Perennial Value Shares for Income Trust

Monthly Report August 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	1.1	6.8	8.4	8.4	8.1	7.7	6.6
Capital Growth	-0.9	2.6	1.3	3.4	3.9	-2.9	-1.7	-1.5	-0.4
Total Return	-0.4	4.2	2.4	10.2	12.2	5.5	6.4	6.1	6.2
Franking Credits#	0.2	0.5	0.3	2.3	3.4	3.6	3.2	3.0	2.4
Income Distribution including Franking Credits	**0.7**	**2.1**	**1.4**	**9.1**	**11.7**	**12.0**	**11.3**	**10.6**	**9.0**
Benchmark Yield including Franking Credits*	0.9	1.2	1.0	6.7	5.7	5.5	5.7	5.8	5.9
Excess Income to Benchmark#	**-0.2**	**0.9**	**0.4**	**2.4**	**6.0**	**6.5**	**5.6**	**4.8**	**3.1**

^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

Markets were generally softer in August, with the S&P500 falling -1.8% and the NASDAQ declining -2.2%, while the FTSE100 fell -3.4% and the Nikkei 225 gave back -1.7%. The continuing weak Chinese data, and renewed concerns over the property market, saw the Shanghai composite fall -5.2%.

The ASX300 Accumulation Index finished the month down only -0.8%. Reporting season was the highlight of the month. Many of the more cyclical stocks delivered better than feared results, while many of the defensives disappointed. Overall, results were sound, and highlighted that the economy continues to perform strongly.

The Trust is currently targeting FY24 net monthly distributions of 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 $19 million

Distribution Frequency
Monthly

Minimum Initial Investment
$25,000

Trust Inception Date
December 2005

Fees
0.92%

APIR Code
IOF0078AU

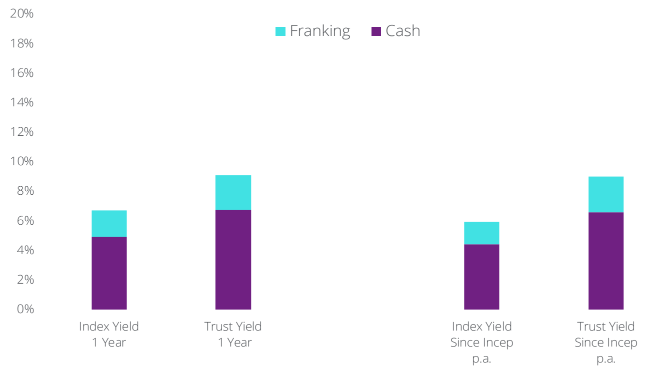
Portfolio Characteristics – FY24	Trust	Market
Price to Earnings (x)	15.6	15.9
Price to Free Cash Flow (x)	14.5	15.1
Gross Yield (%)	5.4	5.1
Price to NTA (x)	2.4	2.5

Source: Perennial Value Management. As at 31 August 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.

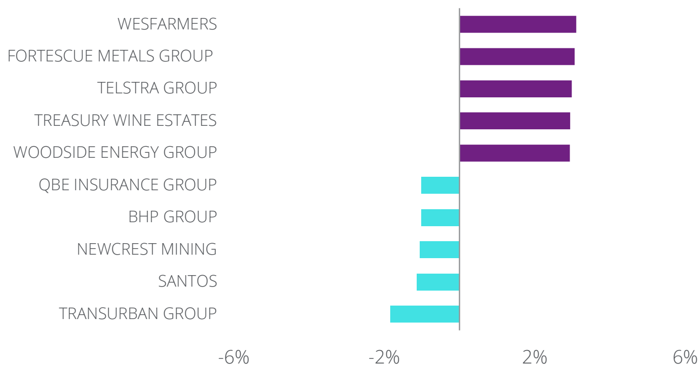
Franking Levels (%)			
FY23	74.3	FY20	94.4
FY22	100.2	FY19	95.1
FY21	90.3	FY18	99.2

Distribution Yield

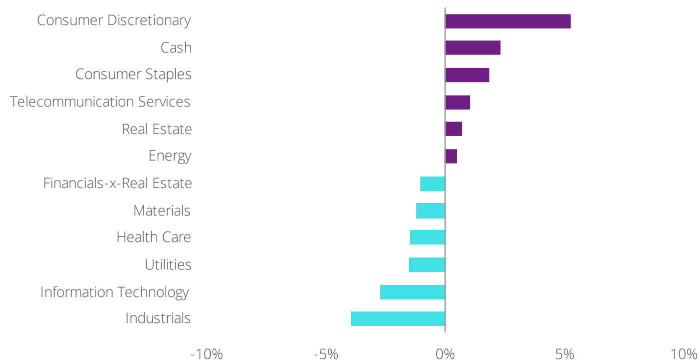


Performance shown net of fees with distributions reinvested. Does not take into account any taxes payable by an investor. Past performance is not a reliable indication of future performance.

Top 5 Over / Underweight Positions vs Index



Sector Active Exposure vs Index



Trust Review

The Trust returned -0.2%, including franking credits and after-fees in August, outperforming the benchmark by +0.3%.

One of the top contributors to performance over the month was building material James Hardie (+7.0%). We have previously written about how we regard this as a very high-quality business, able to generate strong earnings growth, while maintaining a high return on equity. During the month, the company reported its first quarter results, delivering record earnings and strong margins, despite the soft market conditions, which saw sales revenue decline over the quarter. However, there are indications that the US housing market has stabilised after being impacted by the rapid rise in mortgage rates. As is the case in Australia, there is a shortage of housing in the US, with inventories of single family (ie detached) homes well below pre-pandemic levels, which bodes well for underlying demand. 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.

Goodman Group (+13.7%) performed strongly. This is a high-quality business and the clear leader in the industrial property sector. Unlike other REIT sectors such as office or retail, where rental income is under pressure, industrial is experiencing very positive conditions. Demand for logistics properties remains strong and legacy rents are being rolled over at higher rates.

The major banks, where the Trust holds an underweight position, performed in line with the market in August. The CBA result and Q1 trading updates from the others indicated that while credit conditions remain very strong, with minimal evidence of stress in either consumer or business lending, margins are coming under increasing pressure as deposit rates increase.

Aristocrat Leisure (+4.0%) also outperformed, with continuing strong US casino trading data indicating that operating conditions remain favourable. Not only does positive trading conditions suggest that casinos will continue to invest in new gaming machines, but Aristocrat also benefits as many of its machines are sold on a revenue participation basis. The company also began distributing a new range of NFL-themed gaming machines called "NFL Super Bowl Jackpots", timed to coincide with the start of the NFL season.

The main detractors from performance over the month tended to be our Resources holdings, which were weaker on the back of lower commodity prices and negative sentiment around China.

Telstra (-3.9%) also underperformed as investors generally rotated out of defensives and into more cyclical, consumer exposed names. This was despite the company delivering a solid full-year result. It remains one of our preferred defensive exposures.

Trust Activity

During the month, we exited our holding in United Malt, selling it into the takeover bid. Proceeds were used to establish a new position in Computershare, which is benefitting from ongoing higher interest rates and from the expected pick up in corporate activity. At month end, stock numbers were 32 and cash was 2.3%.

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.

Invest Online Now

Contact us

Level 27, 88 Phillip Street
Sydney NSW 2000

1300 730 032

invest@perennial.net.au

www.perennial.net.au