

Ellerston Australian Small Companies Fund

Performance Report | August 19

PERFORMANCE SUMMARY

Performance	1 Month	3 Months	6 Months	1 Year	2 Year p.a.	Since Inception (p.a.)
Net [^]	-1.58%	3.50%	1.86%	-4.29%	8.53%	9.05%
Benchmark*	-3.85%	1.41%	4.14%	0.95%	11.12%	8.00%
Alpha	2.27%	2.09%	-2.28%	-5.24%	-2.59%	1.05%

Source: Ellerston Capital

[^] The net return figure is calculated after fees & expenses. Past performance is not a reliable indication of future performance

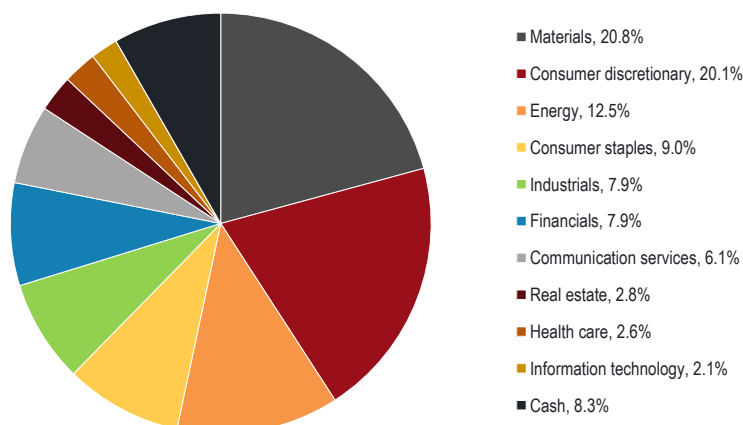
*S&P/ASX Small Ordinaries Accumulation Index

PORTFOLIO CHARACTERISTICS

HOLDINGS

Top 5 holdings	Sector	%
Cooper Energy Limited	Energy	4.3%
A.P. Eagers Limited	Consumer Discretionary	3.5%
Elders Limited	Consumer Staples	3.3%
Ausdrill Limited	Materials	3.3%
Bapcor Ltd	Consumer Discretionary	3.2%

SECTOR ALLOCATION



Investment Objective

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

Investment Strategy

The Fund's active, research-driven approach seeks to identify a concentrated portfolio of smaller companies with sound businesses, attractive earnings profiles and supportive industries, which are trading at a discount.

Key Information

Strategy Inception	10 October 2013
Portfolio Manager	Michael Courtney
Application Price	\$0.9377
Net Asset Value	\$0.9354
Redemption Price	\$0.9331
Liquidity	Daily
No Stocks	49
Management Fee	1.25%
Performance Fee	20.5%
Buy/Sell Spread	0.25%/0.25%
Fund FUM	\$9 Million
Strategy FUM	\$792 Million

COMMENTARY

The Ellerston Australian Small Companies Fund fell -1.58% in August, outperforming the ASX Small Ordinaries Accumulation Index which fell -3.85%. During the month, the Small Industrials Accumulation Index fell -3.00% whilst the Small Resources Accumulation Index fell -7.03%.

The largest contributors to positive attribution were West African Resources (WAF), Smart Group (SIQ), and AP Eagers (APE). The gold price rose almost 7% in August, taking the CYTD gains to just under 19% in USD terms. The move sparked some rapid upward moves in gold stocks with West African Resources rising 35% for the month. At spot gold price, the business still trades at a discount to NPV, versus the large producers, which trade at multiples of NPV. The discount is justified as the company is still building its gold project in Burkina Faso, with first production expected in the second half of next year. Although we like this high grade project, single site businesses in construction do have significant risks and we reduced our holding into the share price strength to a more reasonable position size. Smart Group delivered a half year result which was ahead of market expectations, boosted by sales strength in the last few months of the half. The business had de-rated significantly in the first half of the year due to a lack of major acquisitions and benign organic growth due to difficult economic conditions across the industry. The improved profit performance has caused the business to be re-rated by the market to a more appropriate PE ratio. AP Eagers continued to rally in August after reporting a profit result that was ahead of market expectations. The market is also expecting that we have reached a low point in car sales and like-for-like numbers will turn positive over the next 6 months, resulting in improved profit growth. As we have discussed previously, the take-over of AHG will result in significant synergies being extracted across the business initially. Over the medium term, an improved sales and cost focus should see AHG margins equal the margins that AP Eagers are able to deliver, resulting in a significant profit uplift.

The largest detractors from relative returns were Cleanaway (CWY), Syrah Resources (SYR), and Tassal Group (TGR). After many halves of reporting numbers that exceeded market expectations, Cleanaway delivered a miss on broker consensus numbers. At the full year result they also took the opportunity to manage down market expectations for growth in FY20. The current issues around recycling have impacted profitability and the collapse of SKM Recycling in Victoria should create opportunities for a vertically integrated business like Cleanaway to address the problem in a profitable manner. The business remains one of the highest quality industrial stocks domestically, however, due to valuation we had been reducing our position size over the last few months. The retracement of the share price back to \$2 has created upside to valuation and we have been increasing our position size again. Post another capital raising in July this year, Syrah remains well capitalised to manage the longer than expected ramp up to profitability of its graphite project. The China-US trade dispute is having an impact on demand and internally the business has struggled to produce the higher grade products that were promised in the BFS. The latter issues will likely be solved with time and experience with operating the Balama plant. The trade issue timeline is less predictable, and the timing of producing commercial grade amounts of spherical graphite in the USA, which is really the major value driver of the project. Tassal undertook a 15% capital raising during August to accelerate production in the newly acquired prawn business. The funds will allow for the acquisition of another property in Queensland and expansion at the existing Proserpine property. The raising is dilutionary in the short term, hence impacting the share price negatively. However, longer term this will allow another growth business to develop at the same time as the salmon business is maturing in Tasmania, due to the lack of new lease availability. The investment thesis is that Tassal can repeat the success of developing salmon as an everyday purchase in supermarkets, with prawns. On face value, prawn aquaculture seems to be simpler than salmon, with less environmental issues, a shorter working capital cycle and higher margins.

OUTLOOK

A combination of trade talk rumblings and a reporting season that saw substantially more downgrades than upgrades in Small Cap Industrials weighed on the market in July, reversing the gains of June. The portfolio has held up well during the volatility. The recently completed reporting season has thrown up some opportunities to add to several investments and reduce holdings in others. The economic environment remains difficult, but many of the domestic stocks that rallied during July had seen substantial de-ratings over the previous year and we benefitted from a large overweight to domestic cyclical stocks. The resources sector and valuations in this space still remain attractive and we retain an overweight position in this part of the market. Generally, we are underweight defensive names which remain expensive on many measures.

Regards,

Michael Courtney - Portfolio Manager

All holding enquiries should be directed to our registrar, [Link Market Services](https://linkmarketservices.com.au) on 1800 992 149 or ellerston@linkmarketservices.com.au

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Should investors have any questions or queries regarding the fund,
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