ELLERSTON CAPITAL

Ellerston Australian Market Neutral Fund

Performance Report | October 19

PERFORMANCE SUMMARY

Performance	1 Month	3 Months	6 Months	1 Year	3 Year (p.a.)	5 Year (p.a.)	Since Inception (p.a.)
Net^	3.26%	8.68%	16.47%	8.59%	1.91%	4.10%	7.22%
Benchmark*	0.06%	0.23%	0.55%	1.29%	1.43%	1.66%	1.85%
Alpha	3.19%	8.45%	15.92%	7.30%	0.48%	2.44%	5.37%

Source: Ellerston Capital

^Net return figure is calculated after fees & expenses. Past performance is not a reliable indication of future performance
*RBA Cash Rate

PORTFOLIO CHARACTERISTICS

KEY PORTFOLIO METRICS

Positive months	66%	**Net Equity Exposure**	14.5%
No. Relative Value positions	53	**Gross Portfolio Exposure**	253.4%
No. Special Situations	30	**Correlation Coefficient (vs ASX 200 Accum)**	5.2%
Beta Adjusted	-2.8%	**Net Sharpe Ratio (RFR = RBA Cash)**	0.98

SECTOR ALLOCATION

Sector	Long Equity	Short Equity	Net Equity
Financials	49.6%	-52.1%	-2.5%
Industrials	54.7%	-15.8%	38.9%
Resources	23.2%	-23.0%	0.1%
Index	6.4%	-28.5%	-22.1%
Total	**133.9%**	**-119.4%**	**14.5%**

Investment Objective

The Fund targets Absolute Returns with an annualised return objective of 5% above the RBA Cash Rate over rolling five year periods.

Investment Strategy

The Fund will seek to provide investors with a return profile that has low correlation with traditional asset classes. The Fund aims to generate positive returns in all market environment by reducing the majority of market risk and focusing on capital preservation and alpha generation. The Fund will utilise a Relative Value and a Special Situations strategy.

Key Information

Strategy Inception	3 June 2013
Portfolio Manager	Paul Drzewucki
Application Price	$1.0712
Net Asset Value	$1.0685
Redemption Price	$1.0658
Liquidity	Daily
Management Fee	1.20%
Performance Fee	20% of outperformance
Buy/Sell Spread	0.25%/0.25%

COMMENTARY

The Fund produced a net return of +3.3% in October, outperforming the benchmark return of +0.1%. Both Special Situations (+1.1% gross) and Relative Value (+2.3% gross) added to performance, with a paired position within the Media sector the largest contributor in the period. Net exposure was +14.5% at the end of September, with a beta-adjusted net of -2.8%. Gross exposure closed the month at 253.4%.

Our paired position between Village Roadshow (+12.7%) and Event Hospitality and Entertainment (-2.7%) added to performance in October, with Village Roadshow providing a positive update during the period. Both the Theme Park and Cinema Exhibition divisions have had a strong start to FY20 with incoming CEO Clark Kirby providing the market with confidence regarding FY20 earnings. Despite the share price rally, Village trades on a consensus FY20 EV/EBITDA multiple of 6.1x, compared with Event at 9.3x.

Despite Scentre (-2.5%) once again creeping on the register, Carindale Property (-5.7%) continues to underperform, with the paired position that also features BWP Trust (+5.1%) detracting from the Fund's value in the period. There was no new news on either name, outside Scentre buying an additional 3% of Carindale.

As previously mentioned, a paired position within the Media sector was the largest contributor to performance in the month. Out-of-home media company, QMS Media (+33.2%), announced that it had received an all-cash offer from Quadrant Private Equity and that the QMS board had unanimously recommended the transaction. The offer was pitched at 9.4x FY19 EBITDA, a premium of 39% to QMS's 3-month VWAP.

Our paired position between utility infrastructure companies Spark Infrastructure (-6.5%) and AusNet Services (+1.9%) detracted from the performance of the Fund following the regulator's Draft Decision for the next regulatory cycle. If adhered to in the Final Decision, the Draft will result in a revenue allowance that is 7% below what SAPN initially proposed, crimping the potential distribution that Spark (49% owner of SPAN), will be able to pay.

The Fund participated in the Initial Public Offering of Damstra (+25.6%) which listed in October, adding to the value of the Fund. Damstra provides integrated workplace management solutions and focuses on industries in which compliance and safety is important, such as mining, resources and construction. The company was formed in 2002 and now has approximately 350 clients with operations in Australia, New Zealand, the United States and the United Kingdom.

Following last month's capital raise, the share price of Superloop (+9.5%) continued to rally, adding to the Fund's performance. With the network complete and the balance sheet repaired, investors are now focused on sales and how quickly the company can attract customers to its network. Despite the recent rally, Superloop trades at only a modest premium to book value and still has an expected return to a consensus price target of over 15%.

Our long position in Uniti Group (+2.1%) added to the Fund's performance in the period. During October, Uniti announced the acquisition of OPENetworks, the third largest private fibre operator in Australia. Following the acquisition, Uniti will combine both the second and third private fibre operators with the combination providing synergies in terms of operating systems, geographic footprint and property developer relationships. Pre-synergies, the acquisition is expected to be greater than 10% accretive to EPS in the first full year of ownership.

Despite holding revenue flat in the typically weak 1Q, the market was disappointed with Impedimed's (-22.2%) quarterly and marked the stock lower accordingly. On the call, management indicated that they remained uncertain around the timing of two key triggers – private payer coverage and inclusion in the NCCN guidelines. Management also indicated that the 2 year data from the first cohort of patients in the PREVENT trial will be published in the next few months. The fall in the share price detracted from performance in the month.

ACTIVITY

Relative Value – Gross Contribution +2.31%

We established and unwound a paired position between Karoon Energy (-8.7%) and Senex Energy (+4.3%) in October, following an equity raise by Karoon to complete the funding of the Bauna oil field in Brazil. In July this year, Karoon announced they were acquiring 100% of the operating interest in Bauna, for a headline consideration of USD665m. The acquisition is to be funded by a mix of debt and equity, with the equity raise launched in October, following the signing of a crude oil marketing deal with Shell. Settlement of the acquisition is scheduled for 1Q 2020, with the company trading on a consensus FY21 Price/Earnings multiple of just 2.6x.

It was a busy month in the infrastructure sector, with the Fund adding to its position in Transurban (+1.0%) and Sydney Airport (+9.3%), and reintroducing a paired position between Atlas Arteria (+2.9%) and Sydney Airport. Atlas Arteria is a direct infrastructure fund that has interests in four international toll roads – APRR (France), Dulles Greenway (USA), ADELAC (France) and Warnow Tunnel (Germany). Only the APRR and Dulles Greenway interests have any value of significance and Atlas is currently pursuing a restructure of APRR-related agreements that may result in a change of control in the asset.

In October, APN Convenience Retail REIT (+3.0%) announced the acquisition of 13 service stations and convenience retail properties, for a total consideration of AUD74.6m. The assets have a WALE of 13.8 years with an initial yield of 6.2% and fixed annual rent increases of 3%. The acquisition was funded by an AUD38m equity raise, with stock issued at a 3.7% discount to last. We purchased stock in the placement, hedging the exposure with Viva Energy REIT (+1.4%), which also owns a portfolio of (mainly Shell) service stations.

We unwound our paired position between media companies QMS Media and Nine Entertainment, moving a small balance in QMS to Special Situations. We also unwound paired positions between Charter Hall (-3.0%) and Cromwell (+4.3%), and Eclipx Group (-12.0%) and SmartGroup (-6.6%). During the period, the major shareholder in SmartGroup sold its entire 25% stake, with the Fund covering its short position and establishing a long, this time using McMillan Shakespeare (-1.9%) as the hedge.

Special Situations – Gross Contribution +1.06%

Fruit and vegetable producer Costa Group (-18.0%) lowered guidance for the fourth time this year, with three key drivers for the downgrade: 1. A lower than expected citrus crop due to ongoing dry conditions; 2. Increased supply of blueberries resulting in soft pricing and; 3. Channel mix and pricing below expectations for mushrooms. The company was forced to raise AUD176m of equity, at a deep discount to the prevailing market price. We participated in the institutional shortfall bookbuild, picking up new shares at an incredible 28.3% discount to the Theoretical Ex-Rights Price (TERP).

The Costa downgrade and equity raise also provided an opportunity in VitalHarvest (-12.2%), an externally managed REIT that owns a portfolio of citrus and berry assets, with Costa Group the sole tenant. The leases are all triple-net, with VitalHarvest also entitled to a 25% profit share of each of the citrus and berry assets operated by Costa. Despite the depressed profit share in FY20, VitalHarvest trades at a dividend yield of approximately 6%, with upside to the yield if Costa's fortunes improve. We capitalised on some distressed selling in VitalHarvest, establishing a modest position at a 13.3% discount to NAV.

Also during the month, video technology company Atomos (+0.3%) announced the acquisition of Timecode Systems, with the acquisition funded by an AUD22.5m equity raise. We participated in the placement, adding to an existing position that we purchased in July. Following the acquisition, Atomos is expected to record its maiden profit in FY20, with strong growth forecast for FY21 and FY22.

We reduced our shareholding in Superloop (+9.5%) and completely exited PGG Wrightson (+4.7%) and Buy-Now-Pay-Later company Sezzle (+14.9%), following a period of share price strength in each name.

MARKET COMMENTRY

Market Overview

In October, Emerging Markets (+4.2%) outperformed Developed Markets (+2.6%) by a reasonable margin. Financial markets took some comfort from easing geopolitical tensions, the UK stepping back from its Brexit precipice, and signs that the US and Chinese authorities were edging closer to some agreement on their trade dispute. The US Fed cut rates for the third time this year and global central banks reiterated their accommodative stance, which helped bolster investor sentiment.

USA

Against the backdrop of a positive earnings season, the S&P 500 Index made further gains of +2.2% in October, hitting all-time highs at the end of the month. The Dow Jones Industrial Average Index was up a more modest +0.6%. The NASDAQ was the strongest performer, with a return of +3.7%.

US-China discussions on trade oscillate wildly but appeared to be more constructive in general in October. Financial markets were buoyed by the generally positive sentiment on trade. But US economic data suggested that the economy is fast losing momentum, especially in the trade-dependent manufacturing sector. The manufacturing PMI data indicated that the manufacturing side of the economy is contracting. Consumer confidence was also weaker in October. Not surprisingly, the Fed cut rates by 25bpts for the third time this year but signalled its intention to pause in the easing cycle. Markets took their lead from better than expected 3Q earnings on average and squeezed higher.

Europe

European equities overall were in the black, with the Euro Stoxx returning +1.1%. Among key markets, Germany's DAX was one of the strongest performers with a return of +3.5%. France's CAC 40 was up 0.9%, but the UK's FTSE 100 was down 1.9%, despite the country seemingly stepping back from the Brexit cliff edge. No deal Brexit risks have now faded with the agreement struck between PM Johnson and the EU.

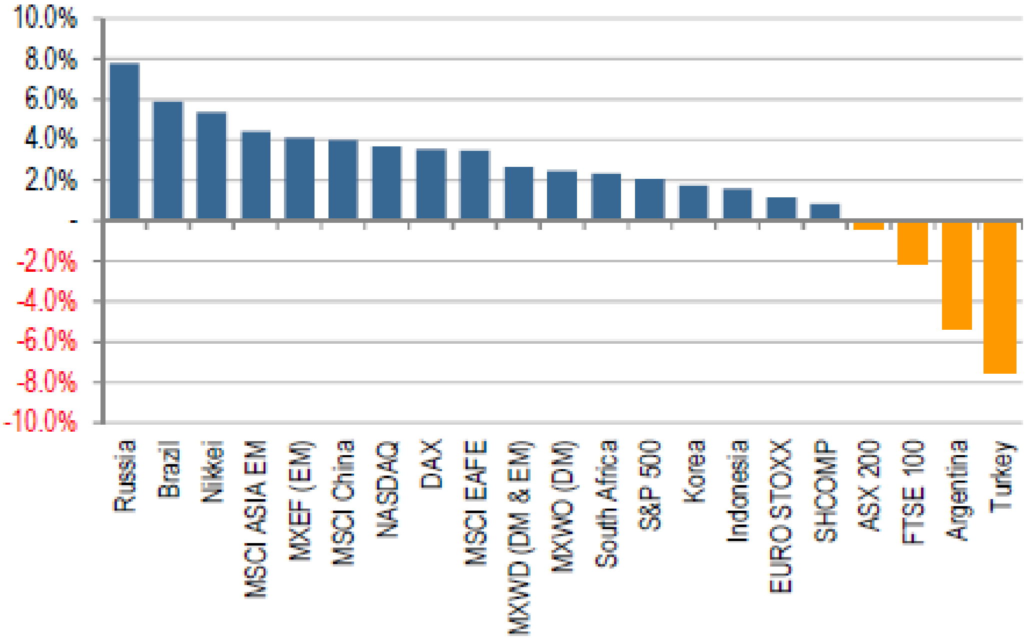
But trade-related weakness globally had a severe impact on the Eurozone and Germany, in particular. German flash PMIs for October remained at 45.7. The ECB saw a changing of the guard: Mario Draghi stepped down and Christine Lagarde, former head of the IMF, took over as President. The ECB last month announced new stimulus measures, but the ECB's toolkit is likely reaching its limits. Ms Lagarde's political skills and persuasion will be called upon to convince European governments to provide further fiscal stimulus.

Asia

Asian equities were also stronger in the month on the back of optimism on US-China trade talks. Despite the ongoing violent protests in Hong Kong, the Hang Seng Index was up 3.3%. Japan's Nikkei 225 was again the best performer of the major Asian markets, up 5.4%, followed closely by India's S&P BSE Sensex (+3.9%), Korea's KOPSI Composite Index which was up 1.0%, and China's SSE Total Market Index which returned +0.7%.

The annual pace of real GDP growth in China eased to 6.0% for the third quarter, down from 6.2% in the previous quarter. China's home prices rose at a modestly slower pace in September, with retail sales showing steady growth at 0.7% m/m. The People's Bank of China implemented its second 50 basis point cut to the reserve requirement ratio, with another cut to follow soon.

Global Equity Markets' Performance in October 2019

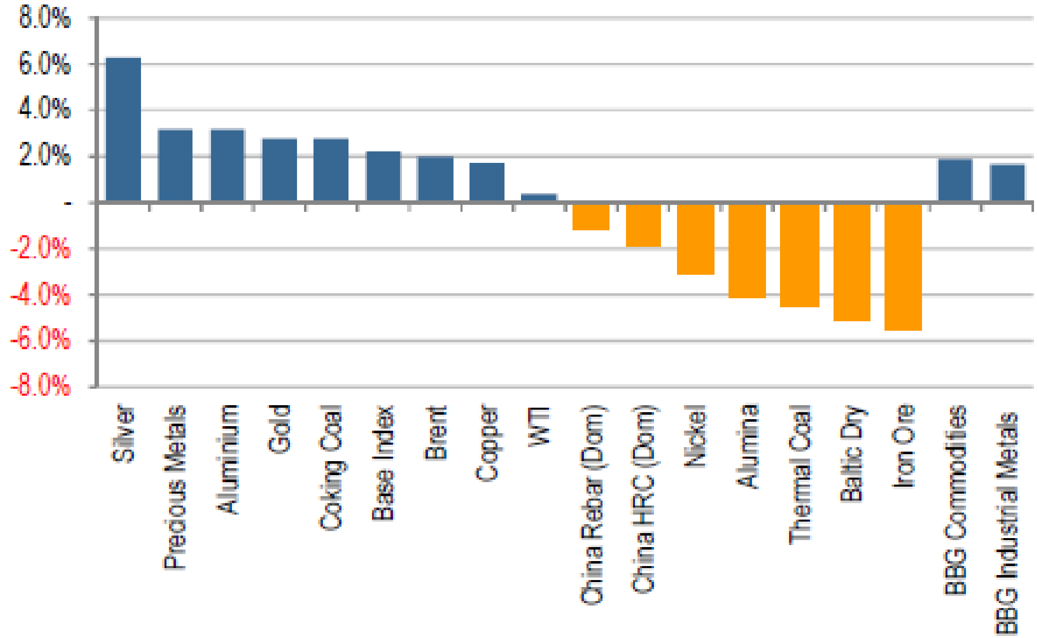


Source: JP Morgan, Bloomberg.

Commodities

The commodities index rose 1.9%. Precious metals were stronger in October, as both Gold (+2.8% to US$ 1,968/oz) and Silver (+6.3%) shone. Among the bulks, Iron Ore had a poor month, down 5.5% with Thermal Coal weaker too, down 4.5%. Brent was up 1.9% to US$59.62/bbl. Base metals were mixed with Copper up 1.7% but Nickel and Alumina were down 3.1% and 4.1% respectively.

Commodity Performance in October 2019



Source: JP Morgan, Bloomberg.

Bonds

As we saw last month, bond yields appeared to have stemmed their seemingly inexorable decline. The US 10-year bond yield moved up to 1.69% while the Australian 10-year bond yield backed up sharply to 1.14%. The Australian 10-year bond yield is now 55 basis points below the US 10-year bond.

Australia

A bad month for Financials, with the S&P/ASX 200 Accumulation Index finishing down 0.4%. The index is still up 22.1% for the calendar year to date.

In October, the best three performing sectors in terms of their contribution to the index's performance were Health Care (which surged 7.6%, with CSL up 9.6% the largest contributor to the ASX 200 Accumulation Index), Industrials (+3.0%) and Real Estate (+1.6%). The bottom three sectors were Financials (-2.8%, with all four major banks in the red, making them the largest negative contributors to the broader market index), Materials (-1.9%, with BHP Group and Rio Tinto reversing last month's gains) and Consumer Staples (-2.2%). The ASX 200 Industrial Accumulation Index posted a negative return of -0.5%, with the Small Ordinaries Accumulation Index also returning -0.5% and then the ASX 200 Resources Accumulation Index, with a return of -1.6%.

The top five stocks that detracted from the performance of the S&P/ASX 200 Accumulation Index were Australia and New Zealand Banking Group (-29 points), Westpac Banking Group (-28 points), Commonwealth Bank of Australia (-22 points), National Australia Bank (-18 points) and Newcrest Mining (-15 points), post a very disappointing quarterly production update.

The top five stocks that made a positive contribution to the index's return were CSL (+58 points), Sydney Airport (+10 points), Brambles (+8 points), Macquarie Group (+5 points) and Stockland (+5 points).

The RBA cut rates in October by 25 basis points as expected and noted in last month's update. The RBA's statement said that rates could be cut further "if needed to support sustainable growth in the economy, full employment and achievement of inflation target over time". NAB's measure of business confidence showed that it had dropped back to pre-election levels, while confidence fell one point to -0.3. The September employment card looked decent as unemployment ticked lower to 5.2%.

The Australian dollar was up 2.1% against the US dollar, and ended the month at 0.69 cents

CONTRIBUTION

Relative Value Gross Contribution +2.31%			
Positive		**Negative**	
NINE ENTERTAINMENT CO HOLDINGS LTD - QMS MEDIA	1.67%	BWP TRUST - CARINDALE PROPERTY TRUST	-0.78%
EVENT HOSPITALITY AND ENTERTAINMENT LTD - VILLAGE ROADSHOW	0.90%	AUSNET SERVICES - SPARK INFRASTRUCTURE	-0.21%
KAROON GAS AUSTRALIA LTD - SENEX ENERGY LTD	0.44%	MIRVAC GROUP - STOCKLAND	-0.16%
APN CONVENIENCE RETAIL REIT - VIVA ENERGY REIT	0.14%	ECLIPX GROUP LTD - SG FLEET GROUP LTD	-0.15%
ABACUS PROPERTY GROUP - CENTURIA INDUSTRIAL REIT	0.13%	CARNARVON PETROLEUM LTD - SANTOS	-0.12%

Special Situations Gross Contribution +1.06%			
Positive		**Negative**	
ATOMOS LTD	0.48%	IMPEDIMED LTD	-0.51%
SUPERLOOP LTD	0.37%	INFIGEN ENERGY	-0.31%
BIGTINCAN HOLDINGS LTD	0.33%	KALIUM LAKES LTD	-0.27%
COSTA GROUP HOLDINGS LTD	0.25%	IMRICOR MEDICAL SYSTEMS-CDI	-0.13%
VOLPARA HEALTH TECHNOLOGIESS	0.20%	APN INDUSTRIA REIT	-0.08%

Top 10 Relative Value Positions	
RIO TINTO - RIO TINTO	EVENT HOSPITALITY AND ENTERTAINMENT LTD - VILLAGE ROADSHOW
BHP BILLITON - BHP BILLITON	SCENTRE GROUP - VICINITY CENTRES
MIRVAC GROUP - STOCKLAND	MCMILLAN SHAKESPEARE LTD - SMARTGROUP CORP LTD
APN INDUSTRIA REIT - ELANOR RETAIL PROPERTY FUND	AUSNET SERVICES - SPARK INFRASTRUCTURE
BWP TRUST - CARINDALE PROPERTY TRUST	ABACUS PROPERTY GROUP - INVESTEC AUSTRALIA PROPERTY

Top 10 Special Situation Positions	
PUT SPREAD ON AS51	QMS MEDIA LTD
NUFARM FINANCE NZ LTD - NSS	ATOMOS LTD
AVEO GROUP	UNITI WIRELESS LTD
INFIGEN ENERGY	AUSTRALIAN UNITY OFFICE FUND
KALIUM LAKES LTD	SUNCORP GROUP

All holding enquiries should be directed to our registrar, Link Market Services on 1800 992 149 or ellerston@linkmarketservices.com.au

Should investors have any questions or queries regarding the Fund,

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