Perennial Value Smaller Companies Trust

Quarterly Report
30 September 2016

	Quarter	FYTD	1 year	3 years	5 years	Since Inception^
	%	%	%	% p.a.	% p.a.	% p.a.
Perennial Value Smaller Companies Trust*	11.8	11.8	19.9	6.7	6.6	10.1
S&P/ASX Small Ordinaries Accum. Index	8.5	8.5	29.2	7.1	5.3	6.0
Value Added (Detracted)	**3.3**	**3.3**	**-9.3**	**-0.4**	**1.3**	**4.1**

*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 2016):
AUD $116 million

Income distribution frequency:
Half yearly

Minimum initial investment:
$25,000

Trust inception date:
March 2002

APIR code:
IOF0214AU

- **During the quarter, the Perennial Value Smaller Companies Trust (the Trust) delivered a strong net return of 11.8%, outperforming the Index by 3.3%.**
- **Positive contributors came from a variety of sectors and included two companies that received takeover offers.**
- **The Trust trades on an FY17 price to earnings ratio of 12.1 times, being a 28.0% discount to the ex-100 market.**

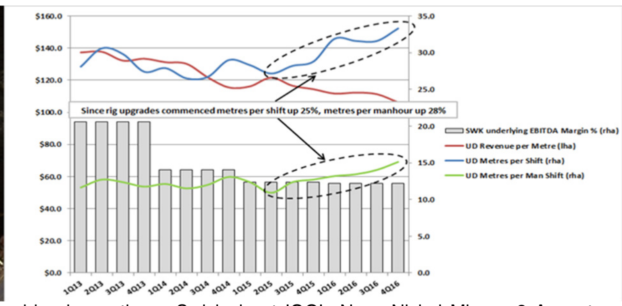
Trust Performance

During the September quarter, the Trust delivered a healthy return and was up 11.8% net of fees, resulting in outperformance of 3.3%.

Globally markets were positive, with the S&P500 finishing the quarter up 3.3%, FTSE100 up 6.1%, Nikkei 225 up 5.6% and the Shanghai Composite up 2.6%. Metal prices rose over the quarter, iron ore was up 7.0%, nickel up 12.0%, copper up 0.4% and aluminium up 1.5%, while the oil price closed down 0.2% and gold fell 0.5%. The Federal Reserve left rates unchanged, while the Reserve Bank of Australia (RBA) reduced the cash rate by 25 basis points in August to 1.5% and the Australian Dollar (AUD) rose two cents to 77 US cents.

The best performing sectors over the quarter were energy (up 17.7%), industrials (up 14.1%) and technology (up 10.2%). The largest negative moves came from the utilities sector (down 6.4%) and property trusts (down 3.9%).

The leading contributor to performance over the quarter was Emerchants Ltd (up 40.9%) which rebounded after having been sold off after the “Brexit” vote in June. Other key contributors included Sundance Energy (up 65.0%) which announced it had received an indicative, non-binding and conditional proposal from a US-based private equity manager and Swick Mining (up 85.0%). Swick’s results announcement showed an improvement in most metrics for the fourth quarter of 2016 and tangible evidence that the recent R&D initiatives aimed at improving productivity are beginning to gain traction. We still see considerable value in Swick given net tangible assets (NTA) of 38 cents versus 26 cents closing price and the early stage in the recovery cycle.



Our small cap resource analyst Sam Berridge inspecting a Swick rig at IGO’s Nova Nickel Mine – 3 August 2016. Slide from Swick’s FY16 result presentation

Smartgroup (up 26.7%) delivered a strong result and announced two strategic and accretive acquisitions. Skydive the Beach (up 28.6%) also delivered an impressive result with revenue and earnings before interest, taxes, depreciation and amortisation (EBITDA) up over 122.0% and announced the accretive acquisition of white water rafting company, Raging Thunder, in Cairns, which will diversify its product offering. Fantastic Holdings (up 10.2%) delivered a result with earnings before interest and tax (EBIT) growth of 58.0% and increased their payout ratio in addition to declaring a special dividend to release some excess franking credits.

It is pleasing to report that two of our holdings received takeover offers during the quarter. Vitaco (up 46.0%) received a takeover offer from a consortium that included a subsidiary of Shanghai Pharmaceuticals Holding Co Ltd, while Intecq (up 28.3%) received a cash offer from Tabcorp, which the Board unanimously approved in the absence of a higher offer. We are of the view that both these offers represent fair value and will be voting in favour.

The largest detractor from performance was Gateway Lifestyle (down 25.4%). Gateway delivered a result which was a substantial miss to market consensus, in part due to a decision to bring forward the conversion of four tourist parks to higher yielding retirement parks – with the benefit of this initiative not seen in earnings until FY18. Clearly this could have been communicated to the market more effectively. However, we were encouraged by the underlying performance of the retirement rental stream and village costs and, thus, used weakness to add to our position.

APN News and Media (down 15.2%) was impacted following a soft outlook statement at its result while Tox Free Solutions (down 9.8%) and Mint Payments (down 20.0%) also detracted from performance.

Trust Activity

During the quarter, we sold out of Ardent Leisure Group following a share price rally post the announcement of the sale of their gyms division for an impressive consideration. We also sold out of Vocus Communications, Energy Action, Tower and Washington H. Soul Pattinson. We took profits in APN News & Media, AVJennings, Breville, Sealink, Emerchants and Fantastic Furniture following their share price gains.

Proceeds were reinvested into new holdings for Imdex to increase our mining services exposure and Adairs to diversify our retail exposure. We participated in equity raisings for Smartgroup, Skydive the Beach and Independence Group and topped up our holdings in Australian Pharmaceutical Industries and Australian Agriculture.

The Trust ended the quarter with 58 stocks and cash of 2.2%.

Environmental, Social & Corporate Governance (ESG)

Perennial Value remains alert and active in ESG matters. During the course of reporting season we met with many companies and discussed a range of ESG issues including environmental issues with APN News & Media, remuneration with Sealink and diversity with HFA Holdings Ltd and Aveo Group.

Outlook

The Trust offers good value trading on 12.1 times FY17 price to earnings (P/E) (a 28.0% discount to the ex-100 market) with a gross yield of 4.9% (12.0% ahead of the yield for the ex-100 market). The Trust 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**	12.1	11.6	4.9	1.7	22.3	24.3
Market Average Ex-100*	16.9	17.2	4.4	2.6	10.3	16.0
Premium/ (Discount) to Market	(28%)	(33%)	12%	(35%)	116%	52%

Source: Macquarie Securities, Goldman Sachs and UBS forecast as at 26 Septmeber 2016 ** Perennial forecast as at 30 September 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	5.7	4.0
Materials	13.4	20.2
Industrials	10.5	10.7
Consumer Discretionary	27.7	21.6
Consumer Staples	5.5	6.5
Health Care	6.9	7.1
Financials-x-Real Estate	6.7	8.0
Real Estate	11.1	11.2
Information Technology	7.9	8.8
Telecommunication Services	1.1	1.3
Utilities	1.3	0.7
Cash & Other	2.2	-

Rounding accounts for small +/- from 100%.

Signatory of:

PRI Principles for Responsible Investment

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