Perennial Value Microcap Opportunities Trust

MONTHLY REPORT JANUARY 2019

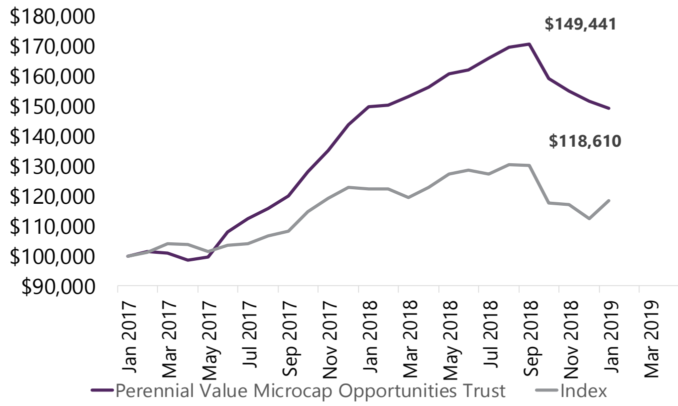
	Month (%)	Quarter (%)	FYTD (%)	1 Year (% p.a.)	Since Inception (%p.a.)	Since Inception Cumulative (%)
Perennial Value Microcap Opportunities Trust (Net)	-1.4	-6.2	-7.8	-0.4	22.3	49.4
S&P/ASX Small Ordinaries Accum. Index	5.6	0.8	-7.8	-3.0	8.9	18.6
Value Added (Detracted)	**-7.0**	**-7.0**	**0.0**	**2.6**	**13.4**	**30.8**

^Since inception: February 2017. Past performance is not a reliable indicator of future performance.

Overview

- The Trust was down 1.4% lagging the strong recovery in the Small Ordinaries Index which was up 5.6%.
- The strong bounce in the market in January was concentrated in the highly liquid (and mostly expensive) small cap stocks which are large in the Index and do not meet our criteria for an attractive investment.
- We were disappointed to have three of our positions downgrade earnings during the period however the bulk of the poor relative performance was explained by many of our holdings drifting lower as investors wait for results in February.
- The apparent apathy to the clear value in many of our names is unlikely to continue past February if earnings growth is as strong as we are forecasting. The Trust trades on an average price to earnings multiple of 9.4x (36% discount to market) with forecast EPS growth of 45.0% p.a. Takeover activity in many of our names is likely if they don't begin to re-rate to more appropriate multiples.

Growth of $100,000 Since Inception



Performance shown net of fees with distributions reinvested. Does not take into account any taxes payable by an investor. Past performance is not a reliable indication of future performance.

Perennial Value Microcap Opportunities Trust

The aim of the Trust is to grow the value of your investment over the long term by investing in a portfolio of Australian companies that are either listed or unlisted companies found outside the S&P/ASX Top 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
Andrew Smith, Sam Berridge

Trust FUM
AUD $108 million

Distribution Frequency
Annual

Minimum Initial Investment
$25,000

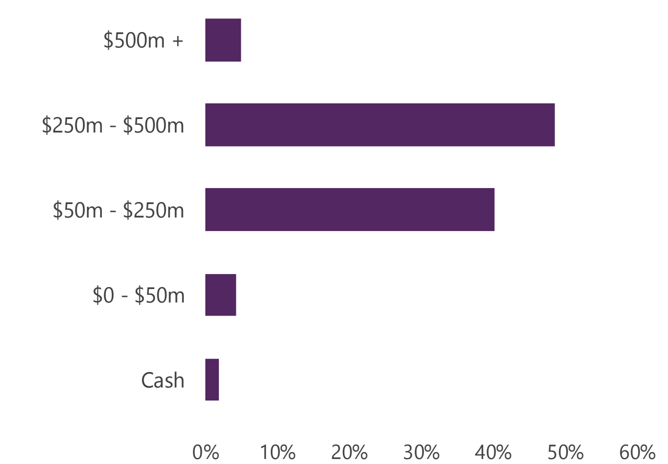
Trust Inception Date
February 2017

Fees
1.20% + Perf fee

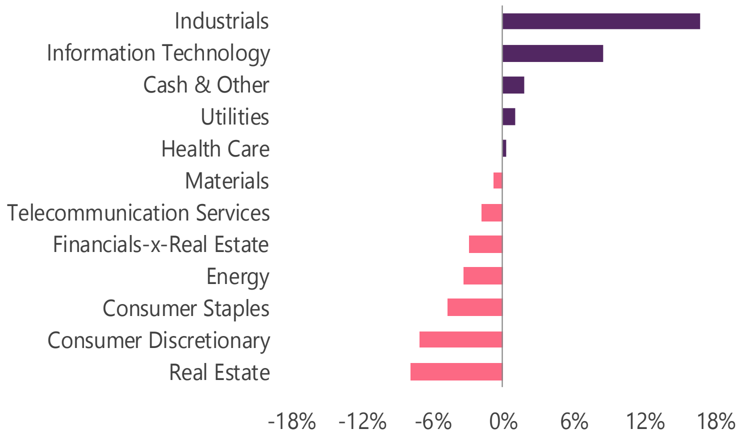
APIR Code
WPC3982AU

Top 5 Positions	Trust (%)	Index (%)
Imdex Ltd	5.2	0.3
Acrow Formwork and Construction Services Limited	3.8	0.0
Rhipe Ltd	3.6	0.0
Primero Group Limited	3.6	0.0
ATOMOS Ltd	3.2	0.0

Market Capitalisation Exposure



Sector Active Exposure vs Index



Trust Review

The 7.0% underperformance relative to market is best explained by breaking this down into the key drivers.

1) Negative Earnings Revisions (Oliver's, Janison, MLX)	– 2.0%
2) Unexplained Index and Portfolio moves	– 4.6%
3) Not holding Expensive Tech (APT, WTC, APN, ALT, NEA)	– 0.8%
4) Downgrades Avoided (Costa Group)	+ 0.4%

1) Negative Earnings Revisions (-2.0%)

While **Oliver's** (-60.0%) was a relatively small position it is certainly an investment mistake we want to eliminate going forward. In our review post the downgrade, we identified that our key mistake was placing too much emphasis in the quality of the asset (in this case the large potential in the Oliver's Real Food brand) and not enough focus on the areas where management appeared to be lacking. Post this we have altered our process to formally exclude stocks where we do not have a strong positive opinion of both the CEO and CFO – the later reflecting the higher risk to earnings forecasts at the microcap end of the market.

While **Janison** (-20.0%) and **Metals X** (-16.5%) provided disappointing earnings updates, they largely reflect timing issues with stronger 2H earnings expected in both cases. We also take comfort from the positive improvement in the quality of management teams in both cases as well as the net cash position on both balance sheets.

2) Unexplained Index and Portfolio Moves (-4.6%)

It is very unusual to have such a large portion of relative performance driven by stock moves with no commensurate change in earnings expectations. The positive from this is that it should quickly reverse if our expectations for earnings results in February are met.

One potential explanation is redemptions in the market of several small and microcap portfolios some of which had cross-over to our names. Such selling pressure tends to be temporary and began to abate towards the end of the month.

We also expect many investors are moving up the market cap curve (above our $500m mkt cap limit) given the perceived lower risk in more liquid names.

This is understandable given the weakness in the December quarter but ignores the compelling value in the less mainstream small and microcaps where risk can also be lower given strong net cash balance sheets and high management share ownership.

We continue to target these type of investments and believe if the market doesn't re-rate them in the near term then corporates are likely to become interested given the high free cash flow on offer.

3) Not holding Expensive, mainstream Tech names (-0.8%)

Another drag on performance was the strong bounce back in the popular tech names with moves of +15.0% - +30.0% during the month. In the case of AfterPay and Nearmap there was at least some positive newsflow however valuations remain our key concern with PE's in FY20 ranging from 33x to 133x – leaving little room for error should earnings growth disappoint in the future.

We prefer the risk/return in microcap tech names which are earlier in their life cycle and thus growing to below market multiples in FY21. Our preferred microcap tech names are Audinate, Latam Autos, Revasum, Rhipe and Redbubble.

4) Downgrades Avoided (+0.4%)

At month end the Trust had 62 stocks and 1.9% cash.

Market Review – Australia (%)

S&P/ASX Small Ordinaries Index	+5.6
Energy	+13.9
Materials	+3.9
Industrials	+6.8
Consumer Discretionary	+4.3
Health Care	+6.4
Financials-x-Real Estate	-1.3
Real Estate	+4.5
Information Technology	+10.0
Telecommunication Services	+6.2
Utilities	+9.3

Global, Currency & Commodities (%)

S&P500	+7.9
Nikkei225	+3.8
FTSE100	+3.6
Shanghai Composite	+3.6
RBA Cash Rate	1.50
AUD / USD	+3.6
Iron Ore	+17.5
Oil	+15.0
Gold	+3.0
Copper	+5.8

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Contact Us

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