PERENNIAL VALUE MANAGEMENT

Perennial Value Smaller Companies Trust

Quarterly Report
31 March 2016

	Quarter	FYTD	1 year	3 years	5 years	Since Inception^
	%	%	%	% p.a.	% p.a.	% p.a.
Perennial Value Smaller Companies Trust*	-1.3	5.1	1.2	1.5	0.6	9.5
S&P/ASX Small Ordinaries Accum. Index	1.0	8.1	3.7	1.5	-2.1	5.2
Value Added (Detracted)	**-2.3**	**-3.0**	**-2.5**	**0.0**	**2.7**	**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 (as at 31 March 2016):
AUD 116 million

Income distribution frequency:
Half yearly

Minimum initial investment:
$25,000

Trust inception date:
March 2002

APIR code:
IOF0214AU

- **During the March quarter, the Trust fell 1.3%, underperforming the index by 2.3%.**
- **The Trusts underweight position in gold was the biggest detractor, with spot gold up 16.0% and gold equities performing much stronger.**
- **Performance began to improve towards the end of the quarter, with the Trust outperforming a strong market in March.**

Trust Performance

During the volatile March quarter, the S&P/ASX Small Ordinaries Index finished up 1.0% while the Perennial Value Smaller Companies Trust (the Trust) was down 1.3% net of fees underperforming by 2.3%.

Global markets were sold off heavily into the new calendar year, unwinding prior strong December gains to plumb to new two to three year lows by mid-January. The main driver was fears for growth, particularly the slowing Chinese economy and falling commodity prices. This led to a broad-based sell-off. Thereafter, concerns of a hard landing in China faded which spurred commodities prices and global markets higher. Moves for the quarter comprised the S&P500 up 0.8%, FTSE down 1.1%, Nikkei down 12.0% and the Shanghai Composite down 16.3%.

The Brent oil price fell 26.0% to 12 year lows before recovering to finish the quarter up 6.0%. The iron ore price fell to 11 year lows in early January, where after it rebounded and closed the quarter up 24.0%.

In Australia, the February unemployment rate fell from 6.0% to 5.8%, with the majority of job creation occurring in the Eastern states, testimony that the transition from the mining/energy to non-mining sectors of the economy is on track. The cash rate remains at 2.0% and the Australian Dollar (AUD) rallied on the back of US Dollar (USD) weakness and iron ore prices to finish at 76.6 US cents (up 5.0%), up 11.8% from mid-January lows.

Better performing sectors over the quarter were utilities up 19.3%, followed by materials up 10.7%, which was largely driven by the strong performance from gold stocks. The weakest sectors were consumer staples down 12.4% and financials down 11.1%.

Stocks which contributed positively to performance over the quarter were Emerchants (up 34.3%), after securing a contract for its payment technology with Bet365, the second largest operator in the UK. Given the UK market is five times as large as Australia, it is likely this will be a significant driver for earnings going forward.

APN News and Media was up 23.8%, which is one of the largest positions in the Trust also had a strong quarter. The profit release in February showed a solid result in their core radio division. In addition, the market reacted to news that they were looking to divest their regional publishing assets which have been in decline. Given the low valuation placed on this asset by the market, any value extracted from the sale process would be a positive.

Other stocks which performed well on the back of solid 1H16 results were Sealink Travel (up 21.1%) and SkyCity (up 12.2%), both of which are benefiting from strong tourism markets. There was also a strong recovery from stocks which had previously been oversold such as Swick Mining (up 32.0%), Energy Action (up 24.1%) and Capral up (20.0%).

Key detractors during the period were Simonds Group (down 59.1%) and Lifehealthcare (down 55.7%), after both companies downgraded earnings forecasts for FY16. In the case of Simonds Group, the margins in the core home building division have underperformed given the costs of moving into New South Wales (NSW) and Queensland too aggressively. At this stage, demand remains solid so investors will be looking for signs of margin recovery in the 2H16 under the new Chief Executive Officer, (CEO) Matthew Chun, who began on 1 April 2016, having moved across from a non-executive board position. For Lifehealthcare, the business lowered earnings forecasts by 10.0% reflecting softer surgeon's volumes in the 1H16. This weakness has also been observed by other industry participants. The stock was sold-off more aggressively than the size of the earnings downgrade as investors grappled with uncertainty over government plans for the prosthesis lists, which could impact pricing on 35.0% of Lifehealthcare's sales.

Trust Activity

In terms of Trust activity, we took profits in Aveo Group (up 6.3%) and Sky City (up 12.2%) and used the proceeds to fund our participation in several placements for stocks in our portfolio which made accretive acquisitions. These were placements in Tox Free Solutions, to fund the Worth recycling acquisition in NSW, Melbourne IT which purchased InfoReady (a data analytics provider) and also Gateway Lifestyle, which bought several retirement parks on the East coast.

At quarter end, the Trust had 56 stocks and cash of 4.4%.

Environmental, Social & Corporate Governance (ESG)

We remain alert to ESG issues in the Trust. During the quarter, Tox Free Solutions continued to demonstrate the quality of their safety programs delivery a Lost Time Injury rate of zero and a 13.7% reduction in all injuries. In addition, they were recognised by Rio Tinto Iron Ore with a CEO Award for Safety.

Outlook

The Trust offers good value trading on 10.0 times FY17 Price to Earning (P/E) and 8.6 times price/free cash flow, being a 31.0% and 36.0% discount respectively to the ex-100 market. The portfolio characteristics are shown below.

Prospective FY17	Price to Earnings (times)	Price to free cashflow (times)	Gross Yield (%)	Price to NTA (times)	Net Interest Cover (times)	3yr EPS growth (%p.a.)
Perennial Value Smaller Companies Trust**	10.0	8.6	6.3	1.4	21.1	14.5
Market Average Ex-100*	14.5	13.3	5.0	2.3	9.1	14.3
Premium/ (Discount) to Market	(31%)	(36%)	27%	(41%)	132%	1%

Source. *Macquarie Securities, Goldman Sachs and UBS forecast as at 4 April 2016. **Perennial forecast as at 1 April 2016

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	4.6	3.5
Materials	6.8	16.8
Industrials	9.7	10.6
Consumer Discretionary	34.4	23.5
Consumer Staples	5.7	8.5
Health Care	4.6	7.5
Financials-x-Real Estate	11.3	7.9
Real Estate	10.1	12.4
Information Technology	5.7	7.3
Telecommunication Services	1.5	1.5
Utilities	1.2	0.7
Other	4.4	-

Rounding accounts for small +/- from 100%.

Signatory of:

PRI Principles for Responsible Investment