Perennial Value Shares for Income Trust

Monthly Report July 2023

	Month (%)	Quarter (%)	FYTD (%)	1 Year (%)	3 Years (% p.a.)	5 Years (% p.a.)	7 Years (% p.a.)	10 Years (% p.a.)	Since Inception^ (% p.a.)
Income Distribution	0.5	1.6	0.5	6.9	8.4	8.4	8.1	7.6	6.6
Capital Growth	2.3	0.3	2.3	4.9	4.7	-2.8	-1.6	-1.2	-0.4
Total Return	2.8	1.9	2.8	11.8	13.0	5.6	6.4	6.4	6.2
Franking Credits#	0.2	0.4	0.2	2.2	3.3	3.5	3.2	2.9	2.5
Income Distribution including Franking Credits	**0.7**	**2.0**	**0.7**	**9.1**	**11.7**	**11.9**	**11.2**	**10.5**	**9.1**
Benchmark Yield including Franking Credits*	0.0	0.8	0.0	6.6	5.7	5.5	5.7	5.8	5.9
Excess Income to Benchmark#	**0.7**	**1.2**	**0.7**	**2.4**	**6.0**	**6.4**	**5.5**	**4.7**	**3.2**

^Since inception: December 2005. Past performance is not a reliable indicator of future performance. #Franking credits are an estimate as tax components will only be known with certainty at the end of the financial year. *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.

Overview

After selling off in the earlier part of the month, markets staged a recovery to finish up strongly. While most central banks raised rates in July, improving inflation data supported the view that we are close to the end of the tightening cycle. At the same time, ongoing healthy economic data gave rise to optimism that a soft landing may be achievable. The Australian market was also strong, with the ASX300 Accumulation Index finishing the month up +2.9%. The market reacted positively as the RBA paused its rate increases, leaving the cash rate unchanged at 4.1% in July.

The Trust is currently targeting FY24 net monthly distributions to remain flat at 0.493 CPU. Based on the unit price at the start of the financial year, this equates to an annualised cash distribution yield of 5.3%.

Fund Characteristics

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 $20 million

Distribution Frequency
Monthly

Minimum Initial Investment
$25,000

Trust Inception Date
December 2005

Fees
0.92%

APIR Code
IOF0078AU

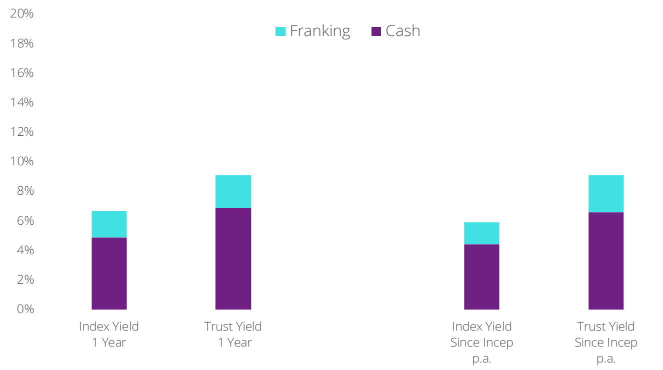
Portfolio Characteristics – FY24	Trust	Market
Price to Earnings (x)	14.2	15.7
Price to Free Cash Flow (x)	14.6	14.4
Gross Yield (%)	5.5	5.3
Price to NTA (x)	2.1	2.6

Source: Perennial Value Management. As at 31 July 2023

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.

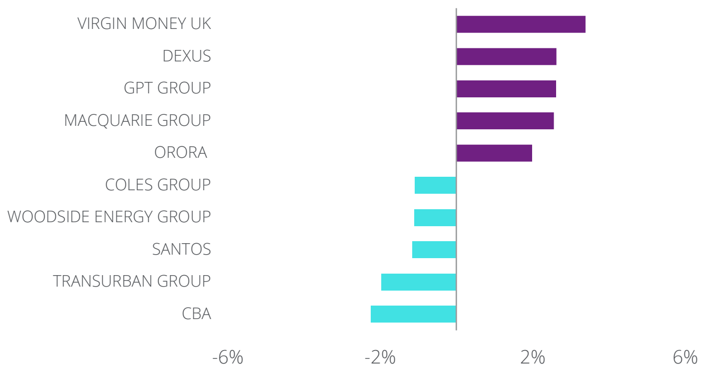
Franking Levels (%)			
FY23	74.3	FY20	94.4
FY22	100.2	FY19	95.1
FY21	90.3	FY18	99.2

Distribution Yield

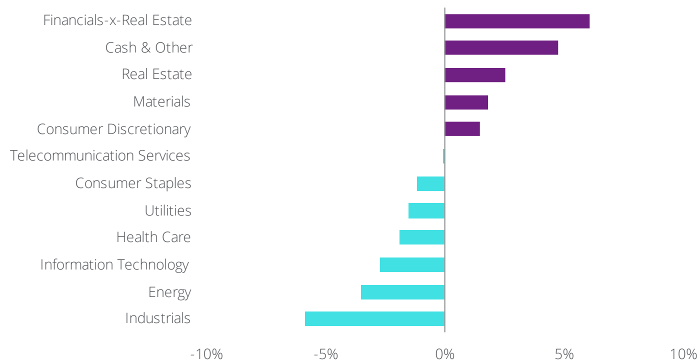


Performance shown net of fees with distributions reinvested. Does not take into account any taxes payable by an investor. Past performance is not a reliable indication of future performance.

Top 5 Over / Underweight Positions vs Index



Sector Active Exposure vs Index



Trust Review

The Trust delivered +2.9%, after-fees in July, level with the benchmark.

The best performing holding over the month was Virgin Money UK (+20.7%). The UK commercial banks are all carrying significant amounts of surplus capital which can be returned to investors. Based on our calculations, Virgin Money UK could theoretically return up to 15% of its market capitalisation. A key pre-requisite for this to occur was the bank passing its annual "Cyclical Scenario Stress Test", which the Bank of England applies to the largest eight banks and building societies in the UK. This test looks at the impact on capital levels of deep, simultaneous recessions in the UK and global economies and higher global interest rates. Pleasingly, Virgin Money passed the test with flying colours, allowing it to resume its buyback program in the current financial year. Further, the sector is trading on very depressed valuations, with Virgin Money UK trading on an FY24 P/E of 5.2x and a P/Book ratio of 0.4x. This combination of surplus capital and very cheap valuation, suggests significant share price upside once the current economic uncertainty subsides.

The Energy sector (+8.4%) performed strongly, as the oil price rallied on the combination of improved sentiment around the economic outlook as well as production cuts by OPEC+. This saw a strong performance from Woodside Energy (+10.3%).

James Hardie (+9.4%) continued its rally, with indications that the US housing market has stabilised after being impacted by the rapid rise in mortgage rates. While the company is subject to the cycle, over time it has consistently outgrown the overall market as its premium, differentiated products take share from other building materials. Management continues to focus on investing in the brand and distribution channels and we expect this to drive double-digit earnings growth over the medium term. The company recently announced that it has become the exclusive supplier of siding and trim to D.R. Horton until the end of 2026. D.R. Horton is the largest home builder in the US, delivering over 80k homes per annum, and this deal is a strong validation of James Hardie's standing in the US market.

United Malt (+9.5%) rose as French suitor, Malteries Souffle, completed due diligence and confirmed its initial offer of $5.00 per share to acquire the business. The takeover price represented a +45% premium to the pre-bid share price in March, highlighting the very great discrepancies that can exist between where the stock market prices a business and the value that strategic buyer with a long-term view ascribes to it. Of course, in addition to strategic buyers, there is a mountain of private capital globally from pension funds and private equity etc, looking for investment opportunities. Looking across the portfolio, we believe that many of our other holdings could well become takeover targets at some point.

The main detractors from performance over the month included Northern Star (-4.7%), with the gold sector weaker. Macquarie Group (-1.5%) underperformed after delivering what was, in our view, conservative FY24 guidance at their AGM. While operating conditions are challenging in certain parts of their business, Macquarie is highly-diversified and has a strong ability to manage their earnings. History also shows that they have a track record of over-delivering versus market expectations.

Trust Activity

During the month, we increased our holdings in CBA, reducing our underweight following a period of underperformance by the banks. The sector is likely to perform better on the back of improved sentiment to the macroeconomic outlook. At month end, stock numbers were 32 and cash was 4.8%.

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.

Looking to the current financial year, while the economic outlook is more uncertain, most companies are in good financial shape, and we expect healthy dividends. The Trust is currently forecasting a flat monthly net cash distribution of 0.493 CPU. Based on the month end unit price, this represents an annualised cash distribution yield of 5.3%.

We do not expect the same level of buy-backs or special dividends in the current year compared to the high levels seen in recent years, as many companies have now restored their balance sheets to their desired gearing ranges.

Outlook

The global economy has proven surprisingly resilient in the face of the sharp rise in interest rates and other economic disruptions. Further, recent data suggests that, while inflation is proving sticky, it appears to have peaked. Importantly, unemployment rates remain very low in most major markets. The Australian economy continues to perform strongly, with strong employment growth, robust spending and healthy property prices. The resources and agricultural sectors continue to experience positive conditions and the surge in immigration is providing a further boost to activity.

While the backdrop is currently sound, the level of uncertainty is elevated, given the long lags in the transmission of monetary policy. As a result, a degree of caution is warranted and we prefer holding stocks with positive company specific drivers, as opposed to pure cyclical leverage, in addition to stocks with solid defensive characteristics. Importantly, the portfolio is positively leveraged to post-COVID normalisation, higher inflation, and higher interest rates.

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.

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