

Ellerston Australian Small Companies Fund

PERFORMANCE REPORT June 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 [^]	Gross	Benchmark	Net Alpha	Gross Alpha
1 Month	1.53%	1.59%	1.06%	0.47%	0.53%
3 Months	7.99%	8.18%	7.67%	0.32%	0.51%
Rolling 12 Months	19.89%	20.76%	24.25%	-4.36%	-3.49%
2 Years p.a.	17.04%	18.13%	15.31%	1.73%	2.82%
3 Years p.a.	14.65%	15.72%	15.01%	-0.36%	0.71%
Since Inception p.a.	11.74%	13.19%	9.51%	2.23%	3.68%

Ellerston Australian Small Companies Fund Top Holdings

Top 5 Stock holdings as at 30 June 2018	Sector	%
Austal Ltd	Industrials	3.48
Southern Cross Media Group Ltd	Consumer Discretionary	2.98
Tassal Group Ltd	Consumer Staples	2.97
Cleanaway Waste Management Ltd	Industrials	2.97
Australis Oil & Gas Ltd	Energy	2.94

[^] 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 1.53% in June, outperforming the ASX Small Ordinaries Accumulation Index which rose 1.06%. During the month, the Small Industrials Accumulation Index rose 1.37% whilst the Small Resources Accumulation Index fell 0.02%.

The largest contributors to positive attribution were Australian Pharmaceutical Industries (API), iSelect (ISU) and OceanaGold Corp (OGC). Australian Pharmaceutical Industries has announced a deal to acquire Clearskincare Clinics for under 8x EV/EBITDA over 3 years funded by net debt. The acquisition is expected to be over 10% EPS accretive and adds a new growth vertical in the expanding skincare service market. The strategic rationale is to leverage Priceline's dominance in female health & beauty retailing and its SisterClub membership base, which offers substantial cross-sell opportunities. iSelect's share price jumped early in the month as the parent company of rival online comparison website Comparethemarket acquired a 19.6% stake on the register. iSelect management announced it had received multiple potential approaches and remains in discussion with a number of interested parties. iSelect's cash, investments and trailing commission book is worth \$0.65/share, leaving little residual value for its core upfront commission generating business lines. OceanaGold rallied during the month, despite the fall in the gold price, as the company upgraded its full year guidance forecasts on the back of increased production out of their Didipio operation in the Philippines. Elsewhere, operations in New Zealand and the USA continue to perform in line with expectations.

The largest detractors from relative returns were Ausdrill (ASL), Appen (APX), and Motorcycle Holdings (MTO). Ausdrill issued a profit downgrade during the month due to issues at two of their clients operations. There was a pit wall failure at the Kalgoorlie Super Pit and Mineral Resources has reduced their expected expansion of production at the Wodgina Lithium project. The combined impact will be a single digit impact on profit in FY19. We do not own Appen. Motorcycle Holdings (MTO AT) fell for the month after issuing a profit downgrade. Sales have been weaker than expected especially due to product issues within the Harley Davidson product range. FY19 should see an improvement in earnings with a full year of the Cassons acquisition and the impact of additional dealerships added in the last year.

Outlook

Financial Year 2018 saw the index deliver a substantial return of over 24% which was particularly weighted to the first half of the year. Recovering commodity prices saw a substantial rally in resource companies in the first half of the year, which then traded sideways for the last 6 months just as "the crowd" become bullish at the start of the year. Industrial stocks rallied 18% which was driven by a PE re-rating rather than any uptick in EPS revisions. Consequently, we believe that some consolidation is required in the small cap market to justify current valuations. In particular, the larger market cap end of the market is looking rather stretched in terms of valuation, probably due to the movement of money by large cap managers who have switched out of the banks in the last year and into this area of the market, where there is a higher level of liquidity. The top 50 stocks in the Small Cap Index represent more than half of the index weighting and our couple of small holdings in this space represent just over 4% of the portfolio, indicating our view on valuations in this part of the market. The lower end of the market offers more opportunities for "alpha" and we have been re-weighting the portfolio towards this space over the last 6 months. We continue to remain aware to the risks to the market after a 9 year recovery from the GFC, and are taking a conservative approach to investing in the belief that the returns of the last 3 years won't be repeated over the next 3 years.

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	54
Application Price	\$1.2504
Redemption Price	\$1.2442
Inception Date	10 October 2013

Disclaimer

Returns are unaudited estimates and before fees and expenses and assume distributions have been reinvested. Ellerston Capital Limited ABN 34 110 397 674 AFSL 283 000 is the trustee of the Ellerston Australian Small Companies Fund. 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.