Perennial Value Smaller Companies Trust

Quarterly Report
31 March 2017

	Quarter	FYTD	1 year	3 years	5 years	Since Inception^
	%	%	%	% p.a.	% p.a.	% p.a.
Perennial Value Smaller Companies Trust*	-1.2	14.7	15.7	6.5	4.2	9.9
S&P/ASX Small Ordinaries Accum. Index	1.5	7.4	13.7	6.4	2.3	5.7
Value Added (Detracted)	**-2.7**	**7.3**	**2.0**	**0.1**	**1.9**	**4.2**

*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
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

- **Over the quarter, the Trust fell by 1.2% (net), underperforming the Index by 2.7% net of all fees.**
- **For the twelve months ending 31 March 2017, the Trust delivered a net return of 15.7%.**
- **Based on our FY18 assumptions, the Trust represents considerable value as the portfolio Trust trades on an FY18 price-earnings ratio of 10.4 times, a 31.0% discount to the ex-100 market.**

Trust Performance

During the March quarter, the Perennial Value Smaller Companies Trust (the Trust) was down 1.2%, net of fees, compared to the S&P/ASX Small Ordinaries Accumulation Index (the Index) which was up 1.5%, underperforming by 2.7%. Over the past twelve months the Trust delivered a strong return of 15.7% net of fees, compared to the Index which was up 13.7% outperforming by 2.0%.

The best performing sectors over the quarter were utilities (up 14.4%), consumer staples (up 14.2%) and energy (up 6.4%). The largest negative moves came from information technology (down 8.1%) and materials (down 4.8%).

The leading contributor to performance over the quarter was Melbourne IT (up 21.4%) which has been a long term holding in the Trust and it was pleasing to see it rewarded by investors for a strong result.

Most importantly it was able to demonstrate growth in their legacy SMB domain business 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 Melbourne IT.

Another strong contributor was New Zealand publishing and media company NZME (up 54.5%) which delivered a better than expected result (the Trust received this holding when it spun out of its stake in APN News & Media last June).

Pacific Energy (up 19.3%) announced contract wins totalling 18 megawatts of additional power generation capacity, an increase of 7.5% on the exit rate at June 30 2016. The wins came from a mix of new customers and organic growth from existing clients. Despite its utility like earnings stream, the stock continues to trade at a discount to the market. With its defensive earnings and positive growth outlook, we expect this discount to close over time.

Imdex (up 13.0%) responded to an increase in broker estimates based off better commodity prices and lifting exploration activity. We expect this to lead to increased activity for Imdex.

Detracting from performance was consumer and commercial rental equipment provider Thorn Group (down 28.9%) following the company taking a provision for the long-standing review being undertaken by Australian Securities and Investment Commission (ASIC), which is taking measures to clean up the industry. Over the past 18 months, Thorn has strengthened its Board and management team by appointing the ex-deputy chairman of ASIC, Belinda Gibson as well as the ex-CEO of Suncorp Bank, David Foster to its Board while also appointing a chief risk officer given the increased compliance and risk focus that the company has adopted. We are of the view that Thorn will emerge stronger as the industry undergoes rationalisation, given smaller, unscrupulous operators will be forced out of business.

EML Payments (down 14.8%) fell despite a solid result. We sold out of Sundance Energy (down 45.5%) during the quarter following a weak quarterly update. Homewares retailer Adairs Limited (down 30.0%) disappointed the market with downgraded guidance. While the stock is screening as very cheap and oversold, we are cautious given the fragile consumer discretionary environment (and hence why we exited Premier, Breville and GUD following their strong share price gains during the quarter as their valuations were no longer compelling amidst this sector backdrop). We will continue to assess the performance and sell through of Adairs' new linen range which only arrived in stores during February.

Trust activity

As is often the case, it was an active quarter in terms of Trust activity as both buying and selling opportunities presented.

During the quarter, the Indonesian Government announced that it will be lifting bans on nickel exports. Prior to this announcement, we had been taking profits in each of Western Areas and Independence Group as both had rallied significantly and were trading at premium valuations. Following the Indonesian update, we exited Western Areas completely at an average price of $2.96 (quarter end price $2.31) and materially reduced our Independence Group position at an average price of $4.06 (month end price $3.58).

In addition, we took profits and exited positions in AAC Co, Abacus Property Group, Breville, GUD, Mantra, Nufarm and Premier Investments.

During the quarter Collins Food, owner of Kentucky Fried Chicken (KFC) franchises in Australia and Germany, announced an equity raising to fund the purchase of a portfolio of 16 KFC franchises in The Netherlands, together with a pipeline to develop 20 more in the region. This acquisition assists in economically supporting a regional office to oversee Germany and The Netherlands and provide a base for further European expansion. We used this raising as an opportunity to establish a position at the issue price of $5.25 as the stock trades at a substantial discount to the market, while offering growth from further restaurant expansion both locally and abroad. It is also one way to play a turnaround on the Western Australian economy, which seems to be bottoming based on feedback we solicited during the recent results season in meeting with a plethora of WA-based companies.

We also built positions in insurance broker Austbrokers at $10.70 (quarter end price $11.70), Doray Minerals (to add to our gold exposure), child-care provider G8 Education and accommodation provider Mantra Group. We also invested in Dacian and Australis via equity placements.

The Trust ended the quarter with 56 stocks and cash of 3.7%.

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 discussing safety with Tox Free Solutions and SkyDive the Beach as well as board structure with AV Jennings.

Outlook

The Trust offers good value trading on 10.4 times FY18 price to earnings (a 31.0% discount to the ex-100 market) with a gross yield of 6.0% (25.0% 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**	10.4	9.2	6.0	1.6	26.1	15.0
Market Average Ex-100*	15.0	14.3	4.8	2.3	11.3	11.8
Premium/ (Discount) to Market	(31%)	(36%)	25%	(28%)	131%	27%

Source: *Macquarie Securities, Goldman Sachs and USB forecast as at 31 March 2017. ** Perennial forecast as at 31 March 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	4.0	6.0
Materials	16.6	17.5
Industrials	10.2	8.7
Consumer Discretionary	23.3	20.8
Consumer Staples	0.4	8.5
Health Care	5.6	7.2
Financials-x-Real Estate	12.3	9.0
Real Estate	8.1	14.1
Information Technology	7.6	5.8
Telecommunication Services	5.1	1.7
Utilities	3.1	0.7
Cash & Other	3.7	-

Rounding accounts for small +/- from 100%.