Perennial Value Smaller Companies Trust

Quarterly Report
30 September 2017

	Quarter	FYTD	1 year	3 years	5 years	Since Inception^
	%	%	%	% p.a.	% p.a.	% p.a.
Perennial Value Smaller Companies Trust*	2.7	2.7	7.4	6.6	5.6	9.9
S&P/ASX Small Ordinaries Accum. Index	4.4	4.4	3.0	8.1	5.1	5.8
Value Added (Detracted)	**-1.7**	**-1.7**	**4.4**	**-1.5**	**0.5**	**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	AUD $108 million
Distribution frequency	Half yearly
Minimum initial investment	$25,000
Trust inception date	March 2002
APIR code	IOF0214AU
Contact us	1300 730 032 invest@perennial.net.au www.perennial.net.au

- **For the quarter, the Trust delivered a return of 2.7% net of all fees, underperforming the benchmark which was up 4.4%.**
- **For the twelve months to September 2017 the Trust has returned 7.4% (net of all fees) ahead of the S&P/ASX Small Ordinaries Accumulation Index (the Index) which was up 3.0% over the same period.**
- **The Trust remains attractively priced, with a price to earnings ratio (P/E) of 12.4 times (a 26.0% discount to the Index) and offering a 4.5% gross yield**

Trust Performance

During the September quarter, the Perennial Value Smaller Companies Trust (the Trust) was up 2.7% net of all fees compared to the Index which was up 4.4%. For the twelve months to September 2017 the Trust has returned 7.4% (net of all fees), ahead of the benchmark which was up 3.0% over the same period.

Global markets were stronger over the September quarter, with the S&P500 up 4.1%, Nikkei 225 up 0.7%, FTSE100 up 0.3% and the Shanghai Composite up 5.0%. Commodity prices were generally stronger, with oil up 20.0%, thermal coal up 23.0%, coking coal up 27.0%, copper up 9.0% and gold up 4.0%. Iron ore was the exception, declining 3.0%. The Reserve Bank of Australia, left the cash rate steady at 1.5% and the Australian Dollar rose 2 cents to 79 US cents .

The US 10yr bond rate remains a key driver of sentiment in the market. The rises of earlier in the year began to reverse during the quarter which caused a weaker US Dollar (helping commodity prices) as well as assisting the performance of stocks perceived as offering higher growth.

The better performing sectors over the quarter were consumer staples up 14.4%, energy up 14.3% and materials up 7.2%. By contrast healthcare (down 9.8%) was the worst performing sector followed by telecommunications (down 3.5%) and consumer discretionary (down 3.2%).

The Trust was reasonably well positioned for the rally that occurred in resources and mining services with holdings in **Alliance Aviation** (up 28.9%), **Imdex** (up 23.3%) and **Metals X** (up 16.7%) performing well.

However relative performance was impacted by not holding large index stocks which look expensive and appear to already factor in high growth prospects (such as **a2Milk** (up 65.9%), **Blackmores** (up 25.7%) and **Costa Group** (up 15.8%)).

We continue to prefer those companies where the market is yet to fully appreciate the growth potential of the business. As this potential is realised, the uplift in the share price can be impressive, as was seen with our holdings in **Synlait** (up 51.1%), **EML Payments** (up 23.8%), **Smart Group** (up 28.2%) and **Helloworld** (up 27.7%) during the quarter.

Holdings detracting from performance during the month were **Pacific Energy** (down 18.8%) after missing out on potential new contracts to a competitor as well as **HT&E** (down 22.0%) due to soft radio markets. Some small gold positions also impacted performance with **Eastern Goldfields** (down 36.5%) and **Doray Minerals** (down 36.1%).

Trust activity

Reporting season provided an opportune time to make some changes to the Trust. We were sufficiently impressed by the **Kogan.com** result to add a position at $2.99 with the share price then rising 28.8% for the rest of the quarter.

We also added **Seven Group** post a strong financial year 2017 result, we then increased the position significantly in the capital raise to fund the Coates Hire acquisition. This increases the exposure of the group to the East Coast Infrastructure boom.

This position was funded by exiting our long held position in **Global Construction** as we deem **Seven Group** a higher quality exposure for the construction market. We also sold out of **Mineral Resources** as the very strong run in the share price left very little margin of safety.

The Trust ended the quarter with 56 stocks and cash of 3.4%.

Environmental, Social and Corporate Governance (ESG)

We often engage with the board of our key holdings to ensure appropriate governance, board structure and remuneration policies. To this end we had several fruitful discussions with the board of **Melbourne IT** over several months including discussions with both the outgoing and incoming chairperson.

Outlook

Economic conditions remains strong around the world and signs of inflation are beginning to appear, as a result we are confident that we are in the early phases of a rate raise cycle. Such an environment typically favours value stocks as markets increasingly discount future growth due to rising interest rates and reward near term cash flow.

As the two charts beside show our style of investing tends to provide the most excess returns when the value style is in favour (as measured by the P/E dispersion in the market). The recent reduction in the Small Cap P/E dispersion has been relatively modest however conditions are in place for this to become a longer running trend.

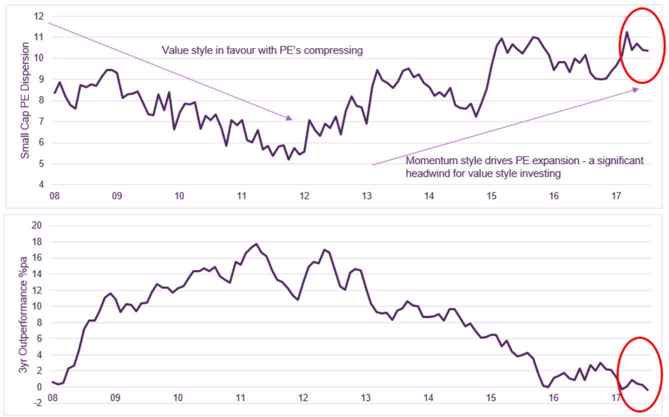
The Trust remains attractively priced on one year metrics with a P/E ratio of 12.4 times (a 26.0% discount to the Index) and offering a 4.5% gross yield.

Asset Allocation

Sector	Trust weight %	Index weight %
Energy	5.0	6.4
Materials	12.5	17.2
Industrials	12.2	9.9
Consumer Discretionary	27.5	19.8
Consumer Staples	4.8	10.4
Health Care	7.0	6.6
Financials-x-Real Estate	7.7	8.0
Real Estate	5.7	12.4
Information Technology	7.9	6.9
Telecommunication Services	3.5	1.8
Utilities	2.9	0.6
Cash & Other	3.4	-

Rounding accounts for small +/- from 100%.

Drivers of Value Style performance in Australia



Source: Small Cap PE gap (80th percentile – 20th percentile) DB. 3yr Rolling Gross Outperformance PVSC. September 2017