Perennial Value Smaller Companies Trust

Monthly Report
30 April 2016

	Month	Quarter	FYTD	1 year	3 years	5 years	Since Inception^
	%	%	%	%	% p.a.	% p.a.	% p.a.
Perennial Value Smaller Companies Trust*	0.1	6.6	5.3	-0.1	4.4	0.9	9.5
S&P/ASX Small Ordinaries Accum. Index	3.0	9.7	11.4	5.1	4.2	-1.0	5.4
Value Added (Detracted)	**-2.9**	**-3.1**	**-6.1**	**-5.2**	**0.2**	**1.9**	**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 April 2016):
AUD $114 million

Income distribution frequency:
Half yearly

Minimum initial investment:
$25,000

Trust inception date:
March 2002

APIR code:
IOF0214AU

- **Markets rallied in April, with the S&P/ASX Small Ordinaries Index (the Index) up 3.0%.**
- **Several earnings downgrades impacted relative performance to the Index.**
- **The Perennial Value Smaller Companies Trust (the Trust) returned 0.1% net of fees, underperforming the Index by 2.9%.**

Market Activity

Globally, markets were mixed with the S&P500 up 0.3%, the FTSE100 up 1.1%, the Nikkei 225 down 0.6% and the Shanghai Composite down 2.2%. The Federal Reserve kept rates unchanged in April. Commodity prices continued to firm, with Brent oil ending the month up 18.0% (closing just below five month highs) and the iron ore price up 22.0%. In Australia, the Reserve Bank of Australia (RBA) left interest rates unchanged at 2.0% for the tenth straight meeting, cautioning that a rising currency could "complicate" the economy's transition away from resources. The weak March quarter consumer price index (CPI) (down 0.2% quarter on quarter) marked the first negative inflation number since December 2008, and drove the Australian Dollar (AUD) down 2.0% on the day. The AUD closed the month at 76.0 US cents, down 1.0 cent.

Energy (up 14.0%) was the strongest sector followed by materials (up 12.7%) led by a rebound in iron ore prices. Consumer staples was the weakest sector down 2.1% followed by Consumer Discretionary (down 1.7%).

Trust performance

The Trust lagged the performance of the Index (up 3.0%) finishing relatively flat, up 0.1% net of all fees. 'Confession season' started early for many smaller companies with the performance of the Trust impacted by several disappointing earnings updates.

The largest downgrade was from the Murray Goulburn Unit Trust (down 45.2%) after it dramatically reduced its earnings expectations based on a lower milk price forecast and slower sales to China (after announcing earlier in the month a minimal impact from regulatory changes in China). In addition, both the CEO and CFO resigned adding further uncertainty in the short term at a time when additional debt has been added to support farmer's cashflow at the expense of unit holders. Clearly such a dramatic change in forecasts and strategy took the market by surprise and until more clarity is provided we decided to exit the position (sold at an average price of $1.33 compared to the month end price of $1.25).

Thorn Group (down 23.6%) was lower after guiding to flat earnings compared to previous expectations of moderate growth. While this was marginally disappointing we were encouraged by the decision to exit the lower quality loans business which will now generate cash in run-off. At current levels, Thorn Group offers an attractive cash yield of 7.0% and the rental book provides defensive revenue streams.

Prime Media (down 16.7%) updated the market on the continued tough conditions in regional media. Although they note some early interest from advertisers around the Olympics which will have a positive impact on revenues next financial year.

Finally Simonds Group (down 26.3%) drifted lower given the lack of news flow and weak sentiment in the housing sector. Despite the poor housing sentiment, the detached housing data released for April showed continued strength in housing starts (particularly Victoria which is Simonds largest market). Therefore while sales are likely to remain strong at Simonds, investors are unlikely to gain confidence in the required margin recovery until some clarity on earnings is provided by the new Managing Director or the Simonds family begins to buy-back stock.

On the positive side several smaller positions began to perform strongly as they attracted investor interest with Mint Payments (up 50.6%), Intecq Limited (up 22.4%) and Skydive the Beach (up 18.9%) all up materially.

Emerchants (up 17.7%) continued to perform and raised money at month end to fund an acquisition in the United States to replicate the successful move into the United Kingdom.

The energy names held in the portfolio performed well during the month with Sundance (up 11.8%) as well as Sino Gas & Energy (up 14.1%). The later rallied on the back of an announcement from its joint venture partner (MIE Holdings) detailing the sale of its 51.0% share of the asset. The transaction price of US$220 million for MIE's share gives a look-through valuation for Sino Gas & Energy of 16 cents per share, compared to the month end close of 8.9 cents per share.


Perennial Value Smaller Companies Analyst Sam Berridge onsite at Sino Gas & Energy

The changes to Chinese regulations around products imported into the free trade zone created volatility for several small cap names (such as Blackmores and Bellamy's) early in the month. The Trust was able to take advantage of this weakness to build a position in Vitaco Holdings at an average of $1.54 compared to a month end price of $1.64.

We have been looking at Vitaco for a long period and began our due diligence prior to the initial public offering (IPO) which occurred in September 2015 at an issue price of $2.10. Our visit to their manufacturing facility in New Zealand revealed a quality business. However at the $2.10 IPO price the investment did not meet our valuation metrics so we did not invest until the recent period of share price weakness. With China representing only 10.0% of sales we see this as more a source of potential growth rather than a driver of current valuation, hence why we viewed the fall in the share price as an attractive opportunity.

Trust Activity

In addition to the trades mentioned above there were several changes made to the Trust. Going into the budget we continued to reduce consumer discretionary exposure exiting Myer during the period. We also exited SkyCity Entertainment following the resignation of the CEO.

The Trust ended the month with 52 stocks and cash of 7.0%.

Outlook

The Trust offers value trading on 10.0 times FY17 price to earnings (P/E) and 8.8 times price to free cash flow, representing a very significant 32.0% and 35.0% 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	5.2	3.9
Materials	6.5	18.5
Industrials	9.4	10.6
Consumer Discretionary	32.7	22.8
Consumer Staples	5.3	8.0
Health Care	4.6	6.5
Financials-x-Real Estate	10.7	7.7
Real Estate	10.0	12.3
Information Technology	6.6	7.5
Telecommunication Services	1.0	1.4
Utilities	1.1	0.7
Cash & Other	7.0	-

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