# Perennial Value Shares for Income Trust

MONTHLY REPORT FEBURARY 2021

| | Month (%) | Quarter (%) | FYTD (%) | 1 Year (%) | 2 Years (% p.a.) | 5 Years (% p.a.) | Since Inception (%p.a.) |
|---|---|---|---|---|---|---|---|
| Income Distribution | 0.4 | 1.2 | 3.6 | 5.7 | 8.9 | 7.9 | 6.3 |
| Capital Growth | 1.3 | 2.4 | 11.4 | 0.3 | -6.1 | -1.3 | -0.5 |
| Total Return | 1.7 | 3.6 | 15.0 | 6.1 | 2.8 | 6.6 | 5.7 |
| Franking Credits# | 0.2 | 0.4 | 1.5 | 2.4 | 3.9 | 3.0 | 2.3 |
| **Income Distribution including Franking Credits** | **0.6** | **1.6** | **5.1** | **8.1** | **12.8** | **10.9** | **8.5** |
| Benchmark Yield including Franking Credits* | 0.6 | 0.8 | 2.7 | 3.8 | 4.7 | 5.7 | 5.9 |
| **Excess Income to Benchmark#** | **0.0** | **0.8** | **2.4** | **4.3** | **8.1** | **5.2** | **2.6** |

#Franking credits are an estimate as tax components will only be known with certainty at the end of the financial year. Since inception: December 2005. *Benchmark yield including franking credits is calculated as the difference between the return on S&P/ASX300 Franking Credit Adjusted Daily Total Return Index (Tax Exempt) and the return of the S&P/ASX300 Index. Past performance is not a reliable indicator of future performance.

## Overview

- Global markets performed strongly in February, driven by continuing positive sentiment around vaccine rollouts and the prospect of large stimulus in the US, with all major indices delivering positive returns. This was despite a selloff in the later part of the month on the back of rising bond yields.
- The Australian market followed a similar path, rallying early in the month before pulling back, with the ASX300 Accumulation Index finishing the month up +1.5%. Cyclical sectors such as Resources, Energy and Financials led the market higher, while defensive, interest rate sensitive sectors lagged.
- The Trust is targeting an FY21 pre-tax distribution yield of around 7%. While market dividends will be lower, the Trust will seek out the best dividend opportunities and may seek to supplement income generation by undertaking limited call-writing.

## Perennial Value Shares for Income Trust

The objective of the Trust is to provide investors with an attractive level of tax effective income, paid via monthly distributions. The Trust aims to provide a gross distribution yield, adjusted for applicable franking credits, above that provided by the S&P/ASX300 Franking Credit Adjusted Daily Total Return Index (Tax-Exempt).

**Portfolio Manager**
Stephen Bruce

**Trust FUM**
AUD $19 million

**Distribution Frequency**
Monthly

**Minimum Initial Investment**
$25,000

**Trust Inception Date**
December 2005

**Fees**
0.92%

**APIR Code**
IOF0078AU

| Portfolio Characteristics – FY22 | Trust | Market |
|---|---|---|
| Price to Earnings (x) | 17.3 | 17.6 |
| Price to Free Cash Flow (x) | 14.6 | 15.4 |
| Gross Yield (%) | 6.1 | 4.9 |
| Price to NTA (x) | 2.4 | 2.6 |

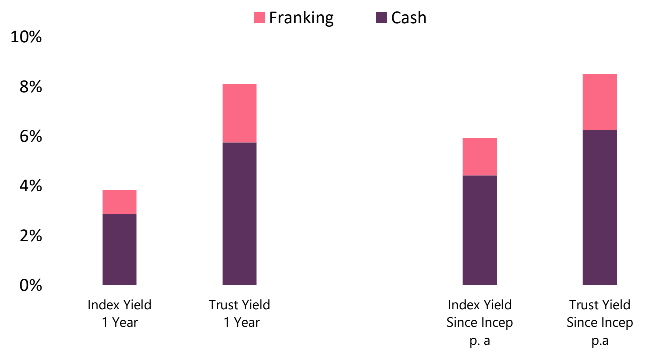
Source: Perennial Value Management. As at 28 February 2021

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.

## Franking Levels (%)

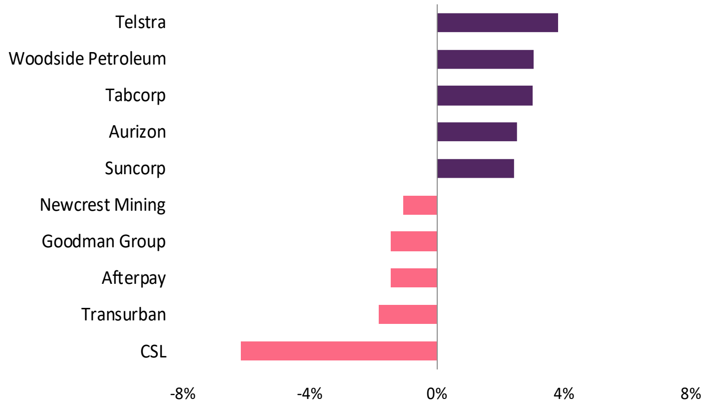
| | | | |
|---|---|---|---|
| FY20 | 94.4 | FY17 | 65.6 |
| FY19 | 95.1 | FY16 | 55.9 |
| FY18 | 99.2 | FY15 | 88.4 |

## Distribution Yield

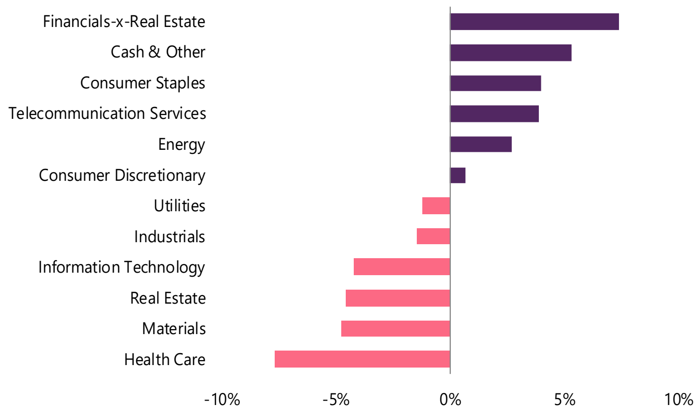



Does not take into account any taxes payable by an investor. Past performance is not a reliable indication of future performance.

## Top 5 Over / Underweight Positions vs Index




## Sector Active Exposure vs Index



## Trust Review

The February reporting season was the main highlight of the month, with companies reporting their results for the half-year to December. In line with the improving economic backdrop, the majority of results were reasonably positive and, in many cases, better than market expectations. While many companies were adversely impacted by COVID, the trends were clearly improving.

Sectors such as retail, which have been clear beneficiaries of COVID-related stimulus delivered very strong results. Resources stocks also delivered bumper results and very large dividends, on the back of high commodity prices. The interim result from CBA and Q1 trading updates from the other banks highlighted that credit quality remains very good.

It is becoming clear that, if current economic trends continue, the banks are significantly overprovisioned for the level of credit losses that will ultimately be realised. The release of these provisions will support earnings growth over the coming years. When improving earnings are combined with strong capital positions, the prospects for strong dividends from the banks are very good. CBA increased its interim dividend significantly from the prior half and we expect similar increases from the other banks at their upcoming results in May. On the back of this improving outlook, the banks outperformed, up an average of +6.8%.

Holdings with leverage to economic reopening performed well, including hotel and cinema operator Event Hospitality (+18.6%) and packaging company Orora (+16.3%), which rallied as its struggling US operations have begun to recover.

Resource holdings performed well, with Rio Tinto (+15.3%), BHP (+12.8%) and Fortescue Metals (+10.6%) all up on stronger commodity prices. We view the outlook for the resources sector positively. Current commodity demand has been largely driven by China, which has remained strong throughout the last year. However, demand is expected to increase further as activity accelerates in the rest or world, further boosting the sector.

Other holdings which performed well included Tabcorp (+13.4%), which rallied after receiving an offer to acquire its wagering business. While this division has struggled in recent times, it is a very attractive asset in a sector undergoing consolidation. We have long believed that a separation of Tabcorp's businesses would realise value by allowing a significant re-rating of the lotteries business, which has very stable earnings underpinned by long-term licences.

The Trust also benefitted from not holding a number of expensive growth stocks which underperformed over the month, including Appen (-25.3%), A2 Milk (-16.0%), Altium (-14.5%), Wisetech (-12.8%), Afterpay (-11.5%) and Xero (-8.8%). Growth stocks such as these have performed very strongly in the low-rate, low-growth environment of recent years. However, life may become significantly more difficult for them should rates continue to rise and growth recover in the broader economy. Further, these types of companies pay little or no dividends.

Holdings which detracted from performance included Coles (-14.0%), which delivered a strong result, however guided to slightly softer than expected sales growth. United Malt (-9.0%), declined after downgrading earnings due to the impact on malt demand from European lockdowns. Ampol (-6.1%), was also weaker, as it continues to be impacted by its loss-making refining division. We expect this division to be closed, which should improve earnings over the medium-term. We remain comfortable with each of these holdings.

## Trust Activity

During the month, we increased our holdings in a number of stocks expected to deliver strong results and pay large dividends, including Telstra and Fortescue Metals. We also increased the holding in Tabcorp, where we believe corporate activity will drive upside near-term. This was funded by exiting a number of holdings including Metcash, which had run particularly hard, as well as REIT holdings GPT and Mirvac. At month end, stock numbers were 32 and cash was 2.5%.

## Distribution

In order to provide a regular income stream, the Trust pays monthly distributions. We aim to pay equal cash distributions each month, based on our estimate of the dividend income to be generated over the year. Franking credits, surplus income and any realised capital gains will then be distributed, as per usual, with the June distribution.

The Trust declared a distribution for February of 0.35cpu, bringing the total income return for the last 12 months to 5.7% or 8.1% including franking credits.

Looking forward, the outlook for dividends for FY21 will become clearer over the next few months. While it is certain that many companies will be reducing their dividends, the market overall should still be expected to generate an attractive level of dividend income in the year ahead, particularly compared to other alternative sources of yield. In addition, we may seek to enhance the income generation of the Trust by undertaking limited call-writing. At this stage, we are targeting a pre-tax distribution yield of approximately 7.0% for FY21.

## Outlook

The start of 2021 may well mark a significant turning point for the global economy and markets, with the prospects of a near-term roll-out of an effective COVID vaccine underpinning the reopening of economies and a return to global growth. Importantly also, the change of leadership in the US should usher in a period of stability in terms of domestic and international policy and, hopefully, a generally more harmonious backdrop. The election result of a Biden presidency and Democratic Senate means there is likely to be increased fiscal stimulus, which should be positive for economic growth, corporate earnings and markets overall.

Domestically, key indicators around employment, loan deferrals and the property market are all surprising to the upside. Finally, the economy is underpinned by historically low interest rates and meaningful fiscal stimulus. If this improvement continues, then corporate earnings and dividends are likely to rebound strongly over the coming year.

**The Trust is positioned to benefit from an ongoing economic improvement. In the meantime, the Trust continues to offer a higher forecast gross yield than the overall market and, as always, our focus will continue to be on investing in quality companies with strong balance sheets, which are offering attractive valuations and have the ability to deliver high levels of franked dividend income to investors. Further, we believe the current very low interest rates highlight the relative attractiveness of financially-sound, high dividend-yielding equities.**

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## Contact Us

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