Perennial Value Shares for Income Trust

Perennial Partners

Monthly Report August 2022

	Month (%)	Quarter (%)	FYTD (%)	1 Year (%)	3 Years (% p.a.)	5 Years (% p.a.)	Since Inception^ (% p.a.)
Income Distribution	0.5	7.3	1.1	11.4	7.7	8.4	6.6
Capital Growth	0.5	-10.4	3.1	-10.9	-3.2	-3.3	-0.6
Total Return	1.1	-3.1	4.3	0.5	4.5	5.1	6.0
Franking Credits#	0.2	3.0	0.4	5.0	3.2	3.6	2.5
Income Distribution including Franking Credits	**0.7**	**10.3**	**1.5**	**16.4**	**10.9**	**12.0**	**9.1**
Benchmark Yield including Franking Credits*	0.8	0.9	0.8	5.1	4.8	5.4	5.9
Excess Income to Benchmark#	**-0.1**	**9.4**	**0.7**	**11.3**	**6.1**	**6.6**	**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

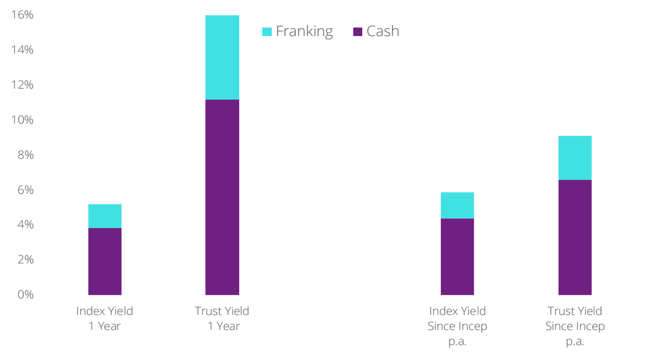
Global markets fell in August, as hawkish commentary from the US Fed meeting in Jackson Hole caused bond yield to rise sharply, as they reiterated their focus on taming inflation ahead of all else.

The Australian market fared better, driven by the Resources sector, with the ASX300 Accumulation Index rising by +1.2% over the month.

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, albeit with less buy-back activity.

The Trust is currently targeting a 5% increase in FY23 net monthly distributions to 0.49 CPU. Based on the unit price at the start of the financial year, this equates to an annualised cash distribution yield of around 6.7% and 9.6%, including franking credits.

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.

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 $19 million

Distribution Frequency
Monthly

Minimum Initial Investment
$25,000

Trust Inception Date
December 2005

Fees
0.92%

APIR Code
IOF0078AU

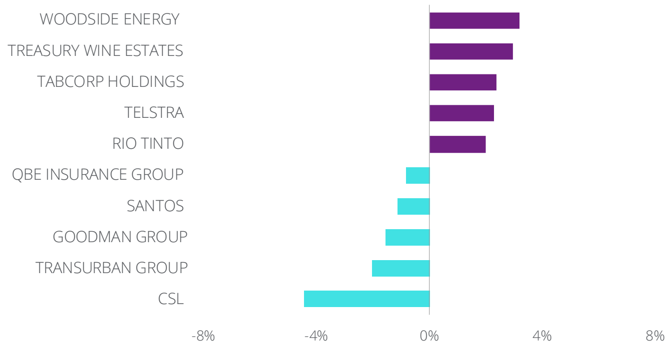
Portfolio Characteristics – FY23	Trust	Market
Price to Earnings (x)	13.8	15.2
Price to Free Cash Flow (x)	14.1	14.1
Gross Yield (%)	6.7	5.4
Price to NTA (x)	2.3	2.6

Source: Perennial Value Management. As at 31 August 2022

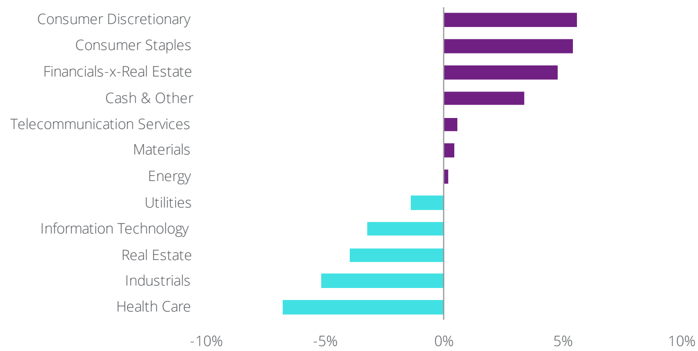
The above figures are forecasts only. While due care has been used in the preparation of forecast information, actual outcomes may vary in a materially positive or negative manner.

Franking Levels (%)			
FY22	100.2	FY19	95.1
FY21	90.3	FY18	99.2
FY20	94.4	FY17	65.6

Top 5 Over / Underweight Positions vs Index



Sector Active Exposure vs Index



Trust Review

The Trust returned +1.2%, including franking credits and after-fees in August, underperforming the market by −0.2%. For the past 12 months the Trust has returned +5.5%, outperforming the market by +7.8%. This highlight's the Trust's leverage to the value rotation currently underway as interest rates rise.

Positive contributors over the month included Woodside Energy (+7.1%), which outperformed after delivering strong results on the back of high energy prices. Woodside, is particularly leveraged to the current high prices, with around a quarter of its production uncontracted and able to be sold into the spot market. This saw average realised prices more than double from the previous period, resulting in massive cash flows. Further, the company stands to benefit from its merger with BHP's energy assets over the medium-term. Resources stocks, BHP (+5.0%) and South32 (+8.9%) also outperformed after delivering strong results. Each of these companies has a strong balance sheet and significantly increased their dividend.

Treasury Wine Estates (+9.0%) rallied as the market became more comfortable with its strategy to grow premium wine sales outside of China. The imposition of punitive tariffs in late 2020, saw Penfolds effectively excluded from the key Chinese market. Management have been working to grow sales in other markets and group earnings have now recovered to more than offset lost contribution from mainland China. The company has also rebalanced its portfolio, shifting out of the low-end commercial wine segment to focus on the higher-margin premium market. Given the long inventory cycle, wine margins are somewhat protected in inflationary environments. Looking further ahead to FY24, earnings are expected to benefit from the lower grape costs in the 2021 and 22 vintages.

Medibank Private (+8.8%) outperformed, with continuing low claims experience due to surgical restrictions, combined with ongoing policyholder growth and high retention rates as COVID has refocussed people's attention on the importance of access to healthcare services.

Telstra (+4.0%) outperformed after delivering a result which showed good growth in their mobiles business. With the NBN roll-out now completed, the company will no longer be facing earnings headwinds as broadband subscribers transition from its network to the NBN at much lower margins. This is likely to mark an inflection point in earnings, with the mobiles division driving positive group earnings growth. The recent merger of TPG with Vodafone has locked in an oligopoly structure in the mobiles market. As a result, we are now seeing more rational pricing, as well as other forms of cooperation such as network sharing agreements – all of which bode well for earnings and returns.

The major banks lagged the market slightly, with the CBA result highlighting the ongoing competition in the mortgage market. On the positive, balance sheet settings remain very strong across the sector and credit quality remains pristine.

The main detractors over the month were our smaller cap holdings, with Perpetual (-9.5%), Orora (-6.5%) and Healius (-3.9%) all underperforming, despite delivering sound results. James Hardie (-4.8%) also fell on concerns over the outlook for the US housing market. Despite potential near-term headwinds, this is a very high quality business, currently trading on a very cheap multiple compared to its history.

Trust Activity

During the month we sold out of our holding in Ampol, locking in profits with the share price now reflecting the benefit of high refining margins. Proceeds were used to increase our holdings in Treasury Wine Estates, where we see significant upside. At month end, stock numbers were 33 and cash was 3.4%.

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 5% increased in monthly net cash distributions to 0.49 CPU. Based on the month end unit price, this represents an annualised cash distribution yield of 6.7% or 9.6%, including franking credits.

We do not expect the same level of off-market buy-backs or special dividends in the coming year compared to the high level seen in FY22, as many companies have now restored their balance sheets to their desired gearing ranges.

Outlook

Global growth is clearly slowing as interest rates rise and economies grapple with the impacts of high inflation and energy supply problems. However, we believe that this will be offset to some extent by the benefits to economies as COVID disruptions continue to recede. While economic data is mixed, and varies greatly from region to region, unemployment rates are very low in most major markets. The Australian economy is performing particularly strongly and will continue to be a key beneficiary of the strength in commodity markets. However, there are a number of potentially significant changes in the global economic and political backdrop, from the return of inflation and the change in the interest rate cycle, to rising geopolitical tensions. As a result, the level of uncertainty is elevated, and a degree of caution is warranted.

This view is expressed in the portfolio through holding a combination of stocks with cyclical leverage, as well as stocks with solid defensive characteristics. Importantly, the portfolio is positively leveraged to improving growth, higher inflation, and rising interest rates. Within the cyclical part of the portfolio, this is achieved through overweight positions in the Resources, Energy and Consumer Discretionary sectors. In the defensive part of the portfolio, this is achieved through holdings in the sectors such as Telcos and Consumer Staples.

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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