Funds Management

Monthly update: 31 July 2020

Celeste Australian Small Companies Fund

Performance Statistics (Total Returns net of fees)

	1 mth %	1 yr %	3 yrs % p.a.	5 yrs % p.a.	10 yrs % p.a.	15 yrs % p.a.
Celeste Aust. Small Co. Fund	+3.0	-6.5	+3.5	+8.5	+5.9	+6.8
Performance (relative to Index)	**+1.6**	**+2.0**	**-3.0**	**+0.6**	**+1.7**	**+3.0**
S&P/ASX Small Ords Acc Index	+1.4	-8.5	+6.5	+7.9	+4.2	+3.8
S&P/ASX Small Inds Acc Index	-0.1	-10.9	+5.3	+6.4	+7.9	+4.7
S&P/ASX Small Res Acc Index	+7.6	+1.5	+11.5	+14.4	-4.9	+1.5

Past performance is not indicative of future returns. Total returns shown for the Celeste Australian Small Companies Fund has been calculated using exit prices after taking into account all of the Fund's ongoing fees and assuming reinvestment of distributions. No allowance has been made for entry fees or taxation.

Global Index Performance (Accumulation)

	1 month %	1 year %	3 years % pa
Australia – S&P/ASX All Ordinaries	+0.9	-9.0	+5.7
USA – S&P 500	+5.5	+9.8	+9.8
USA – NASDAQ Composite	+6.8	+31.4	+19.2
Europe – FTSE (UK)	-4.4	-22.3	-7.2
Europe – DAX (Germany)	0.0	+1.0	+0.5
Asia – Nikkei (Japan)	-2.6	+0.9	+2.9
Asia – Shanghai Composite (China)	+10.9	+12.9	+0.4

Source: IRESS

Portfolio Commentary

The Fund rose 3.0%[1] in July, with its benchmark, the S&P/ASX Small Ordinaries Accumulation Index increasing by 1.4%. Since inception (May 1998) the Fund's return is 12.4% pa[1], net of all fees, against the Index's 5.4% pa.

Markets remain volatile driven by short term concerns. The economic landscape remains Covid-19 affected with the 'state of emergency' declared in Victoria impacting some 25% of the nation's GDP. We expect that Federal Government stimulus initiatives will be extended well into 2021.

Looking forward, the August reporting season will be decidedly digital and will focus on a handful of key themes. Earnings quality will see reported numbers adjusted to include all one offs (+ve and –ve) from the Covid-19 response. We think most companies will be reluctant to provide guidance, given uncertainty and the additional Victorian lockdown impact. Most consensus forecasts are working to a FY22 normalisation of earnings (back to FY19 earnings levels) and we see risk in those companies where the assumptions to build the earnings bridge over the next few years requires far too aggressive assumptions. We think market EPS estimates for FY21 are cum downgrade. For the Celeste portfolio, companies that have high earnings certainty (some have already pre-reported strong numbers) remain key portfolio investments.

Dividends are likely to see significant downward pressure as a consequence of reduced earnings, however this will be exacerbated by cautious Executives and Boards, striking more conservative payout ratios. We see it as inevitable that there will be numerous asset write-offs as auditors assess the carrying value of goodwill, intangibles, capitalised costs and software. This may present some balance sheet risk to companies that have higher gearing levels and crimped earnings. The Celeste portfolio is focused on companies with conservative gearing levels and significant balance sheet flexibility. We expect further equity raising activity in August as some companies look to reduce balance sheet stress or pre-fund potential strategic transactions. With all this in mind, markets will remain volatile, share prices will have larger than usual intraday moves and opportunities will arise.

Celeste continues to apply its rigorous investment process, a process that has delivered long term alpha generation. We believe a focus on high quality management/Boards, conservative accounts and durable business models, mitigates risk, protects capital and generates long term value. We think a strong focus on valuation and a disciplined portfolio construction process remain paramount in providing high quality risk adjusted returns for investors. We remain positively disposed to the alpha potential in the small companies sector. We continue to believe that our process in the current volatile market environment will reward patient long term investors with above benchmark, tax effective returns.

In the month, we added a new position into the portfolio. **Event Hospitality and Entertainment** (EVT) owns the Rydges & QT Hotel chains, Event cinemas and operates the Thredbo Ski Resort. The cost base of land owned by the company underwrites the current share price. While Covid-19 will see changes to the way we visit the cinema and patronise hotels, these operating businesses pre-Covid-19 generated $250m of EBITDA. Change may lead to lower earnings but they are unlikely to completely disappear. With higher market valuations for the land on balance sheet and shuttered business eventually returning, we think the stock is significantly undervalued.

Eagers Automotive (APE) performed strongly in July, rising 20.2%. At the company's AGM, it was announced that initiatives taken during the June qtr resulted in $78m of permanent cost reduction, driving a better than expected underlying operating profit of $40.3m, while corporate net debt was reduced to $8m from $316m 6 months earlier. While the near-term financial performance of APE through Covid-19 is not core to our investment thesis, the financial outcomes delivered highlight APE's industry leading board & management team, who we expect to take advantage of significant industry dislocation that will take place over the medium term.

IT solutions provider**, Data #3** (DTL) rose 24.5% in July. DTL advised that its FY20 pre-tax profit grew 28% year on year, to approximately $34m, a record result for the company. We anticipate that DTL will continue to be a beneficiary from societal changes wrought by Covid-19 as remote working drives demand for software licences, IT security and hardware upgrades.

In July, **City Chic** (CCX) moved to acquire the online assets of US retailer, Catherines, for USD $16m. Catherines was established in 1969 and has a long history of operating in the plus size women's fashion category. Catherines is being bought via a US Chapter 11 bankruptcy process. We anticipate further online acquisition opportunities will emerge for CCX, globally, as Covid-19 is accelerating the demise of a number of bricks and mortar retailers. CCX rose 17.2% in July.

Australian skin care product manufacturer, **BWX**, rose 11.1% in July. In the month, BWX preannounced its FY20 result with sales up an impressive 25%, and EBITDA growth of 30%. In tandem with the preannouncement, BWX raised $50m in equity to fund the construction of a new manufacturing facility and support office.

Portfolio Top 5 Holdings

Stock	% of Fund
1 STEADFAST GROUP	4.0
2 LIFESTYLE COMMUNITIES	4.0
3 OMNI BRIDGEWAY	3.8
4 BREVILLE GROUP	3.7
5 CODAN	3.6

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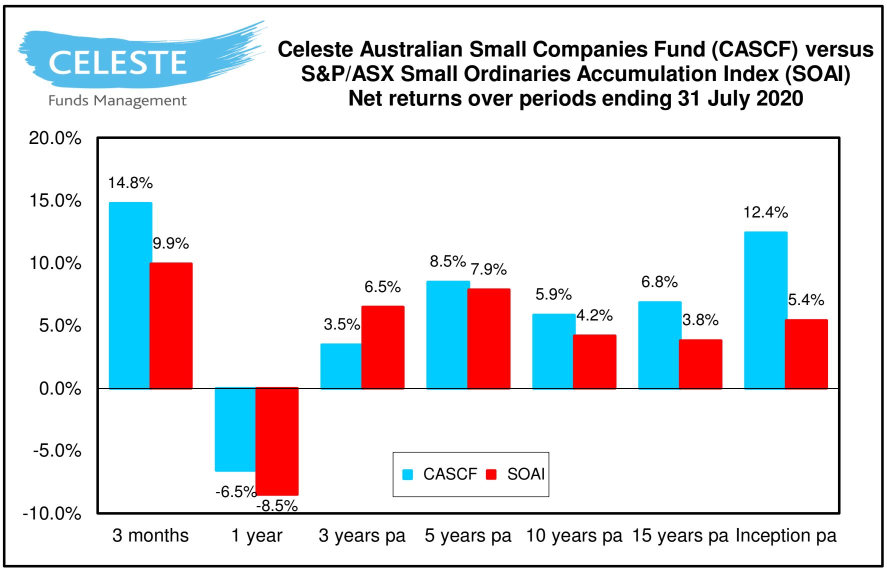
Fund at a Glance

Fund Information

Primary Investments	Shares in listed Australian smaller companies
Investment objective	Exceed Small Ordinaries Accumulation Index over rolling 5 year periods
Unit price (redemption) as at 31.07.2020	$3.3326
Unit price (application) as at 31.07.2020	$3.3527
Fund Size as at 30.06.2020 [ex-distribution]	$62m
Minimum investment	$25,000
Minimum additional investment	$1,000
Minimum balance	$15,000
Redemption will generally be available in	7 days
Distributions	30 June and 31 December
Entry fee*	0%
Exit fee*	0%
Buy/Sell differential*	0.30%
Management fee*	1.10% p.a
Performance fee**	20% of return above benchmark

** These fees and charges apply for the duration of the Product Disclosure Statement (PDS) and are inclusive of the Goods and Services Tax.*
*** A fee charged on performance of the investments of the Fund above the nominated benchmark performance. The benchmark is the S&P/ASX Small Ordinaries Accumulation Index.*

Fund Returns



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Distribution History

Total distribution year ended	Cents Per Unit	Annual Yield %**
June 11	11.89	4.6
June 12	4.07	1.4
June 13	15.81	5.5
June 14	14.56	5.4
June 15	12.67	4.5
June 16	9.95	4.0
June 17	6.87	2.6
June 18	7.01	2.2
June 19	10.46	2.9
June 20	9.51	2.8

*** CPU / unit price at beginning of period*

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[1] Total returns shown for the Celeste Australian Small Companies Fund has been calculated using exit prices after taking into account all of the Fund's ongoing fees and assuming reinvestment of distributions. No allowance has been made for entry fees or taxation. You should not base an investment decision simply on past performance. Past performance is not an indicator of future performance. Returns are not guaranteed and so the value of an investment may rise or fall.

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