Perennial Value Smaller Companies Trust

Monthly Report
28 February 2017

	Month	Quarter	FYTD	1 year	3 years	5 years	Since Inception^
	%	%	%	%	% p.a.	% p.a.	% p.a.
Perennial Value Smaller Companies Trust*	-0.6	2.8	14.1	23.7	6.1	4.5	9.9
S&P/ASX Small Ordinaries Accum. Index	1.3	2.4	4.6	16.8	5.1	1.8	5.6
Value Added (Detracted)	**-1.9**	**0.4**	**9.5**	**6.9**	**1.0**	**2.7**	**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 $109 million

Income distribution frequency:
Half yearly

Minimum initial investment:
$25,000

Trust inception date:
March 2002

APIR code:
IOF0214AU

- **The S&P/ASX Small Ordinaries Accumulation Index (the Index) was up 1.3% for February, while the Trust declined 0.6% net of all fees, underperforming the benchmark by 1.9%.**
- **The focus of February was reporting season, with the industrial stocks held in the Trust delivering 21.0% EPS (earning per share) growth and 24.0% dividend growth on average.**
- **The Trust offers very good value with an FY18 P/E (price to earnings) of 10.6 times (23.0% discount to the market) and a gross yield of 6.0% (19.0% premium to the market).**

Trust Performance

The Index increased by 1.3% during the month as investors reacted to a reporting season where, on average, expectations were met. The Trust declined 0.6%, net of all fees, thereby underperforming by a net 1.9%.

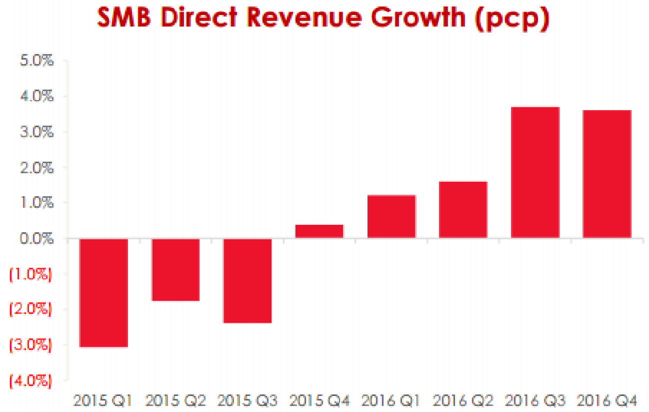
The relative performance of the Trust was impacted by the strong outperformance of several growth stocks which are not held in the Trust on valuation grounds, including Costa Group (up 24.1%), Next DC (up 20.5%) and NIB Holdings (up 15.6%). However, this same valuation discipline enabled the Trust to avoid several well held small cap industrial stocks which fell sharply after delivering disappointing results, including Isentia (down 41.0%), CSV (down 39.1%) and Ardent Leisure (down 22.1%).

Global markets were strong, with the S&P500 up 3.7%, FTSE100 up 2.3%, Shanghai Composite up 2.2% and Nikkei 225 up 0.3%. Commodity prices were generally firm, with iron ore up 10.0%, gold up 4.0%, thermal coal up 2.0%, copper and oil were flat while coking coal declined 5.0%. The Reserve Bank of Australia left the cash rate steady at 1.5%, while the Australian Dollar finished the month up one cent at 77 US cents.

During February, the better performing sectors where consumer staples (up 5.0%), health care (up 4.5%) and property trusts (up 3.7%). The worst performing sectors were utilities (down 4.2%) followed by telecommunication services (down 3.4%).

Many of the stocks in the Trust delivered results or news flow ahead of market expectations. Capral (up 16.7%) was rewarded after announcing their first dividend in many years and delivering a result in-line with guidance. RPM Global (up 13.6%) demonstrated over 20.0% organic growth in software as well as the successful integration of iSolutions.

Melbourne IT (up 11.6%), a long term holding in the Trust, delivered a strong result. Most importantly, it was able to demonstrate growth in their legacy SMB domain business (as seen in the Chart below) which many in the market thought was in terminal decline. The reversal of this trend is likely to lead to a continued re-rating of the stock.



Source: Melbourne IT CY16 Investor Presentation

Infomedia (up 11.0%) signed a new contract with Nissan demonstrating that their recent investment in sales and marketing is paying off. Other solid results included GUD Holdings (up 9.7%) driven by their Auto division which accounts for over 80.0% of their earnings and NZME (up 9.2%) with both lower revenue declines and higher cost savings than expected.

Cooper Energy (COE) up 9.3%, announced a non-binding agreement with APA Group to buy COE's Orbost Gas plant and spend $250 million refurbishing it in readiness for gas from COE's offshore Sole development in 2019. This deal shifts capex to opex for COE, decreasing the need for new equity with limited NPV (net present value) impact. The east coast gas shortage is becoming more acute and COE's Sole gas project will be one of the first sources of new supply to reach the market.

Super Retail Group (up 8.3%) announced a clean result with all 3 divisions experiencing EBIT (earnings before interest and tax) margin expansion as supply chain benefits started to deliver, leading to strong cash flow and debt reduction. We added to our position just prior to their result and despite the gains over the month, the stock still represents good value in the current market.

We used weakness in the retail sector early in the month to add to our position in Premier Investments at an average $12.60. The company then issued a positive trading update, after which we took profits and reduced our exposure at an average price of $13.99 (month end closing price $13.45).

The largest detractor from performance was Sundance Energy (down 24.5% to our exit price). We had been reducing our positon in SEA for some time but made the decision to sell out completely post the quarterly update at the end of January. While the position did impact performance this month the exit price of (15.1 cents) compares with the share price of 11.5 cents at month end as the broader market began to focus on the balance sheet concerns.

DRM (down 21.8%) was sold off on equity raising concerns. DRM has up to $16 million of copper-gold inventory which it's likely to sell in the very near term. This, coupled with a restructured amortisation schedule for its debt is likely to allay balance sheet concerns. Due to relative underperformance DRM also screens as very cheap versus peers, so with improving performance at its flagship asset, Deflector, M&A is a possibility.

Swick Mining (down 19.0%) disappointed the market with flat revenue guidance for the 2HFY17. This reflected a weather related disruption such that the benefit of near full utilisation will not be seen until FY18. Swick's share price had run hard into the result and we took some profits at $0.31 earlier in the month. Given numerous indicators pointing to the positive exploration thematic enduring for some time, we are happy to add to our position on weakness.

Adairs Limited (down 18.9%) disappointed the market with downgraded guidance despite the new range only arriving in store in early February. With a strong balance sheet in place, we will assess our small holding following the company's roadshow in mid-March.

Other stocks that detracted from performance included Tox Free Solutions (down 16.2%) after delivering a disappointing result which management attributed to hot/dry weather in November & December leading to reduced liquid waste volumes. Looking forward the recently acquired Daniels business (medical waste) will benefit the current half for a full six months, providing the company with a better balanced waste exposure going forward.

Trust activity

It was an active month with reporting season providing many opportunities to enter and exit stocks at attractive prices. Stocks such as AAC Co, Mantra, Nufarm and Breville were exited during the month on valuation grounds. Proceeds used to establish a position in Austbrokers at $10.70 (month end price $11.25) after they delivered a credible result and upgraded their outlook commensurate with a recovering insurance premium cycle. Other stocks added included G8 Education, post an encouraging result, as well as Dacian Gold and Australis Oil and Gas via equity placements. At month end the Trust held 58 stocks and cash of 1.1%.

Outlook

The Trust offers very good value trading on a FY18 P/E of 10.6 times (23.0% discount to the ex-100 market) and a Gross Yield of 6.0% (19.0% premium to the ex-100 market).

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

Signatory of:

PRI Principles for Responsible Investment

Asset Allocation		
Sector	**Trust weight %**	**Index weight %**
Energy	3.2	5.0
Materials	16.5	20.5
Industrials	10.2	10.3
Consumer Discretionary	26.0	21.2
Consumer Staples	0.0	6.4
Health Care	5.6	6.4
Financials-x-Real Estate	11.8	8.8
Real Estate	9.7	13.4
Information Technology	8.8	5.6
Telecommunication Services	4.3	1.5
Utilities	2.8	0.8
Cash & Other	1.1	-

Rounding accounts for small +/- from 100%.

For all other enquiries please contact us on 1300 730 032
or visit www.perennial.net.au.

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