Ellerston Capital

Ellerston Australian Share Fund (ASF)

Performance Report | June 19

PERFORMANCE SUMMARY

Net %	1 Month	3 Months	1 Yr	3 Yr p.a.	5 Yr p.a.	Strategy Since Inception p.a.
ASF	0.62	-2.02	-8.33	6.00	5.20	8.28
Benchmark	3.70	7.97	11.55	12.88	8.86	10.75

Past performance is not a reliable indicator of future performance.

MARKET COMMENTARY

Market Overview

Global equity markets rallied strongly in June, delivering their second best monthly gain in a decade, as major central banks signalled an easing bias. Developed Markets rose 6.6% and outperformed Emerging Markets by 0.3% (in US$ terms). The main geopolitical event at month's end was the G20 summit in Osaka. The summit concluded with news that US President Trump and Chinese President Xi agreed to a "ceasefire" in the trade war between their two countries. Markets which anticipated a conciliatory outcome, have interpreted this as good news and have continued to rally in early July. In June, bonds rallied sharply too, with US 10-year bond yields falling to 2.00% from 2.12%. Also of note was the continued strength in the iron ore price which was up another US$11/t to close the month at US$116.5/t.

USA

The S&P 500 Index and the Dow Jones Industrial Average Index were sharply higher in June, returning +7.1% (reaching a record high) and +7.3% respectively. The NASDAQ performed even better, +7.5%, with Uber Technologies raising US$8.1 billion in its IPO.

Key US economic activity indicators for May were mixed: manufacturing ISM missed, falling to 52.1 (consensus: 53.0, previous: 52.8), non-farm payrolls also missed, but composite non-manufacturing ISM beat expectations, rising to 56.9 (consensus: 55.4). An easing bias indicated by the Fed was enough to lift markets.

Europe

European equities also delivered positive returns, with the Euro Stoxx 50 rising 6.0% in June, led by the Basic Resources and Chemicals sectors. Leadership confusion continued in the UK post Theresa May's resignation, with Boris Johnson in a strong position to take over as the UK's next prime minister. The Europeans began to publically voice disagreements on who would steer the European Commission, the European Council and the ECB. Uncertain political leadership dovetailed with moderating activity indicators: the flash Eurozone manufacturing PMI for June came in at 47.8,misseing consensus expectations of 48.0.

But the ECB indicated that it was preparing fresh stimulus measures, buoying equity markets, with the FTSE 100 returning +4.0%, France's CAC 40 returning +6.8%, and Germany's DAX doing +5.7%

Asia

Asian equities also delivered very strong returns in the period. Chinese PMI held at 49.4, Chinese CPI came in at 2.7% (in line) and the May surplus of $41.7 billion beat consensus expectations of $22.3 billion. But it was the prospect of additional stimulus – the PBoC announcing further measures to boost the economy and the BoJ altering its bond buying – together with hopes of a resolution to the US-China trade that encouraged equity markets. Political tensions and riots in Hong Kong had no impact on the Hang Seng, with the Index rallying by

Investment Objective

The Investment objective for the Ellerston Australian Share Fund is to outperform the S&P/ASX 200 Accumulation Index (Benchmark).

Investment Strategy

The Fund uses a benchmark-independent, high conviction approach that looks beyond investing in the Top 20 stocks in order to capture the neglected opportunities created by under-researched stocks in the broader Australian market.

Key Information

Strategy Inception Date	1 April 2009
Fund Net Asset Value	$0.9414
Liquidity	Daily
Application Price	$0.9438
Redemption Price	$0.9390
No Stocks	19
Management Fee	0.90%
Buy/Sell Spread	0.25%
Performance Fee	15%
Firm AUM	Over $5 Billion

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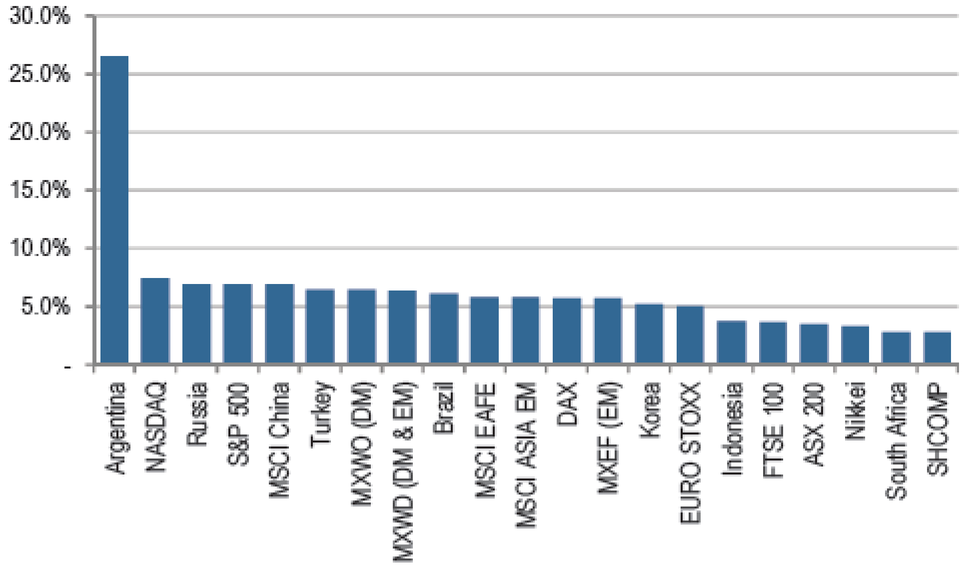
6.7%, while Japan's Nikkei 225 was up 3.5%, Korea's KOPSI Composite Index was up 4.4% and the Chinese SEE Total Market Index was up 5.6%.

Global Equity Markets' Performance in the month of June 2019

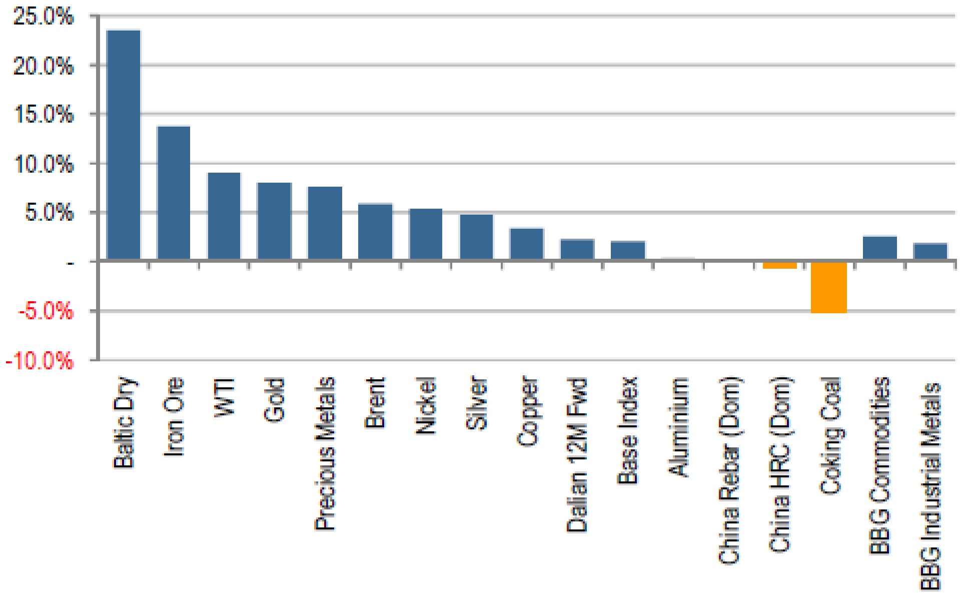


Source: JP Morgan, Bloomberg.

Commodities

Bulk commodities were mixed, but the outperformer was again iron ore, up US$11/t to US$116.5/t. While supply has been constrained due to the Vale disaster, in June, Brazil's Superior Court removed the suspension imposed by the Minas Gerais State Court on the Laranjeiras dam, Brucutu's main iron ore tailing facility. So Vale was allowed to restart wet processing capacity at Brucutu, a step-change to its full 30Mtpa (dry and wet processing). However, at the same time, Rio announced a cut to its calendar year 2019 shipment guidance by 4% from 333-343Mt to 320-333Mt on mine supply issues, squeezing iron ore prices higher. Thermal coal and hard coking coal both retraced in June, with coking coal the worst performing commodity, falling 5.1%. Brent oil prices rose US$2.06/bbl to US$66.55/bbl on a weaker US dollar and increased tensions between Iran and the US. And gold prices rallied 8% to US$1,409/oz during the month as concerns over global growth increased and record low interest rates reduced holding costs.

Commodity Performance in June 2019



Source: JP Morgan, Bloomberg.

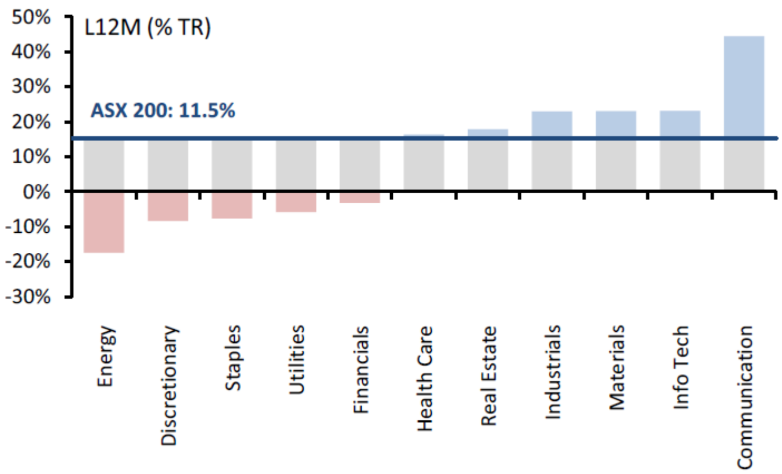
Bonds

Global growth concerns saw bonds rally in June with US 10-year bond yields falling to 2.00% and Australian 10-year bond yields down to 1.32%. Australian 10-year bond yields have now widened their gap to US 10-year bond yields. Expectations of further rate cuts to stimulate a flagging economy are pushing the yield curve lower.

Australia

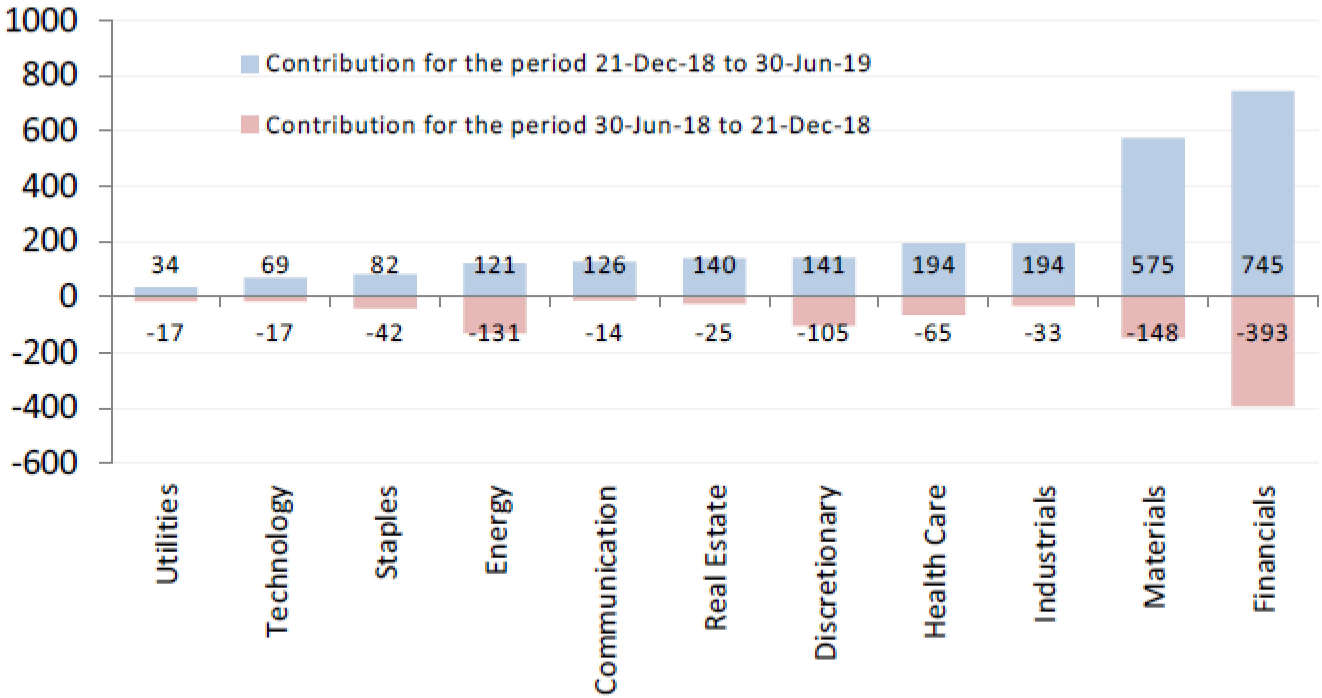
The S&P/ASX 200 Accumulation Index ended the month up 3.7%, capping off an impressive 1H return of +19.7%, the best since 1991 and closing within 2% of its all-time high of 6829 pts (set on Nov 1st, 2017). The market returned +11.6% for FY19 and has yielded 24% from the December 21, 2018 lows.

ASX 200 Sector Performance



Source: RIMES, S&P, Morgan Stanley Research

FY19 performance pre and post 21-Dec-2018 low – the ASX has rallied +24% from 21-Dec-2018 low



Source: Bloomberg, Morgan Stanley

For June, the best three performing sectors were Materials (+6.7%), Financials (+3.5%) and Industrials (+5.4%). The bottom three sectors were Consumer Discretionary (-1.5%), Information Technology (+1.0%) and Utilities (+3.2%).

In June, the Small Ordinaries Accumulation Index was the worst performer for the second month running despite a positive return of +0.9%, while the ASX 200 Resources Accumulation Index was the best performer, up 6.4%. The ASX 200 Industrials Accumulation Index returned a solid +3.0%.

The top five stocks that detracted from the performance of the S&P/ASX 200 Accumulation Index were Wesfarmers (-5 points), Vocus Group (-5 points), Challenger (-5 points), Lendlease (-5 points) and South32 (-4 points).

The top five stocks that added to the positive index return were BHP Group (+58 points), Commonwealth Bank of Australia (+45 points), CSL (+25 points), Newcrest Mining (+21 points) and Westpac Banking Corporation (+19 points).

While business confidence bounced in May after the surprise re-election of the Coalition government, 1Q GDP data showed that the economy grew at a listless 0.4% on the back of weak domestic demand. The annual growth rate of GDP dropped to 1.8% from 2.4%, the lowest since the negative effects of the GFC in 2009.

After holding rates steady for three years, the RBA cut the cash rate to a historic low of 1.25% in June. The RBA claimed that it took the decision to support employment growth and provide confidence that inflation will be consistent with its medium-term target. The consensus expectation is for further rate cuts in the coming months. Following its meeting on 2nd of July (at the time of writing), the RBA cut cash rates by another 25 basis points to 1.00%. The RBA's July statement said: the easing of monetary policy will support employment growth and provide greater confidence that inflation will be consistent with the medium-term target. The statement also noted that global financial conditions remain accommodative, but "consumption growth remains subdued", and "demand for credit by investors continues to be subdued".

The AUD was up against the USDbut was among the weakest "risk on" currencies, underperforming the Canadian dollar, Norwegian Krone and New Zealand dollar. It ended the month at 0.7020 against the USD.

COMPANY SPECIFIC NEWS

The Market Misses

Vocus Group (VOC, -28.8%)

Two potential acquirers walked away from their takeover bids in June. First it was the Swedish private equity outfit EQT withdrawing its $2.3bn offer, and then AGL. Several parties have now conducted due diligence on VOC and not liked what they have seen. Another takeover bid seems increasingly unlikely. So the management team will have to execute on their turnaround strategy if shareholders are to generate a satisfactory return on their investment.

Pilbara Minerals (PLS, -24.3%)

This lithium miner warned customer demand for its materials in the June quarter had been softer than initially anticipated. A key customer in China has been slow to ramp up their processing capacity. This news only compounded the impact of recent weakness in lithium prices.

Challenger Limited (CGF, -17.7%)

At its investor day, CGF reset its earnings and ROE targets. CGF guided to a lower equities normalised growth rate assumption, softer sales from the ongoing disruption to financial planners and walked away from its pre-tax ROE target of 18%. This resulted in FY20 earnings being downgraded and caused a de-rating of the stock, causing it to perform poorly in the month. CGF shares slumped to a three year low.

Link Administration (LNK, -16.3%)

LNK issued an earnings downgrade in the month and attributed it mainly to one-off factors, namely business delays caused by Brexit and higher costs from earlier than anticipated implementation of “Protecting Your Super” legislation. Earnings were downgraded by double digits in FY19 and FY20 and a shadow was cast over management’s credibility. It’s likely that the stock will be in the “sin bin” until confidence in its earnings prospects and management returns.

Ardent Leisure Group (ALG, -12.9%)

Dave & Buster’s Entertainment, a competitor to ALG’s Main Event business in the United States, issued a quarterly earnings report below market expectations and downgraded its earnings guidance for the full year. The 19% fall in the Dave and Buster’s share price unfortunately dragged ALG down with it.

The Market Hits

Nanosonics Limited (NAN, +24.9%)

Some fresh broker research reminded investors there is potentially a significant opportunity to grow revenue from the company’s unique ultrasound probe disinfection technology. The stock price has now doubled since January.

Ausdrill (ASL, +24.6%)

The mining services company announced a material contract win to construct and operate a copper-silver mine in Botswana, Africa.

Bingo Industries (BIN, +22.5%)

Shares in Bingo rallied during the month as the company seeks 20-25% price increases across its NSW business to compensate for QLD landfill levies, other cost increases and increased demand for its post-collections capacity.

Northern Star Resources (NST, +20.0%), Regis Resources (RRL, +18.7%), Newcrest Mining (NCM, +17.4%)

The surge in the gold price, to record levels in AUD terms, on the expectation for monetary easing across the globe and heightened geopolitical tensions helped most gold miners. NST also confirmed it is on track to meet its production guidance (850-900koz) at an average cost of A$1,225-1,275/oz.

Eclipx Group (ECX, +17.0%)

This fleet leasing company continued to re-rate as the market reacted to the newly appointed CEO’s plans to sell non-core assets (Grays Online and Right2Drive) and simplify its fleet business.

Austal Limited (ASB, +24.6%)

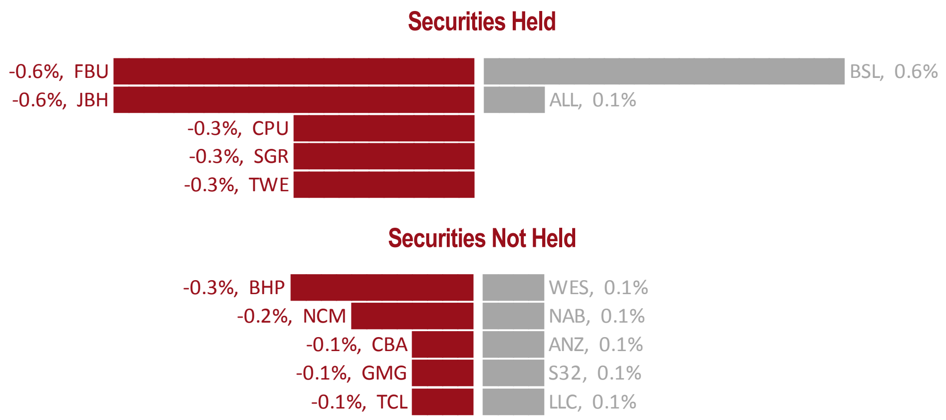
Austal was admitted to the S&P/ASX 200 index during the month and the latest US Congress report appears supportive of Austal’s workload beyond the current Littoral Combat Ship (LCS) program.

FUND PERFORMANCE

The Fund delivered a return of +0.71% in the month of June, capping off a very disappointing financial year where we significantly underperformed the benchmark return of +11.55%.

RETURNS[1] (%)	GROSS	BENCHMARK*	EXCESS	NET
1 MONTH	0.71	3.70	-2.99	0.62
3 MONTHS	-1.74	7.97	-9.71	-2.02
ROLLING 12 MONTHS	-7.33	11.55	-18.88	-8.33
3 YEARS (P.A.)	7.13	12.88	-5.75	6.00
5 YEARS (P.A.)	6.33	8.86	-2.53	5.20
SINCE INCEPTION (P.A.)	9.45	10.75	-1.30	8.28

Past performance is not a reliable indicator of future performance.



Source: Ellerston Capital..

For the month of June, the main detractors were overweight positions in Fletcher Building (FBU -5.5%), JB Hi-Fi (JBH -8.1%), Computershare (CPU -2.3%), Star Entertainment (SGR -7.8%) and Treasury Wine Estates (TWE -0.9%).

Having a zero holding in BHP (BHP +9.0%) and Newcrest (NCM +17.4%) also contributed to the Fund's underperformance.

The main positive contributors to this month's performance and again, not enough to effectively cover the weight of the detractors, were overweight positions in Bluescope Steel (BSL +14.3%) and Aristocrat Leisure (ALL +5.5%).

Having zero holdings in Westfarmers (WES -2.4%), National Australia Bank (NAB +0.9%), ANZ Bank (ANZ +1.2%), South32 (S32 -4.2%) and Lendlease (LLC -8.8 %) also contributed positively, albeit marginally.

[1] 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.

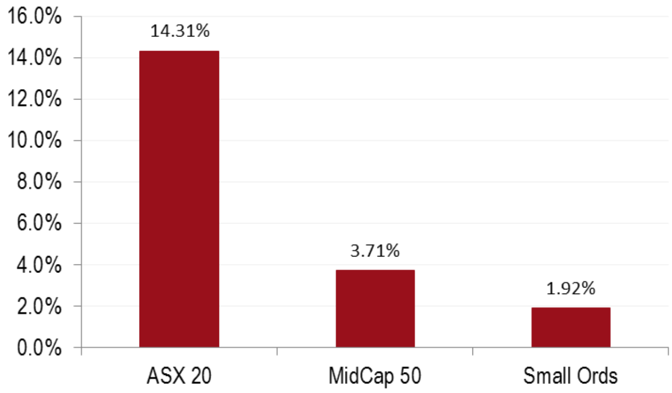
The Fund's 12 month performance has been totally unsatisfactory with market conditions not suiting our valuation-disciplined approach. In the financial year to end of June 2019, there have been some clear stock specific factors that have contributed to underperformance, coupled with non-stock specific factors like momentum, size and dividend yield.

At the start of the financial year, we expected volatility and we thought that we were well positioned for the reflation trade and anticipated higher interest rates in 2H18, but disappointingly, we unwound all our previous alpha generation and underperformed. The strategy which had been working until mid-way through CY2018, **unravelled when we encountered the "perfect storm"**:

- **Poor stock selection** this year predominantly in the **Materials** sector was the major performance detractor:
  - Namely, Nufarm, Bluescope, Fletcher Building.
  - Many of our core stocks suffered **significant de-ratings** (despite delivering on earnings e.g. Treasury Wine Estates).

- **Momentum, Size and Dividend Yield** were also key detractors:
  - ***Momentum*** worked against us with some of our biggest positions all moving meaningfully down in share price at the same time but for different reasons.
  - ***Size*** worked against us with Large Caps (ASX Top 20) significantly outperforming their Mid Cap peers by over 1,000 basis points and Small Ords by over 1,200 basis points during the year.

Performance for the 12-months to 30 June 2019. Our Ex-Top 20 Mid-Cap orientation hurt performance

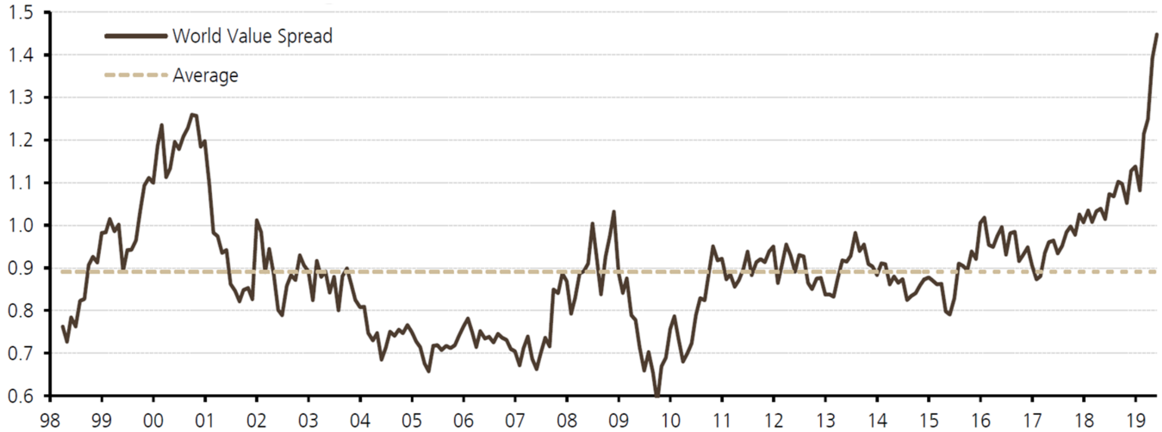


Source: RIMES, Morgan Stanley Research, Accumulation Returns

  - ***Dividend Yield*** worked against us (not banks) with our big underweight position in miners (BHP Group, RIO Tinto, Fortescue Metals Group) which paid special dividends to clear franking credits ahead of the federal election, particularly hurting. These stocks subsequently capitalised on the unforeseen immediate spike in iron ore prices post the Vale dam disaster in January 2019 and continued to pay healthy dividends.

- **Our zero Banks position has not impacted performance**, as the Banking sector was broadly a market performer for FY19 (Banks TR +10.1% versus the ASX 200 Accumulation Index return of +11.6%). The CBA return of 20.4% was the main driver, with ANZ, NAB and WBC all underperforming, with a total return of 6.0%, 4.8% and 3.9% respectively.
- Our **selectively contrarian and valuation disciplined approach** worked against us in FY19, as investors chased Growth and Momentum.

Valuation spread between Value and Growth stocks breaks through previous dot.com bubble peak.



Source: UBS European Equity Strategy, UBS Quant Group, 1 July 2019.

NB – P/Book spread between top and bottom tercile of stocks ranked by a Value composite measure of P/Book, PE and Dividend Yield. This is measured sector-neutral.

FUND ACTIVITY

In June, we strengthened Core positions (Treasury Wine Estates, BlueScope Steel, Orica, Macquarie Group and Flight Centre) and took further profits in JB Hi-Fi as the shares spiked towards $28.00 (we have now halved the position in JBH from where it was in January) as we look to reduce the portfolio's consumer discretionary, domestic retail exposure. We also trimmed the Fletcher Building position ahead of its investor day, as the shares rallied in anticipation of expected capital management initiatives to be announced.

NEW STOCKS ADDED	STOCKS EXITED
• None	• None

POSITIONS INCREASED	POSITIONS DECREASED
• Treasury Wine Estates	• JB Hi-Fi
• BlueScope Steel	• Fletcher Building
• Macquarie Group	
• Orica	
• Flight Centre	

FUND STRATEGY AND OUTLOOK

We remain committed to our bottom up, stock focussed strategy as we seek to identify mispriced stocks where earnings growth is underappreciated.

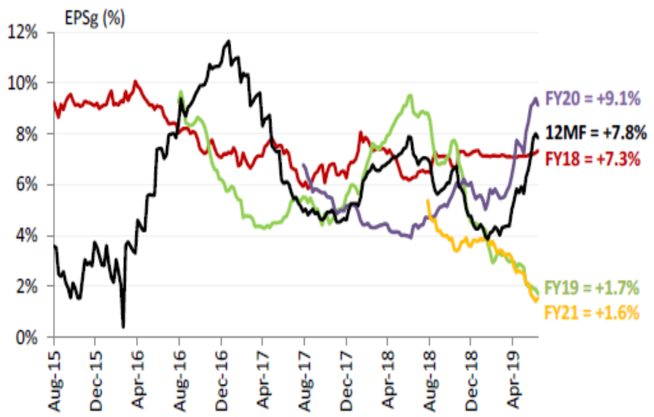
This month we have provided write-ups on two stocks – namely, Aristocrat Leisure and Woodside Petroleum – that are Core holdings in your portfolio and the reasons we consider them good long-term investments. We have also provided an updated view on the banks sector and the reasons we still remain cautious.

We reiterate our concerns on the sustainability of earnings ahead of the upcoming reporting season, which we approach with some trepidation given the markets complacency and valuation insensitivity.

Following the extended run of positive prints, taking CY19 gains to +20%, valuations continue to squeeze higher, despite a subdued earnings growth profile. Forward consensus multiples are now **22.5 times for the Industrials ex-Financials and may be justified in a historically low interest rate environment. The conundrum facing all investors of course, is: what is the correct discount rate to input?**

ASX 200 Industrials ex Financials

Annual consensus EPS Growth FY18 - FY21



Source: RIMES, IBES, Morgan Stanley Research.

We target the best longer-term stock opportunities and it is worth restating our segmented portfolio positioning:

1. Quality Franchises/ Defensive characteristics

Solid companies with strong/leading market positions and credible management with good balance sheets

Macquarie Bank, Computershare, Treasury Wines and Aristocrat

2. Businesses that are highly cyclical or seasonal in nature, facing certain headwinds

Companies with strong market positions and strategic assets, but very sensitive to economic conditions/seasonality/weather

Graincorp, Nufarm, JB Hi-Fi, Downer EDI, Star Entertainment, Flight Centre and Ooh Media

3. Turnarounds

Sound businesses that have historically generated poor returns, have been badly managed, under-earned versus their potential, are in transition, and where we think earnings/returns will improve over the medium term

Ignored by the market, contrarian positions

Orica, QBE, Janus Henderson and Fletcher Building

4. Deep Value Cyclical and Resource Plays

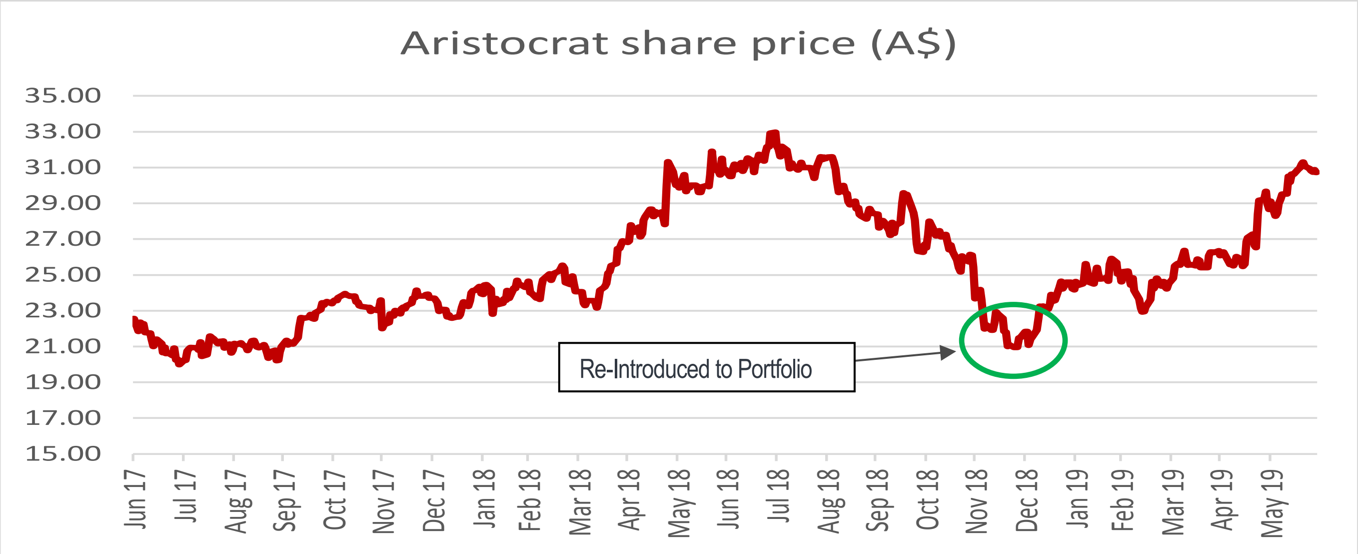
Stocks trading at discounts to NPVs, with growth optionality, where much of the heavy lifting has been done

BlueScope Steel, Woodside Petroleum and Origin Energy

Still **Zero Big Four Banks** (a position held for some years now)

Aristocrat Leisure (ALL)

Aristocrat made a return to your portfolio in December 2018 following a sharp pull back from recent highs of over $32.00. Since then, the share price has outperformed the S&P/ASX 200 Index by 20%. **So why is it still ~6% of the portfolio?** In short, the investment case is playing out as we expected. **There is still a long runway of growth ahead and that growth is not being appropriately reflected in the share price.**



Source: Bloomberg, Ellerston Capital Limited.

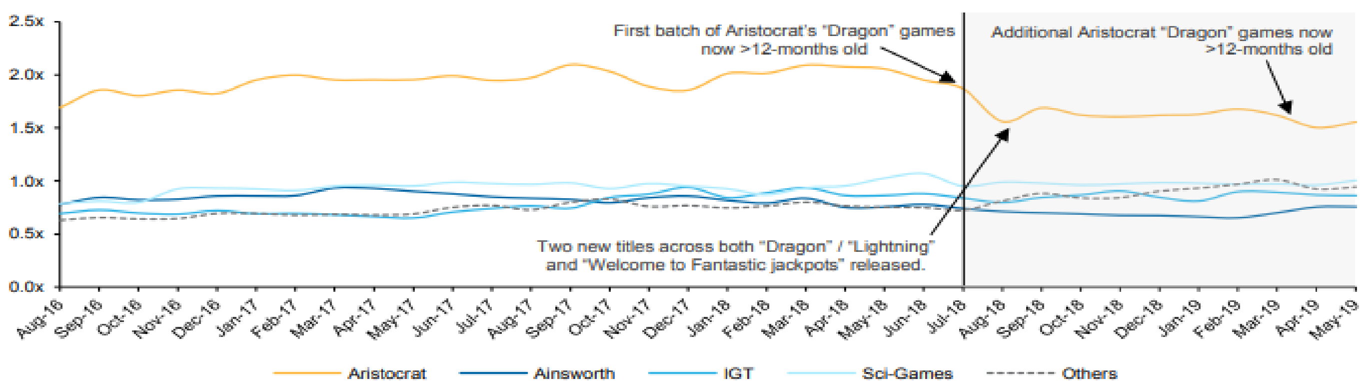
In the slot machine and game industry, the product cycle is all important. The number of machines and games sold in key markets (eg US and Australia) is typically stable from year to year. What does change, is manufacturer market share based on relative game performance. The significant operating leverage in these businesses means changes in customer preference (revenue) will have a material impact on earnings.

Aristocrat's game performance and best in class content remain market leading. In our view, ALL will continue to take market share from its rivals. In the US, the rollout of the Lightning Link family of games is nearing completion. But the Dragon Link franchise is far from saturation. The installation of more Dragon Link games at attractive fixed fee per day rates **will continue to see Aristocrat build its base of recurring revenue.** Aristocrat's total portfolio of games contributes approximately 28% of revenue for casinos, but only makes up 22% of the installed base (source: Eilers-Fantini game performance database). It makes economic sense for casino customers to add more Aristocrat games to their floor than to switc

h to a new game from most other manufacturers. Aristocrat is also expanding successfully into market adjacencies and regions where it previously had little or no presence - stepper, bar top, Washington CDS, Canadian VLT.

In Australia, both the Lightning and Dragon Link franchises are near saturation. But importantly, it is Aristocrat that has the best performing new title in the market - Welcome to Fantastic Jackpots. Aristocrat should be able to sustain its clear number one position in the Australian market in the near term. One just has to look at the Ainsworth Game Technology (AGI) share price, which has fallen from $4.00 to 67 cents (with a market cap of only $225m) to reach that conclusion. That said, Australia only makes up 15% of earnings for Aristocrat.

Fig 1 Australian new game performance (released within the last 12 months)

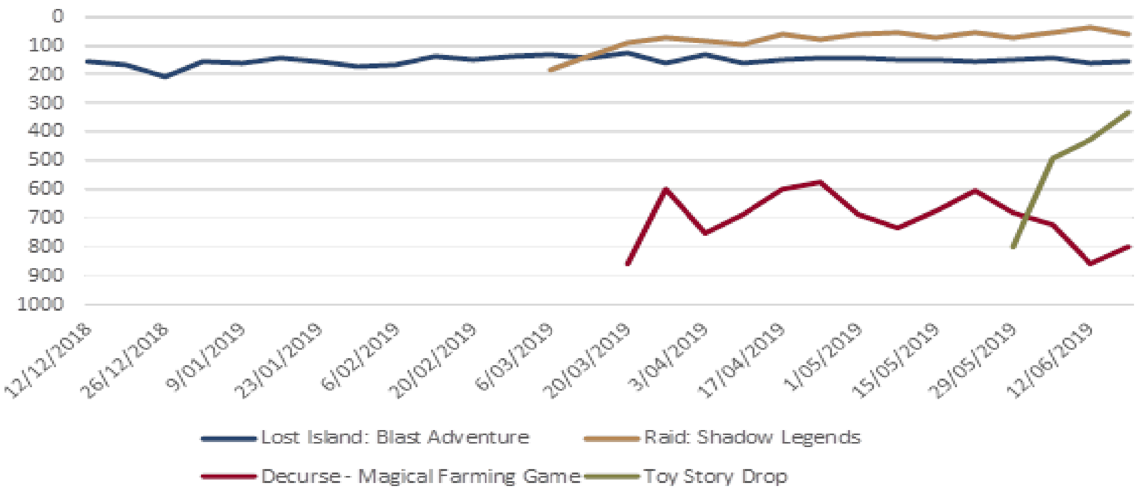


Source: AstuteBI, Macquarie Research, June 2019, * based on turnover share / installed base share

Aristocrat's Digital business is a market leader in an industry that is set to grow at circa high single digits for several more years. Misunderstanding of the digital business's earnings profile created the opportunity for us to buy back into Aristocrat in December. The market had seriously underestimated the amount Aristocrat needed to spend on user acquisitions to support new game releases and to sustain the revenue growth trajectory.

Early signs from that user acquisition spend are encouraging. The revenue uplift is coming through for new game releases Raid: Shadow Legends and Toy Story Drop. The social casino titles remain strong performers, aided by the release of new game features (collectibles, leagues).

New casual games (<1 year old) - Apple



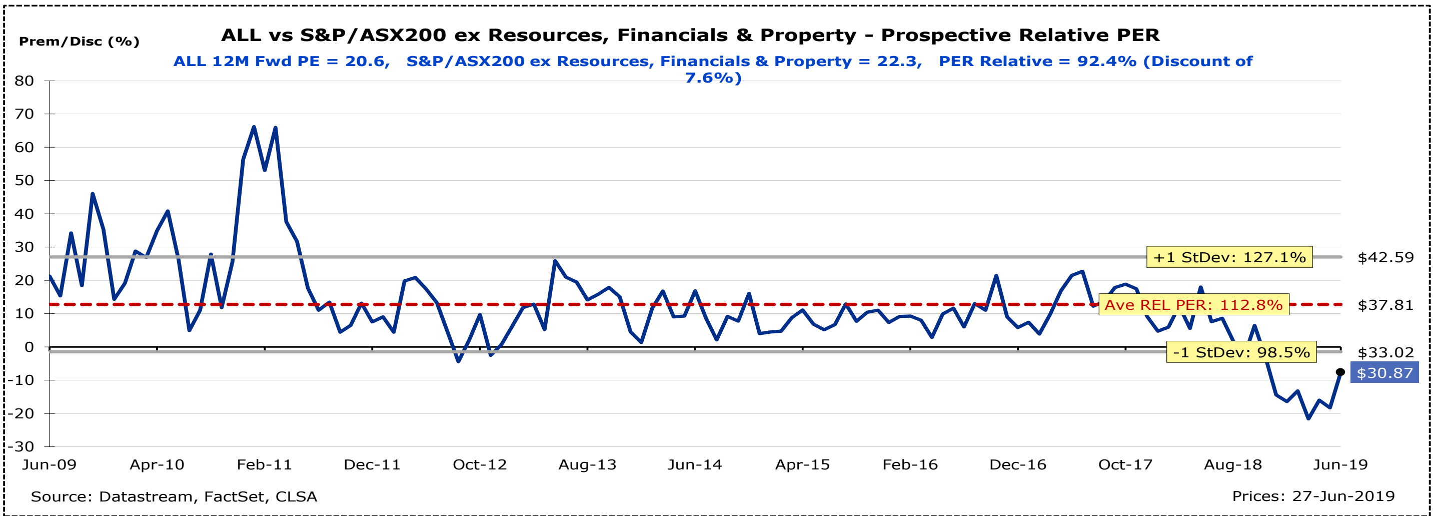
Source: Evans & Partners, selected Aristocrat new social casual games - gross revenue ranking in Apple App Store

The investment case for Aristocrat has evolved over the last few years from the successful launch of the Lightning and Dragon franchises, the company transforming acquisition of VGT, Digital social casino growth and new adjacencies. The investment case still has at least one more evolution to play out.

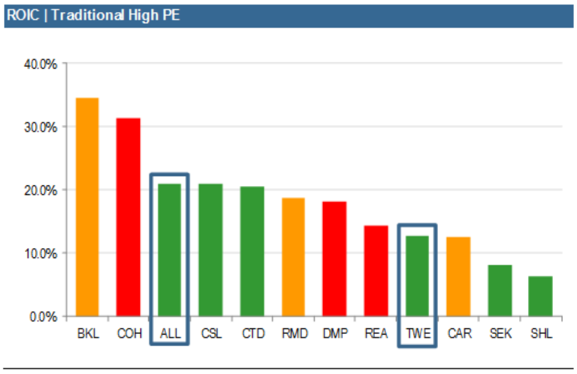
Aristocrat's Digital business has a very strong position in the social casino market and emerging presence in some segments of the social casual market. The social casual market is enormous and remains largely untapped/underpenetrated by Aristocrat. We would expect Aristocrat to enter additional segments of the social casual market, largely through content partnerships with small scale game development studios and even possibly through further M&A, just as the company successfully did in the land based market.

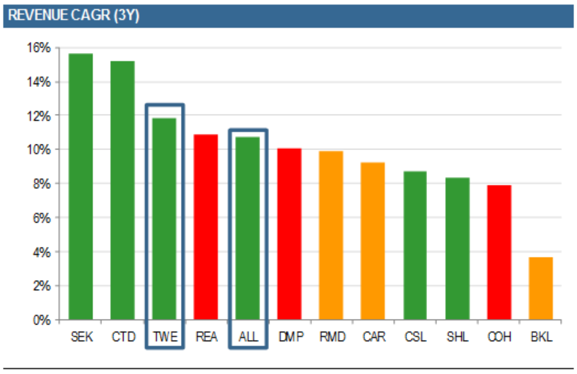
One of the beauties of the Aristocrat investment case is the strength of the balance sheet and the optionality it provides the management team who have in the past, executed well. The business is highly cash generative and gearing is declining at a rapid rate - ND/EBITDA should be less than 1.0x by FY20. The need to make acquisitions in the digital arena appears to have subsided, as Aristocrat looks to enter more content partnerships with smaller game design studios. A buy back or some other form of capital management may not be far away.

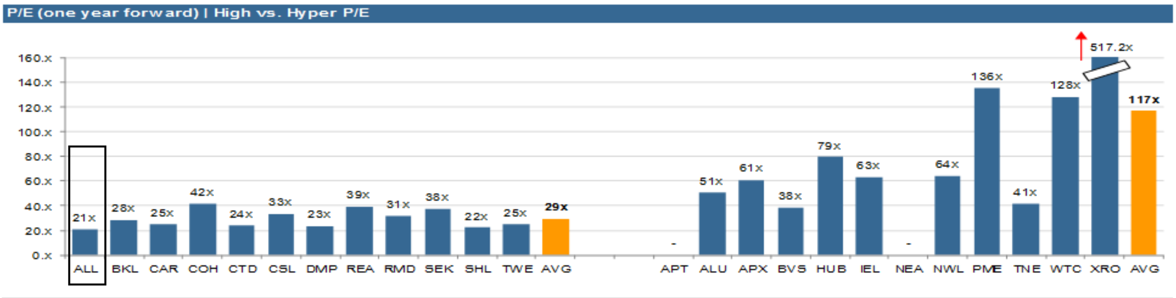
Market share gains in the land based casino market in the US, stable earnings in Australia and the Rest of the World and continued growth from the digital business is likely to deliver earnings growth at approximately 13% pa for the next three years. Yet Aristocrat continues to trade at a discount to Australian Industrials and on earnings multiples that imply an imminent sharp earnings decline. The recent listing of the digital business SciPlay from close competitor Scientific Games, trading at 14-15x EBITDA, only reinforces the relative attractiveness of Aristocrat's valuation, less than 13x EBITDA.



Further evidence of the relative attractiveness of Aristocrat is visible in a comparison with the 'traditional high PE' and 'hyper-PE' stocks. Aristocrat's revenue growth and return on capital profile is at the upper end of the range for the group but trades at a more attractive multiple than the peer group.







Source: JP Morgan

Aristocrat represents relatively attractively priced growth in an Australian market where growth is prohibitively expensive.

Aristocrat will remain a significant position in your portfolio while the market underestimates the delivery of its growth profile.

Woodside (WPL): Why it's still 7.5% of your Portfolio

WPL's Burrup Hub concept to drive medium to long term growth potential:

We view WPL as a tier 1, quality defensive stock within the Australian E&P sector given its solid leadership, low-cost operations, strong balance sheet **and ability to pay healthy, fully franked dividends (payout range 50-80%).**

Over the past 12 months, WPL has outperformed its closest ASX-listed Energy peer Oil Search (OSH) by 28% as its business benefitted from relative capital flexibility, a stable regulatory outlook and strong cash flows to progress on its three Horizons of growth to 2025.

WPL is in a privileged position of generating a globally competitive EBITDAX Margin of ~70%, with its superior production CAGR of ~7% from Calendar 2018 to 2025 to be phased over the next decade. The first phase of growth will be driven by the ramp up of Wheatstone and start-up of Greater Enfield (in 2H of 2019). WPL's Australian LNG projects - North-West Shelf, Pluto T1 plus T2, and Wheatstone account for the bulk of the company's valuation and attraction.

Ramp-up of Wheatstone will progress over the next 12 months, combined with commissioning Greater Enfield oil to support a 6% production CAGR to 2020, ahead of its ASX-listed peers, followed by Senegal, Scarborough and Browse. WPL's two largest brownfield development projects, Scarborough and Browse, which will be leveraging off existing infrastructure, are long-dated. Both present significant upside when fully commissioned (guided capex of ~US$11bn on the development of Scarborough and ~$US15bn on the development of Browse in 2018 real terms, with FIDs targeted for 2020 and 2021 respectively).

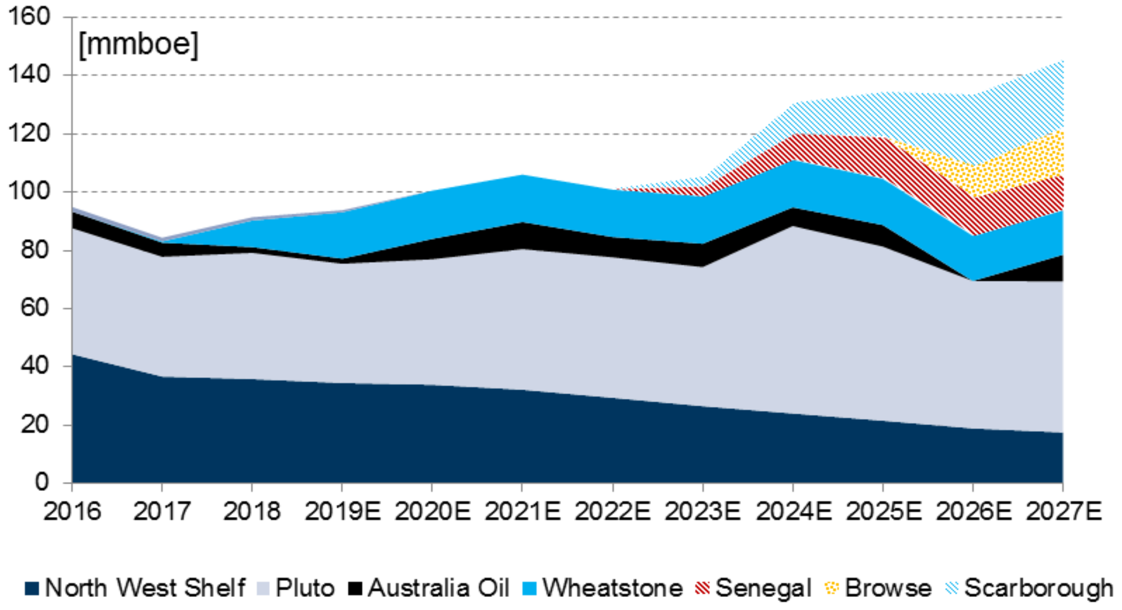
The key to a re-rating of the stock rests with the progression of these major projects. WPL is gradually de-risking from this current capex cycle and we believe this is not reflected in the current share price.

Next steps to de-risking these projects include the signing of a tolling agreement in the 2H 2019 to support alignment of the infrastructure JV partners in the Burrup Hub with the upstream field developers. After which FID on Scarborough and Browse is expected in 2020 and 2021 respectively.

Finally, ahead of FID on Scarborough, we expect Woodside to farm-down some of its interest in the development. Woodside currently owns a 75% interest and the farm-down is expected to support a de-risking of valuation for the asset.

In the near term, production growth is comfortably ahead of its peers at 7% from 2019 to 2020, versus a sector average of 1.3%.

WPL's strong earnings and production growth profile.

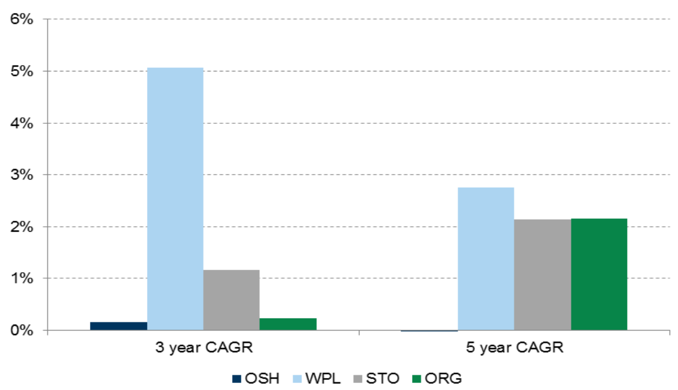


The Burrup Hub project and the development of the Scarborough and Browse projects combine with Senegal development and Woodside's base portfolio to deliver ~45% production from 2019 to 2025.

Our DCF for the company increases steadily to A$49.97 over time (2025 forward valuation).

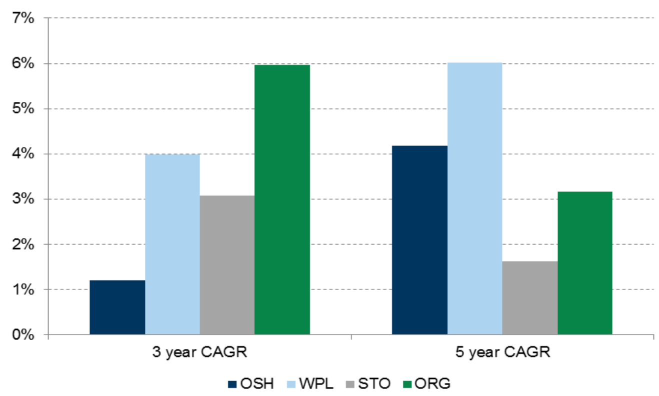
Production CAGR growth versus peers

2018-21/23: normalised for Santos acquisition of Quadrant Energy

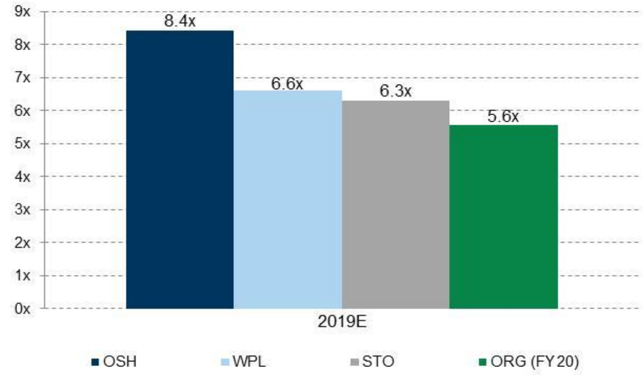


EBITDA CAGR growth versus peers

2018-21/23: normalised for Santos acquisition of Quadrant Energy

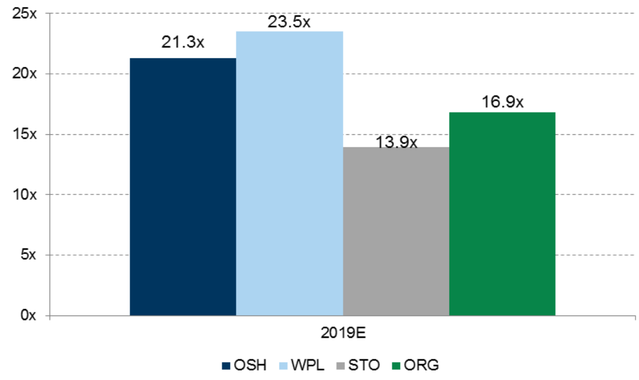


EV/EBITDA versus peers



EV/2P versus peers

Conversion of Scarborough and Browse to 2P Reserves lowers Woodside's EV/2P multiple to 12.1x on current capex guidance

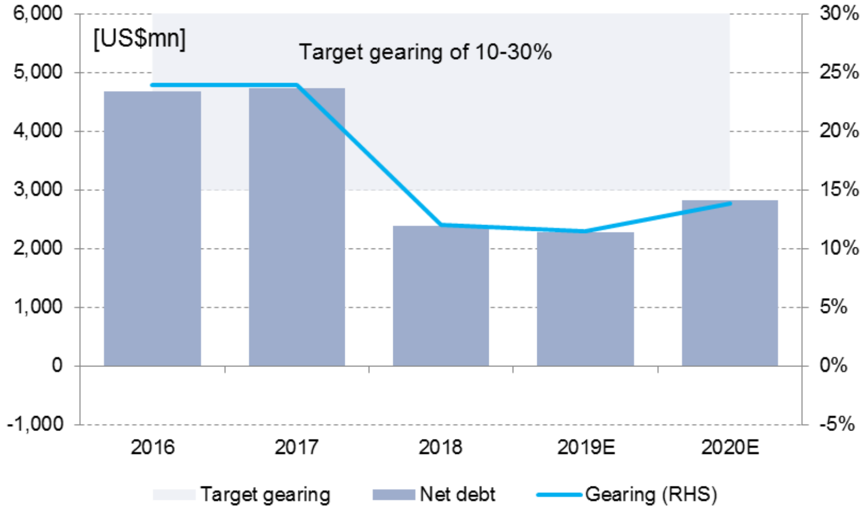


Source: Goldman Sachs Research, June 2019

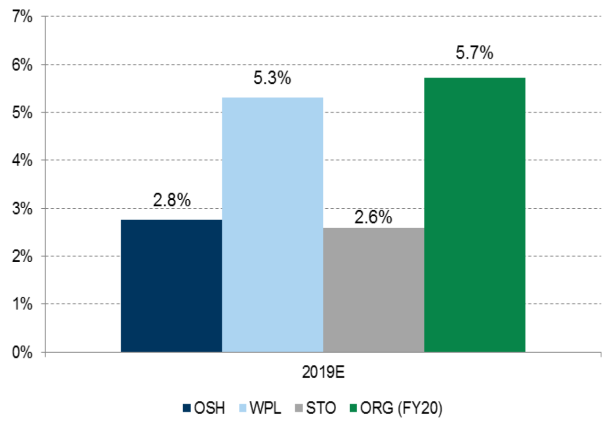
WPL's balance sheet remains pristine and should have limited funding requirements ahead of target FID. **On an 80% EPS payout ratio and a US$65/bbl brent oil price to 2025, Woodside (on our current estimates), is expected to cumulatively yield ~$17.04 per share by 2025, equivalent to an average annual yield of 7.7% versus the ASX-listed peers trading on an average yield of 2.9% on a 12 month forward basis.**

Target gearing

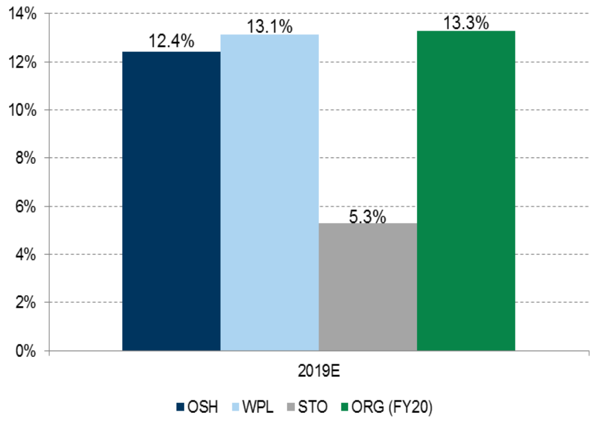
Woodside raised US$1.95bn in February 2018 to strengthen its balance sheet ahead of its next phase of growth



Dividend Yield versus peers



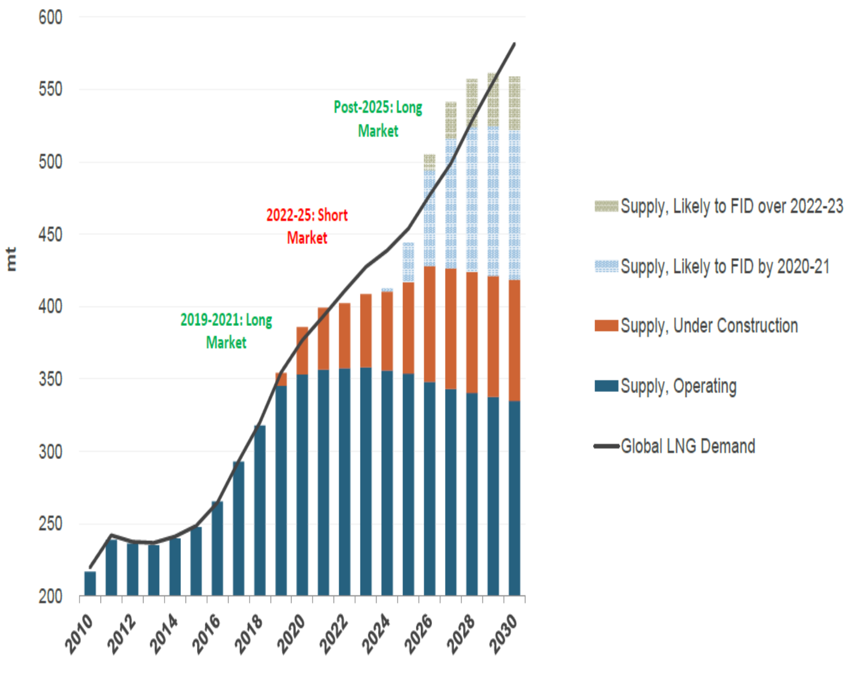
FCF yield verses peers



Risks:

Any major production or timing disruption to a key facility or to a new project, would have serious ramifications for earnings and valuation. WPL is exposed to the cyclicality of the Oil and LNG markets, where periods of short term over/under supply drive price volatility.

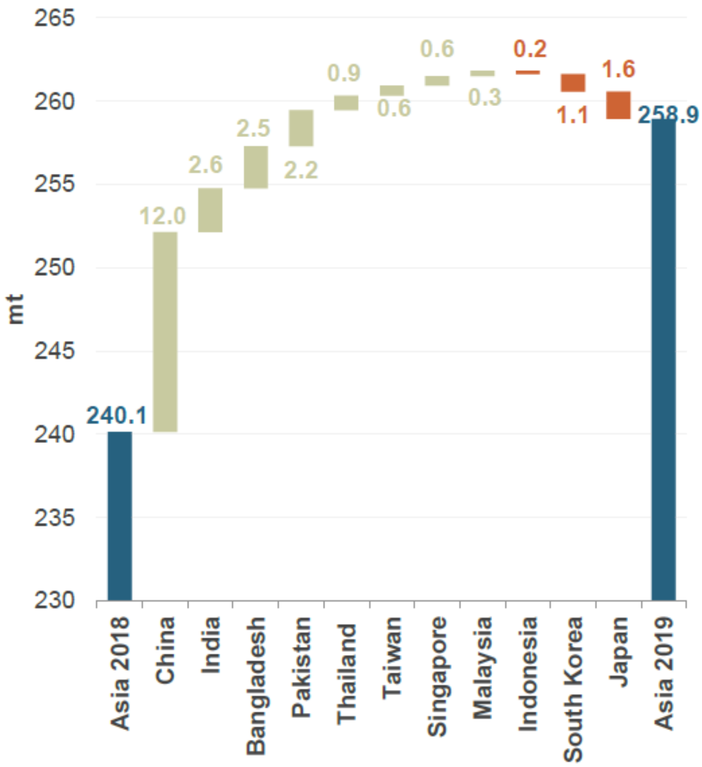
Global LNG Supply-Demand Balance, China's environmental and cleaner air drive should underpin the longer term demand for LNG.



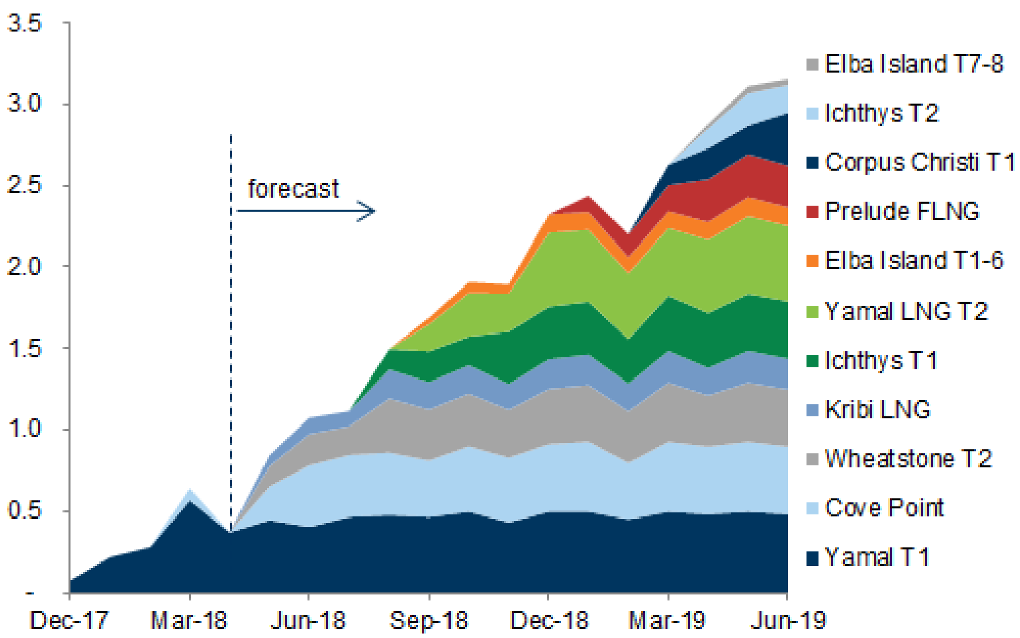
*The above supply numbers factor in unplanned outages from 2019 onwards

Source: CLSA, FGE, Dr. Fereidun Fesharaki, May 2019

Asian LNG Demand (2019 vs 2018)



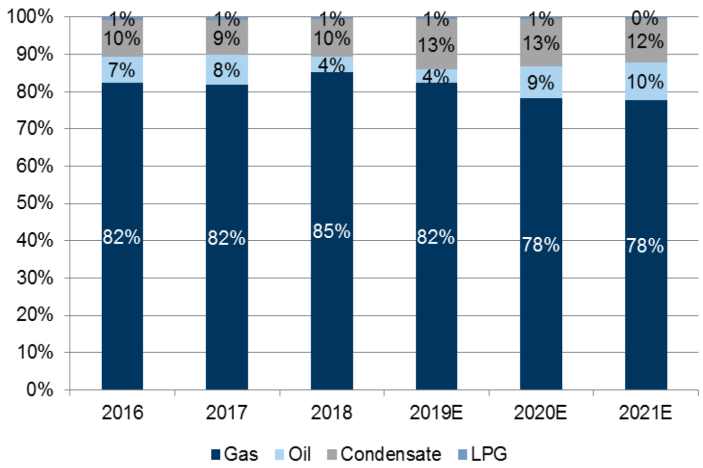
Downside risks to LNG spot prices and contract repricing with new Trains listed below



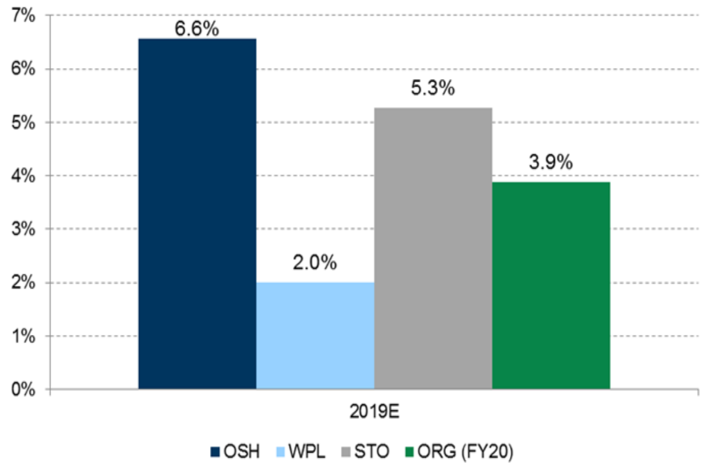
LNG spot price volatility is mitigated by:

(i) Woodside's long term LNG offtake agreements underpinning the historical investments in the Karratha and Pluto gas plants;
(ii) A rising contribution of oil production to earnings (from Greater Enfield coming into production) which accounts for 22% of production in 2021, up from 14% in 2019;

Greater Enfield and Wheatstone drive a ramp-up in oil & condensate production from 14% to 22% of production from 2018 to 2021



EBITDA sensitivity to US$5/bbl oil move vs peers



(iii) Furthermore, we expect Woodside to underpin its growth projects with long term contracts equivalent to at least 40% of production.

Banks – remain cautious

Since the surprise re-election of the Coalition government on 18 May 2019, the major banks have rallied strongly as the policies proposed by Labor – changes to negative gearing, capital gains tax and franking credit rebates – viewed as risks, were no longer relevant. APRA also proposed that it would revise the buffer and minimum floor rate when assessing loan serviceability – effectively removing the 7% floor and introducing a buffer of 2.5% over a loan's interest rate, leading to speculation that this could spur credit growth. In early June, as expected, the RBA cut the overnight cash rate by 25bps to 1.25% and signalled further cuts.

Following the post-election rally, the 'Big Four' do not offer compelling value.

The banks' EPS growth forecasts can be attributed mostly to promised cost control, low impairment charges and the impact of likely buy-backs (for ANZ and CBA in particular). Importantly, loan growth, net interest income and non-interest income remain under pressure. The prospects of a credit crunch are now less likely: the regulators have eased conditions in the hope of stimulating credit growth. But we believe excessive optimism is being factored into prices, as tighter income and expenditure verification continues, wages remain subdued and economic growth is the lowest in 10 years.

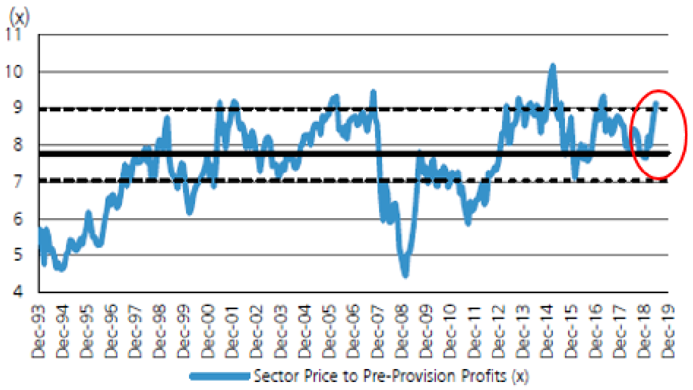
Falling official interest rates will put pressure on net interest margins: banks will be pressured to pass on the majority of RBA rate cuts, and with deposit products approaching zero and 3-year bonds now below 1%, NIMs will fall as hedges roll off. This should reduce **current forecast earnings, dividends and returns. A further 0.25% cut in the RBA cash rate broadly impacts earnings negatively by approximately 4% for the Big 4, and closer to 8% for the regionals (over the next few years) given the banks' inability to re-price already low interest rate-bearing deposits. Dividends will be cut!**

Additionally, the **pressure on returns from higher capital requirements** has not disappeared: while the RBNZ has been less aggressive in public recently, nothing would suggest that they are backing away from requiring higher Core Equity Tier 1 (CET1) capital as previously stated.

Also, APRA is yet to disclose its new capital requirements with respect to risk weights for mortgages, their response to the RBNZ's proposals and whether "unquestionably strong" capital positions still equates to having CET1 of 10.5% or some higher level.

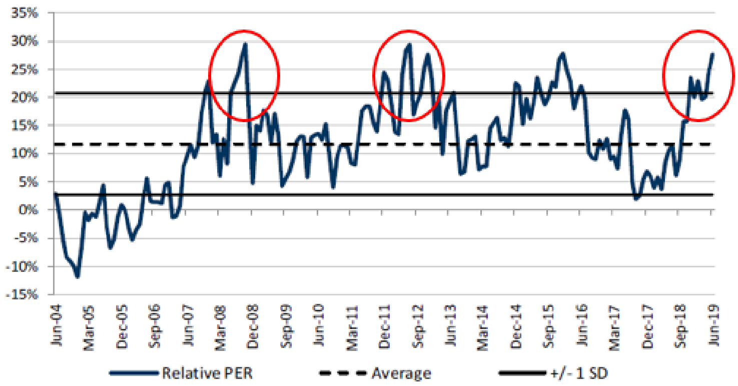
The banks don't offer compelling value:

Sector trading at +1 std. dev over historical Price to pre-provision profit



Source: UBS, June 2019

PER – CBA relative to the Banks sector (ex-CBA)



Source: Goldman Sachs, IRESS, June 2019

The bank sector's pre-provision profit multiple looks stretched given earnings risks especially from lower rates. **And by way of an individual stock example, CBA is trading at a 28% premium to peers currently – in over 20 years, CBA's PER has never been over 30% more expensive versus peers!**

An expectation of mid-to-high single digit credit growth in the near-term could be a triumph of hope over reality. The RBA, in its latest statement, noted subdued consumer spending and investor demand for credit. The consumer remains very indebted, wages remain subdued, verification of income and expenditure is stricter, and economic growth is the lowest in 10 years. In the context of challenged earnings, and structural and cyclical headwinds, we believe that earnings, dividends and returns are subject to further downgrades.

The risk to our view on the banks are: a stronger pick up in credit growth and the absence of credit impairments.

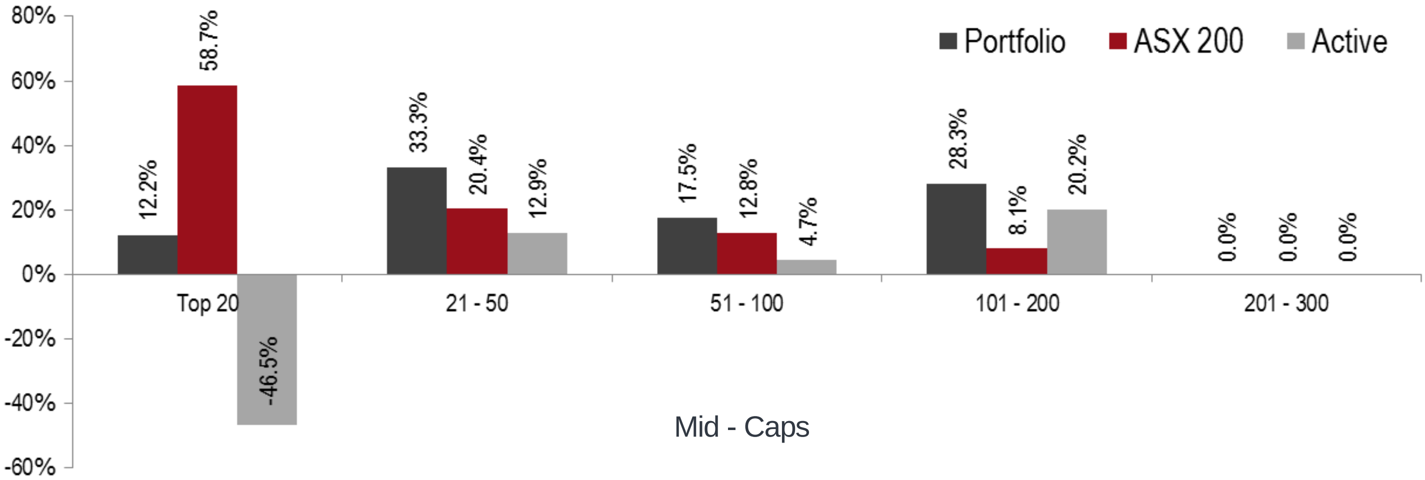
Warm Regards,

Chris Kourtis

Portfolio Manager

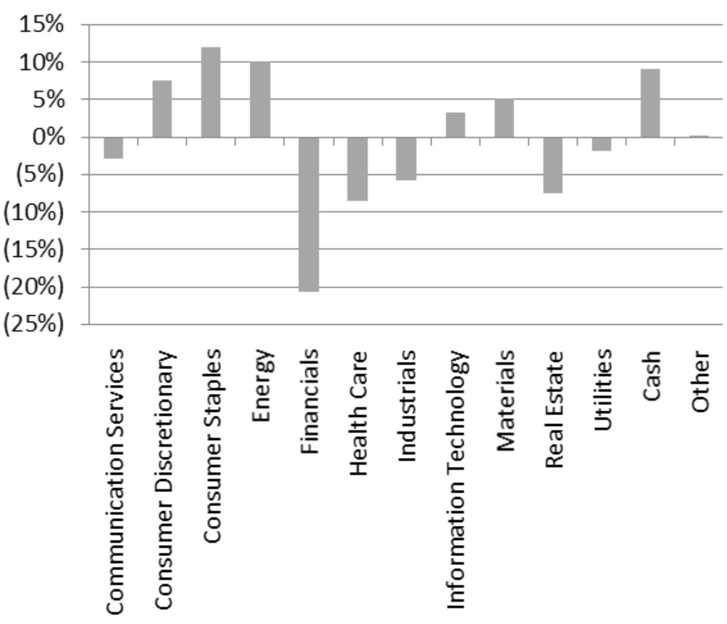
PORTFOLIO FEATURES

Size comparison Chart vs ASX 200^



^Size Comparison Data as at 2 July 2019
Source: Bloomberg, Ellerston Capital Limited

Active Sector Exposures*



Source: Ellerston Capital Limited

TOP 10 HOLDINGS**
ARISTOCRAT LEISURE
BLUESCOPE STEEL
COMPUTERSHARE
FLETCHER BUILDING
GRAINCORP
NUFARM
ORICA
ORIGIN ENERGY
TREASURY WINE ESTATES
WOODSIDE PETROLEUM

* 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	$3.2 BILLION
FUNDS UNDER MANAGEMENT – ASF UNIT TRUST	$48 MILLION
APPLICATION PRICE	$0.9438
REDEMPTION PRICE	$0.9390
NUMBER OF STOCKS	19
INCEPTION DATE	1 APRIL 2009

Source: Ellerston Capital Limited

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