ELLERSTON CAPITAL

Ellerston Australian Share Fund

PERFORMANCE REPORT April 2018

The investment objective of the Ellerston Australian Share Fund is to outperform the S&P/ASX 200 Accumulation Index (Benchmark). The Fund aims to achieve this by investing in a concentrated portfolio of no more than 25 Australian listed securities.

Ellerston Australian Share Fund Performance to 30 April 2018

	Gross (%)	Benchmark* (%)	Excess (%)	Net (%)
1 Month	6.65	3.91	2.74	6.54
3 Months	5.81	0.34	5.47	5.60
FYTD	14.47	8.26	6.21	13.61
Rolling 12 Months	16.32	5.46	10.86	15.23
2 Years (p.a.)	17.97	11.45	6.52	16.77
3 Years (p.a.)	9.74	5.70	4.04	8.60
5 Years (p.a.)	10.26	7.53	2.73	9.11
Since Inception (p.a.)	12.00	10.34	1.66	10.81
Since Inception (CUM)	180.04	144.50	35.54	154.08

The return figures are calculated using the redemption price for Class A Units and on the basis that distributions are reinvested. The Gross and Excess return figures are before fees and expenses whereas the Net Return figures are net of fees and expenses for the Class A Units. Returns of the Fund may include audited and un-audited results.

Past performance is not a reliable indicator of future performance. * The benchmark was changed from the S&P/ASX 200 Accumulation Ex REITS Index to the S&P/ASX 200 Accumulation Index on 1 July 2012.

Market Commentary

Market Overview

In April, global equity markets rebounded modestly from the depressed levels in March as markets assessed the prospects of a trade war and geopolitical tensions eased. Chinese President Xi's conciliatory tone on trade and encouraging talks of denuclearisation on the Korean peninsula buoyed sentiment. Equity markets were also fuelled by continued evidence of economic strength and strong US corporate earnings. It was a choppy start to the month, as US sanctions hit metal prices and Russian companies (and the oligarchs who own those companies) extremely hard. But volatility, as measured by the VIX Index, actually fell in April, while US10-year treasury yields rose sharply, finally cracking the 3% level, before ending the month marginally below the figure. The Australian market outperformed global bourses despite the Financial Services Royal Commission dominating media headlines and casting a long shadow on financial stocks.

USA

The S&P 500 Index and the Dow Jones Industrial Average Index ended April up 0.4% and 0.3%, respectively. After selling off early in April when trade tensions between the US and China hit fever pitch, stocks recovered their poise after Chinese President Xi struck a more appeasing tone on trade, and US companies reported earnings that in aggregate were well ahead of consensus expectations. Also, the new Chair of the FOMC, Jerome Powell, provided an update that suggested that above-trend growth was continuing and that the Fed was prepared to gradually increase the Federal Funds rate. In other words, the US economy was continuing its strong recovery and interest rates were heading up. The US10-year bond yields traded above 3% for the first time since 2014.

Europe

European stocks rebounded strongly in April after a poor first quarter, with the Euro STOXX 50 Index returning 5.8%. France's CAC 40 and the UK's FTSE 100 were amongst the top performers, returning 7.1% and 6.8% respectively. The European Central Bank kept rates on hold in April and said that it expected "interest rates to remain at their present levels for an extended period of time, and well past the horizon of net asset purchases". Russian stocks were particularly weak in early April after the US sanctioned several Russian oligarchs, officials, businesses and agencies. This led to a rally in aluminium and nickel prices. But Russian aluminium giant, Rusal, saw its share price halve in one day on the Hong Kong stock exchange after Washington announced the sanctions. Later in the month, commodity prices pared their gains and Rusal's share price rallied after the US government said it would not impose previous sanctions immediately if the oligarchs divested their interests in certain enterprises.

Asia

Asian markets were also broadly higher as trade tensions eased and relations on the Korean peninsula showed signs of improvement. The historic meeting between the leaders of North and South Korea was hailed as opening "up a new era of peace". The Hang Seng Index closed up 2.5%, while Japan's Nikkei 225 Index was up 4.7%, with investors in Japan relieved that the US did not make fresh trade demands during the summit between Prime Minister Abe and President Trump.

During the month, China's central bank announced a 100 basis point reserve requirement ratio cut - currently 17% for large institutions and 15% for smaller banks. This effectively released RMB1.3 trillion in liquidity, lowered funding costs for banks and lowered corporates' financing costs, helping sentiment across the region.

Commodities

Bulk commodity prices were mixed in April, with iron ore and thermal coal prices up modestly, but hard coking coal prices fell sharply. The big movements were in the base metals complex, with aluminium hitting multi-year highs after the previously mentioned US sanctions. However, metal prices generally retraced after the US pulled back from its initial rhetoric. Oil was the standout performer and rallied US$4.90 per barrel on concerns over renewed US sanctions on Iran, falling Venezuelan production and stronger global demand. Gold prices eased as the dollar firmed and geopolitical tensions eased.

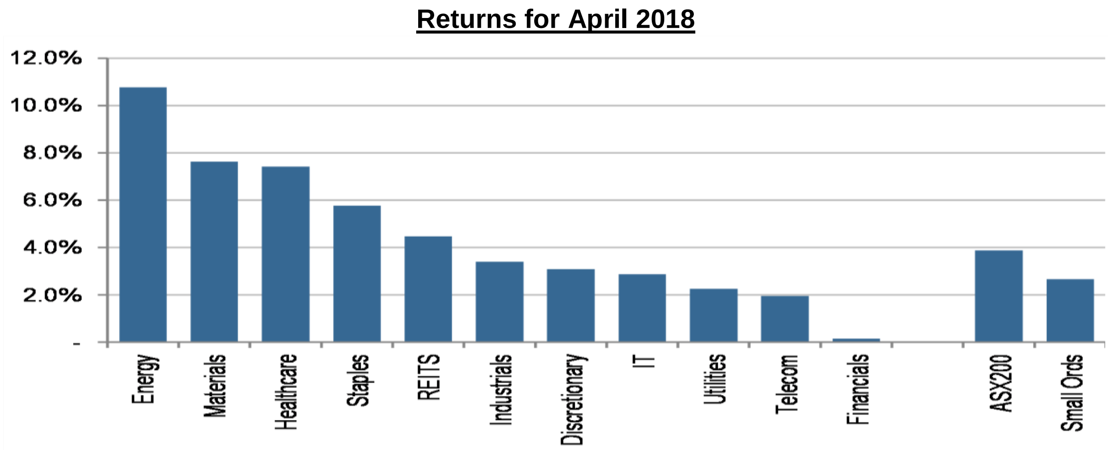
Bonds

Global bond yields backed up as bonds continued their sell off. The US 10-year treasury yield briefly broke through the 3% threshold for the first time since 2014. US inflation measures remained firm and not surprisingly, the Fed signalled its intention to keep raising rates if the positive trends in the economy continued.

Australia

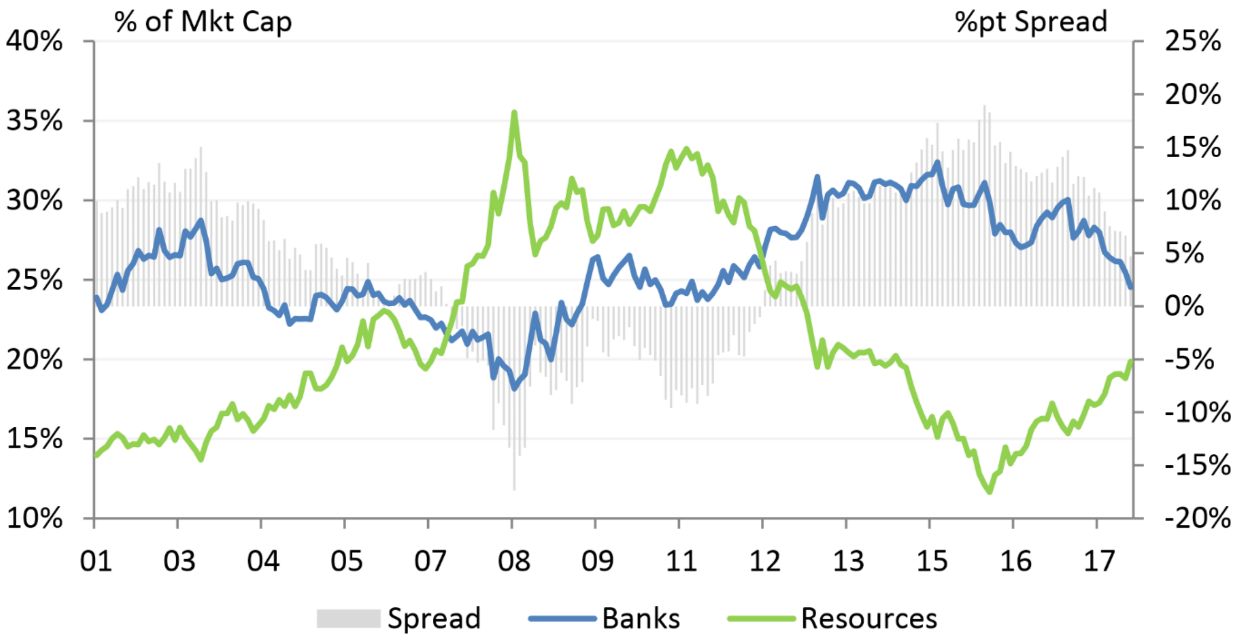
The Australian equity market had an excellent month despite the big 4 Bank share prices constrained by fallout from the Royal Commission. The S&P/ASX 200 Accumulation Index ended April up 3.9%. The ASX 200 Resources Accumulation Index was the star performer (after taking out the wooden spoon for two months in a row), returning 9.8%, while the Small Ordinaries Accumulation Index lagged and returned 2.8% with the ASX 200 Industrials Accumulation Index returning a more modest 2.6%.

The sharp rebound in iron ore and the oil price propelled large miners and energy stocks, with all sectors adding value, though financials, telecommunications and utilities were the laggards. See chart below.



Source: Bloomberg, April 2018.

Resources contributed over half of the ASX 200's total return, continuing to gain index share at the expense of the banks. See chart below.



Source: Factset, Morgan Stanley Research, April 2018.

Round 2 of the Hayne Royal Commission cut a swath through the country's financial planning industry, which is meant to play a major role in helping consumers manage their $2.6 trillion in superannuation savings. The news flow was brutal and AMP was by far the worst hit in terms of reputational damage and share price. Evidence presented and cross examination revealed that AMP was charging fees for no service, had lied to the regulator and that the Chairperson had apparently interfered with an independent report. There were necessary casualties, with AMP's Chair forced to fall on her sword while the CEO brought forward his retirement and instead quit suddenly. IOOF was also caught up in the negative sentiment from the Royal Commission, as investors speculated on the implications for integrated advice and platform businesses. The bank sector was only modestly in positive territory (having suffered badly in the first round of the commission's public hearings). The evidence in the second round suggested that banks continue to offend with respect to advice being provided.

While all banks had a charge sheet of transgressions, Commonwealth Bank stood out and took line honours as it was accused of charging dead people! More negative headlines are expected, as further rounds of the Royal Commission are scheduled to take place before it concludes in September.

Not surprisingly, the Reserve Bank of Australia (RBA) chose to keep rates on hold at 1.5% in April. The outlook for growth was relatively unchanged compared to last month. The RBA did however note that credit spreads were wider, with tighter US dollar funding conditions flowing through to higher short-term rates in Australia. The Australian dollar fell 1.2 cents against the US dollar to 0.755.

Company Specific News

The Market Misses

Blue Sky Alternative Investments (BLA -70.4%)
Blue Sky emerged from voluntary suspension at the beginning of the month after spending the best part of a week considering the merits of a damning report released by US-based fund Glaucus, in part asserting that BLA was overstating its fee earning assets under management. BLA retorted that the report was fundamentally flawed and materially misleading. Alas, the market didn't listen, initially selling the shares down 27%. A raft of buying from directors followed which gave some support to the stock. However this support evaporated and was just like trying to hold back Niagara Falls with a teaspoon, when the company soon announced cuts to the very assets under management under question and slashed FY18 earnings estimates. Putting an exclamation mark on the sorry saga was the resignation of Managing Director, Robert Shand.

iSelect (ISU -44.1%)
Comparison website iSelect was another company searching for a new chief executive after declaring a huge downgrade to guidance due to a slump in activity that showed no sign of improving, even going into the company's busiest time of the year. The shock earnings downgrade, up to 69% at the low end of new guidance, left investors scrambling for the exit door. The stock finished the month at $0.57, a long way below its 2013 listing price of $1.85 and recent highs of ~$2.13.

AMP Ltd (AMP -19.0%)
AMP faced the full blast of the Royal Commission. It was found to have lied to the regulator, interfered with an independent report and charged customers fees while not providing any advice. These findings had consequences. The CEO brought forward his retirement and quit the company, and the Chair fell on her sword after some hesitation and following substantial external pressure from investors, the press and politicians. It was an ignominious month for the venerable brand and investors decided that the Royal Commission's recommendations and negative sentiment would likely hurt the structure, reputation and fundamentals of the group.

G8 Education (GEM -14.4%)
Child care centre operator, G8 Education, provided a trading update at its AGM indicating new centre supply was forecast to continue to outstrip demand. G8's occupancy declined by approximately 2.5-3.0% on the prior corresponding period due to the increased supply environment. GEM has not provided earnings guidance.

Navitas Ltd (NVT -13.7%)
Perennial downgrader NVT also released enrolment figures for the first semester of 2018 for its University Programs division, with total enrolments up 3% year-on-year. This was well below market expectations and represented a significant slowdown on the previous semester. With the company trading on a P/E north of 20 times, there was little room for disappointment.

Perpetual (PPT -13.5%)
Perpetual had yet another quarter of negative net funds flow - the outflows in the March 2018 quarter were $1.3 billion. In the past decade, PPT has not enjoyed a single year where net fund flows post distributions have been positive. The shares sold off and have continued to be de-rated, along with other financial stocks.

The Banks (BOQ -4.7%/ WBC +0.1%/ ANZ -0.1%/ CBA -0.7%/ NAB +1.6%)
Round 2 of the Royal Commission and there was no letup in the negative headlines. Sentiment towards the sector sunk to new lows, with even previously supportive politicians engaging in (seemingly justifiable) bank-bashing. There are further rounds of evidence and inquisition to come. The third round of hearings at the end of May will focus on Banks treatment of small and medium sized enterprises. The banks are bracing for more bad news. Senior management and boards are not losing any public opportunity to offer customers, employees, investors and society profuse apologies for their past bad

behaviour and malfeasance. The Royal Commission concludes in September, with a report by the commissioner due on 1 February 2019.

Besides the negative sentiment from the commission, the risks to future earnings growth have escalated, as the outlook for credit growth has deteriorated and the imposition of higher compliance-related costs and risk capital are expected to constrain earnings and returns.

Bellamy’s Australia (BAL -8.7%)
After dominating ‘The Market Hits’ section of this report over the last 12 months, it is not surprising to see Bellamy’s give a little back. A few substantial shareholders locking in gains across the month was enough to see the shares pullback.

Boral (BLD -7.5%)
Boral issued a trading update late in the month highlighting a soft March quarter in both the US and the Australian operations. This is the second downgrade in succession for the US business and worryingly, comes against the backdrop of a strong housing market. In addition, the company attributed poor weather in Australia as the driver of weakness, raising eyebrows of those on the east coast experiencing drought conditions.

The Market Hits

Beach Energy/ Santos (BPT +30.0%/ STO +21.1%)
The stars aligned for the energy sector in the month as M&A combined with a rally in crude to see energy stocks bid higher. The month started with Harbour Energy making a A$6.50 bid for Santos, representing a 28% premium to the last trading price. Further adding to the excitement in the sector, Brent Crude rallied from US$66 to circa US$74, as production constraints and OPEC compliance met strong global demand.

Healthscope (HSO +25.6%)
Another stock to benefit from M&A interest during the month was hospital operator Healthscope. A consortium, led by private equity group BGH, in conjunction with Australian Super, GIC, Ontario Teachers and Canada Pension Plan, bid $2.36 cash for the group, a 16% premium to the last traded price.

Infigen Energy (IFN +18.0%)
Brookfield, a major infrastructure investor, lodged a substantial shareholder notice in Infigen, highlighting that it had acquired 9% of its issued capital. Whilst Brookfield confirmed that it had “no current plans” to take over the company, its presence on the register was enough to see the stock jump 20% in 2 days.

APN Outdoor (APO +17.7%)
Outdoor industry revenues jumped nearly 9% in the first quarter of 2018, fuelling excitement across the out of home sector. Roadside and transport sectors were both strong which plays into APO’s hands. At its AGM, APO suggested the year was off to a good start with revenue up mid-single digits, excluding the lost Yarra Trams contract.

Metcash (MTS +15.0%)
Food price inflation appears to be back on the radar screen. The latest CPI data showed seasonal pressures had abated and a renewed focus on profits by Coles and Woolworths suggests competitive tensions are easing. Metcash and its wholesaling model should benefit significantly from any recovery in food price inflation. In addition, sales figures released by market leader Bunnings indicated the home improvement sector remained very buoyant, a look through win for MTS’s Mitre 10 and Home Timber & Hardware brands.

South 32/ Alumina Ltd (S32 +15.5% / AWC +11.9%)
The alumina price went on a wild rollercoaster ride across the month as the extent of US sanctions against Russian producer Rusal pushed prices (briefly) above US$700/tonne. Whilst the sanction rhetoric from the Trump administration was tempered late in the month, prices remained strong, fuelling exposed equities.

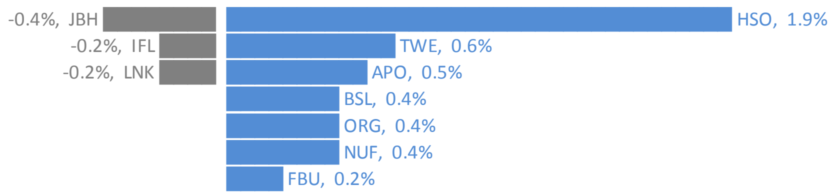
Treasury Wine Estates (TWE +13.1%)
Phenomenal wine export numbers released by Wine Australia for the year ended March 2018 saw another wave of interest in TWE. Exports to China, at the luxury end (greater than $50 a litre) jumped more than 100%. Given that TWE dominates Australia’s exports to China in this segment, it was no surprise to see the market continue to chase the stock.

Fund Performance

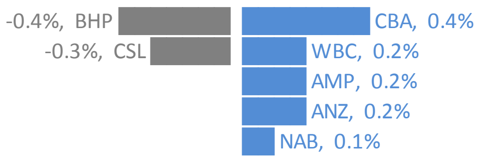
We are delighted to report that the Funds return of 6.65% significantly outperformed the benchmark return of 3.91% in the month of April.

This brings the return for the FYTD and rolling year to a satisfactory 14.47% and 16.32%, outperforming the benchmark return by 621 bpts and 1,086 bpts respectively.

Securities Held



Securities Not Held



The main contributors to this month's performance were overweight positions in Healthscope (HSO +25.6%), Treasury Wines (TWE +13.1%), APN Outdoor (APO +17.7%), Bluescope Steel (BSL +9.4%), Origin Energy (ORG +12.1%), Nufarm (NUF +8.6%) and Fletcher Building (FBU +7.0%).

As has been the case in recent months, having a zero holding in the Banks was a major positive for relative performance this month with Commonwealth Bank (CBA -0.7%), Westpac Bank (WBC +0.1%), AMP (AMP -19.0%), ANZ Bank (ANZ -0.1%) and National Australia Bank (NAB +1.6%) all underperforming.

The main detractors were overweights in JB Hi-Fi (JBH -0.4%), IOOF (IFL -11.9%) and Link Administration (LNK -0.5%). Additionally, having zero holdings in BHP Billiton (BHP +9.7%) and CSL (CSL +9.6) had a marginally negative impact on performance.

But it's not all good news. It is fair to say that we were surprised by the modest downgrade announced by JB Hi-Fi at the Macquarie Australia Conference in early May (the stock fell ~9% intra-day). Whilst we and the market were aware that The Good Guys (TGG) were going through significant transition post the acquisition, we felt that the synergies from the deal should have been sufficient to offset any disruption. We were clearly wrong.

That said, our original thesis for investing in JB Hi-Fi remains intact. The JB Hi-Fi brand has by far the lowest cost of doing business in Australia, is a price leader and is winning in the market place. JB Hi-Fi had been sold down aggressively on the fears of Amazon's entry to the Australian retail scene and it is trading at a significant discount (>40%) to the market and its historical rating. Our confidence in the JB Hi-Fi business remains as strong as ever.

We have of course been disappointed by the recent performance of TGG. Integration challenges have taken longer than we anticipated and its biggest competitor HVN, who seem to be in more trouble than the early settlers (if you believe the press), has seized an opportunity to aggressively price discount to win market share. This discounting has impacted the short term profitability at TGG, which led to the downgrade. Importantly, we believe the discounting will be temporary (as we've seen many times in the retail industry) and that profitability will be restored. Indeed we and the market, would expect to see supplier led price increases to come through in the next 3 months.

We firmly believe that the issues with JBH are transitionary and it will be a profitable investment over the medium term.

The new month of May is already proving challenging.

Fund Activity

New stocks added	Stocks exited
	▪ AWE

Strengthened positions	Decreases to positions
▪ QBE Insurance	▪ Origin Energy
▪ Fletcher Building	▪ Rio Tinto
▪ IOOF Holdings	▪ Treasury Wines Estates
▪ Star Entertainment Group	▪ BlueScope Steel
▪ Suncorp Group	▪ Link Administration Holdings
	▪ Primary Health Care
	▪ Rio Tinto

We did not add any new stocks to the portfolio. We exited AWE, having accepted the 95 cents per share cash take-over offer by Mitsui.

We have added selectively to stocks we have previously discussed, as attractive share price opportunities emerged and took profits/trimmed other positions. Specifically, we strengthened our positions in Fletcher Building, QBE Insurance, IOOF Holdings, Star Entertainment and Suncorp Group. Conversely, we trimmed the Fund's holdings in Treasury Wines Estates and BlueScope Steel following continued share price outperformance and took further profits in Origin Energy, Link Administration, Primary Healthcare and Rio Tinto.

Fund Strategy and Outlook

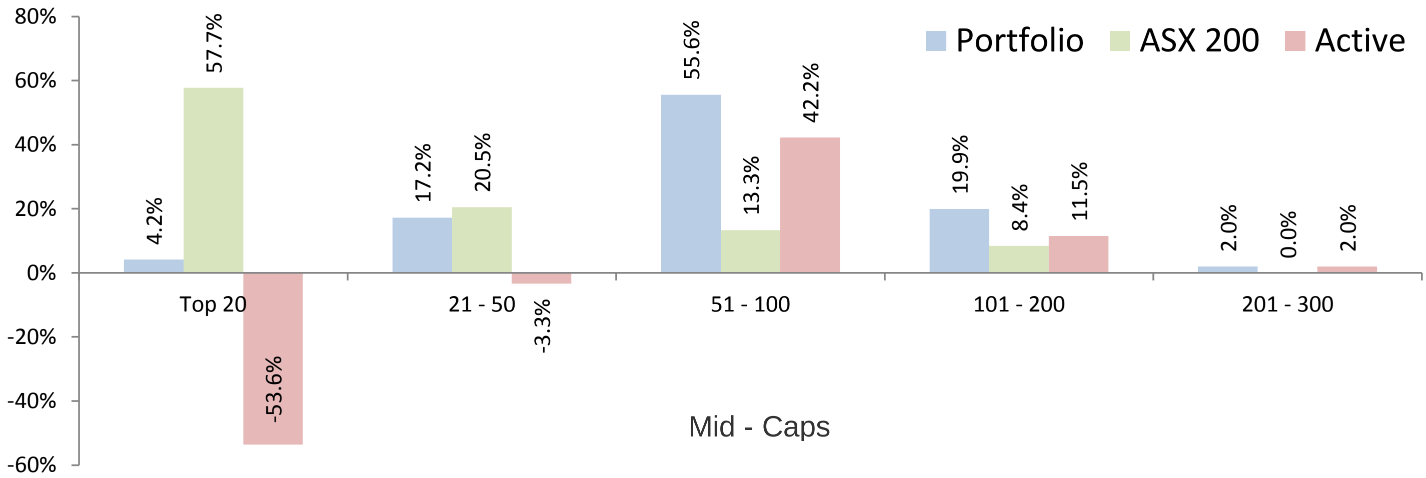
Our strategy remains unchanged from that articulated in our last update.

The easing of geopolitical tensions on the Korean peninsula and trade war and sanctions rhetoric have helped markets squeeze higher. The relief rally that we expected following the last month's pull back actually eventuated. Global growth continues to firm but so also are expectations of inflation and accompanying higher interest rates. The RBA governor, Philip Lowe, said, "…the last increase in the cash rate was more than seven years ago, so an increase will come as a shock to some people". We don't disagree. While the VIX Index, as a measure of volatility, fell in April and is closer to levels seen towards the end of February, it remains at more elevated levels relative to the start of the year. We continue to expect more volatility but will remain true to label and stick to our disciplined valuation investment approach.

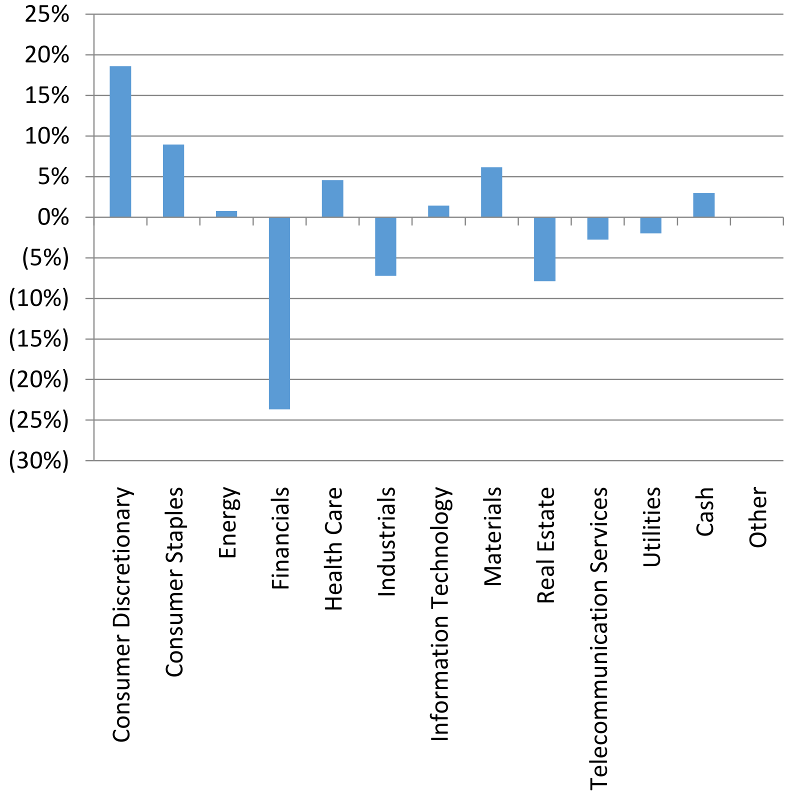
Warm Regards,

Chris Kourtis
Portfolio Manager

Size comparison Chart vs ASX 200



Active Sector Exposures*



Top 10 Holdings**

APN OUTDOOR

BLUESCOPE

FLETCHER BUILDING

GRAINCORP

HEALTHSCOPE

JB HI-FI

NUFARM

ORIGIN ENERGY

TABCORP HOLDINGS

TREASURY WINE ESTATES

APN OUTDOOR

* Active sector exposures are determined by subtracting fund sector weights from benchmark weights. Positive percentages represent over-weight sector exposures relative to benchmark and negative percentages represent under-weight sector exposures relative to the benchmark.
** Top 10 Holdings are listed in alphabetical order.

About the Ellerston Australian Share Fund

The Fund aims to achieve its performance objectives by adopting a fundamental “bottom-up” investment approach to stock selection which is focused on identifying and then constructing a portfolio of the highest conviction ideas.

Investment opportunities for the Fund are identified by analysing and understanding the factors affecting (amongst other things): business model, industry structure, management team and overall valuation. Ellerston Capital typically favours businesses that can sustain high returns or improve their return on capital and looks to invest in businesses with a market value below the value we attribute to them.

Benchmark weightings do not drive our stock decisions, our approach is totally benchmark independent.

Due to the high conviction nature of the portfolio and the resulting deviation in portfolio composition relative to benchmark weighting, it is expected that the returns from the Fund will differ significantly from the broader market indices.

Fund Facts

Strategy Funds Under Management	$3.9 Billion
Funds Under Management - ASF Unit Trust	$55 Million
Application Price	$1.1566
Redemption Price	$1.1508
Number of Stocks	22
Inception Date	1 April 2009