Perennial Value Smaller Companies Trust

MONTHLY REPORT JANUARY 2019

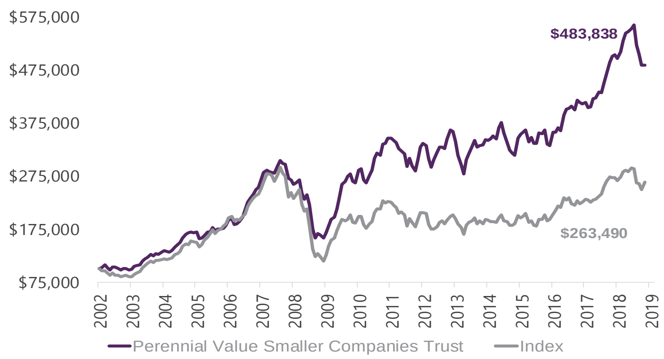
	Month (%)	Quarter (%)	FYTD (%)	1 Year (% p.a.)	3 Years (% p.a.)	5 Years (% p.a.)	Since^ Inception (%p.a.)
Perennial Value Smaller Companies Trust (Net)	0.1	-7.3	-11.1	-3.5	13.0	7.7	9.8
S&P/ASX Small Ordinaries Accum. Index	5.6	0.8	-7.9	-3.1	11.3	7.4	6.0
Value Added (Detracted)	**-5.5**	**-8.1**	**-3.2**	**-0.4**	**1.7**	**0.3**	**3.8**

^Since inception: March 2002. Past performance is not a reliable indicator of future performance.

Overview

- The Trust was up 0.1% 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.
- Only two of our positions downgraded earnings during the period with the bulk of the poor relative performance reflecting the fact that most of our holdings drifted lower as investors wait for results in February.
- The apparent apathy to the clear value in many of our holdings 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 9.7x (34% discount to market). At these levels, we expect many stocks could become takeover targets if they do not re-rate in the near term.

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 Smaller Companies Trust

The aim of the Trust is to grow the value of your investment over the long term by investing in a portfolio of listed Australian companies predominantly 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 and Julian Guido

Trust FUM
AUD $134 million

Distribution Frequency
Half yearly

Minimum Initial Investment
$25,000

Trust Inception Date
March 2002

Fees
1.20% + Perf fee

APIR Code
IOF0214AU

Top 10 Positions

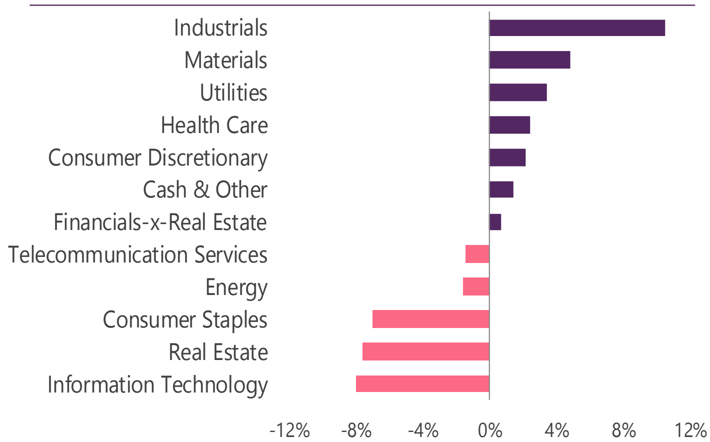
	Trust (%)	Index (%)
Imdex Ltd	6.4	0.3
Integral Diagnostics	4.5	0.0
Pacific Energy	3.8	0.0
EML Payments Ltd	3.5	0.2
Navigator Global Investments Ltd	3.2	0.2
SRG Ltd	3.0	0.0
Cooper Energy Ltd	3.0	0.4
Pwr Holdings Ltd	2.9	0.0
Ausdrill Ltd	2.6	0.4
National Veterinary	2.3	0.0

Portfolio Characteristics – FY20	Trust	Index
Price to Earnings (x)	9.7	14.8
Price to Free Cash Flow (x)	7.2	14.4
Gross Yield (%)	6.2	5.0
Price to NTA (x)	1.6	3.1

Source: Perennial Value Management. As at 31 January 2018.

The above figures are forecasts only. While due care has been used in the preparation of forecast information, actual outcomes may vary in a materially positive or negative manner.

Sector Active Exposure vs Index



Trust Review

The 5.5% underperformance relative to market is best explained by breaking this down into the key drivers.

1) Negative Earnings Revisions (Navigator, Metals X)	– 1.7%
2) Downgrades Avoided (Costa Group)	+ 0.4%
3) Not holding Expensive Tech (APT, WTC, APX, ALU, NEA)	– 0.8%
4) Unexplained Index and Portfolio moves	– 3.4%

1) Negative Earnings Revisions (-1.7%)

Our large position in **Navigator Global Investments** (-28.1%) impacted performance following a disappointing earnings update. We had expected their fund of hedge fund strategy to hold-up better in the severe December sell-off however this was not the case. As an example, their Diversified Strategy was down 3.7% for the quarter given the unusually high correlation amongst asset classes during the sell-off. While performance seems to have 'normalised' since December, management flagged the lagged impact to 2H19 earnings from lower funds under management resulting in market downgrades. At these levels, investors seem overly bearish on Navigator given a strong balance sheet (US$36m in net cash) and strong recovery in markets throughout January.

The only other stock to downgrade earnings expectations was **Metals X** (-16.5%) which provided a quarterly update. While production continued to recover at their Nifty copper mine (for the third consecutive quarter), this was not enough to meet the high expectations of the market. The market is clearly waiting to see consistent cashflow from the copper mine and is largely ignoring the strong earnings from their Renison Tin mine in Tasmania which we believe is a strategic asset. Over time we expect these assets will attract increasing investor (and corporate) interest given their cash producing potential.

2) Downgrades Avoided (+0.4%)

One pleasing aspect of the month was to avoid the earnings downgrade at Costa Group, a well-held small cap and a stock we did a detailed review of last year and concluded earnings risk was too high given the valuation. The severe share price fall is a reminder of what can happen to highly priced stocks if they disappoint.

3) Not holding Expensive 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 news flow 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.

4) Unexplained Index and Portfolio Moves (-3.4%)

It is very unusual to have such a large portion of relative performance driven by stock moves with no commensurate change in earnings expectations (e.g. RPM Global was down 12.9%). 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 indeed began to abate towards the end of the month.

We also expect many investors are moving up the market cap curve given the perceived lower risk in the more liquid names. This is understandable given the weakness in the December quarter however ignores the compelling value in the less mainstream small caps where risk can also be lower given strong net cash balance sheets and high management ownership. We continue to target these types of investments and believe if the market doesn't re-rate these names, then corporates are likely to become interested given the high free cashflow on offer.

At month end the Trust had 61 stocks and 1.5% 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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