QUARTERLY INVESTMENT REPORT

June 2021

Over the quarter the Fund returned 2%. As we review the quarter, we observe that the recovery from the market crash last March has created two tiers of companies: one tier that benefitted (or at least barely suffered) through the pandemic; and a second tier that saw a large impact on operations and earnings and a significant increase in short-term uncertainty (think energy companies or retail manufacturers). The first tier saw valuations return to pre-pandemic levels very quickly (and to our mind, have returned to being extremely expensive) while the second tier is yet to see valuations recover and hence present exceptional opportunities for value investors.

Within this second tier, there are some companies for whom time (and effective vaccines) has improved the visibility significantly and share prices have begun to recover in the first half of 2021. For Kennox, this list includes **energy companies**, **Quadient**, **M6-Metropole**, **Texwinca** and **Stella International**. Quadient and Stella have been our top performing positions in Q2.

Quadient (up 25% in the quarter) released first quarter results that were ahead of expectations, with both sales and operating profit guidance for 2021 increased. Importantly the declining mail business, which remains ~65% of revenues, saw sales growth albeit against a low base last year. Additionally, the two other core divisions (intelligent communication automation and parcel lockers) also continue to grow, with new contracts announced recently in each, and are becoming more significant divisions for the company. Operationally it appears the company is coming through the worst of the pandemic while also progressing well with its turnaround plan. Despite the recent run in the share price (up over 50% this year), it remains frugally priced at just 13x our Sustainable Earnings (SE). Given the attractive pricing and positive momentum, we have maintained our full position and it is currently a 6.1% position in the Fund.

Stella International (a HK-listed manufacturer of high-end fashion and athleisure shoes) also had a strong quarter, with shares up 22%. Despite very tough conditions in 2020, with customers cancelling orders as shops were shut with lockdowns, Stella was profitable (aided by being one of the top manufacturers of the popular Nike Air Jordans). As with Quadient, results so far this year show some recovery in all parts of Stella’s business and the market has responded to this decrease in short-term uncertainty. We believe the market has been too focused on the short-term impact to earnings and not focused on the long-term competitive advantages: Stella’s reputation with a high-quality customer list; expertise in a niche area; high exposure to the growing athleisure trend; and a very strong balance sheet (with a significant net cash position). Despite the recent run in the share price and the fact our conservative Sustainable Earnings estimate (below the FCF the company made in 2020), it is on 16x SE and is a 2.9% position.

Still within the second tier of companies, there are some where the visibility has yet to clear, and earnings are yet to recover to pre-pandemic levels. Amongst this group, Kennox would count **telecoms companies**, pharmaceuticals (**GlaxoSmithKline** and **Taisho**) and our small headphone manufacturer Fujikon. These companies have yet to see share price gains of the scale seen amongst the first group, but the valuations remain incredibly attractive, and therefore full of latent potential for when the headwinds ease and confidence returns. Singapore Telecommunications (down 6%) and Fujikon (down 20%) were amongst the biggest detractors to performance in the quarter.

Singapore Telecommunications faces headwinds both due to the pandemic as well as operational challenges outside of it. The pandemic has impacted the top line with lower roaming charges while a new entrant in the Singapore market has also negatively impacted revenues. Furthermore, the build out of its 5G networks has put pressure on free cash flow and the dividend has been cut (it now yields c. 3%). As was the case with Stella six months ago, there are many reasons why we feel comfortable looking through these short-term headwinds: Singtel is the number 1 market leader in four of its six jurisdictions (and the number 2 in the others); it provides an essential service; it has a rock-solid balance sheet; and valuations remain at multi-year lows. It trades at 11x our view of Sustainable Earnings and is a 3.7% position in the Fund.

Fujikon is a smaller position in the Fund at 2.1%. The company is based in Hong Kong and makes headphones and accessories for high quality Western brands. The pandemic has impacted margins as it negatively hit the demand side, while electronic parts costs have risen with the global chip shortage. Despite these headwinds, with careful cost management the company broke even last year. The opportunity here is extraordinary for those willing to look through the current operating environment. It now trades at a 20% discount to the cash on its balance sheet, meaning that essentially no value is ascribed to its operations. Even a small increase in operating performance could yield enormous returns – we see it on just 8x SE.

Outside of company specific considerations, it also seems to us that global stock markets are reliant on the 'Goldilocks' scenario: that Central Banks will help us grow out of the lockdowns without higher long-term inflation and without raising rates too far too fast and thereby causing a bust. We are not macro economists, and the central bankers may achieve this feat, but we feel it is sensible to be prepared in case this does not happen. Only a passing knowledge of economic history tells us that Central Banks often get this transition wrong. To us, cutting valuation risk and investing in companies facing short-term uncertainty but with long-term competitive advantages is a very sensible approach. Over the last decade, but exacerbated since the pandemic, the market has bifurcated into 'winners' and 'losers'. The winners have become consensus trades, with the mass-uptake driving valuations far above historic norms. This "valuation risk" becomes significant if the Goldilocks scenario does not play out and the market experiences some jitters. At Kennox, we sift patiently through those the market perceives to be 'losers' to find opportunities where the market has under-represented the long-term strengths of the company. This "time-arbitrage" (focusing on the long term when the market focuses on the short) allows us to hold a concentrated portfolio of high-quality companies, trading at valuations usually only reserved for the lowest quality – a very nice combination indeed.

Fund Data – 30 June 2021

Performance (total return net of fees) in Pounds Sterling

Period	Professional share class	Institutional share class	Class A share class
YTD	7.8%	8.0%	8.1%
2020	-11.3%	-11.1%	-10.9%
2019	4.5%	4.8%	5.1%
2018	-2.5%	-2.2%	-2.0%
2017	2.1%	2.5%	2.6%
2016	35.4%	35.8%	36.2%
2015	-4.3%	-4.0%	-3.8%
2014	-1.5%	-1.1%	-0.9%
2013	15%	15%	4.3%*
2012	9.4%	10%	N/A
2011	-4.4%	-4.0%	N/A
2010	21%	12%*	N/A
2009	15%*	N/A	N/A

Source: Bloomberg. Performance figures are total return generated from the accumulation units since their launch (29 April 2013), and from the income shares prior to that. * Share classes launched mid-year: Professional on 30 April 2009; Institutional on 12 May 2010; and Class A on 29 April 2013.

Top 10 Holdings

	Stock	Region	Sector	Market Cap (US$m)	Fund Weight
1	NEWMONT CORP	N. America	Materials	51,000	7.1%
2	QUADIENT	Europe	Information Technology	1,000	6.1%
3	ROYAL DUTCH SHELL	UK	Energy	156,000	5.2%
4	EQUINOR	Europe	Energy	69,500	4.9%
5	BP	UK	Energy	90,000	4.7%
6	CHINA MOBILE	Asia	Communication Services	128,000	4.0%
7	FUKUDA DENSHI	Japan	Health Care	1,600	4.0%
8	NEWCREST MINING	Asia	Materials	16,000	3.9%
9	SINGAPORE TELECOM	Asia	Communication Services	28,000	3.7%
10	SWISSCOM	Europe	Communication Services	29,500	3.7%
	Total Top 10				47.4%
	18 Other Holdings				51.7%
	Cash				0.9%

Unit Prices

As at 30 June 2021:

- Professional Share Class:
    - Income: 115.90 pence (unit price at inception, 30 April 2009: 70.08 pence)
    - Accumulation: 136.60 pence (unit price at inception, 29 April 2013: 103.1 pence)
- Institutional Share Class:
    - Income: 117.10 pence (unit price at inception, 12 May 2010: 85.46 pence)
    - Accumulation: 141.60 pence (unit price at inception, 29 April 2013: 104.3 pence)
- Class A Share Class:
    - Income: 117.10 pence (unit price at inception, 29 April 2013: 104.3 pence)
    - Accumulation: 143.80 pence (unit price at inception, 29 April 2013: 104.3 pence)

Charles L. Heenan	**Geoff Legg**
(Investment Director)	(Investment Director)

If you have any questions on Kennox or the Kennox Strategic Value Fund, please contact Peter Boyle on +44 (0) 131 563 5440 or email him at pboyle@kennox.co.uk. Our website is www.kennox.co.uk

We do not track, nor are we constrained by, a benchmark. Reference to the MSCI World, MSCI World Value and IA Global indices are for comparative purposes only.