Perennial Value Smaller Companies Trust

MONTHLY REPORT FEBRUARY 2020

	Month (%)	Quarter (%)	FYTD (%)	1 Year (%)	3 Years (% p.a.)	5 Years (% p.a.)	Since Inception^ (%p.a.)
Perennial Value Smaller Companies Trust (Net)	-9.2	-4.6	4.0	11.1	11.3	10.3	10.2
S&P/ASX Small Ordinaries Accum. Index	-8.7	-5.9	-1.9	1.6	8.3	7.4	6.0
Value Added	**-0.5**	**1.3**	**5.9**	**9.5**	**3.0**	**2.9**	**4.2**

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

Overview

February finished with the largest sell-off in financial markets since the GFC given concerns about the demand impact from the spread of the Coronavirus. Investors were desperate for liquidity and sold irrespective of whether companies were directly impacted. For example, the gold sector sold off (ASX gold index down 4.1%) despite the A$ gold price being up 5.3% for the month. Investors ignored the improving outlook for gold equities, instead selling them for liquidity. We use gold equities to partially hedge our more cyclically exposed industrial portfolio and thus, without this offset working, our portfolio was down 9.2% (net of all fees) compared to the Small Ordinaries Index which was down 8.7%.

Looking forward, such a large and indiscriminate sell-off creates great investing opportunities. We await signs of a bottoming in demand before adding to resources and also think it is too early for travel stocks and other directly affected sectors. However, there are many stocks in the portfolio that displayed positive fundamentals in the February reporting season and were ignored given 'macro' concerns. Over time, these stock-specific attributes will shine through. In the meantime, the portfolio is the best value it has been since the GFC at 11.6x FY21 earnings (a 31.4% discount to the Index) and a gross yield of 4.7%. The portfolio also holds four industrial stocks now trading below hard book value.

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 $143 million

Distribution Frequency
Half yearly

Minimum Initial Investment
$25,000

Trust Inception Date
March 2002

Fees
1.20% p.a. + Performance fee

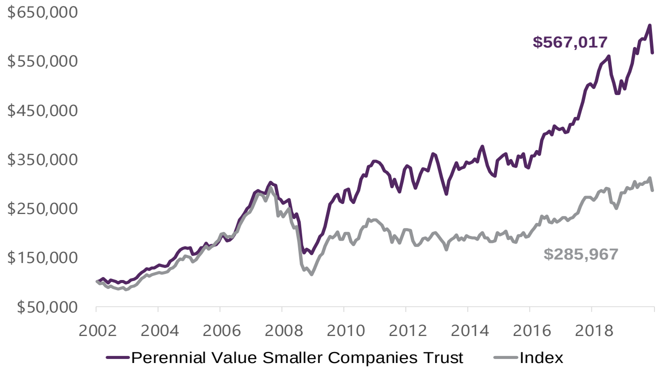
APIR Code
IOF0214AU

Portfolio Characteristics – FY21	Trust**	Index*
Price to Earnings (x)	11.6	16.9
Price to Free Cash Flow (x)	8.1	15.3
Gross Yield (%)	4.7	3.9
Price to NTA (x)	2.5	2.3

Source: *Macquarie Securities, Goldman Sachs & UBS forecast as at 29 February 2020. **Perennial Value Management as at 29 February 2020.

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.

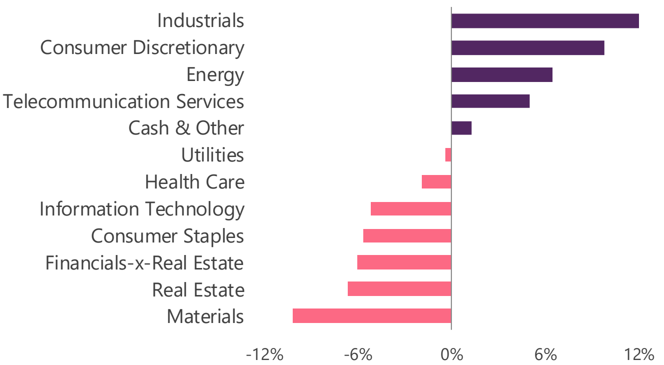
Growth of $100,000 Since Inception



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.

Top 10 Positions	Trust (%)	Index (%)
ALLIANCE AVIATION SERVICES L	3.8	0.0
INTEGRAL DIAGNOSTICS LTD	3.4	0.0
LIMEADE INC	3.2	0.0
EMECO HOLDINGS LTD	3.0	0.3
PWR HOLDINGS LTD	2.9	0.0
SEALINK TRAVEL GROUP L	2.8	0.0
NAVIGATOR GLOBAL INVESTMENTS L	2.8	0.2
SRG GLOBAL LTD	2.7	0.0
SEVEN GROUP HOLDINGS LTD	2.7	1.3
ATOMOS LTD	2.6	0.0

Sector Active Exposure vs Index



Trust Review

February finished with the largest sell-off in financial markets since the GFC given concerns about the demand impact from the spread of the Coronavirus. Investors were desperate for liquidity and sold irrespective of whether companies were directly impacted. For example, the gold sector sold-off despite the A$ gold price being up 5.3% for the month. Investors ignored the improving fundamentals for gold stocks and instead sold them for liquidity (see attached chart).

For investors looking forward, this detachment from fundamentals creates great investment opportunities. For now, we are focusing on companies with the least exposure to the slowdown caused by Coronavirus and which have also been caught in the widespread selloff.

In this vein, there were many positive results reported late in the month that were ignored given a very distracted market:

- **PWR Holdings** (down 9.1%) posted revenue growth of 20% on increasing margins, resulting in EBITDA growth of 34% year-on-year and a net cash balance of $7.9m.
- **Seven Group Holdings** (down 13.3%) upgraded guidance for the full year despite including some one off costs.
- **Limeade** (down 1.6%) reported 20% growth in annual contract value, with closing net cash of US$32m.
- **MoneyMe** (+7.3%) reported 112% growth in the loan book and is now well positioned to significantly exceed prospectus forecasts.

Two companies that did gain investor interest post strong results were:

Adairs (+8.5%), reported good sales driven by its online sales channel. Importantly, despite a lower AUD, gross margins actually improved from better selling prices. Looking forward, we expect higher revenue growth rates from the recent Mocka acquisition and further margin improvement post implementation of a new warehouse programme.

Johns Lyng Group (+6.6%), reported strong sales growth of 42% with EBITDA almost doubling. While earnings guidance was recently upgraded, it is likely to prove conservative given it is it yet to include subsequent domestic catastrophe events that have occurred post December.

Source: Perennial Value and Bloomberg

Austin Engineering (down 26.2%) reported a mixed 1H20 with order delays into the 2H but high cash generation which significantly improved the balance sheet. The market seemed concerned with the large skew of earnings to the 2H but management reconfirmed guidance given revenue forecasts are 90% covered by existing orders.

The main stock with a direct impact from the Coronavirus was **Atomos** (down 40.8%). The 1H20 result was solid with both revenue and EBITDA growth of 35% driven by new products clearly gaining traction. However, the market focused on the potential supply chain disruptions which could impact product flow going forward. We now expect some delays to the new Neon product but thanks to a large pre-Christmas restock, core product inventory is sufficient to meet forecast demand in April, and the latest update suggests the key factories are at least partially back on line. The improving traction Atomos is having with customers and growing brand presence will be the long term driver of value rather than the short-term supply issues – hence we were buying on weakness.

Oil stocks were clearly impacted from lower oil prices which pushed **Karoon Energy** (down 27.2%) and **Otto Energy** (down 34.4%) down significantly. Media stocks were weaker given the mixed outlook **oOhMedia** (down 15.4%) and **HT&E** (down 17.9%).

At month end we held 63 positions and cash of 1.3%.

Market Review – Australia (%)

S&P/ASX Small Ordinaries Index	-8.7
Energy	-21.8
Materials	-10.6
Industrials	-11.0
Consumer Discretionary	-5.7
Consumer Staples	-7.9
Health Care	-14.1
Financials-x-Real Estate	-10.5
Real Estate	-1.6
Information Technology	-15.5
Telecommunication Services	-10.4
Utilities	-6.6

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Small Cap Portfolio Managers: Andrew Smith (left) and Julian Guido (right)

Contact Us

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