

# Ellerston Australian Small Companies Fund

PERFORMANCE REPORT April 2018

The Ellerston Australian Small Companies Fund employs an active research driven investment approach to identify a portfolio of 30 - 60\* small company securities which aims to deliver returns superior to the S&P/ASX Small Ordinaries Accumulation Index over time.

## Ellerston Australian Small Companies Fund Performance

Return %	Net <sup>^</sup>	Gross	Benchmark	Net Alpha	Gross Alpha
1 Month	2.73%	2.78%	2.75%	-0.02%	0.03%
3 Months	-0.48%	-0.34%	0.44%	-0.92%	-0.78%
Rolling 12 Months	17.38%	18.85%	18.45%	-1.07%	0.40%
2 Years p.a.	15.64%	16.71%	14.17%	1.47%	2.54%
3 Years p.a.	10.95%	12.09%	11.07%	-0.12%	1.02%
Since Inception p.a.	10.98%	12.44%	8.76%	2.22%	3.68%

## Ellerston Australian Small Companies Fund Top Holdings

Top 5 Stock holdings as at 30 April 2018	Sector	%
Cleanaway Waste Management Ltd.	Industrials	4.84
HT&E Ltd	Consumer Discretionary	3.86
Austal Limited	Industrials	3.83
SpeedCast International Ltd	Telecommunication Services	3.50
Tox Free Solutions Limited	Industrials	3.44

<sup>^</sup> The net return figure is calculated after fees & expenses. The gross return is calculated before fees & expenses. Past performance is not a reliable indication of future performance

The benchmark is the ASX Small Ordinaries Accumulation Index. The Fund commenced on 10 October 2013.

\*This is the typical number of stocks in the portfolio. The Information Memorandum does allow for 20 - 60 stocks.

## Commentary

The Ellerston Small Companies Fund rose 2.78% in April, marginally outperforming the ASX Small Ordinaries Accumulation Index which rose 2.75%. During the month, the Small Industrials Accumulation Index rose 1.46% whilst the Small Resources Accumulation Index rose 6.92%.

The largest contributors to positive attribution were Mineral Deposits (MDL), Here, There and Everywhere (HT1) and SpeedCast (SDA). Mineral Deposits was subject to a bid at \$1.46 from JV partner Eramet from France. We sold part of our shareholding, in conjunction with some other shareholders, in an on market transaction so that the bidder could secure a reasonable stake in the company. We would expect that this initial bid is unlikely to secure enough support to finalise the transaction and hope to see a higher price secured by the board or another bidder makes a tilt at MDL. Here, There and Everywhere was subject to a bid for the Adshel business from rival Ooh Media. The board rejected the bid as undervaluing the asset but have not ruled out selling for a higher price. This, combined with an improved performance from the radio business, has seen a re-rating of the shares from oversold levels. We would expect there is a reasonable chance of further parties being interested in acquiring the Adshel business. SpeedCast refinanced its existing debt package with a senior secured credit facility in the US institutional term loan B market and an enlarged revolving USD credit facility. This is likely to reduce SDA's debt costs by over 100bps. Additionally, positive industry commentary from various oil service provider's quarterly results in the US reinforced confidence in offshore O&G outlook for next year.

The largest detractors from relative returns were iSelect (ISU), Beach Petroleum (BPT) and Motorcycle Holdings (MTO). iSelect downgraded its FY18 earnings guidance range by 60-70% and the CEO resigned. Higher cost of lead generation and conversion from the recent change in marketing spend away from digital channels led to below expected performance in the latter half of March and into April, a key period in iSelect's annual sales generation. The health insurance segment in particular suffered from a 33% increase in marketing spend, despite similar revenue levels compared to last year. The stock is currently trading at around cash and trail commission book value, with little to no value attributed by market capitalisation to its domestic operating business and Asian iMoney investment. Beach Petroleum is not held by the fund and as such the significant share price rally was a negative for relative performance. We had previously held Beach from \$0.60 to \$1.15 believing that fair value for the business is in the \$1.20's. Motorcycle Holdings has seen a significant de-rating of the shares on slowing industry demand this year. However, FY19 should see a significant improvement earnings on the Cassons acquisition, the lack of the insurance commission drag (which affected FY18) and the cycling of easier comparable numbers. As such we have been adding to our position during this period of weakness.

## Outlook

There is little change to our view from last month despite the small rally in the market. Our focus remains in finding, and increasing our holdings, in undervalued investments which will do well in a market we expect to be subject to increased levels of volatility in the next couple of years. Dividend yield has become a higher component of our "expected return" in our industrial holdings, which is an indication of the higher valuations that persist in the market and our view that there is little room for further PE expansion unless earnings growth returns to the small industrial market as a whole. That said, the high PE dispersion in the market has enabled us to make new investments in companies that are looking attractive on a "risk-return" basis due to the large de-ratings that they have experienced, well beyond the level of earnings correction.

## About the Ellerston Australian Small Companies Fund

The Fund employs an active, research-driven investment approach which seeks to identify a portfolio of smaller company securities with the aim of delivering superior returns to the Benchmark over time.

The Fund will invest in companies that are believed to have the potential to deliver significant upside over the medium term and where there is a reasonable margin of safety to mitigate the downside risk. We will actively manage the positions of the Fund.

Investments will generally be made in companies that have a sound business franchise with an attractive earnings profile, that operate in growth industries and trade at a discount to valuation.

### Fund Facts

Strategy Funds Under Management	Over \$700 Million
Total number of Stocks	50
Application Price	\$1.1896
Redemption Price	\$1.1836
Inception Date	10 October 2013

## Disclaimer

Returns are unaudited estimates and before fees and expenses and assume distributions have been reinvested. Past performance is not indicative of future performance. This letter does not constitute an offer of any Units in the Fund. This letter does not take into account your investment objectives, financial situation or particular needs. Before making an investment decision about the Fund, persons should read the information memorandum which can be obtained from Ellerston Capital and obtain advice from an appropriate financial adviser. This material has been prepared based on information believed to be accurate at the time of publication. Assumptions and estimates may have been made which may prove not to be accurate. Ellerston Capital undertakes no responsibility to correct any such inaccuracy. Subsequent changes in circumstances may occur at any time and may impact the accuracy of the information. Stock opinions and views expressed in this document are Ellerston Capital's and are not necessarily the views or opinions of the market. To the full extent permitted by law, none of Ellerston Capital, or any member of the Ellerston Capital Limited Group of companies makes any warranty as to the accuracy or completeness of the information in this document and disclaims all liability that may arise due to any information contained in this document being inaccurate, unreliable or incomplete.