PERENNIAL VALUE MANAGEMENT	# Perennial Value Smaller Companies Trust

Quarterly Report
31 December 2016

	Quarter	FYTD	1 year	3 years	5 years	Since Inception^
	%	%	%	% p.a.	% p.a.	% p.a.
Perennial Value Smaller Companies Trust*	3.9	16.2	15.6	8.0	8.1	10.2
S&P/ASX Small Ordinaries Accum. Index	-2.5	5.8	13.2	6.2	4.9	5.7
Value Added (Detracted)	**6.4**	**10.4**	**2.4**	**1.8**	**3.2**	**4.5**

*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 December 2016):
AUD $114 million

Income distribution frequency:
Half yearly

Minimum initial investment:
$25,000

Trust inception date:
March 2002

APIR code:
IOF0214AU

- **During the quarter, the Trust delivered a strong net return of 3.9%, outperforming the Index by 6.4% net of all fees.**
- **The Trust continued to benefit from a rotation away from high PE (price to earnings ratio) stocks towards more value orientated investments.**
- **The Trust trades on an FY17 PE ratio of 13.4 times, a 19.3% discount to the ex-100 market.**

Trust Performance

During the December quarter, the Perennial Value Small Companies Trust (the Trust) delivered a healthy return of 3.9%, net of fees, compared to the S&P/ASX Small Ordinaries Accumulation Index (the Index) which was down 2.5% - that is an outperformance of 6.4%.

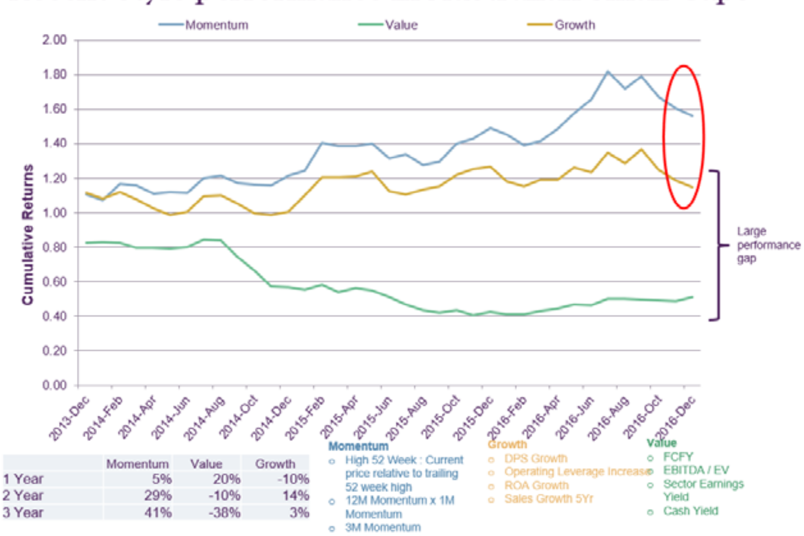
Global markets were positive, with the S&P500 up 3.3%, Nikkei 225 up 16.2%, FTSE100 up 3.5% and the Shanghai Composite up 3.3% all advancing over the quarter. Commodity prices were up strongly with oil up 13.7%, iron ore up 41.2%, thermal coal up 22.7%, coking coal up 7.9% and copper up 13.8%, while gold declined 12.5%. The highlights of the quarter were the result of the US election and the Federal Reserve's decision to lift the Federal Funds rate by 25 basis points. The Reserve Bank of Australia (RBA), however, left the cash rate steady at 1.5% and the Australian Dollar (AUD) fell five cents to 72 US cents.

The best performing sectors over the quarter were energy (up 12.4%), utilities (up 12.2%) and industrials (up 3.7%). The largest negative moves came from the health care sector (down 13.9%) and information technology (down 11.6%).

The leading contributor to performance over the quarter was Fantastic Holdings (up 45.2%) which received a bid at a 43.0% premium to the previous closing price. This outcome was particularly pleasing given Perennial Value, as a 10.0% shareholder, had nominated a new director and lobbied the board for improved capital management and corporate governance in the wake of the poorly handled Managing Director resignation. We also suggested privatisation was a logical option given the 40.0% holding of the Chairman.

The other key factor behind relative performance was the selloff in high PE growth stocks (not held by the Trust) as captured in the chart below.

Recent style performance in Australian Small Caps



Source: Macquarie. January 2017

Thorn Group (up 25.9%) reported an interim FY17 result which included very strong growth in the equipment finance division, beating market expectations. Thorn is leading the way in implementing best practice processes in their core business to allay regulatory fears, which have been a headwind for the sector. The stock remains at a 30.0% PE discount to the Index, and offers a fully franked gross dividend yield of 8.1%.

Sundance Energy (up 33.3%) benefitted from a rising oil price and improved oil sentiment after OPEC announced production cuts in November. US shale production has been leading the supply response to higher oil prices, whereas there has been little to no pick up in conventional oil drilling activity.

Global Construction Services (up 26.7%) announced an asset sale which improved the balance sheet to a net cash position. They also announced a contract win in November which enabled them to attract more investor interest as its low earnings multiples and balance sheet fit well with the shift in preference towards value stocks.

Lifehealthcare (up 23.8%) continued its recent recovery from oversold levels following a positive AGM and investor day, where more comfort was given around government changes to the prosthesis list. This source of investor concern looks to be of limited impact at present.

Sino Gas Energy (SEH) (up 19.8%) reported a substantial increase in gas production rates from its Sanjiaobei and Linxing fields in China as statutory and pricing issues were resolved. It was a positive end to a frustrating year for SEH, which included a change of a joint venture partner at a price which valued SEH's assets at $0.16 per share. We expect SEH to be a beneficiary of China's sustained push towards increasing the proportion of gas in its energy mix, as a means of improving air quality.

Detractors from the fund included Evolution Mining (down 15.5%) which fell with the gold price. We took the opportunity to close some of our gold underweight, adding to our position at $1.69 per share versus quarter end price of $2.12 per share. Integral Diagnostics (down 22.8%) fell on a soft trading update and CEO succession announcement. Smartgroup (down 12.7%) softened on broker downgrades.

Trust Activity

During the quarter we sold out of Collins Foods after solid share price gains prior to and after its interim financial result. We profitably sold out of OZ Minerals, which had benefitted from a rise in the copper price. We also exited Intecq, Pulse Health and Fantastic Furniture following takeover offers.

Proceeds were reinvested into new holdings in Austin Engineering to increase exposure to an expected uptick in mining maintenance, Regis Resources to reduce our gold underweight, Baby Bunting for retail exposure and PWR Holdings due to share price weakness despite an improving organic growth outlook.

The Trust ended the quarter with 57 stocks and cash of 3.5%.

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 Western Areas Limited, remuneration with Evolution Mining and diversity with Regis Resources.

Outlook

The Trust offers good value trading on 13.4 times FY17 PE (a 19.3% discount to the ex-100 market) with a gross yield of 4.8% (11.6% ahead of the yield for the ex-100 market). The Trust characteristics are shown below.

As always, our focus will continue to be on investing in quality companies which are offering attractive valuations.

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**	13.4	12.1	4.8	1.7	21.5	16.6
Market Average Ex-100*	16.6	16.0	4.3	2.3	10.8	17.3
Premium/ (Discount) to Market	(19%)	(25%)	11%	(27%)	99%	(4%)

Source: Macquarie Securities, Goldman Sachs and UBS forecast as at 30 December 2016 ** Perennial forecast as at 30 December 2016

Asset Allocation

Sector	Trust weight %	Index weight %
Energy	5.3	4.8
Materials	13.6	20.1
Industrials	10.4	10.2
Consumer Discretionary	26.9	22.1
Consumer Staples	0.9	6.2
Health Care	6.4	6.4
Financials-x-Real Estate	7.2	8.7
Real Estate	12.4	13.0
Information Technology	7.1	6.2
Telecommunication Services	4.0	1.5
Utilities	2.4	0.8
Cash & Other	3.5	-

Rounding accounts for small +/- from 100%.

Signatory of:

PRI Principles for Responsible Investment

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