Ellerston Australian Micro Cap Fund

Performance Report | December 19

PERFORMANCE SUMMARY

Performance	1 Month	3 Months	6 Months	1 Year	2 Year p.a.	Since Inception (p.a.)
Net^	0.50%	7.76%	20.81%	44.79%	12.84%	23.14%
Benchmark*	-0.29%	0.76%	3.89%	21.36%	5.28%	10.79%
Alpha	0.79%	7.00%	16.92%	23.43%	7.56%	12.35%

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

COMMENTARY

The Ellerston Australia Micro Cap Fund delivered 0.5% in December outperforming the Small Ordinaries Accumulation Index by 0.8%. The Small Ordinaries was weighed down by Real Estate (-3.0%), Utilities (-1.6%) and Energy (-1.2%). For the Calendar Year the Fund was up 44.8% outperforming the index by 23.4%. This is a pleasing result and our outperformance has been driven by the market's reversion to a stock pickers market, compared to the momentum trade which we saw in early in the year.

Looking more broadly at the market, December was marred by further portfolio transitions and several downgrades, which we avoided. We saw names like AMA Group fall 28% on the back of drier weather conditions and declining new car sales. The heavy share price move in our view can also be attributed to its recent capital raise and acquisition where it provided a more upbeat outlook and geared up the balance sheet. We also saw Jumbo Interactive (JIN) fall 27% after providing a trading update which was below market expectations. We have previously owned JIN but sold it (albeit too early) on the back of our concerns around the valuation. JIN is a good case study on why we are so strict with our views on valuation support. While JIN's downgrade was low-double-digit miss to consensus, the stock fell by nearly double this level given the lofty multiple it was trading on. Another downgrade was SmartGroup (SIQ) which fell 23% after a weaker-than-anticipated trading update, reflecting changes to insurance products from their underwriters so close to the retirement of its long serving CEO.

Looking out into CY20, the Small Ordinaries Index is trading on a one year forward PE of 16.6x which is a 6% premium to its five year average, while the Small Industrial Index is trading at 18.2x which is an 11% premium to its five year average. We continue to believe there is inherent value in our portfolio and are positioning it for the catalyst rich reporting season in February where we hope to see some of this value realised.

On a stock specific front during December Aerometrex (AMX) one of our Pre-IPO positions floated. We invested in AMX in June 19 through a convertible note (our preferred structure). AMX is a professional aerial mapping business, specialising in aerial photography, photogrammetry, LiDAR, 3D modelling and aerial imagery subscription services. What attracted us to the investment was the fact it had been operating for over 20 years and had grown strongly with minimal external capital being invested into the business. Our convertible note structure resulted in an entry price of $1.00 or A$94m market cap with downside protection secured against physical assets. At the end of December AMX has returned 97% and was a key contributor to this month's strong performance. As a Fund we have the capacity to hold unlisted investments which we hold at cost. While the unlisted component of the Ellerston Australia Micro Cap Fund will remain small given our daily liquidity requirements, it does provide our unit holders with additional alpha and exposure to securities which would be unavailable in a pure listed equity micro-cap fund. We have several Pre-IPO holdings which should be released throughout CY 2020.

Another positive outcome this month was our investment in Village Roadshow (VRL), which operates cinemas and theme parks around Australia, including Movie World and Seaworld on the Gold Coast. VRL's core assets have proven to be high-quality and the capital structure has created good buying opportunities over recent years. We bought back into VRL around June 2018 (approx. $2.00 share price & $300m market cap). At this point the gearing (Net Debt/EBITDA) had blown out to around 4x, as its theme park EBITDA had dropped from $80m in FY16 to $42m FY18 on the back of the Dreamworld tragedy (owned by Ardent – ALG ASX). Our view was pretty simple, the company had multiple leavers within its reach to drive earnings growth, but we knew that the balance sheet needed to be repaired. Despite our view that Net Debt/EBITDA should be under 3x for this type of asset, we thought the company had two choices - either a discounted equity raise or figure out how to grow earnings quicker than the market expected to repair its balance sheet. As it turns out the company did a combination of both.

Investment Objective

To provide investors with long term capital growth via investing in a portfolio of quality Australian & New Zealand Micro Cap companies. The fund aims to outperform the S&P/ASX Small Ordinaries Accumulation Index over the medium to long term.

Investment Strategy

The Fund employs an active, research-driven investment approach which seeks to identify and invest in companies that are believed to have the potential to deliver significant upside over the medium term and where there is a reasonable margin of safety to mitigate downside risk. Positions are actively managed within the Fund.

Key Information

Strategy Inception	1 May 2017
Portfolio Manager	David Keelan & Alexandra Clarke
Application Price	$1.5821
Net Asset Value	$1.5782
Redemption Price	$1.5743
Liquidity	Daily
No Stocks	57
Management Fee	1.20%
Performance Fee	20%
Buy/Sell Spread	0.25%/0.25%

In December VRL received an indicative bid from Pacific Equity Partners Pty Ltd (PEP) at $3.90 per share, an approximate 30% premium. We believe the valuation should be higher for the following reasons: 1) global peers have been acquired for a considerably higher premium, 2) the company has some potential easy wins on the cost front and 3) theme park earnings growth is expected to accelerate during the next 3 to 5 years. Despite VRL trading near its takeover value, we continue to hold the stock and will wait to see how the takeover plays out.

David Keelan

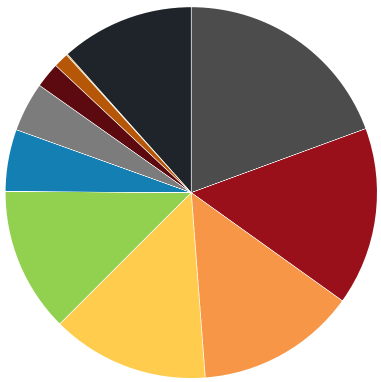
Alexandra Clarke

PORTFOLIO CHARACTERISTICS

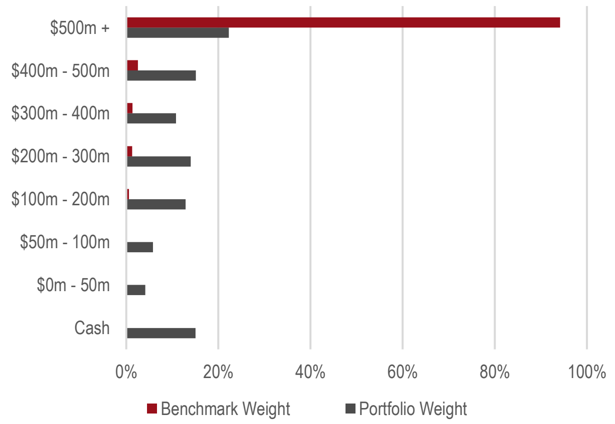
KEY PORTFOLIO METRICS

FY20e	Fund	Benchmark
Price/Earnings	18x	18.6x
Dividend Yield	1.40%	3.00%
Net Debt/EBITDA	0.0x	1.4x

SECTOR ALLOCATION



MARKET CAPITALISATION



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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