless (down 19.2%), Mayne Pharma (down 18.0%) and Aconex (down 16.3%) were also lower despite no changes to earnings expectations,

Stocks which detracted from the performance of the Trust included Smartgroup (down 17.0%), Evolution (down 10.0%) and AVJennings (down 9.5%) which all gave back some of the gains of prior months.

APN News and Media (down 14.9%) announced a large rights issue and placement to fund the buyout of the remaining 50.0% interest in their Adshel joint venture. While the acquisition makes strategic sense and makes for a better quality business, the

stock was sold off as the market digested weaker radio earnings and the full price paid for the balance of Adshel.

### Trust activity

The position in Vitaco was exited on market as the share price moved closer to the takeover bid announced in August. The position in RCR Tomlinson was profitably exited at \$2.74 (month end price \$2.66) in response to large insider selling by the Managing Director. Ridley was also exited given several challenges to FY17 earnings with both the dairy and aquaculture industries under strain. Profits were also taken in Emerchants, Independence Group and Collins Foods.

Proceeds were used to add new positions in Platinum Asset Management and Baby Bunting following recent weakness in addition to several initial public offerings (IPO's) which list towards the end of the year.

The Trust ended the month with 59 stocks and cash of 4.5%.

### Outlook

With many small cap stocks trading on lofty price-to-earnings multiples (which we do not hold in the Trust as they do not meet our value process) and little margin of safety, the Trust offers value trading on 12.6 times FY17 price to earnings ratio and 11.9 times price to free cash flow ratio, representing a very significant 25.0% and 29.0% discount respectively 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	5.0	4.6
Materials	13.6	20.0
Industrials	9.0	11.0
Consumer Discretionary	28.8	21.1
Consumer Staples	2.1	6.4
Health Care	7.5	6.7
Financials-x-Real Estate	7.4	8.4
Real Estate	11.4	11.4
Information Technology	7.4	8.3
Telecommunication Services	1.3	1.4
Utilities	2.1	0.8
Cash & Other	4.5	-

Rounding accounts for small +/- from 100%.

For all other enquiries, please contact us on 1300 730 032  
or visit [www.perennial.net.au](http://www.perennial.net.au)

Signatory of:



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