ELLERSTON CAPITAL

Ellerston Australian Share Fund (ASF)

Performance Report | September 19

PERFORMANCE SUMMARY

Net %	1 Month	FYTD 2020	CYTD	1 Yr	3 Yr p.a.	5 Yr p.a.	Strategy Since Inception p.a.
ASF	5.37	8.73	13.47	-0.67	5.21	6.93	8.94
Benchmark	1.84	2.37	22.56	12.47	11.88	9.50	10.72

Past performance is not a reliable indicator of future performance.

MARKET COMMENTARY

Market Overview

Equity markets were up strongly in September, with Developed Markets up 2.2% in US dollar terms and Emerging Markets up 1.9%. Globally, September marked the 2nd largest monthly outperformance of global value vs. growth in the past decade. Investors positioned themselves in extreme "risk off" positions, which combined with a sustained period of value underperforming, saw a sharp rotation back towards value as global bond yields rose. Not surprisingly, the US Federal Reserve cut rates for the second time this year, and the European Central Bank announced a comprehensive stimulus package. Financials and Energy stocks were among the strongest performers. Markets rallied despite central banks' concerns over a global growth slowdown, as evidenced by announcements of further monetary and fiscal stimulus.

USA

The S&P 500 Index and the Dow Jones Industrial Average Index were in the black in September, returning +1.9% and +2.1% respectively. The NASDAQ was also in positive territory, but with a more modest return of +0.5%.

US economic data was mixed: manufacturing ISM missed, falling to 49.1 (consensus: 51.3, previous: 51.2) but composite non-manufacturing bounced to 56.4 (consensus: 54, previous: 53.7). Also, non-farm payrolls missed, rising to 130,000, which was below consensus of 160,000. The Federal Reserve cut rates by 25 basis points, taking the benchmark rate to 1.75% - 2.00%, however, President Trump tweeted that he wanted a more aggressive move down. Trade tensions simmered in the background but were off the front pages for now.

Europe

European equities were much stronger across the board, with the Euro Stoxx returning +4.3%. In a dovish surprise, the index was pushed higher after the ECB announced a fresh 5 point comprehensive stimulus package. The deposit rate was cut further into negative territory after the ECB re-launched a QE program of Euro 20bn of asset purchases per month.

Among the major markets, Germany's DAX was one of the strongest performers with a return of +4.1%, followed by France's CAC 40 which returned +3.7%. In the UK, MPs voted to control the parliamentary agenda backing a bill to stop a "no deal" Brexit by 31 October, whilst towards month end, Britain's Supreme Court ruled Johnson's suspension of Parliament unlawful. The FTSE 100 bounced sharply, up almost 3%, but economic data in Europe continued to moderate: flash Eurozone manufacturing PMI for September missed, falling to 45.6 (consensus: 47.3, previous: 47.0) and the composite PMI moderated to 50.4 (consensus: 52.0, previous: 51.9), justifying further stimulus from the ECB.

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	$0.9660
Liquidity	Daily
Application Price	$0.9684
Redemption Price	$0.9636
No Stocks	19
Management Fee	0.90%
Buy/Sell Spread	0.25%
Performance Fee	15%

Ellerston Capital Limited
ABN 34 110 397 674
AFSL 283 000

Level 11
179 Elizabeth Street
Sydney NSW 2000

Ph: +61 2 9021 7797
Fax: +61 2 9261 0528

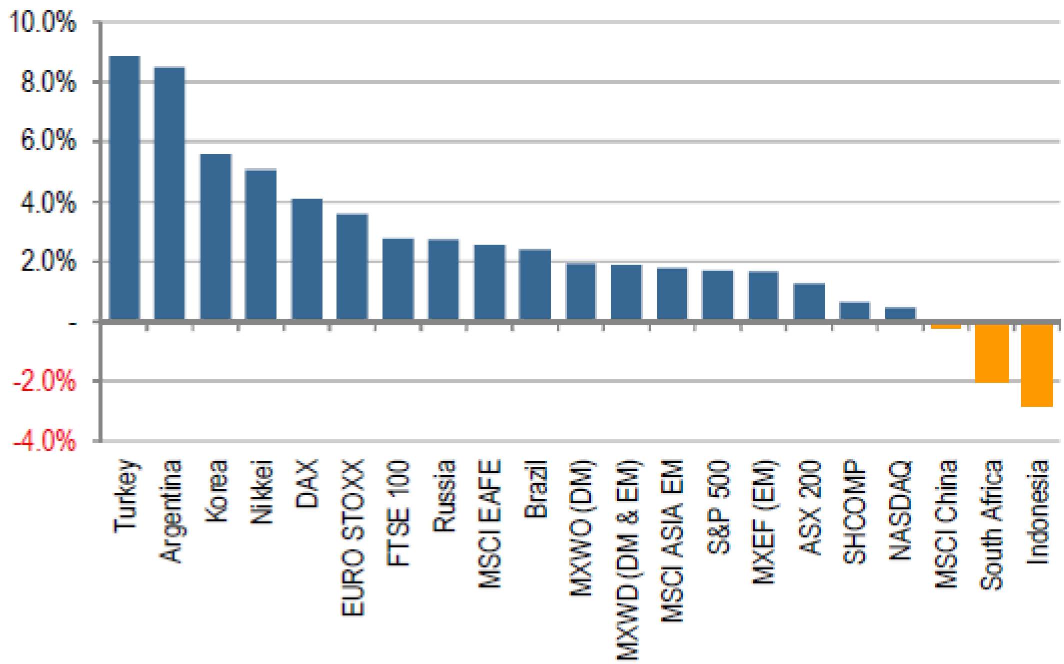
info@ellerstoncapital.com
www.ellerstoncapital.com

Asia

Asian equities were also stronger in the month as talk of global stimulus tempered the extreme bearishness of investors. Despite the protests in Hong Kong intensifying, the Hang Seng Index was up 1.9%. Japan's Nikkei 225 was the best performer of the major markets, up +5.7%, followed by Korea's KOPSI Composite Index which was up 4.8%.

Chinese economic data was broadly weaker. The trade surplus of $34.8 billion was below expectations (consensus: $44.3 billion), and September manufacturing PMI fell to 49.8, again below consensus expectations of 49.6. The Chinese SSE Total Market Index delivered a very modest return of +0.4%.

Global Equity Markets' Performance in the month of September 2019

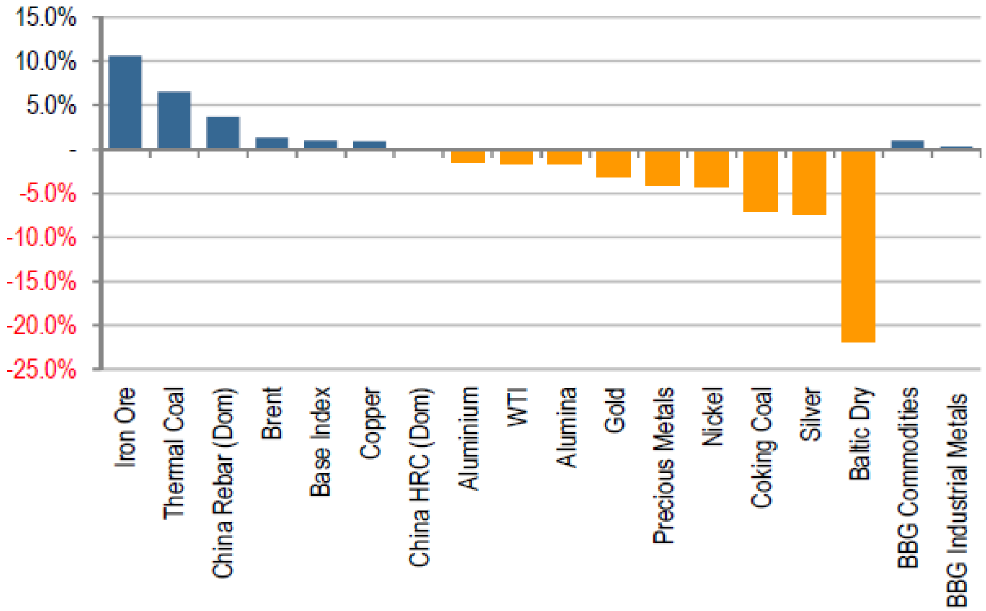


Source: JP Morgan, Bloomberg.

Commodities

The commodities index was up in September. Among the Bulk commodities, Iron Ore rebounded and closed up 10.6% to US$93.8/t, Coking Coal was down 7.1%, but Thermal Coal rose 6.5%. The Base Metals Index was stronger up 1.0%, with Copper up 1%. Nickel was the laggard, down 4.4%. Oil prices were volatile in the month as two Saudi oil processing facilities were attacked by drones. The facilities were shut down for immediate repairs, which resulted in 5.7mb/d or over half of Saudi Arabia's total oil production temporarily being cut (around 5% of global oil supply). Brent Crude oil futures prices initially surged 15%, but as production was brought back on line, the oil price retraced from those highs. Brent soon normalized and ended the month +1.4% or US$59.25/bbl. Precious metals were weaker as a "risk on" mindset took hold: Gold was down 3.2% and silver was down 7.3%.

Commodity Performance in September 2019



Source: JP Morgan, Bloomberg.

Bonds

Despite ongoing weakening global economic data, the relentless compression in bond yields came to a shuddering halt, with global bond yields rising sharply in early September, but then drifted lower. US 10-year bond yields rose 18 basis points to 1.68%. In the US, August retail sales and consumer sentiment were better than expected and this may have contributed to the sell-off in US bonds. The Norwegians bucked the trend and lifted their official rates, causing the Krone to rally. Australian 10-year bonds rose 7 basis points to 0.96% and are now 72 basis points below 10-year US yields.

Australia

The S&P/ASX 200 Accumulation Index ended the month up 1.8%. The index is now up 22.6% for the calendar year to date.

In September, the best three performing sectors in terms of their contribution to the index's performance were Financials (+4.1%, with all the major banks up strongly), Materials (+3.1% driven mainly by BHP Group and Rio Tinto) and Energy (+4.7% with Oil Search up 11.5%). The bottom three sectors were Health Care (-2.5%), Real Estate (-2.3%) and Communication Services (-3.0%). The ASX 200 Resources Accumulation Index was the best performer, with a return of +3.0%. The Small Ordinaries Accumulation Index returned +2.6%, while the ASX 200 Industrial Accumulation Index rose 1.6%.

The top five stocks that detracted from the performance of the S&P/ASX 200 Accumulation Index were CSL (-15 points), Telstra Corporation (-14 points), Newcrest Mining (-10 points), Dexus (-6 points) and a2 Milk Company (-6 points).

The top five stocks that added to the positive index return were dominated by the big banks, including National Australia Bank (+36 points), Australia and New Zealand Banking Group (+29 points), Westpac Banking Corporation (+28 points), BHP Group (+27 points) and Commonwealth Bank of Australia (+18 points).

The RBA September minutes were more dovish than expected and business confidence fell further. In early October, the RBA cut rates by 25 basis points taking official rates to 0.75%. The RBA is widely expected to cut rates by a further 25 basis points in the coming months.

The Australian dollar was up marginally against the US dollar, and ended the month at 0.68 cents.

COMPANY SPECIFIC NEWS

The Market Misses

Pro Medicus (PME -24.3%)

Founders selling shares in market darlings is never an encouraging sign. So the decision by PME's founders to offload 1 million shares each in September spooked investors, causing a large share price correction that also coincided with broader weakness in share prices of technology companies. The founders have committed to retaining the balance of their holding (27% of the company) until at least February 2020.

CYBG PLC (CYB -18.4%)

CYB stunned the market and announced a further increase in its legacy payment protection insurance (PPI) costs of between GBP300 million and GBP450 million. While the increase was broadly in line with the industry, the quantum was material relative to CYB's market capitalisation, significantly higher than expectations and negative for earnings and capital. This and Brexit risks saw earnings cut materially and the stock was sold off aggressively.

Appen (APX -18.2%)

With the tech sector under broad pressure during the month, APX de-rated post it tough 1H19 result. The performance of Figure Eight, which was recently acquired, got off to a slow start and alarm bells rang that the US$300m price tag was over the odds.

Resolute Mining/ Evolution Mining (RSG -15.0%/ EVN -12.5%)

A 4% decline in the gold price in Australian Dollar terms during the month weighed heavily on the entire gold sector, including EVN and RSG.

Bravura Solutions (BVS -14.5%)

After a strong rally in August on the back of its FY19 results, profit taking continued for the software company. It wasn't helped by an ASX enquiry into the late lodgement of a retiring director's final holding notice.

Webjet (WEB -10.8%)

The company has been a casualty of the collapse of UK travel company, Thomas Cook. WEB was forced to write off ~$44m in receivables in addition to lost revenue from B2B sales.

A2 Milk (A2M -10.3%)

A2 Milk hosted their inaugural Strategy Day in Beijing during September, with the presentation focused on demonstrating the size of the international opportunity, specifically in China and the US. Management continued to re-iterate their focus on investing for the long-term, which has resulted in a greater degree of margin uncertainty related to the years ahead.

Sims Metal Management (SGM -9.5%)

The scrap metal market continued its volatile run and caught SGM in the crosshairs. On Sep 16, the company warned that 1H20 would be materially lower than 1H19 as volumes, ferrous and non-ferrous prices and freight costs all went in the wrong direction, causing Sims Metal shares to fall 13% on the day.

The Market Hits

Bellamy's (BAL +73.6%)

On the 16th September, Bellamy's announced that they had agreed to be acquired by China Mengniu Dairy Company Limited for $13.25, comprised of $12.65 cash and a $0.60 per share fully franked special dividend. The $1.5 billion acquisition price represents an enterprise value of 30 times normalised FY19 EBITDA.

Speedcast International (SDA +58.1%)

SDA is a clear example of when no news can be good news. After two profit warnings across July and August, which caused the stock to plummet from $3.50 to $0.75, the selling dried up and the share price bounced.

Premier Investments (PMV +30.3%)

PMV's FY19 results delivered a rebound in sales in its domestic apparel operations, with like-for-likes up 7.8%. In addition, the new wholesale model for Smiggle got off to a very strong start, with 180 doors opened during the year. With the shares significantly underperforming the sector over last 12 months, the catch up was swift.

IOOF Holdings (IFL +30.3%)

IFL's shares rallied strongly after the Federal Court threw out that the case brought by APRA against the former CEO and Chairman. This led to a relief rally and was followed by more positive comments from sell-side analysts. Winning the case was seen by the market as removing one of the risks overhanging the completion of the acquisition of OnePath from ANZ, which if completed would be accretive to earnings.

Western Areas / Independence Group (WSA +25.8% / IGO +19.9%)

The decision by the Indonesian government to bring forward the ban on the export of unprocessed nickel ore to December 2019 from January 2022 continues to provide strong support for nickel prices and nickel producers such as WSA and IGO. Nickel prices are up 12% since late August 2019.

Costa Group (CGC +20.2%)

After reporting a weak half year result and guiding to further uncertainty for the calendar year 2019, the stock has rebounded strongly as focus reverts back to the long term opportunities and speculation of a take-over.

Blackmores (BKL +18.8%)

With no company specific news during the month, BKL's September performance can be attributed in part to a bounce following its poor result in August (BKL was down 19.6% in Aug) and some read-through from the Bellamy's acquisition, demonstrating Chinese interest in Australian-based consumer goods companies.

Nufarm (NUF +17.0%)

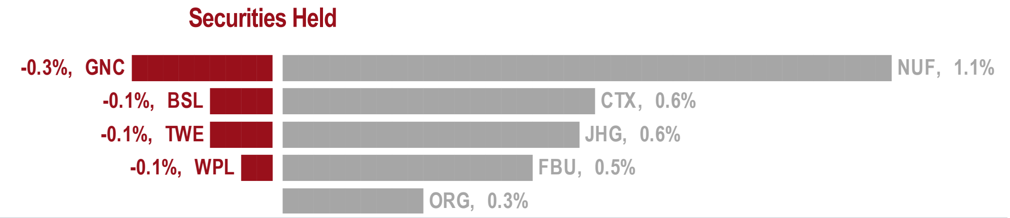
Nufarm surged 26.5% on the day after the company announced the sale of its Latin America business to Sumitomo for an eye watering sum of $1.188 billion, which came at a very attractive price (12.3x EBITDA), enabling the company to eliminate the balance sheet risk that the market had become fixated on. Management and investor focus can now shift back to the underlying crop protection and seeds operations, without the balance sheet distraction.

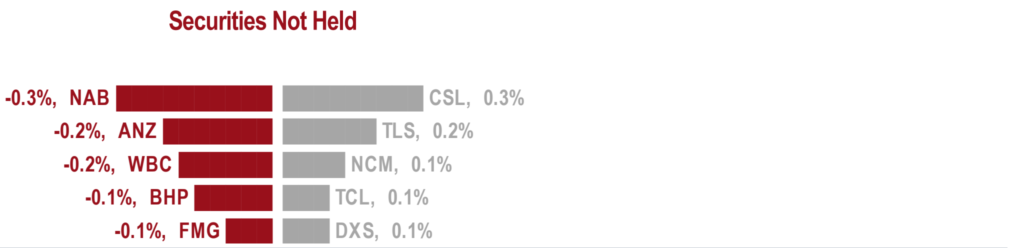
FUND PERFORMANCE

Despite being zero weighted to the best performing sector in September (with Banks up an impressive 4.9%), the Fund managed to outperform the benchmark return by a solid 362 bpts, capping off a strong Quarter and kicking off the new Financial Year on a positive footing.

RETURNS[1] (%)	GROSS	BENCHMARK*	EXCESS	NET
1 MONTH	5.46	1.84	3.62	5.37
2020 FYTD	9.02	2.37	6.66	8.73
CYTD	14.39	22.56	-8.17	13.47
ROLLING 12 MONTHS	0.42	12.47	-12.05	-0.67
5 YEARS (P.A.)	8.07	9.50	-1.42	6.93
SINCE INCEPTION (P.A.)	10.12	10.72	-0.61	8.94

Past performance is not a reliable indicator of future performance.





Source: Ellerston Capital..

The main positive contributors to this month's performance, were overweight positions in Nufarm which rebounded sharply (NUF +17.0%), Caltex (CTX +11.3%), Janus Henderson (JHG +15.6%), Fletcher Building (FBU +14.2%) and Origin Energy (ORG +6.6%).

Having zero holdings in the miners and other well held stocks were also a reasonable contributor to performance, with CSL (CSL -2.4%), Telstra Corporation (TLS -5.7%), Newcrest Mining (NCM -6.1%), Transurban Group (TCL -1.7%) and Dexus (DXS -7.5%) all underperforming the market.

The main detractors were overweight positions in Graincorp (GNC -1.0%), Bluescope Steel (BSL -3.3%), Treasury Wine Estates (TWE +0.2%) and Woodside Petroleum (WPL +0.8%).

Having a zero holding in National Australia Bank (NAB +8.6%), ANZ Bank (ANZ +6.6%) Westpac Bank (WBC +5.0%), BHP Group (BHP +4.4%) and Fortescue Metals Group (FMG +13.4%) also constrained returns.

[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.

FUND ACTIVITY

In September, the Fund was again highly active.

We introduced Goodman Group into the portfolio. We also continued to strengthen Core positions (namely Aristocrat Leisure, Caltex Australia, Downer EDI, Flight Centre and James Hardie Industries). Following the strong recovery in share prices from recent lows, we took the opportunity to selectively reduce the Fund's positions in Bluescope Steel, Computershare, Fletcher Building, Janus Henderson and Origin Energy.

We also took profits and sold some of the stock we received in the Macquarie Group placement at $120, as the stock rallied hard following the completion of the equity raising. We continue to have material exposure to Macquarie Group as its investment case remains attractive.

We have provided a write up on Goodman Group, Aristocrat (following a field research trip to the US) and Nufarm (after the sale of its Latam business).

NEW STOCKS ADDED	STOCKS EXITED
• Goodman Group	

POSITIONS INCREASED	POSITIONS DECREASED
• Aristocrat Leisure	• Bluescope Steel
• Caltex Australia	• Computershare
• Downer EDI	• Fletcher Building
• Flight Centre	• Janus Henderson Group
• James Hardie Industries	• Macquarie Group
	• Origin Energy

Goodman Group

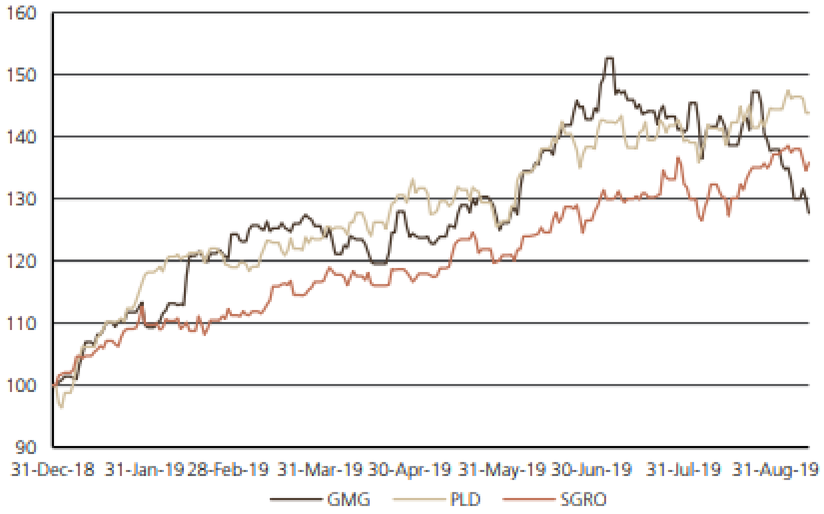
Goodman Group (GMG) is an integrated owner, developer and manager of industrial properties with operations across Australia, Europe, Asia and the Americas. GMG is a clear leader in providing property solutions for increasingly sophisticated logistics problems, with Amazon included as one of its many key clients. Its integrated platform for the development and management of property assets reminds us of how Macquarie Group created a dominant position in infrastructure. financing, which underpinned decades of growth for the company. It is GMG's market leading position in providing property solutions and enduring income streams, that has captured our interest.

Post the sharp correction in its share price, in part driven by index exclusion, a valuation window opened to invest in an attractive company given:

- Robust Global demand for warehouses and industrial assets driven by e-commerce and last mile delivery,
- Significant development pipeline, with completions expected to average $4 billion per annum,
- Management fee growth from increasing Asset Under Management driven by new development completions,
- Strong performance fees from rental growth in their current portfolio of well-located infill assets and compression in cap rates from investor demand for logistics,
- A very strong Balance sheet with 9% gearing supported by a low and sustainable payout ratio at 50% of Adjusted Net Profit.

Since GMG's share price peaked in early July 2019 at $16.10, the stock has underperformed its global peers by ~18% (SEGRO & Prologis) and underperformed the Australian market by 14% despite management reporting FY19 annual EPS growth of 10.5% (above the already upgraded guidance of 9.5%). Whilst FY20 EPS guidance of 56.3cps, implying 9% growth, is below consensus expectations of 57cps, Goodman Group has a history of both upgrading and beating guidance throughout the year.

GMG performance YTD versus peers (Segro and Prologis)



Source: Factset, UBS

As was well telegraphed to the entire market, effective the 20th of September, Goodman Group was removed from the FTSE EPRA NAREIT Index (previous weight: 1.1%) as it generates >25% from development activities. The deletion triggered passive selling of approximately 50 million shares, representing 1.9% of GMG shares outstanding. This had been widely expected by the market and was a key driver of its underperformance relative to the broader AREIT Index and Australian market.

The liquidity event has provided the opportunity to initiate a core position in this high quality, defensive growth security. GMG currently trades at 23.5x FY20 PER, offering 12%/8%/9% growth for FY20/21/22 respectively, broadly in line with the ASX 200 ex Financials, which has virtually no profit growth.

We value GMG at $15.61 using a 50% weighting to Discounted Adjusted FFO and 50% weight to a Net Asset Value SOTP.

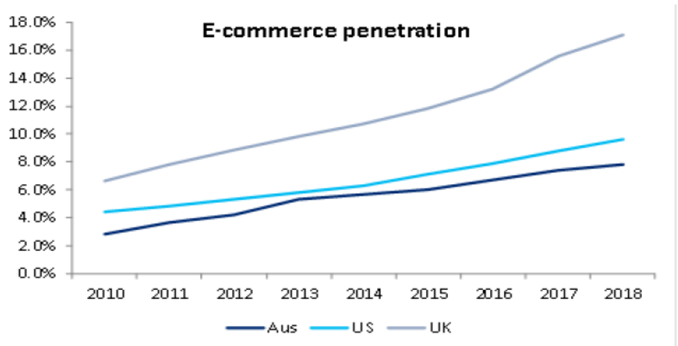
	EPS FY20	PER FY20	EBIT FY20	Debt	Net Debt	Equity	Implied EV/EBITDA	Target Price	Upside /(Downside)	Weighting
AFFO						29,959	25.2x	16.52	19%	50.0%
NAV						26,662	22.5x	14.70	6%	50.0%
Mixed	56.2	27.8x	1,243	2,975	1,320	28,310	23.8x	15.61	12.7%	100.0%

Implied Yield	2.2%
Implied PER	24.6x

Source: Ellerston Capital

Goodman Group is set to further benefit as its **Net Tangible Assets (NTA) and cash flow are leveraged to the growing demand for logistics centres from the expansion of e-commerce and last mile delivery**. We especially see significant room for logistic rents to grow as retailers face competitive pressure to move their distribution online. Consumers are demanding faster delivery times and the estimated warehouse space required for e-commerce is 2.5x greater than a traditional distribution model. We believe that while online sales have grown substantially over the last decade there is still a long way to go, as they remain a low percent of overall sales in GMG's key markets.

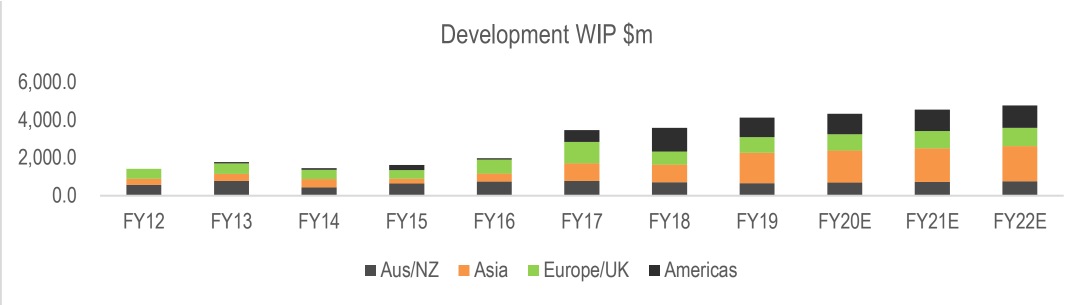
Figure 18. E-commerce penetration continues to rise across markets



Source: Citi Research, NAB-Quantium, US Census Bureau, Thompson Reuters Datastream

GMG has successfully repositioned its portfolio, through asset sales in secondary locations and redeployed funds into land constrained. Prime infill locations to ensure they are able to benefit from these trends. We estimate GMG's property portfolio will be able to achieve at least mid to high single digit rental growth over the medium to long-term. This is through a combination of annual fixed rent escalators and positive releasing spreads.

Goodman has also capitalised on strong investor demand for logistics assets with **Assets under Management (AUM) growing at a five year CAGR of 14%, with a further $10bn development pipeline to be completed over the next 3 years.** Importantly this locks in future development earnings and management fee growth.



Source: Ellerston Capital

We also expect performance fees to remain elevated for the medium term as;

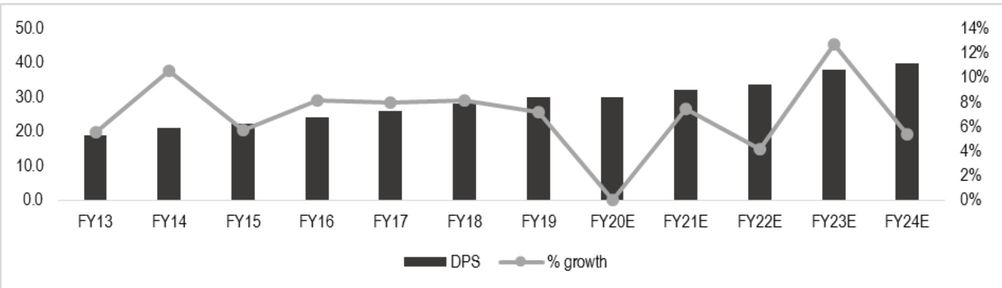
- Cap rates compress further driven by investor demand for industrial assets, Preqin estimates there **is $327billion in unspent commitments** (dry powder) raised by real estate PE needing to be deployed on a finite number of assets; and
- IRR requirements (used for performance fee measurement), which are often linked to government bond benchmarks, continue to decline.

Scenario Analysis:

Bear	Base	Bull
11.6% Downside	12.7% Upside	37.1% Upside
Management fees: 80bps assumes no further performance fees, reduce to 13x **Cap rates**: assumes 50bp increase in FY20 and FY21 **AUM and development**: -15% reduction in AUM growth forecast over 5 years and no additional developments	**Management fees**: 110bps (80bps base, 30bps performance) in FY20/21 reducing to 100bps **Cap rates**: assumes 25bp decrease in FY20 and FY21 **Asset under management**: 30% AUM growth forecast over 5 years. This compares to 90% over the previous 5 years	**Management fees**: 120bps (80bps base, 40bps performance) in line with FY19, increase to 20x **Cap rates**: assumes 50bp decrease in FY20 and FY21 **Asset under management**: 50% AUM growth forecast over 5 years

Source: Ellerston Capital

GMG retains a **pristine Balance sheet, supported by a low and sustainable payout ratio at 50% of Adjusted Net Profit,** allowing the firm to execute on its significant development pipeline. While GMG's gearing increased from ~5% in FY18, it remains conservatively geared at 9% in FY19. Goodman intends to fund further equity contribution to its development pipeline through internally generated cash (having decreased their payout ratio to 50% from 55% - 65%) and asset sales. Goodman Group has guided to flat dividend growth in FY20 due to decreasing the payout ratio, however have a history of growing dividends post GFC. It is not a distribution yield story.



Source: Ellerston Capital

Aristocrat Leisure (ALL) - Insights from our recent research trip to the US

Meeting with executives and industry participants from peers, competitors and suppliers to companies listed on the ASX is a key part of our investment process. It provides additional insight and a more complete picture of trading conditions, industry behaviour, outlook and appropriateness of company strategy when formulating our investment thesis.

For that reason, we spent a week on the road in the west coast of the USA to further develop our understanding of the US digital and land-based gaming businesses within ALL. These businesses contribute ~75% of Aristocrat's earnings and represent the key investment debate in the market. **So what did we learn?**

When it comes to the traditional land-based business for ALL in the US, everything appears on track for further earnings growth. Entry into new adjacencies and geographies, along with market leading game content and performance means ALL is likely to continue to gain share across almost all segments of the slot machine market - for-sale video and stepper, class 2 and class 3 gaming operations (leased machines), bar top, video lottery terminal (VLT), Washington State and Canada.

In the gaming operations (premium leased games) segment, our channel checks showed that customers remain very satisfied, not only with the market leading performance of games under the Lightning Link and Dragon Link franchises, but also with the competitive fixed fee per day pricing. It is this attractive fixed fee per day rate that will ensure the existing products stay on the floor well after the three-year depreciation life of the machines. The fixed fee per day model will be adopted for the rollout of the new wide area progressive jackpot game, Dollar Storm, at a higher rate than the current installed base.

In bar top, ALL is entering a segment of the market that competitor, IGT, has always dominated and held ~95% market share. Limited competition in this segment means there has been a lack of innovation. The average age of the 90,000 bar top machines installed in the US market is relatively old and ripe for a refresh. ALL's product offer will incorporate its long time number one slot game, Buffalo, alongside traditional bar top poker and keno games that should help bar owners improve turnover and yield on machines. ALL only needs to take 10-20% market share in bar top for the extra sales to be material to profit. An easily achievable goal, given the intentions of the buyers that we spoke to.

Conversations with players in the digital game industry highlighted several key insights. The cost of developing a game for the mobile market is not prohibitive (<$10 million). While it is important to get game play right, a good game is a just a ticket to the dance. Other aspects of ongoing game management will determine how profitable the game will be, including:

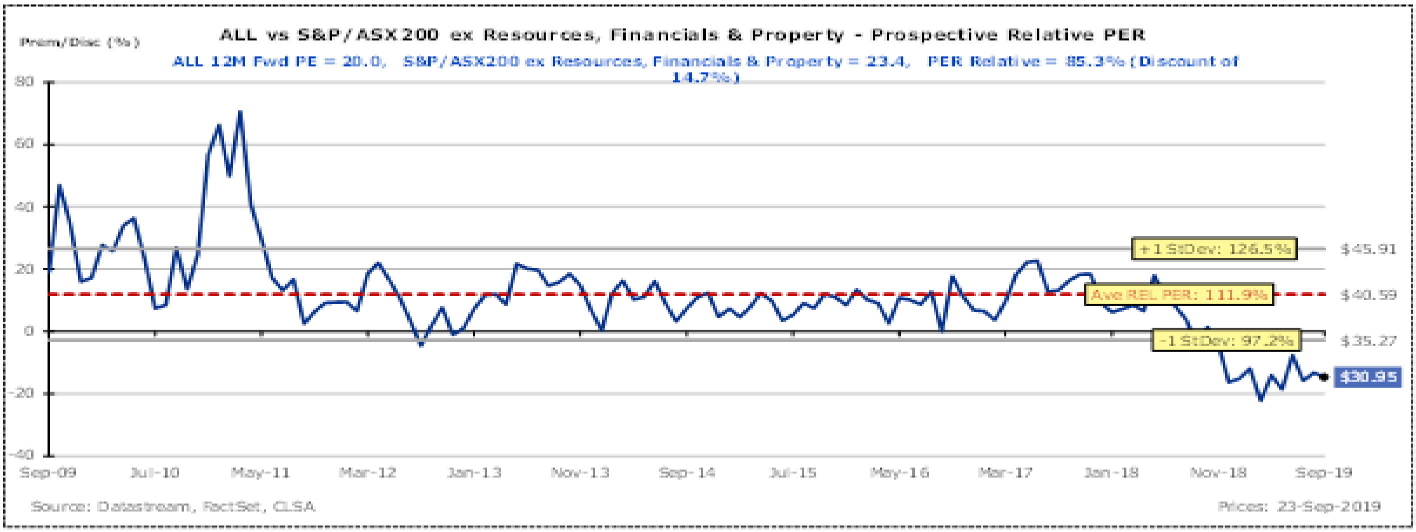
- Game development process. Do not rush the release of a game. Player expectations have increased over time, so a focus on quality over quantity makes the most sense. Developers need to utilise soft launches in small markets and pre-release testing to decrease game launch risk.
- **User acquisition (UA) costs - this line is critical.** UA is the largest cost item in digital gaming. UA spend needs to be allocated efficiently, dynamically managed and not wasted on inferior games.
- Live operations and social features. These so called 'meta' features are key to monetisation and game life extension. Players need to be given a reason to come back regularly that can be based upon a limited time event, reward or 'guilt' (for example, sense of obligation to other 'clan' or club members in the game).
- Advertising revenues. Advertising execution in-game remains an opportunity for improved monetisation, albeit the industry has gotten better at in-game advertising in recent years. It remains the primary way to monetise the majority of players that will never make in-app purchases in free-to-play games.
- Diversify talent sourcing. The operation of game development studios in a variety of locations, particularly developing countries, reduces talent poaching risk and provides as much as a 4-5 times cost advantage over game studios located on the US west coast.

Encouragingly, most of ALL's Digital strategy, capability and game development process encompasses these best practice aspects, albeit, it is fair to say, execution is 1-2 years behind the industry leaders.

Our research trip only reinforced our conviction in the ALL investment case. Barring any disasters, continued market share gains in ALL's key land based casino market in the US, stable earnings in Australia and in the Rest of the World and further growth from the digital business is likely to deliver very solid earnings growth of approximately 13% per annum for the next three years. Yet Aristocrat continues to trade at a discount to Australian non-Bank Industrials and on earnings multiples that imply an imminent sharp profit decline.

This is a classic case of mispricing of a growth stock: ALL is trading at a very attractive valuation multiple in the Australian market, where investors are paying prohibitive multiples for growth generally.

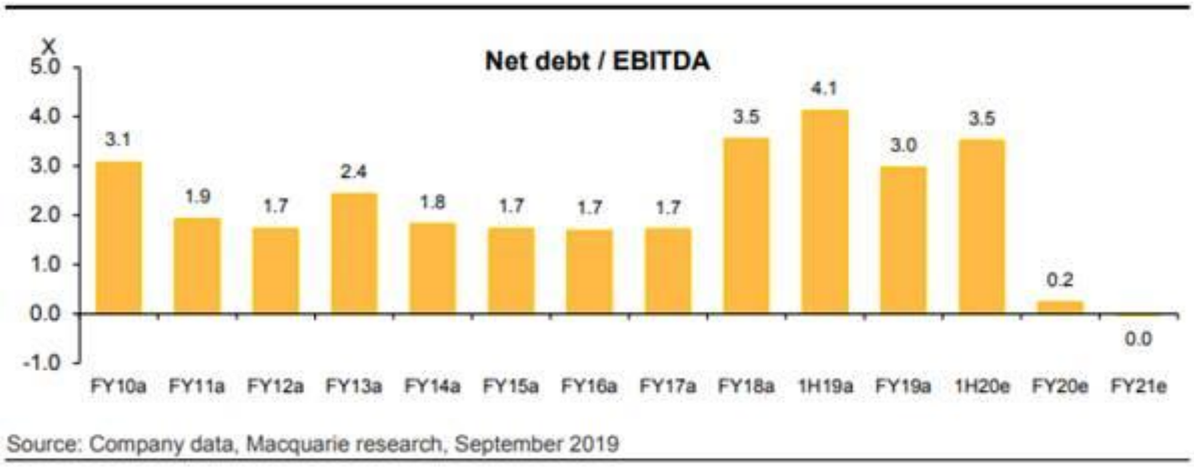
Aristocrat will remain a significant position in your portfolio as long as the market continues to underestimate its predictable earnings growth profile.



Nufarm (NUF) - LatAm sale marks a key inflexion point

Months and years from now, the sale of NUF's Latin American business will likely be seen as the turning point in the fortunes of the company. The sale to Sumitomo for A$1.188 billion came at a very attractive price (10x divisional EBITDA or 12.3x EBITDA if hedging and working capital costs are incorporated) and has enabled NUF to eliminate the balance sheet risk that the market had become fixated on.

Proceeds from the LatAm sale will be used to pay down debt



Management and investor focus can now shift back to the underlying operations without the balance sheet distraction. In Australia, the drought is entering its third year. Earnings from the region are severely depressed and long-term weather forecasts suggest the drought will not break soon. So the prospects of a rapid earnings bounce in the near term is low. But the management team continues to manage the cost base for the weak operating conditions and there will be a $10-15 million improvement in FY20.

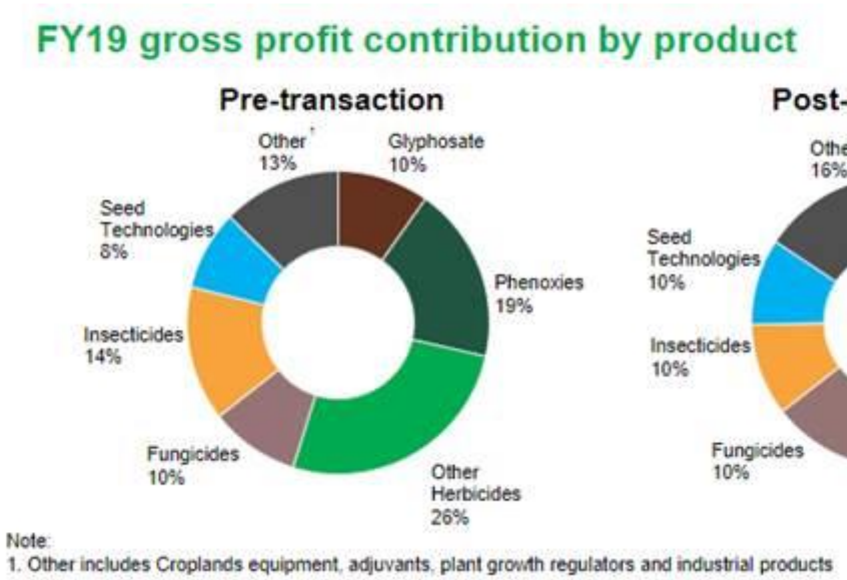
The earnings contribution from the Century and FMC businesses acquired in Europe has been less than expected so far, due to supply chain disruptions and NUF's own manufacturing missteps. These earnings headwinds will fade in FY20 and deliver a $20 million improvement in earnings from that division.

North America faces some short-term headwinds, a result of too much rain in the last 12 months and a distribution channel left carrying too much inventory. But the healthy sub-soil moisture sets up favourable cropping conditions and a path for the channel inventories to be cleared relatively quickly.

Trepidation surrounding NUF's glyphosate exposure is unlikely to dissipate in the short term. Thousands of cases against Bayer (Monsanto), the inventor and manufacturer of glyphosate (with ~ 65% market share in North America versus NUF with less than 1%) are before the US courts and some countries like Austria, Germany and Luxembourg are legislating precautionary bans on the chemical.

As we have stressed in the past, NUF is a formulator of glyphosate, not a manufacturer and to date, no other non-manufacturer has been named in any litigation. Regulators in large glyphosate consuming countries remain steadfast in their support for the chemical they believe is safe. On the 8th of August 2019, the influential US Environmental Protection Agency (EPA) issued a major media release, once again reinforcing that **glyphosate poses no risk to public health, "is not a carcinogen" and that it would not approve any product label that warns consumers about a link between glyphosate and cancer because it would "constitute a false and misleading statement prohibited under federal law".**

To the extent there is risk to glyphosate consumption levels over time, an added benefit of the LatAm sale to Sumitomo is that Nufarm has reduced its earnings exposure to glyphosate - it is now only 7% of gross profit, down from 10% in FY19 and 12% in FY18.



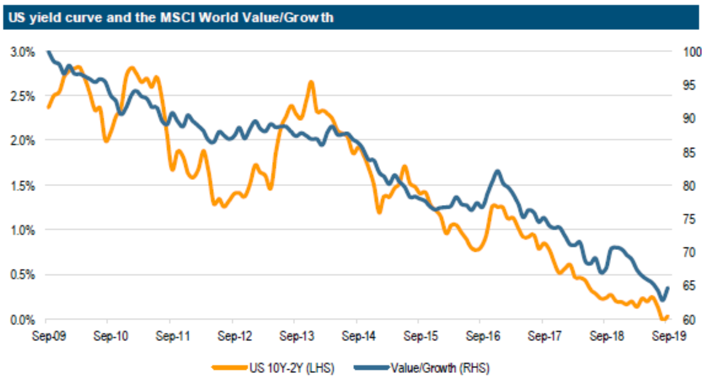
The sale of the LatAm business was a sound strategic move and was sold for a price well above that incorporated in our base valuation and implied by the share price. Accordingly, our target price increases materially to $8.23, including Omega 3 which we estimate could be worth ~ $1 per share. The balance sheet repair and earnings recovery profile provides a clearer pathway for the ~46% valuation upside (including Omega 3) to be realised. Nufarm remains a large position in your portfolio.

FUND STRATEGY AND OUTLOOK

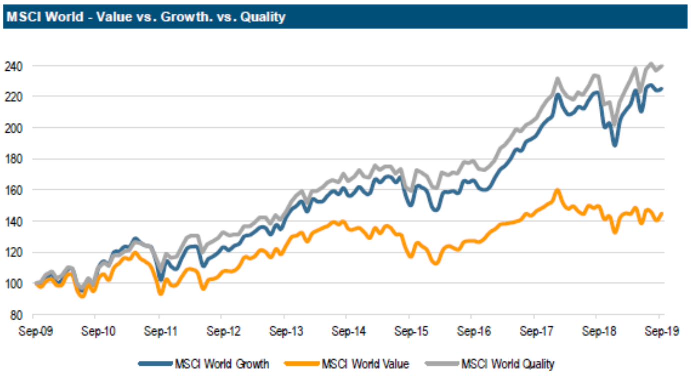
In the last month, value strongly outperformed growth. Over the past decade, value has lagged growth noticeably. It is worth highlighting (see chart below on the left) that there is a close relationship between the US yield curve and value versus growth. A flattening yield curve, which is typically associated with worsening macro conditions, is detrimental to value and supportive of growth. So the correlation suggests that a steepening yield curve is a critical factor needed to sustain a revival in the fortunes of value stocks.

And the steepening is reliant on an improvement in the outlook for economic growth, which appears weak.

10-year yield correlation to value/growth

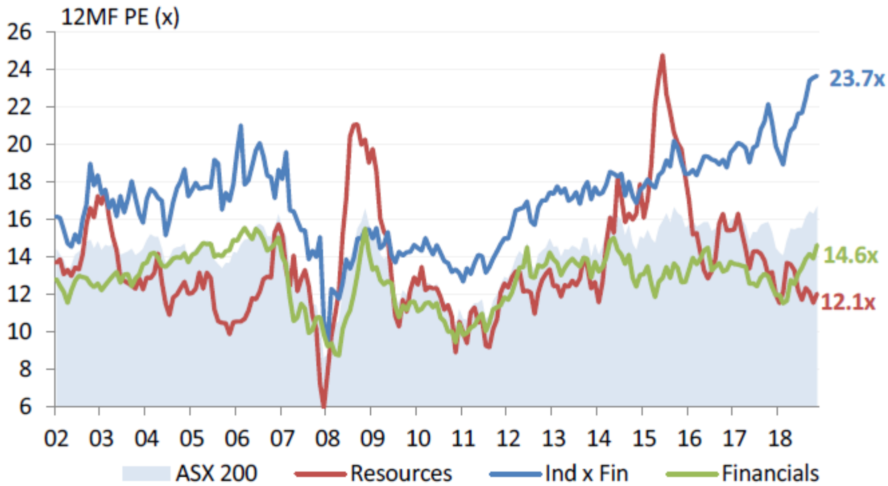


Value showing signs of life but has lagged growth over the decade



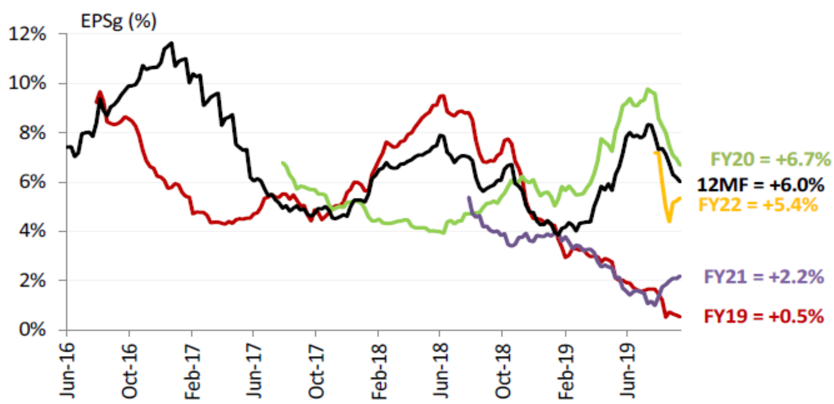
Source: JP Morgan estimates, Bloomberg.

Valuations in Australia are stretched relative to historical levels and forecast earnings. Following last month's rally, the ASX 200 Industrials ex-financials PE continued to extend further to high fresh highs. It finished the month at 23.7x or over 2 standard deviations over the long-run average.



Source: RIMES, IBES, Morgan Stanley Research.

Meanwhile, earnings forecasts continue to look anaemic:



Source: RIMES, IBES, Morgan Stanley Research.

Bonds for some time have been pricing in a higher chance of sharply slowing global growth. Further weakness in global manufacturing data, softer private sector jobs data in the US and ongoing geopolitical fears have resulted in equity markets selling off in early October - a move we would view as the beginning of an overdue correction.

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

Our near-term unease on the Australian market pertains primarily to the absence of earnings growth. We have noted that most of this year's rally has been driven by PER expansion.

As outlined in the Activity section, we have been selectively deploying cash and putting it to good use as attractive opportunities present themselves.

To summarise your portfolio's positioning:

1. Quality Franchises

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

Macquarie Bank, Computershare, Treasury Wines, Aristocrat, Goodman Group and James Hardie Industries

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 and Flight Centre

3. Turnarounds

Sound businesses that have historically generated poor returns, have been poorly managed, under-earned versus their potential, are in transition, and where we think earnings/returns will improve over the medium term. Out of favour with the market, somewhat contrarian positions

Caltex, Orica and Janus Henderson

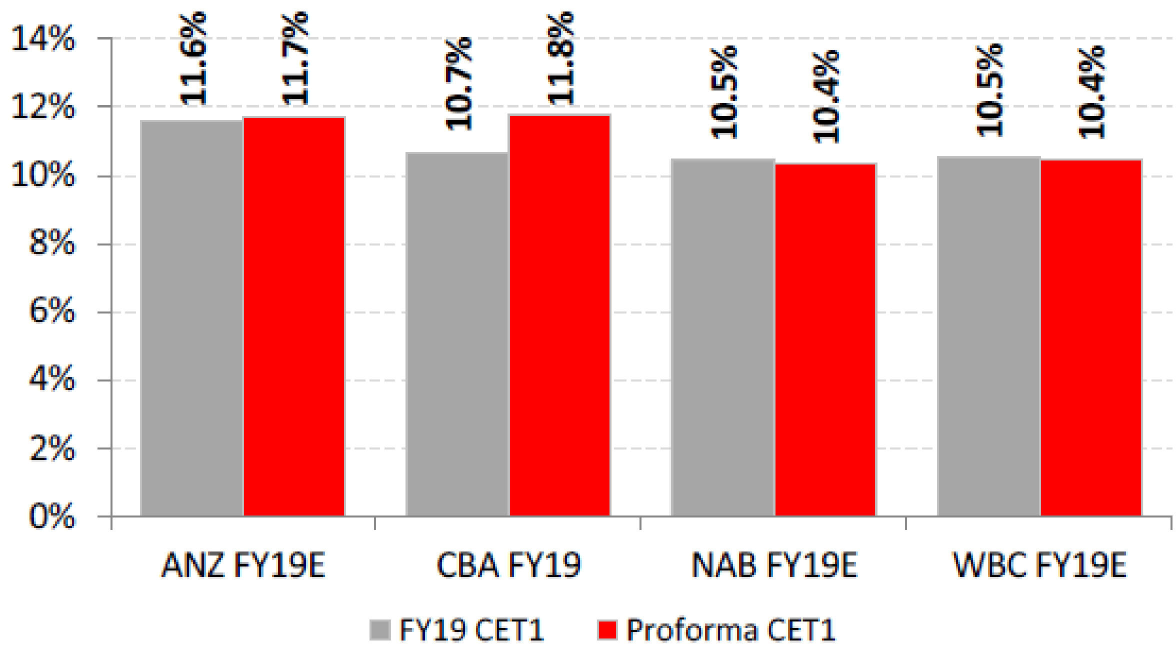
4. Deep Value Cyclical and Resource Plays

Stocks trading at discounts to NPVs, or with growth optionality, where much of the heavy lifting has been done (cost out, self help)

BlueScope Steel, Woodside Petroleum and Origin Energy

Still **Zero Big Four Banks**

Lack of earnings and capital pressure, means cuts to dividends are unavoidable



Source: Morgan Stanley Research.

Cuts to absolute level of dividends and payout ratios are coming

	FY17	FY18	FY19E	FY20E
ANZ				
Dividend per Share (¢)	**160¢**	**160¢**	**160¢**	**144¢**
Change (y-o-y)	*0%*	*0%*	*0%*	*-10%*
Dividend Payout Ratio (%)	68%	80%	66%	69%
CBA				
Dividend per Share (¢)	**429¢**	**431¢**	**431¢**	**431¢**
Change (y-o-y)	*2%*	*0%*	*0%*	*0%*
Dividend Payout Ratio (%)	75%	80%	88%	87%
NAB				
Dividend per Share (¢)	**198¢**	**198¢**	**166¢**	**166¢**
Change (y-o-y)	*0%*	*0%*	*-16%*	*0%*
Dividend Payout Ratio (%)	80%	95%	81%	80%
WBC				
Dividend per Share (¢)	**188¢**	**188¢**	**188¢**	**188¢**
Change (y-o-y)	*0%*	*0%*	*0%*	*0%*
Dividend Payout Ratio (%)	79%	80%	83%	74%

Source: Morgan Stanley Research.

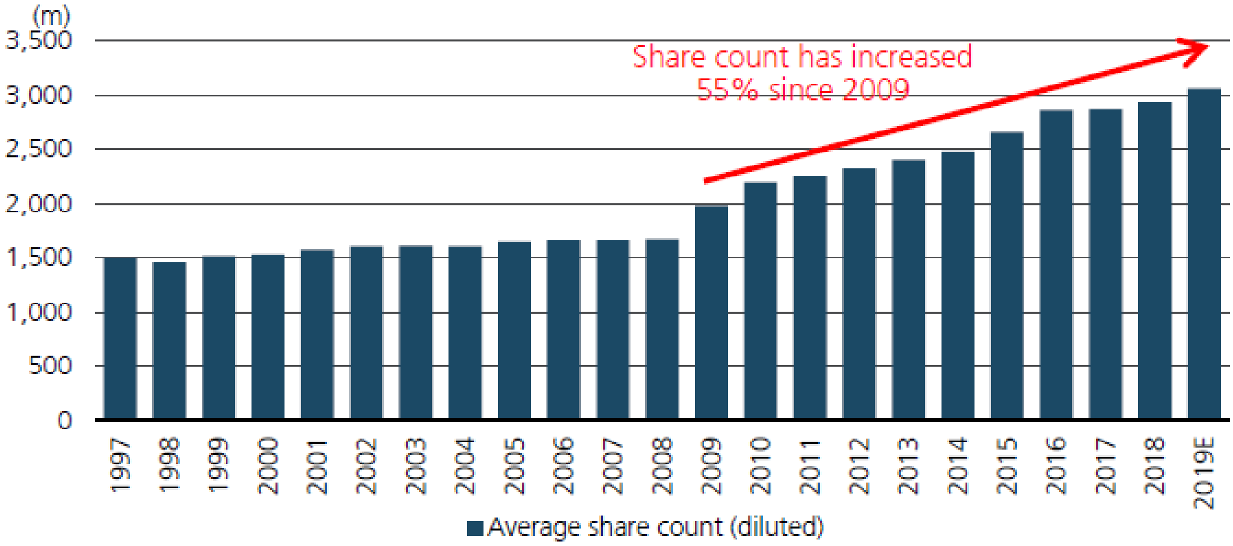
Bank Valuations look stretched given absence of earnings growth (negative in fact for the likes of NAB) but search for "yield" continues…

			FY20E		
	P/E	**RoNTA**	**P/NTA**	**Payout Ratio**	**Yield**
ANZ	13.5x	10.4%	1.4x	69%	5.1%
CBA	16.0x	14.0%	2.3x	87%	5.4%
NAB	13.6x	12.5%	1.7x	78%	5.7%
WBC	13.5x	13.9%	1.8x	74%	5.5%

Source: Morgan Stanley Research.

NAB's elevated payout ratio has been funded through consistent share dilution. NAB's share count has doubled since 1997 and increased 55% since 2009 post the Financial Crisis capital raisings.

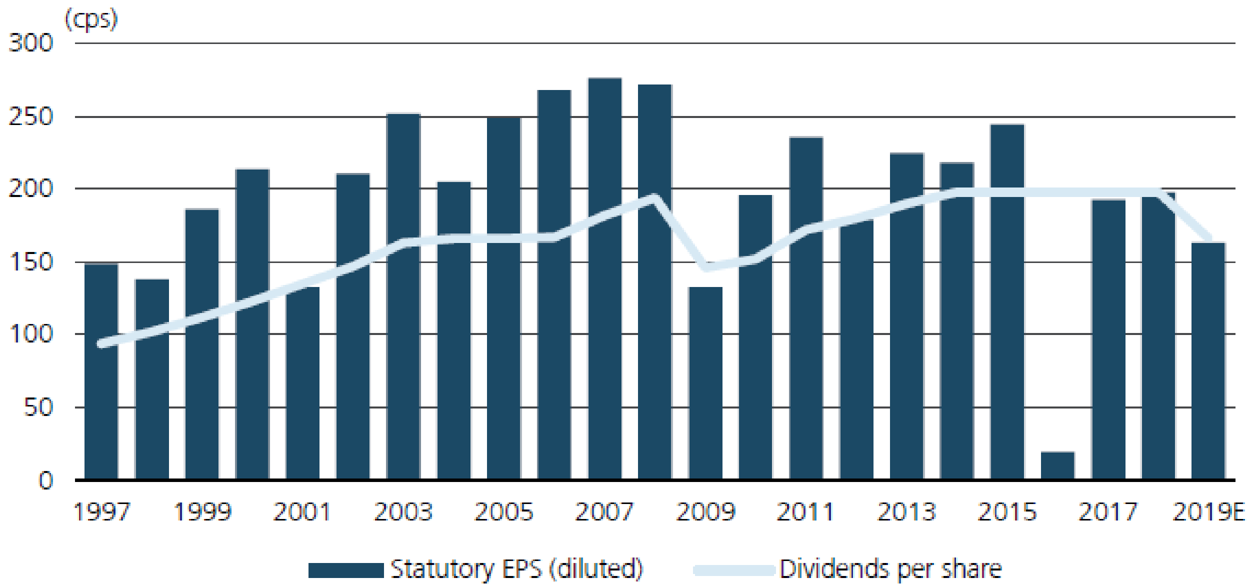
Average diluted share count since 1997 (m)



Source: Company Data: UBS estimates

NAB's EPS hasn't grown in 20 years

Diluted Statutory EPS over time vs Dividends per share (CPS)



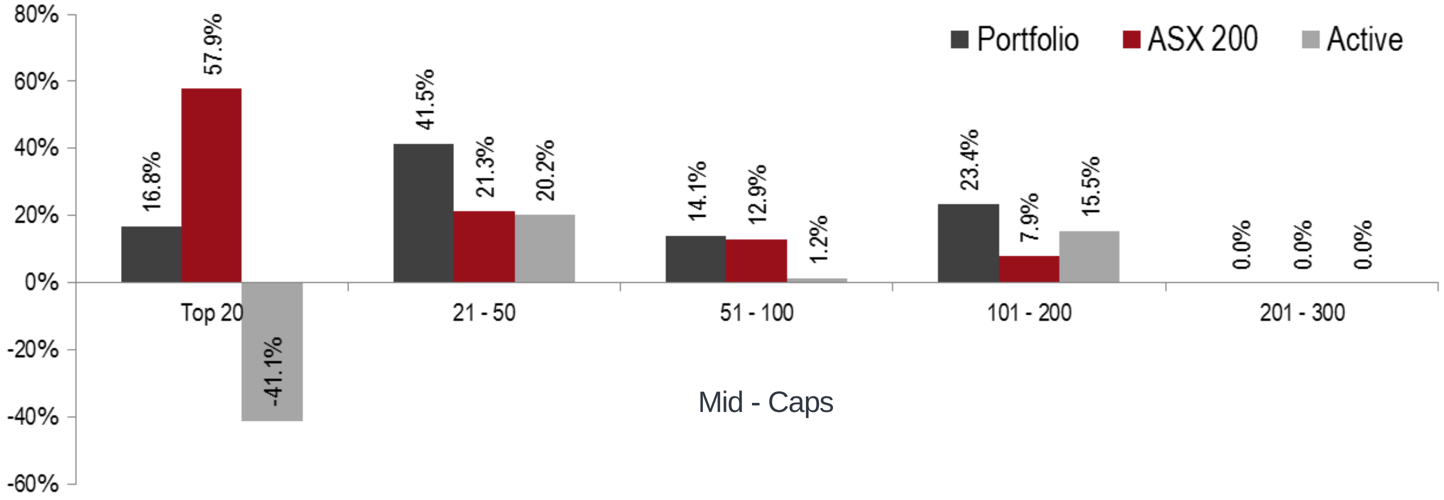
Source: Company Data: UBS estimates

Warm Regards,

Chris Kourtis
Portfolio Manager

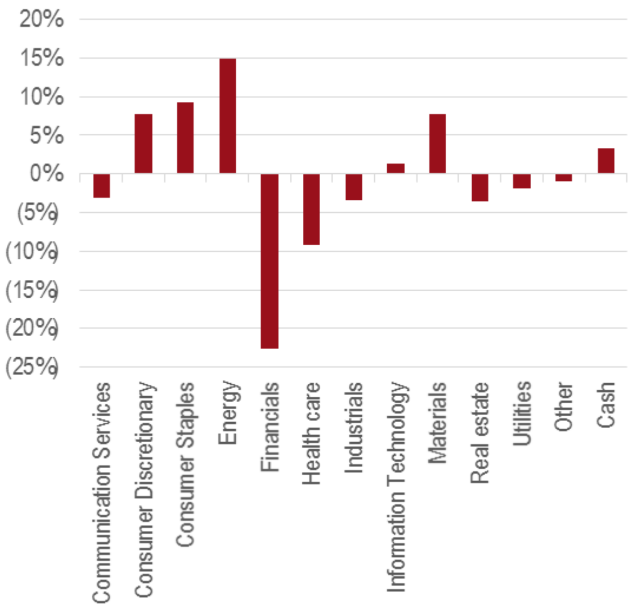
PORTFOLIO FEATURES

Size comparison Chart vs ASX 200^



^Size Comparison Data as at 27 September 2019
Source: Bloomberg, Ellerston Capital Limited

Active Sector Exposures*



Source: Ellerston Capital Limited

TOP 10 HOLDINGS**
ARISTOCRAT LEISURE
CALTEX AUSTRALIA
FLIGHTCENTRE
GRAINCORP
MACQUARIE GROUP
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	$3.3 BILLION
FUNDS UNDER MANAGEMENT – ASF UNIT TRUST	$50 MILLION
APPLICATION PRICE	$0.9684
REDEMPTION PRICE	$0.9636
NUMBER OF STOCKS	19
INCEPTION DATE	1 APRIL 2009

Source: Ellerston Capital Limited

For further information, please contact:

INSTITUTIONAL CONTACT

Andrew Koolman
+61 2 9021 7760
akoolman@ellerstoncapital.com

RETAIL CONTACT

Simon Glazier
+61 2 9021 7790
sglazier@ellerstoncapital.com

SYDNEY OFFICE

Level 11, 179 Elizabeth Street,
Sydney NSW 2000

MELBOURNE OFFICE

Level 4, 75-77 Flinders Lane,
Melbourne VIC 3000

Ph: +61 2 9021 7797
E: info@ellerstoncapital.com