Perennial Value Smaller Companies Trust

Quarterly Report
30 September 2015

	Quarter	FYTD	1 year	3 years	5 years	Since Inception^
	%	%	%	% p.a.	% p.a.	% p.a.
Perennial Value Smaller Companies Trust*	-1.1	-1.1	-5.8	0.6	1.7	9.4
S&P/ASX Small Ordinaries Accum. Index	-3.9	-3.9	-4.9	-1.2	-2.5	4.5
Value Added (Detracted)	**2.8**	**2.8**	**-0.9**	**1.8**	**4.2**	**4.9**

*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 30 September 2015):

AUD114. million

Income distribution frequency:

Half yearly

Minimum initial investment:

$25,000

Trust inception date:

March 2002

APIR code:

IOF0214AU

- **Globally, the quarter was dominated by extreme gloominess about the prospects for growth in China.**
- **The one constant in Australia throughout the June quarter was the strength in Sydney's housing market.**
- **The best performers in the Trust during the quarter were Citadel Group, Smartgroup Corporation, and Sandfire Resources.**

During the quarter, the Perennial Value Smaller Companies Trust (the Trust) was down (net of all fees) by 1.1% compared to the S&P/ASX Small Ordinaries Accumulation Index (the Index) which was also down 3.9%, resulting in outperformance of 2.8%. This strong relative performance was despite impressive gains over the quarter in some high Price Earnings (PE) (higher than 36x forward) index stocks such Blackmores (up 95.7%) and Bellamy's (up 80.5%) as well as Veda Group on 26x (up 23.0%) – these stocks are not currently held in the Trust on valuation grounds.

Globally, the quarter was dominated by extreme gloominess about the prospects for growth in China. Key data disappointed, including the latest monthly production and investment prints, alongside the manufacturing Purchasing Managers Index and many investors seem to be losing faith that China can maintain growth of close to the 7.0% target. This is despite even more stimulus being announced and further exchange rate depreciation. The weakness in China is reverberating through the region, with Taiwan, Singapore and now Japan in technical recession. Outside Asia, however, the news was better, with European growth seemingly tracking close to 2.0%, although inflation across the region has dropped back close to zero. Similarly, the US economy is doing well, although employment growth was unexpectedly weak early in the month. The Federal Reserve (the Fed), however, baulked at raising interest rates, citing offshore "wobbles" as a key reason for caution. Equity markets had a very tough quarter, with most indexes losing further ground, as many investors reassessed the prospects of a world without the same momentum in China's growth engine.

In Australia, the biggest development was not in economics, but in politics, with Malcolm Turnbull successfully challenging incumbent Tony Abbott to become Australia's fifth Prime Minister in as many years. There has been no significant policy change yet, but consumer and business confidence likely will lift on hopes of a fresh start, particularly around economic reform. The domestic data was a mixed bag. Retail sales growth was weak and consumer and business confidence fell, but the August employment report was much better than expected and the jobless rate fell slightly to 6.2%. The Q2 Gross Domestic Product (GDP) report was also underwhelming, showing that growth was barely positive, albeit after a decent Q1. The Australian Dollar (AUD) weakened further over the quarter, in line with Reserve Bank of Australia (RBA) expectations, dropping below 70 US cents, and the RBA left the cash rate steady.

The key drag on the index from a sector point of view was energy (down 47.7%), utilities (down 20.9%) and financials (down 7.4%). The best performing sectors were information technology (up 6.3%) and consumer staples (up 4.0%).

The best performer for the Trust during the quarter was Regis Resources (up 70.8%) after the company made a number of positive announcements, including the re-commencement of dividends. Regis delivered a strong cash flow during the June quarter, announced a mine life extension and also confirmed a $25 million share buy-back for FY16. This was followed by a non-executive director buying shares on market. This was a strong performance relative to the move in the AUD gold price of 4.4% over the quarter. We re-established the position in Regis Resources in March 2015 at $1.31 compared to a quarter end price of $1.78.

Sealink Travel Group (up 47.9% to $3.20) was stronger after the accretive acquisition of Transit Systems Marine which operates ferry services in several Queensland (QLD) locations. The acquisition has some annuity like revenue via worker transport to Curtis Island but also some medium term upside in under penetrated tourism locations like Stradbroke Island. We were cornerstone investors in Sealink at their Initial Public Offering (IPO) in October 2013 at $1.10 and also supported the recent raising at $2.50 to fund this acquisition.

The Trust also benefitted from the large position in HFA Holdings (up 34.2% to $2.70) after delivering a strong FY15 result and entering the Index for the first time since 2010. The position in HFA was acquired in January 2014 at $0.94 following a profit upgrade which went under the radar of most investors given there was no research coverage. The move to a simplified capital structure and divestment of the loss-making Australian business since then has been highly accretive to earnings and it is pleasing to see one major broker and a large retail broker now covering the stock. With a forecast cash yield of over 8.0% we still believe HFA offers good value.

Recent IPO's Gateway Lifestyle (up 25.5%) and QMS Media (up 19.5%) also made solid contributions during the quarter.

The key detractors for the Trust during the quarter came from the energy sector with Sundance Energy (down 43.6%), Austex Oil (down 34.3%) and Sino Gas (down 34.4%) all impacted by the sector weakness. We maintain a small overweight position in energy as we believe that the recent cuts in US production and pressure on other areas will result in sufficient supply cuts necessary for higher oil prices – albeit we don't expect prices to be materially firmer until early CY16. Panoramic Resources (down 38.7%) was also impacted by lower nickel prices.

Weakness also came from APN News and Media (down 31.0%) following the release of their interim result which was marginally below expectations. In addition they provided a mixed outlook with July described as being down on a like-for-like basis, while August saw improvement across all their divisions. The subsequent share price response seems an over-reaction and we used this weakness to add to our position.

As shown below, the valuation of the Trust remains attractive relative to market:

Prospective FY16	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**	11.0	10.2	5.9	1.1	22.8	25.0
Market Average Ex-100*	14.1	12.8	5.0	2.3	8.2	11.5
Premium/ (Discount) to Market	(22%)	(20%)	18%	(52%)	178%	117%

Source. *Macquarie Securities, Goldman Sachs and UBS as at 1 Oct 2015. **Perennial as at 30 September 2015

During the quarter we exited Western Areas to reduce our Nickel exposure and also Mortgage Choice given the prospect for slower loan growth as the investor and apartment market may have peaked. Conversely we are still positive on the detached housing market which is still well below peak, therefore we used these proceeds to add to our position in AVJennings which was down 9.3% during the quarter despite two recent profit upgrades and the stock trading at a greater than 30% discount to NTA. We also locked in profits in Citadel Group on valuation grounds following a successful first year since IPO. These proceeds were used to buy back into M2 Group limited at $8.90 post a period of share price weakness. We were encouraged by the bid late in the quarter from Vocus Communications for M2 Group as this will create a large consumer and corporate telco covering Australia and New Zealand with large synergies given the infrastructure of Vocus – post the bid M2 finished the quarter at $9.49.

Perennial Value Management remains alert to Environmental, Social and Corporate Governance (ES&G) issues in the Trust. One area of constant focus is the quality and independence of the board of companies we own. In some circumstances we need to actively engage with board members to bring about change, which we think is necessary. One example during the quarter was Energy Action, which, after repeated lobbying by ourselves and others introduced two independent directors to their board. Both directors bring a strong skill set which should help avoid the teething issues Energy Action has experienced of late following several acquisitions. Investors also seemed to have taken note with the share price beginning to recover (up 28.3% for the quarter).

At quarter end, stock numbers were 50 and cash was 3.1%.

Asset Allocation		
Sector	Trust weight %	Index weight %
Energy	7.7%	3.0%
Materials	8.2%	14.3%
Industrials	9.4%	13.5%
Consumer Discretionary	33.1%	21.9%
Consumer Staples	1.7%	7.0%
Health Care	4.2%	8.7%
Financials-x-Real Estate	9.5%	8.7%
Real Estate	14.0%	12.6%
Information Technology	5.3%	6.3%
Telecommunication Services	2.7%	3.3%
Utilities	1.1%	0.6%
Other	3.1%	-

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