Funds Management

Monthly update: 31 August 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	+10.1	+5.4	+6.3	+10.7	+6.7	+7.2
Performance (relative to Index)	**+2.9**	**+3.3**	**-1.7**	**+0.2**	**+2.0**	**+3.2**
S&P/ASX Small Ords Acc Index	+7.2	+2.1	+8.0	+10.5	+4.7	+4.0
S&P/ASX Small Inds Acc Index	+9.6	+0.7	+7.9	+9.3	+8.8	+5.0
S&P/ASX Small Res Acc Index	-1.5	+7.6	+8.4	+16.0	-5.3	+1.1

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Global Index Performance (Accumulation)

	1 month %	1 year %	3 years % pa
Australia – S&P/ASX All Ordinaries	+3.7	-3.5	+6.7
USA – S&P 500	+7.0	+19.6	+12.3
USA – NASDAQ Composite	+9.6	+47.9	+22.4
Europe – FTSE (UK)	+1.1	-17.3	-7.1
Europe – DAX (Germany)	+5.1	+8.4	+2.4
Asia – Nikkei (Japan)	+6.6	+11.8	+5.6
Asia – Shanghai Composite (China)	+2.6	+17.7	+0.3

Source: IRESS

Portfolio Commentary

The Fund rose 10.1%[1] in August, with its benchmark, the S&P/ASX Small Ordinaries Accumulation Index increasing by 7.2%. Since inception (May 1998) the Fund's return is 12.9% pa[1], net of all fees, against the Index's 5.7% pa.

In a broad sense, the strong August performance of the small cap market was incongruous with the earnings disappointment it delivered. 2H20 EPS growth fell 38% for the average ASX200 company, a far larger fall than during the weakest point of the GFC (-20%). Margins were weaker than during the GFC and 29% of companies reported a 2H loss. Only 26% of companies actually grew earnings for the half. Small companies faced even bigger challenges due to Covid-19 with the Small Industrials EPS growth for FY20 declining by 33%. Around 40% of companies missed consensus expectations up from the typical 30%. Earnings quality was low with companies reporting $25bn in 'one-off' charges which amounted to approximately 85% of the reported underlying profit. These non-cash charges will artificially boost earnings in future years as they did in the post-GFC period. A big focus on capital management saw dividends cut at almost twice the rate of earnings (-30% v -16%) with expectations now anticipating further cuts in FY21. We had thought that significant capital raisings were likely as asset values declined and balance sheets exhibited some stress. $4bn of new capital was raised but this was well below the $21bn raised since the February reporting season, the peak of Covid-19 hysteria. As expected, earnings visibility remained low with a 50% reduction in firms prepared to provide forward earnings guidance.

Despite rolling global Covid-19 lockdowns markets remain extremely bullish and have been prepared to look through weak FY20 reported earnings. Increasingly, valuation focus has drifted towards 'normalised earnings' being delivered in FY22 with FY21 now being assigned 'lost year' status. Valuations remain elevated versus history despite the significantly challenging earnings backdrop. The willingness of the market to ascribe aggressive multiples on forecast earnings in FY22 presents significant share price risk. We continue to seek stocks that have higher earnings resilience in FY21 hoping to avoid downgrade disappointment.

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 June we mentioned that we felt that the **Hansen Technologies** (HSN) share price performance had been detrimentally affected by substantial shareholder selling. We noted that the HSN share price was out of kilter with the underlying value of the company's long term cash flow stream. In August HSN rose 41.4% post a robust FY20 profit result and increased dividend. Strong integration of acquired businesses and new business wins in mission critical billing systems will continue to underpin reliable revenue growth, steady earnings increases and higher dividends over time. In volatile economic times, we continue to think that the cash flow stream HSN will produce over the medium term remains under rated.

Money3 Corporation (MNY) provides finance to purchasers of used cars. During August, the stock performed strongly up 26.7%. This was driven by the reporting of a solid operating performance in 2H20. In what was a particularly challenging period, MNY achieved extremely strong cash collections, ensuring a strong June 30th balance sheet. This positions MNY well to grow its loan book as demand for used cars continues its sharp recovery.

ARB Corporation (ARB) rose 37.1% in August. ARB reported a solid FY20 result, with demand for its 4WD accessories benefiting from a post Covid-19 lockdown sales boom. ARB noted that its order book is strong, with June and July sales at record levels. We anticipate that the 'holiday at home' trend will provide a healthy backdrop to ARB sales in the medium term, globally, with exports > 30% of revenues. We remain attracted to ARB's attractive returns, its strong competitive position, its brand, and to its globally scalable product offering.

Software and IT services company, **Citadel Group** (CGL), reported a solid FY20 result. The performance of the FY20 acquired UK healthcare software company, Wellbeing, was to expectation despite the challenges presented by Covid-19. Software now accounts for > 65% of CGL's gross profit, with the bulk of revenues in the area contracted and multi-year in nature. Cash generation in FY20 was a feature of the result, with net debt materially below expectation. In its outlook commentary CGL noted long term organic growth targets in its software division of 15% pa, and in its services division of 5-10% pa. We believe CGL is attractively priced, and offers compelling medium term growth in a low growth world.

Portfolio Top 5 Holdings

Stock	% of Fund
1 CODAN	3.9
2 STEADFAST GROUP	3.9
3 BWX	3.6
4 ARB CORPORATION	3.6
5 EAGERS AUTOMOTIVE	3.6

Monthly update: **31 August 2020**

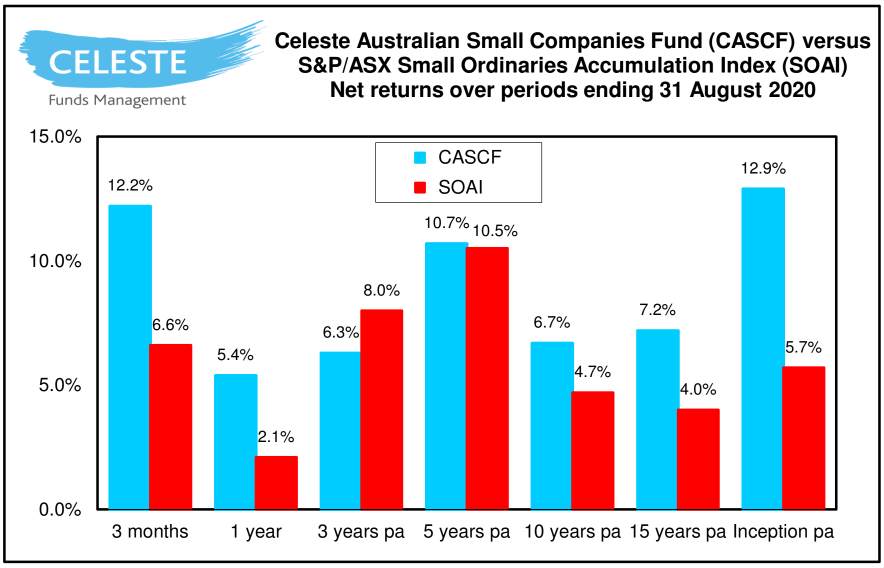
Fund at a Glance

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 31.08.2020	$3.6684
Unit price (application) as at 31.08.2020	$3.6905
Fund Size as at 31.08.2020	$69m
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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