PERENNIAL VALUE MANAGEMENT

Perennial Value Smaller Companies Trust

Quarterly Report
30 June 2017

	Quarter	FYTD	1 year	3 years	5 years	Since Inception^
	%	%	%	% p.a.	% p.a.	% p.a.
Perennial Value Smaller Companies Trust*	1.9	16.9	16.9	6.9	7.7	9.9
S&P/ASX Small Ordinaries Accum. Index	-0.3	7.0	7.0	7.1	5.7	5.6
Value Added (Detracted)	**2.2**	**9.9**	**9.9**	**-0.2**	**2.0**	**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:
AUD $110 million

Income distribution frequency:
Half yearly

Minimum initial investment:
$25,000

Trust inception date:
March 2002

APIR code:
IOF0214AU

Contact us:
invest@perennial.net.au
1300 730 032
www.perennial.net.au

- **In the quarter, the Perennial Value Smaller Companies Trust (the Trust) delivered a net return of 1.9%, outperforming the Index by 2.2% net of all fees.**
- **For the twelve months ended 30 June 2017, the Trust has delivered a net return of 16.9%.**
- **Based on our FY18 assumptions, the Trust represents considerable value, trading on an FY18 price to earnings ratio of 11.5 times, a 23.8% discount to the ex-100 market.**

Trust Performance

During the June quarter, the Trust was up 1.9%, net of fees, compared to the S&P/ASX Small Ordinaries Accumulation Index (the Index) which was down 0.3%, delivering outperformance of 2.2%.

Over the past twelve months the Trust delivered a strong return of 16.9% net of fees, compared to the Index which was up 7.0%, delivering outperformance of 9.9%.

The best performing sectors over the quarter were utilities (up 10.9%), telecommunications (up 7.3%) and property trust (up 7.1%). The largest negative moves came from consumer discretionary (down 22.5%) and consumer staples (down 9.2%).

The top performing stock for the quarter was Alliance Airlines (up 36.6%), which has been a beneficiary of increased activity in the mining space. Alliance won a major contract extension with Citic Pacific during the quarter, as well as forming a new partnership with Virgin Australia Airlines targeting FIFO customers.

Melbourne IT (up 31.2%) announced an accretive acquisition of WME Group, which is expected to lift earnings per share by between 12.0% to 18.0%. WME significantly enhances the web design capability of Melbourne IT as well as providing digital marketing solutions.

Prime TV (up 28.8%) reiterated underlying earnings guidance and also outlined the benefit from the reduced license fees. While the reduction in license fees is a positive, we await progress on the government's attempts to remove cross media ownership restrictions, something that would further enhance the corporate value of Prime TV. Another positive is the likely weakness in competitor Channel 10 as they face funding issues.

Imdex (up 17.1%) had another strong quarter, helped by market updates in April and June which continued to show solid growth in equipment hire up (40% year on year in May). Despite some commodity price volatility during the quarter, there was no sign of a slowdown in exploration activity.

Stocks which detracted from performance in the quarter included **Oroton** (down 34.5%). Perennial established a relatively small position (1.0%) in Oroton, given it is a company in turnaround, which announced an earnings downgrade during April, largely due to the clearance of discontinued lines (apparel, footwear, lingerie) and a very poor performance from their non-core GAP agency. Perennial is actively engaging with the Board and we were pleased to see Board independence restored with one of the non-executive directors resigning. Additionally, the Board appointed Moelis to conduct a strategic review and towards the end of the quarter we were pleased that they have announced several avenues that the Board is open to pursuing, one of which is putting the company up for sale.

Capral (down 27.5%) downgraded guidance due to poor weather on the east impacting demand during the quarter, as well as a higher aluminium price.

Swick (down 14.5%) was weighed down by a capital raising. The company is approaching 100% utilisation of its drilling fleet and was seeking funds to build additional rigs and to move to 100% ownership of Orexplore, the owner of a mineral analysis tool, which we have a positive view on. We took the opportunity to add to our position.

Sino Gas & Energy (down 8.5%) reported quarterly production in April which was at the lower end of its guidance range. The company did note, however, that production had picked up post quarter end. Chinese government agency, the NDRC, reiterated its target for 10% of power generation to come from gas by 2020, compared to 6.0% at present. This policy initiative should support domestic gas demand and prices in China for the foreseeable future.

Trust activity

We added several stocks which were overly impacted by tax-loss selling in June. One example is **Baby Bunting**, a specialty retailer and market leader of baby goods. This stock had been drifting lower due to general weakness in the consumer discretionary sector combined with fears of disruption from Amazon's entry into the Australian market. When this selling accelerated in June, we used the weakness to add it to the Trust at an average entry price of $1.61 (versus June end price $1.95).

We added a new position in **Synlait** (a dual listed NZ stock), which manufactures infant formula for A2 Milk and others. The valuation is much more compelling than the brand exposures and with the changes in Chinese regulations, the manufacturing sites are becoming more strategic (as evidenced by A2 Milk acquiring a stake in Synlait). As part of our due diligence we toured the key site in Christchurch NZ during June.

During the quarter we exited **Tassal Group**, with our preference being **Huon Aquaculture** given the current environmental disputes in Macquarie Harbour which provide some uncertainty for Tassal. We also exited residential land developer AV Jennings given our view of the current housing cycle maturing and decided to take advantage of a liquidity event that presented for this relatively less liquid stock.

The Trust ended the quarter with 56 stocks and cash of 6.1%.

Environmental, Social and 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 work place safety and employee mental health with gold miners **Regis Resources** and **Doray Minerals**.

Outlook

The Trust offers good value trading on 11.5 times FY18 price to earnings (a 23.8% discount to the ex-100 market) with a gross yield of 5.2% (10% ahead of the yield for the ex-100 market). The Trust characteristics are shown below.

Prospective FY18	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**	11.5	9.1	5.2	1.7	25.1	15.1
Market Average Ex-100*	15.1	15.0	4.7	2.5	11.5	14.0
Premium/ (Discount) to Market	(24%)	(39%)	10%	(33%)	117%	8%

Source: *Macquarie Securities, Goldman Sachs and USB forecast as at 30 June 2017. ** Perennial forecast as at 30 June 2017

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	3.4	5.6
Materials	13.7	16.3
Industrials	12.2	9.6
Consumer Discretionary	24.2	21.4
Consumer Staples	2.6	9.3
Health Care	7.0	6.8
Financials-x-Real Estate	10.7	7.5
Real Estate	5.2	14.4
Information Technology	7.1	6.5
Telecommunication Services	4.6	2.0
Utilities	3.2	0.6
Cash & Other	6.1	-

Rounding accounts for small +/- from 100%.

Signatory of:

PRI Principles for Responsible Investment