

Ellerston India Fund

Performance Report | October 19

PERFORMANCE SUMMARY

Performance	1 Month	3 Months	6 Months	1 Year	2 Year (p.a.)	Since Inception (p.a.)
Net [^]	1.05%	4.14%	3.30%	21.73%	8.37%	8.92%
Benchmark*	2.13%	4.44%	1.03%	20.83%	7.00%	8.42%
Alpha	-1.08%	-0.30%	2.27%	0.90%	1.37%	0.50%

Source: Ellerston Capital

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

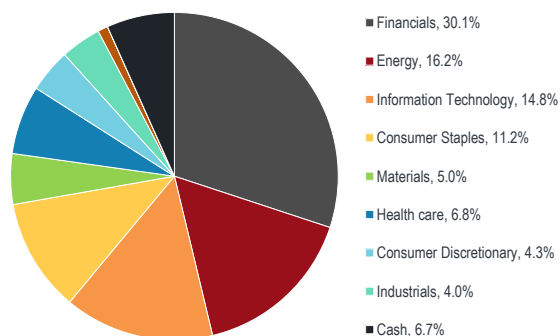
* MSCI India Net Return Index (AUD)

PORTFOLIO CHARACTERISTICS

HOLDINGS

Top 10 holdings	Sector	%
Reliance Industries Limited	Energy	16.2%
Housing Development Finance Corp Ltd	Financials	8.2%
Hindustan Unilever Limited	Consumer Staples	8.0%
Tata Consultancy Services Limited	Information Technology	8.0%
Axis Bank Limited	Financials	5.8%
ICICI Bank Limited	Financials	5.5%
HDFC Bank Limited	Financials	5.4%
Infosys Limited	Information Technology	5.3%
Larsen & Toubro Ltd.	Industrials	4.0%
Bajaj Finance Limited	Financials	3.5%

SECTOR ALLOCATION



Source: Ellerston Capital

Investment Objective

To outperform the MSCI India Net Return Index (AUD) with a focus on risk management and capital preservation.

Investment Strategy

The Fund's investment strategy is to construct a concentrated portfolio with exposure to Indian Companies using the Manager's high growth, high conviction, benchmark independent investment approach. The Fund has identified a number of core thematic areas that will drive returns in the Indian market in the medium term. The focus is on investing in Indian Companies that benefit from these fundamental drivers.

Key Information

Strategy Inception	4 May 2017
Portfolio Manager	Mary Manning
Application Price	\$1.1553
Net Asset Value	\$1.1524
Redemption Price	\$1.1495
Liquidity	Daily
No Stocks	21
Management Fee	1.10%
Performance Fee	15%
Buy/Sell Spread	0.25%/0.25%

COMMENTARY

The Ellerston India Fund was up 1.05% in October versus the benchmark which was up 2.13%. Calendar year to date in 2019 the fund is up 8.83%.

October was a frustrating month from a portfolio positioning perspective. As our investors know, the EIF portfolio is constructed of high growth, high quality, large cap companies. October saw many companies that do not fit these categories outperform.

Benchmark heavy weight Tata Motors was up 51% during the month on short covering, better than feared results for Jaguar Land Rover (JLR) and positive sentiment that there will be no hard Brexit. Similarly, zombie bank YES Bank rallied over 70% after an exchange filing said that the bank had received M&A interest from foreign and domestic private equity and strategic investors.

These two stocks alone accounted for over 50% of the negative alpha generated during the month. We do not think that YES Bank is an investable stock nor does it meet our strict ESG criteria. On Tata Motors, we need to see a sustained improvement in JLR results and more visibility from management before considering the stock for the portfolio.

We have however re-initiated a position in Eicher Motors. We exited the Eicher position in early February 2019 as the demand outlook for the 2 wheeler sector was deteriorating quickly. The stock fell another 20% after we exited. The auto sector still faces headwinds but sales during the recent festival season showed some encouraging signs and the stocks are oversold, under-owned and attractively valued. We have held Maruti Suzuki in the portfolio since inception and continue to do so.

Two other major events occurred in the Indian market during October – the Infosys “whistle blower” letter and the Supreme Court decision on telcos.

On Infosys, during October a “whistle blower” (in quotations as it is unclear if their claims are legitimate) sent an anonymous letter to the Board and to regulators accusing Chief Executive Officer Salil Parekh and Chief Financial Officer Nilanjan Roy of accounting irregularities and a laundry list of other grievances. In addition, the letter accuses management of withholding information from the Board. Infosys is a large position in EIF and ESG is a bedrock of our investment process, therefore we took these accusations very seriously.

From an accounting perspective, one of the most important issues is whether Infosys management has taken on zero margin deals which boost sales but have no positive impact on earnings. Since some of management’s ESOP is dependent on meeting sales targets, this is viewed as unethical by the letter writers.

Our view is that it is important to distinguish between accounting fraud and unwise financial and strategic decision making. Taking on zero margins deals, in our view and in the view of the accounting experts we have consulted, is not unethical or fraudulent, however it may not be good, sustainable business practice. Infosys has appointed PWC to assist with the audit and investigation into these complaints.

The other issue is whether management has withheld information from the Board. This will be more difficult to determine than the accounting issues. Infosys has appointed 2 law firms to assist with this aspect of the complaint. We have maintained our investment in Infosys and are watching the situation closely. If it comes to light that Infosys no longer meets our stringent ESG criteria, we will exit the position. If there is no evidence of wrong doing, we intend to maintain the position but engage with management to ensure that remuneration and KPIs are better aligned with shareholder interests.

On telecom, in late October the Supreme Court ruled in favour of the Department of Telecommunications (DOT) in a long standing dispute regarding the definition of Adjusted Gross Revenue (AGR). India is currently a 3 player telco market consisting of Reliance Jio, Bharti Airtel and Vodafone Idea. Because Reliance is a relatively new player, the accrued charges from the AGR decision are minimal versus peers. The total outstanding payable from Vodafone as a result of this ruling is approximately \$4 billion, which swamps its \$1.6 billion market cap. Not surprisingly, Vodafone Idea fell 37% in 5 trading days following the decision.

We have zero weights in both Vodafone Idea and Bharti Airtel while Reliance is the largest position in the fund. The decision by the Supreme Court is very favourable for this positioning because Vodafone’s may not be able to survive after paying the AGR charge. This would leave India as a 2 player telco market with Reliance being by far the dominant player.

From a sector perspective, Consumer Staples and Industrials were the largest contributors to alpha during the month while Consumer Discretionary (autos in particular) was the largest detractor. The largest contributors to alpha were Reliance, Britannia and Hindustan Unilever and the largest detractor was Tata Motors. Cash at the end of October was 6.52%.

Ellerston senior analyst Eric Fong is currently on the ground in India and we will send out an “On The Ground Views” communication upon his return.

Kind regards,

Mary Manning - 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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