Ellerston Capital

Ellerston Australian Share Fund (ASF)

Performance Report | December 19

PERFORMANCE SUMMARY

Net %	1 Month	3 Month	FYTD 2020	1 Yr	5 Yr p.a.	Strategy Since Inception p.a.
ASF	-1.54	4.73	13.88	18.84	7.95	9.19
Benchmark	-2.17	0.68	3.06	23.40	8.98	10.53

Past performance is not a reliable indicator of future performance.

MARKET COMMENTARY

Market Overview

In December, global equities squeezed higher with Australia being the exception. Developed Markets rose 5.2% in local currency terms, outperforming Emerging Markets which rose 2.3%, despite strong gains in Argentina, Brazil and China. Investors were encouraged by positive developments in the discussions between the US and China regarding their ongoing trade war.

USA

The US equities market continued to rally in December buoyed by positive headlines on the trade war with China and reinforced by solid economic data. The Dow Jones Industrial Average Index was up 1.9%, while the NASDAQ returned an impressive +3.6%. The best performing sectors for the month were Energy and Information Technology.

The S&P 500 had its fourth consecutive month in the black with a return of +3.0%, capping off a very strong calendar year that rewarded investors with a total return of +31.5% and enduring the first decade without a recession. Impressively, 67 of the 68 S&P 1500 Industries (GICSL3) finished in positive territory. The top 5 stocks for 2019 (AAPL, MSFT, FB, GOOGL and AMZN) accounted for 730 basis points of the S&P 500's 31.5% gain, or circa 23% of the performance, very similar to last calendar year's percentage contribution.

The markets finally had some concrete good news on the trade war front towards the end of the year after it was confirmed that the US and China had agreed to a "phase one" trade deal. Also, a stronger non-farm payroll number which showed that payrolls had increased to 266,000 in November against an estimate of 180,000, contributed positively to investor sentiment.

Europe

European equities overall were also in positive territory, with the Euro Stoxx returning +1.2%. The month started with some trepidation with respect to the trade war, but equities rallied with the announcement of the "phase one" deal and the resounding re-election of the Conservative Party in the UK.

The UK's FTSE 100 was up 2.8%, lifted by the convincing victory by the Conservative Party. France's CAC 40 was up 1.3%, while Germany's DAX was only modestly in positive territory, returning +0.1%.

Activity indicators may have bottomed, with flash Eurozone manufacturing PMI for November of 46.9, ahead of consensus of 46.6.

Asia

Asian equities finished December in positive territory after enduring a few months of protests in Hong Kong and trade-war related uncertainty. Markets were stronger after a fresh round of tariffs on Chinese consumer goods were averted following the "phase one" deal on trade.

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	$1.0117
Liquidity	Daily
Application Price	$1.0142
Redemption Price	$1.0092
No Stocks	24
Management Fee	0.90%
Buy/Sell Spread	0.25%
Performance Fee	15%

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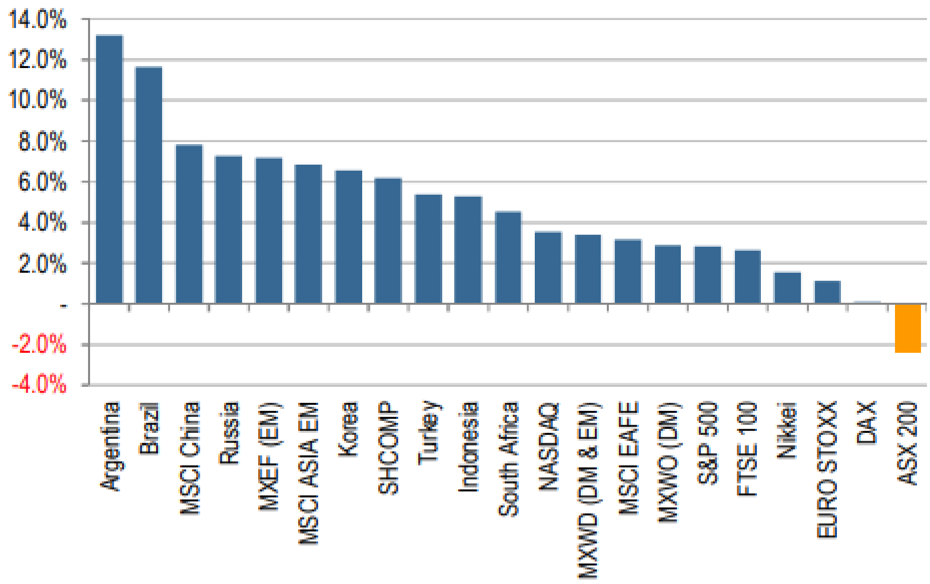
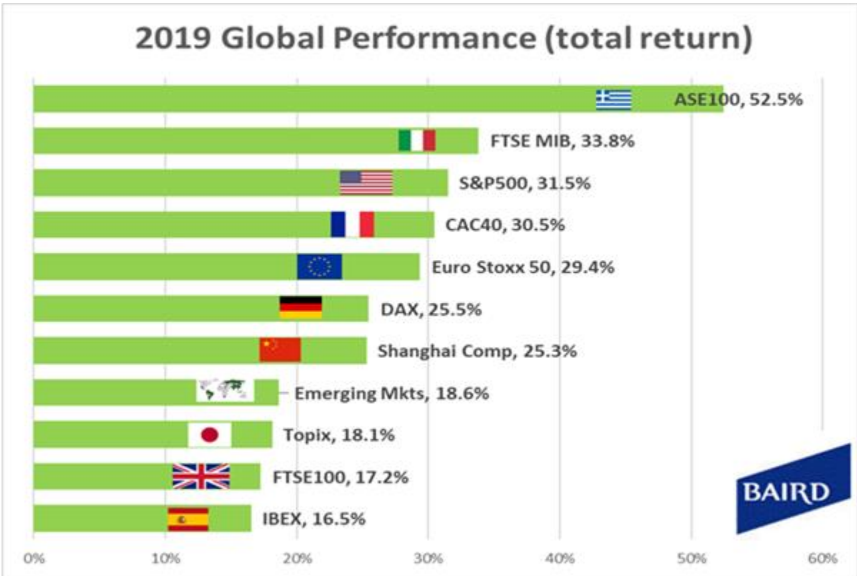
In Hong Kong, the Hang Seng Index rallied strongly, up 7.0%, China's SSE Total Market Index returned +6.5%, and Korea's KOPSI Composite Index was up 5.3%. Japan and India rose more modestly in comparison: Japan's Nikkei 225 was up 1.7% and India's S&P BSE Sensex was up 1.1%.

Global Equity Markets' Performance in December 2019



Source: JP Morgan, Bloomberg.

Global equity market returns - Greece leads the way up 52%, with Spain lagging, up 16.5%.

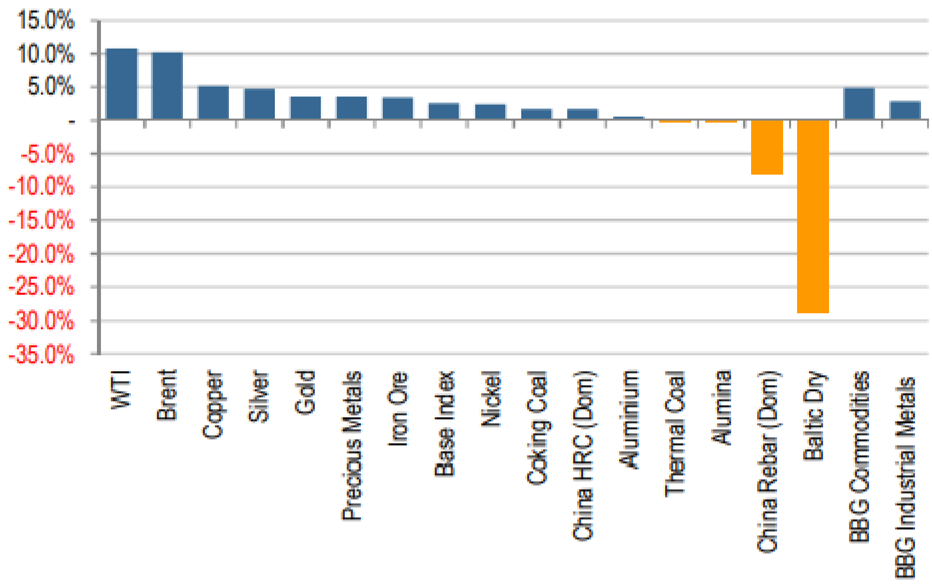


Source: Robert W. Baird Limited, January 2020

Commodities

Bulk commodities were mixed, with iron ore up 3.4% to US$90.50/t, whilst thermal coal drifted lower. Brent oil rose 10.3% to US$66/bbl, while gold prices rose to $1,517/oz. as geopolitical risks rose.

Commodity Performance in December 2019



Source: JP Morgan, Bloomberg.

Bonds

Global bond yields sold off again in December. The US 10-year bond yield rose 14 basis points to 1.92% and the Australian 10-year bond yield rose 34 basis points to 1.37%, the highest level since July 2019.

Australia

The S&P/ASX 200 Accumulation Index bucked the trend and had a poor month, with a return of -2.2%, but was one of the top performing global equity indices in both AUD and USD terms for the year. The domestic market finished the calendar year with a total return of 23.4%, its best performance since 2009 and rising from the ashes of a dreadful end to the previous year, where global equities sold off sharply in December 2018.

In December, the best three performing sectors in terms of their contribution to the index's performance were Materials up 1.6%, with BHP Group (+1.8%), Fortescue Metals Group (+9.9%) and Rio Tinto (+3.6%) being the top three stocks contributing to the ASX 200 index's return, Utilities (+0.8%) and Energy (-1.5%).

Bond proxies came under pressure, buffeted by the headwind of rising treasury yields which posted their largest increase since July. The bottom three sectors were Consumer Staples -8.1%, (with Woolworths Group (-9.1%) being the single largest detractor from the index's performance), Financials -1.6% and Real Estate (-4.8%).

The ASX 200 Resources Accumulation Index, with a return of +1.4% outperformed, followed by the Small Ordinaries Accumulation Index ASX (-0.3%), with the wooden spoon being awarded to the ASX 200 Industrial Accumulation Index which posted a return of -3.0%.

The top five stocks that detracted from the performance of the S&P/ASX 200 Accumulation Index were Woolworths Group (-26 points), Telstra Corporation (-21 points), National Australia Bank (-20 points), CSL (-19 points) and Goodman Group (-11 points).

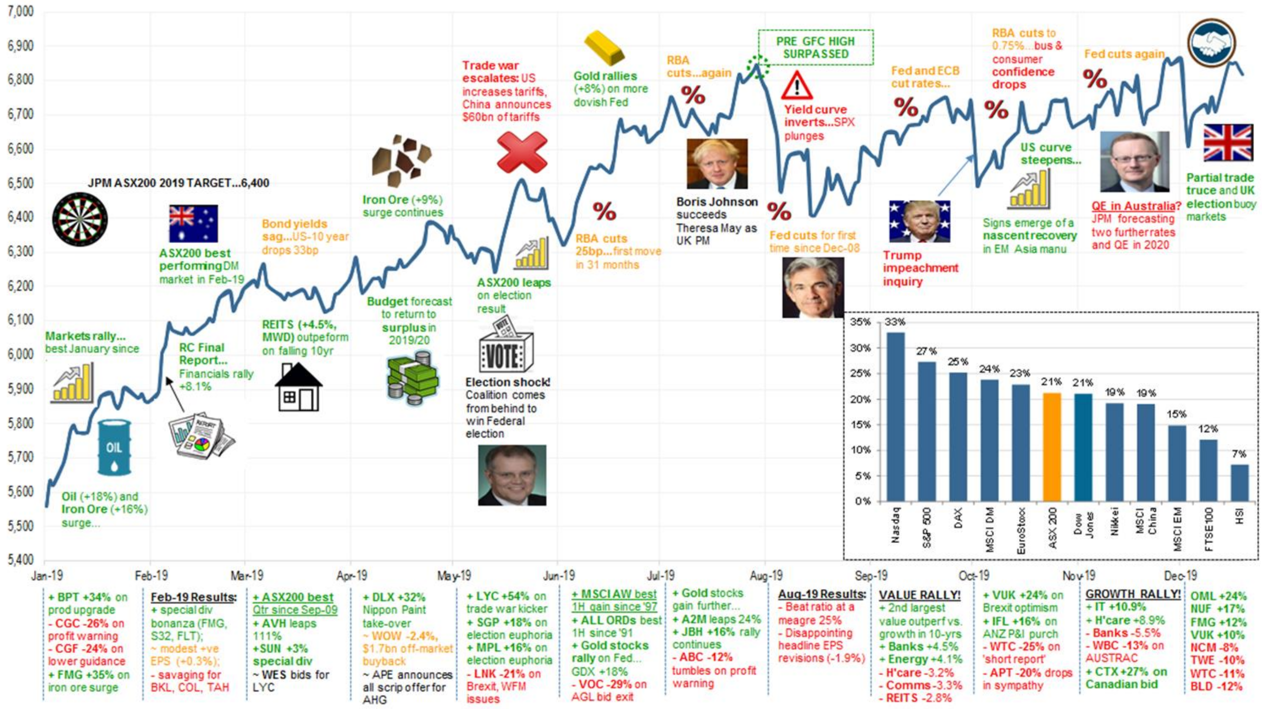
Conversely, the top five stocks that made a positive contribution to the index's return were BHP Group (+11 points), Fortescue Metals Group (+9 points), Rio Tinto (+7 points), Northern Star Resources (+6 points) and Magellan Financial Group (+4 points).

It was a mixed bag on the economics front. NAB business confidence dropped to +0 from +2 previously. October retail sales missed expectations and were flat at 0.0% month-on-month. But employment in November was ahead of expectations, lifting by almost 40,000 against consensus of 15,000.

The RBA left interest rates unchanged at 0.75%, and economic growth, measured by GDP, was in line with expectations at 1.7% year-on-year (in the third quarter of 2019) annualised.

The Australian dollar rose 3.5% against the US dollar, and ended the month at 0.70 cents.

Review of the 2019 calendar year: the pictorial below captures the key events and performance



Source: JP Morgan, Bloomberg

Following the frightening conclusion to 2018, we commenced 2019 more positively, with the ASX200 rising for seven consecutive months from January. Healthcare dominated yet again, rising an astonishing 45%, led by CSL which was the driver of the sector's outperformance, up 52.6%. This gain equates to an increase in market capitalisation of $44.2 billion, which, for context, is almost the current market cap of Wesfarmers at $48billion! A horrendous year for the Banks dragged Financials into last position on the YTD table, albeit still with a gain of 13.5%.

COMPANY SPECIFIC NEWS

The Market Misses

Jumbo Interactive (JIN -27.3%)

The online retailer of lottery tickets issued an underwhelming trading update in December. Revenue from the core lotteries business continues to grow at a rapid rate on the back of good jackpot activity. However, the company is investing more in its emerging 'Software as a Service' business to deliver its customer growth targets. Accordingly, EBITDA margins will be significantly lower in the near term, leaving investors underwhelmed.

Smart Group (SIQ -23.3%)

Downgraded FY20 profit by ~5% due to a change in the level of commission on its insurance products, resulting in an estimated $4m reduction in 2H20 profit and an $8m reduction in FY21. The downgrade compounded nerves post the long-term CEO resigning in November 2019.

Perenti Global (PRN -16.7%)

Following on from last month's tragic incident in Burkina Faso, PRN advised in its December update that the Ghana Manganese Company had terminated its equipment hire contract with the company. As a result, PRN now expects underlying FY20 NPAT to be approximately $115 - $120 million, down from previous guidance of approximately $140 million.

Whitehaven Coal (WHC -16.2%)

The company downgraded its coal production guidance for FY20 by 8% and increased its unit cost forecast by 7% due to operational issues at its Maules Creek coal mine in NSW. Operations were negatively impacted by skilled labour shortages and the impacts of dust management, exacerbated by the severe drought conditions in NSW.

Viva Energy Group (VEA -15.4%)

Viva provided an underwhelming earnings update in December, guiding to EBITDA of $625m-$655m for CY19. The Retail, Commercial and Refining divisions, all missed expectations, as cost pressures proved difficult to offset.

WiseTech Global (WTC -14.3%)

WTC continues to get caught up in the tug of war between short sellers and long-term investors. With further acquisitions undertaken during December, the stock is likely to stay under close scrutiny.

Southern Cross Media (SXL-13.5%)

The company provided very soft earnings guidance back in October and the share price has been out of favour ever since.

Treasury Wine Estates (TWE -13.2%)

TWE came under renewed pressure after the company announced that Australian MD Angus McPherson would no longer take up his position as head of the US due to personal circumstances. Ben Dollard, a long-term executive at Constellation, was installed to head-up the US market. This news was coupled with major shareholder, Capital Group reducing its shareholding to 8.6%, spooking the market.

Boral (BLD -12.8%)

Revelations of "financial irregularities" in its North American Windows business and the engagement of forensic accountants to get to the bottom of the "misreporting" resulted in a one-off hit to earnings to the tune of ~A$29-43 million and a likely permanent, material reduction in the division's future earnings. CEO Mike Kane subsequently came under increasing pressure from some investors and commentators to step down, but is yet to yield to their demands.

McMillan Shakespeare (MMS -12.4%)

Downgraded FY20 profit guidance by 4% blaming challenging market conditions and regulatory changes impacting commissions received on credit and insurance products.

The Market Hits

Silver Lake Resources / Gold Road Resources (SLR +20.7% / GOR +18.6%)

Silver Lake performed strongly due to the increase in the gold price together with a recent outperform initiation by a major stockbroker. Apart from the bullion price impact, Gold Road announced some extension drilling results at its Gruyere mine joint venture which were encouraging.

Northern Star Resources (NST +17.9%)

The company acquired Newmont Goldcorp's 50% share of the Kalgoorlie Super Pit in WA for $1.2bn, funded by a $765m equity placement at $9.00 per share and debt, which the market viewed as highly accretive. This together with a material operational improvement announced at its key Pogo gold mine in Alaska and the increase in the gold price provided a strong tailwind for the share price.

Nufarm (NUF +17.0%)

The crop protection manufacturer bounced back after the earnings downgrade it issued back in November. Weather conditions, especially in Australia, are yet to materially improve, but there are signs the US federal government via the EPA and Justice Department is stepping up its defence of the biggest manufacturer of glyphosate products in North America, Bayer, in the US courts by filing "friends of the court" briefs on December 21st. Trump's recent support for Monsanto which was acquired by Bayer has also prompted some short covering. As widely reported in the media, Bayer is being sued by numerous parties who believe glyphosate caused their non-Hodgkin's lymphoma.

oOH! Media (OML +16.3%)

The out-of-home advertising company bucked the trend in the media sector and surprised the market with an earnings upgrade. Revenues have been stronger in the December half than what was factored into the weak guidance provided back in August. The structural shift in advertising dollars from newspapers, TV and radio to outdoor billboards continues.

Bega Cheese (BGA +14.3%)

BGA rallied during the month after providing an update to the market on the 23rd re-confirming guidance issued in October, and that the new Lactoferrin facility in Koroit will be fully operational in FY21.

Cooper Energy (COE +13.1%)

Cooper Energy announced that after 6 months of delays, the company's $360m Sole gas project in the Gippsland basin was on track to deliver gas to the Orbost plant in late January 2020. APA Group, the Orbost gas plant owner, received the handover for commissioning from the construction contractor, Downer Limited on 10 December.

PolyNovo (PNV +10.1%)

The Australian medical device company that designs, develops and manufactures skin regeneration solutions received an important regulatory approval that will enable its product to be sold into the UK and EU for use in a wide range of dermal loss procedures including burns, reconstructive surgery, ulcers and pressure injuries.

Fortescue Metals Group (FMG +9.9%)

The third largest iron ore producer in Australia, benefitted from the kick in iron ore prices. Higher winter demand in China due to milder weather conditions, higher steel prices, together with lower Brazilian iron ore supply, lifted iron ore prices from already elevated levels.

Resolute Mining (RSG +9.1%)

Resolute Mining, which also benefitted from the rise in the gold price, announced completion of the stage 1 of its Queensland Ravenswood mill expansion to 5Mtpa for target production of 80kozpa, with stage 2 to commence in 2020 and expected to produce 200kozpa from 2022. It also announced that the damaged sulphide roaster at its Syama gold mine in Mali, which reduced gold production, was repaired and now fully operational.

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FUND PERFORMANCE

The Fund consolidated earlier gains made in the second half of the calendar year by returning -1.45% for the month of December, outperforming the benchmark return of -2.17% by 72 basis points.

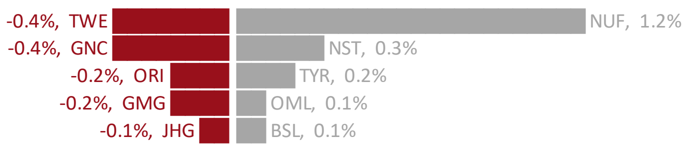
The 2019 calendar year was very much a "Tale of Two Halves". After a very disappointing first half, pleasingly, the new 2020 Financial Year has kicked off on a very strong footing and the Fund has delivered a V-shaped performance recovery across the portfolio.

Strong performance and rebounds in the share prices of Core stocks (where we held our nerve mid-way through the year and actually strengthened many positions), namely Nufarm, Caltex, TWE, Origin, James Hardie, Bluescope, Aristocrat, Janus Henderson, Downer, Macquarie Bank, Orica and JB Hi-Fi and at the same time remaining significantly underweight the Financials sector, were the key drivers of alpha over the last 6 months.

RETURNS[1] (%)	GROSS	BENCHMARK*	EXCESS	NET
1 MONTH	-1.45	-2.17	0.72	0.63
3 MONTH	5.03	0.68	4.34	4.05
2020 FYTD	14.50	3.06	11.44	10.82
CALENDAR YEAR 2019	20.14	23.40	-3.25	-4.56
5 YEARS (P.A.)	9.10	8.98	0.13	-1.02
SINCE INCEPTION (P.A.)	10.37	10.53	-0.16	-1.34

Past performance is not a reliable indicator of future performance.

Securities Held



Securities Not Held

Source: Ellerston Capital.

The main positive contributors to this month's outperformance were:

Overweight positions in Nufarm (NUF +17.0%), Northern Star Resources (NST +17.9%), Tyro Payments (TYR +28.0%), Ooh Media (OML +16.3%) and Bluescope Steel (BSL +3.5%).

Zero weight positions that helped performance included; Woolworths (WOW -9.1%), Telstra (TLS -8.3%), National Australia Bank (NAB -4.9%), and Coles Group (COL -8.7%) which all underperformed the market.

The main detractors to relative performance for the month were overweight holdings in; Treasury Wine Estates (TWE -13.2%), Graincorp (GNC -6.8%), Orica (ORI -7.6), Goodman Group (-8.8%) and James Hardie (JHX -3.8%).

Underweight positions that constrained returns included; BHP (BHP +1.8%), Rio Tinto (RIO +3.6%), Fortescue Metails (FMG 9.9%) and Commonwealth Bank (CBA -1.1%).

[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

We added two new stocks to the portfolio: Nextdc and Northern Star Resources. We have detailed write-ups below.

The fund was also active during the month trimming core positions that have either performed very strongly in recent times or where we've decided to right size the position in the portfolio due to lower conviction.

NEW STOCKS ADDED	STOCKS EXITED
• Nextdc	
• Northern Star Resources	

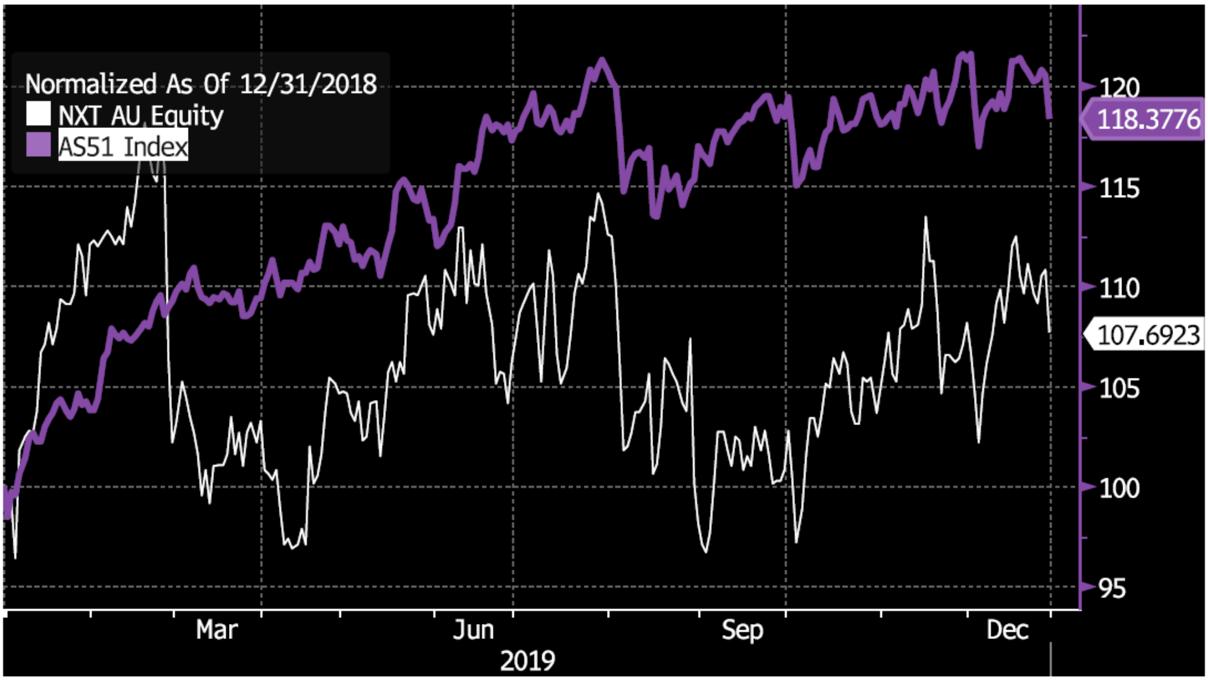
POSITIONS INCREASED	POSITIONS DECREASED
• Medibank Private	• Aristocrat Leisure
• Goodman Group	• James Hardie Industries
	• Flight Centre
	• Orica
	• Origin Energy
	• Woodside Petroleum

NEXTDC

Investment Summary

We introduced Nextdc (NXT) to the portfolio this month after a significant period of underperformance by the company. We see two major catalysts on the horizon which should turnaround the stocks' fortunes. Completion of the 2nd generation assets, particularly in Sydney and the potential to tap into alternative funding sources to fund the 3rd generation centres.

2019 performance NXT vs ASX 200



Source: Bloomberg

Key Facts

- NXT is highly leveraged to growth in cloud demand, IT outsourcing and software-as-a-service (SaaS) adoption. Global cloud demand is likely to continue on an incredible growth path driven by the Internet of Things, mobile 5G, Blockchain and Artificial Intelligence. Supply/demand balance is still in favour of the data centre (DC) providers.
- NXT is currently well funded to meet expansion across its multiple markets. A build-on-demand model lowers the need for capital.
- NXT has developed high barriers to entry. Unique availability zones and an enterprise eco-system are competitive advantages.
- NXT's revenue streams are highly predictable, with long term contracts extending out over 10 years.
- NXT's financials are at an inflection point and will improve as the business matures with EBITDA margins north of 60% and ROIC in excess of 15% achievable.

Company background

Nextdc is Australia's premier data centre provider with multiple assets across the country's major cities including Sydney, Melbourne, Brisbane, Perth and Canberra. NXT has built and fully leased its 1st generation centres in Sydney, Melbourne, Brisbane and Perth. Second generation centres in Melbourne, Sydney and Brisbane are under construction. The company recently announced plans to acquire two new sites in Sydney and Melbourne with S3 & M3 both targeted at 80MW. S3 has recently received development approval and will lift NXT's total capacity to over 300MW.

Source: Company Reports

Demand driven by the cloud

According to industry specialist IDC, the total data produced is expected to double every 2 years and needs to be stored. Increasingly, the cloud will be that storage destination.

Australia has six major hyper-scale cloud providers including: Amazon (AWS), Microsoft, IBM, Google, Oracle and Alibaba Cloud which are all strategic partners with NXT.

The table below outlines the growth in demand from the "super 6" over the next 3 years according to external estimates. Effectively, the hyper-scale providers will require ~350MW of storage space over 3-5 years and total incremental demand could be up to 500MW over the same time period.

Forecasts in September 2018	June 2018 Footprint (MW)	1-2yr growth (MW)	3-5yr growth (MW)	1yr Comment based on Industry Feedback
AWS	65	20-40	70-100	Demand tracking to top end
Microsoft Azure/Office365	53	20-40	70-100	Demand already above top end
IBM Bluemix	26	5-10	10-15	Demand tracking to top end
Google Cloud	6	0-5	15-20	Demand already at top end
Oracle Cloud	2	5-10	30-50	Demand tracking to top end
Alibaba Cloud	15	10-15	30-50	Demand tracking to mid-point
Tencent	5	5-10	15-20	Demand tracking to mid-point
Baidu	0	0-5	5-10	no update
Facebook	0	0-5	5-10	no update
Apple	0	0-5	5-10	no update
Samsung	0	0-5	5-10	no update
TOTAL HYPERSCALE	172	75-160	275-425	
Retail/Wholesale/Network	217	25-40	80-120	
TOTAL Industry	389	100-200	355-545	

Source: Company Reports

Leading specialist research firm Gartner predicts that 80% of all organisations will shift workloads to co-location and cloud based computing models by 2025. Not only will this drive demand it will ensure co-location sites, like NXT's will remain a priority.

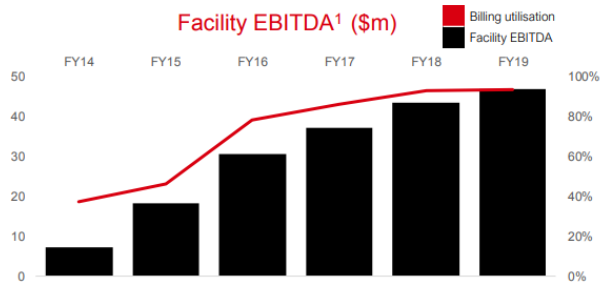
Mature returns

Below is a case study of detailing the ramp up and returns of M1 & S1. The returns profile is similar across all of NXT's fully utilised facilities. Key observations to note are a steady build-up of EBITDA and margins over the ramp-up in the facility, which have settled at north of 70%.

Case study – **M1** Melbourne

★ Highlights

- NEXTDC's second facility, commenced operations in September 2012
- Break-even reached after 11 months of operation

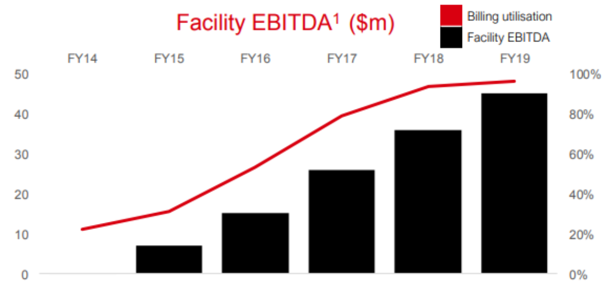


($'000s) Period ended	FY14	FY15	FY16	FY17	FY18	FY19
Billing utilisation[2]	37%	46%	78%	86%	93%	93%
Recurring revenue	14,051	25,522	38,231	48,193	59,550	61,306
Project revenue	2,254	2,261	4,310	3,122	3,005	1,656
Gross data centre revenue	16,305	27,782	42,541	51,315	62,554	62,962
Facility EBITDA[1]	7,010	18,047	30,620	37,261	43,534	46,783
EBITDA margin %	43%	65%	72%	73%	70%	74%
Fitout capex to date ($m)	84	87	120	139	147	150
Property value at cost ($m)	–	–	–	–	–	98

Case study – **S1** Sydney

★ Highlights

- NEXTDC's fourth facility commenced operations in September 2013
- Break-even reached after 7 months of operation



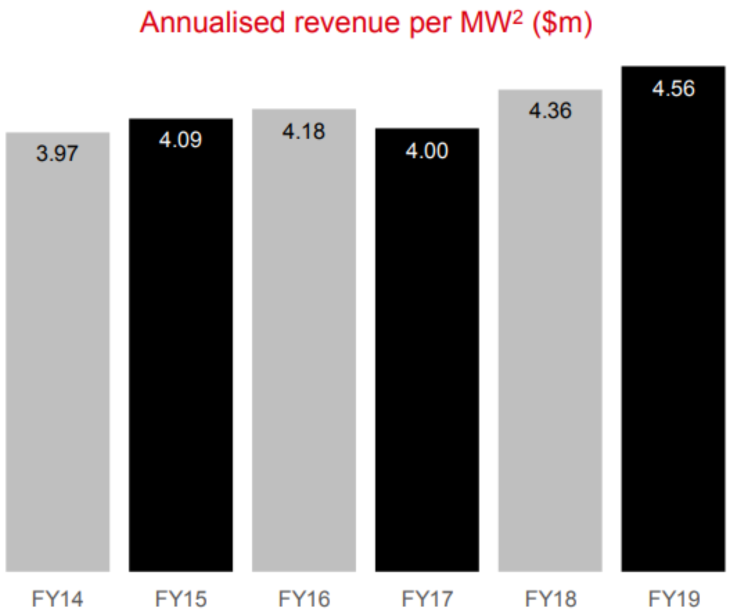
($'000s) Period ended	FY14	FY15	FY16	FY17	FY18	FY19
Billing utilisation[2]	22%	31%	53%	79%	94%	96%
Recurring revenue	4,069	12,711	22,195	34,730	51,111	59,140
Project revenue	1,825	3,703	4,147	6,274	5,073	2,943
Gross data centre revenue	5,894	16,414	26,342	41,004	56,184	62,083
Facility EBITDA[1]	(295)	6,979	15,176	26,083	36,051	45,364
EBITDA margin %	(5%)	43%	58%	64%	64%	73%
Fitout capex to date ($m)	64	78	114	135	155	160
Property value at cost ($m)	–	–	–	–	–	118

Source: Company Reports

Valuation – over the horizon view

Revenue

Currently NXT is generating revenue per MW of ~$4.6m across its portfolio, which has been growing steadily over the last 4 years. As hyper-scale cloud contracts grow, revenue per MW should probably fall. Our long-term valuation uses a more conservative $3.5m of revenue per MW.



Source: Company Reports

Margins

NXT is generating EBITDA margins north of 70% at its sites which are fully utilised. Whilst HO costs will never be eliminated (unless there is a potential takeover) they are largely fixed and will continue to fall as a % of revenue which should drive up group margin. EBITDA margins of 60% for a mature operation is readily achievable. Currently EBITDA margins for the group are north of 50%.

Fully utilised assets scenario analysis (5 years out)

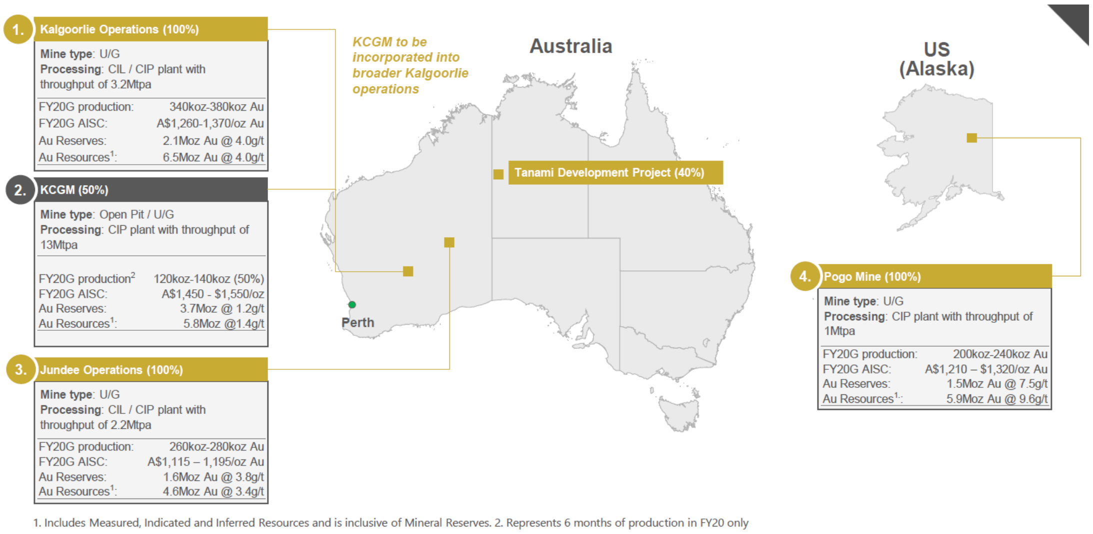
Revenue: 300MW x 3.5m	= $1,050m
EBITDA: $1,050m x 60%	= $630m
EV Multiple: 18x (in-line with mature peers)	=$11,340m
Less Debt + Capex to build 300MW	=$3,000m
Market Cap:	=$8,340m
Share price FY24:	=$24.20
Discount to FY20:	**=$17.30**

Source: Ellerston Capital

Northern Star Resources (NST)

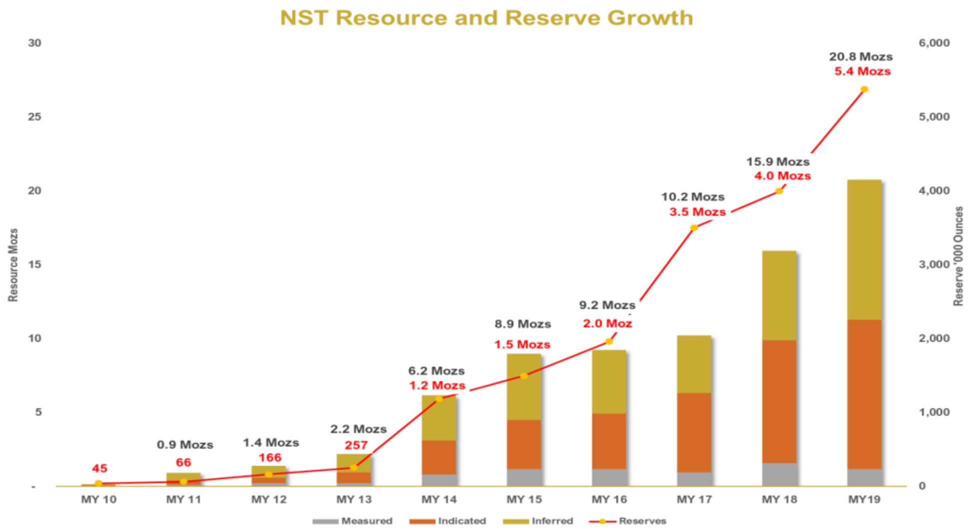
NST is recognised in the industry globally as one of the best underground mining operators of gold mines. The gold industry has for some time struggled to find large gold resources in tier 1 countries. Consequently companies have ventured into higher geo-political risk regions like Africa and Latin America, with very mixed outcomes. The North American gold majors, in particular, have struggled with underground mining. This has created opportunities for smaller companies to acquire assets with short reserve life and allowed them to add value through lower cost structures and, in particular, exploration.

NST Major Assets



Source: Company Reports

NST has been an acquirer of mines sold by gold majors as their open-pit reserves approach the end of their economic lives e.g. acquired Jundee from Newmont Gold for $82.5m with a reported 2 years life in 2014. The mine has produced for 5 years and still has 5+ years of reserves left, with a valuation of $1.7bn (increases of > 300% in reserves and >700% in resources). NST also acquired their Kalgoorlie asset, Kanowna Belle, from Barrick Gold in 2014, for $75m (which also included valuable infrastructure including a 2mtpa mill with a replacement cost of $250m) and have since increased reserves by >500%.

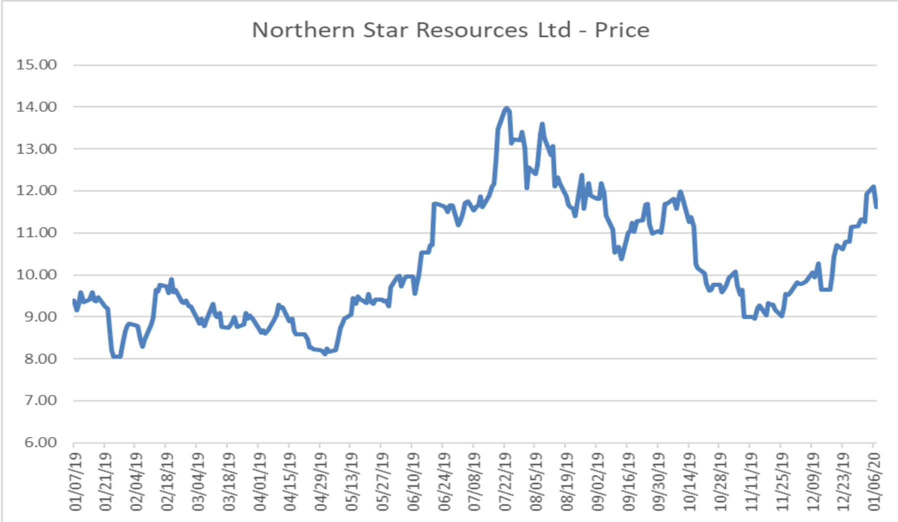


Source: Company Reports

NST has added 5.5moz through exploration near existing operations over the last 5 years. Post the KCGM acquisition NST reserves will be 10Moz and resources of 24Moz.

In 2018, NST acquired the **Pogo Mine in Alaska** from Sumitomo for US$260m. They bought an historic very high grade underground mine which has been starved of capital and exploration. NST is taking longer to turn this mine around than they initially annunciated to the market. This together with a short term operational issue at their Kalgoorlie operation has led to a de-rating of the stock, as management's credibility is on the line as they have executed very well in the past. They are 6 months behind schedule, but the change of mining method and equipment is starting to gain traction. The June 2020 half should demonstrate the production capacity of the mine and restore market confidence. This acquisition is similar in geology and scope to the Jundee acquisition and has even more potential to increase reserves – **Jundee has a 10moz endowment which required 10m metres of drilling, whereas Pogo has the same endowment with only 1m metres of drilling.** The exploration potential is huge.

We used this de-rating as well as the lower gold price which saw NST's share price fall from $14 to $9.50 per share to start accumulating the stock.

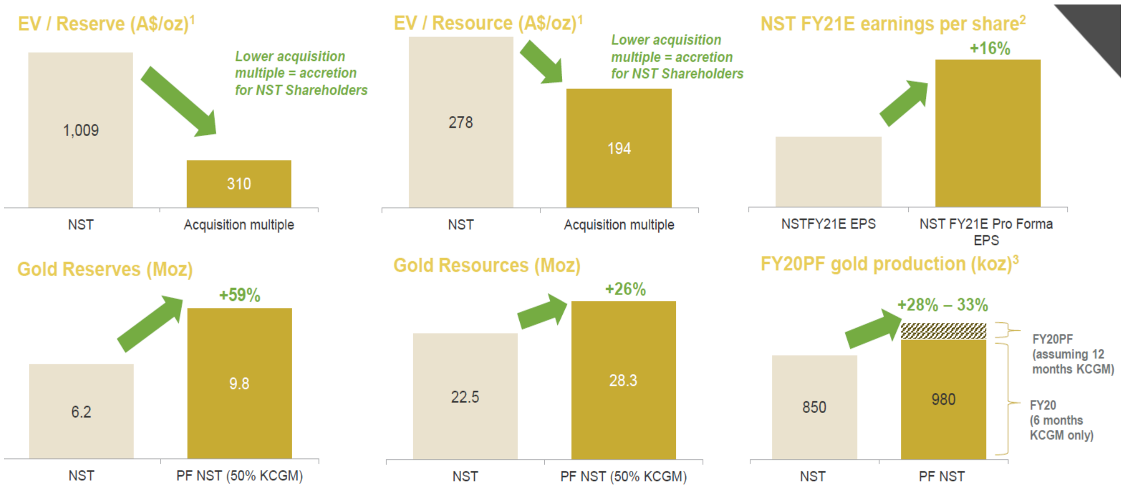


Source: Bloomberg

Not long after, NST announced the **acquisition of a 50% interest in the Kalgoorlie Super Pit**. The details are:

- It acquired Newmont Goldcorp's 50% interest in the Kalgoorlie Super Pit (KCGM) and additional associated assets for US$775m, plus a refundable US$25m option on the nearby Parkeston power plant. The acquisition was funded via a A$765m placement at $9.00 per share and debt.
- The acquisition gives NST a half-share of one of the most significant gold systems in the world with an endowment of ~80Moz and a spectacular gold content of 45,000 to 60,000oz per vertical metre. The acquisition is accretive to EV/reserve, resource and production metrics, NPV and earnings accretive from FY2021. It also extends NST's portfolio mine life from 7 to 12 years. Significant short, medium and long term growth potential exists through optimising mining schedules, underground mine development, expanding resource inventory and exploration.
- The current KCGM mine plan sees a three-year $50mpa (100% basis) investment to remediate the pit wall slip and increase production from the current 570koz toward the previous rate of ~700kozpa.
- NST has a strong balance sheet (Net debt of $400m post the acquisition and gearing of only 11%).

The KCGN Acquisition is accretive on a range of key metrics



Source: Company Reports

We participated in the placement at $9.00 per share

Conclusion

Post the acquisition, NST is on track to **double earnings and gold production to 1.5moz over the next 3 years.** All-in sustaining costs (AISC) should fall 10% for a pre-tax cash margin of $1000/oz and generate a free cashflow yield of 8%, rising to 15% in the next 3 years.

It trades on an attractive FY 2021 EV/EBITDA of 5.1x, moving to 3.6x over the next three years.

On a Discounted Cashflow basis (5% real discount rate – as is standard in the gold industry) and on a flat current spot rate of US$1550/oz, it is **valued at $12.60 (11% upside from $11.31**. Sensitivity is +/- US$100/oz = +/- A$1.25/share (+/- 10% on our valuation).

FUND STRATEGY AND OUTLOOK

As highlighted in the previous section, we added Nextdc and Northern Star to the portfolio. The strategy remains the same otherwise.

We have highlighted several times our concern that valuations appear stretched in the absence of earnings. This remains the case. FY19 earnings growth (which consensus forecasts to be 4.4% this time last year) finished in negative territory, at -0.7% by year end. Despite the significant stimulus measures (3 rate cuts and 1 tax cut) FY20 EPSg is following a similar trajectory, with lofty expectations during the year reaching 10%, now having been pruned to end the year at a more pedestrian 3.8%.

The main concerns facing investors at the beginning of 2019, post the sharp December sell off, were the hawkish Fed, trade war, slowing global growth and a fairly mature bull market. The key driver of markets in the end was the Fed's U-turn and more dovish approach (delivering 3 rate cuts) which helped drive a 31.5% return for the S&P 500. This time, the focus is geopolitics and the pending US election. The Fed is likely to remain on hold in the near-term.

It's difficult to ignore the geopolitical significance of the attack at Baghdad International Airport and killing of General Qassim Soleimani, architect of Iran's foreign military affairs for over two decades and arguably the most powerful man in Iran after the Supreme Leader. Given that the leadership is dominated by hardliners, the question for markets, is how and when Iran will retaliate. For investors, one of the key issues that immediately springs to mind is the impact of the Iranian response on oil prices. This game-changing assassination will no doubt have far-reaching implications for the region and is likely to put a premium on oil prices for the time being.

Iran's military reach across the Middle East certainly provides plenty of options, including retaliatory assassination attempts (with a bounty already put on Trump), bombings of U.S. government installations and attacks on shipping. The wild card is whether this renewed turmoil in the Middle East triggers a sustained sell-off in equities, depressing business and consumer confidence and negatively impacting global growth. We will have to wait and see.

Putting aside a geopolitically intense start to the new year, the next month or so will be key data-centric: industrial production, US employment figures and so on and the ultimate wash up of the trade war. Beijing's heightened concerns on economic growth headwinds and credit contraction pressure prompted a cut early in the new year in the PBoC's reserve rate, freeing up cash for lending, estimated to add ~800 billion renminbi ($164 billion) in extra liquidity to the banking system. We watch with interest.

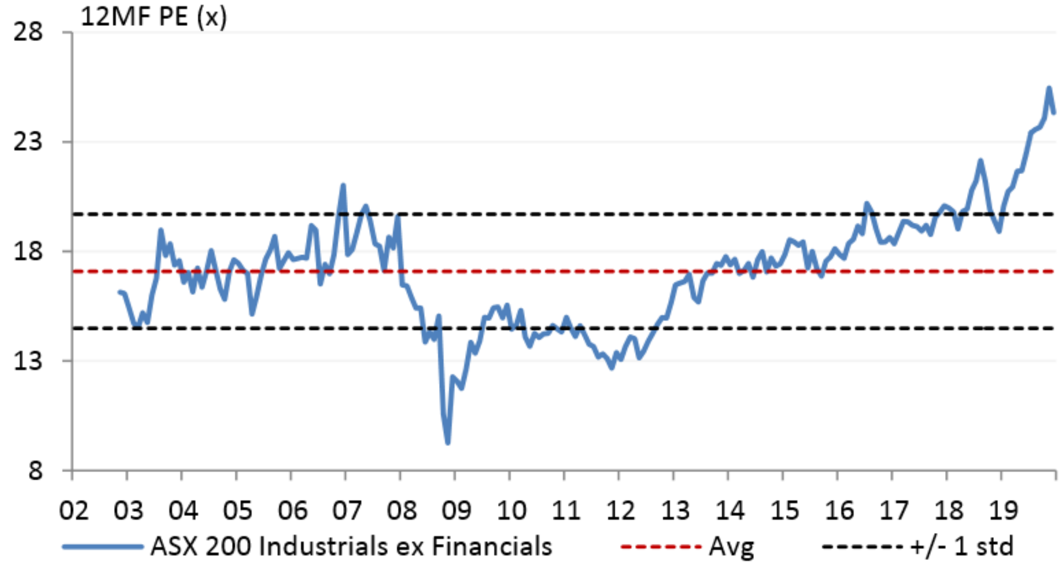
On the domestic front, the bush fires in Australia are also unprecedented in their scale, duration and ferocity. The impact on human life, property, wildlife and nature has been severe and tragic. There have been some very early estimates of the cost of the fires in terms of property and infrastructure. IAG has already said the bush fires will see the company push above it catastrophe allowance for the 1H20. These estimates are likely to increase further and the costs are impossible to ascertain at this stage. The impact on consumer sentiment is even more difficult to estimate. But it is our expectation that a hit to consumer sentiment could impact spending and have a negative impact on domestic economic growth.

Rising geopolitical risks and the bush fires are exogenous shocks that add to our concerns on valuations, investor sentiment and the absence of underlying earnings growth. Central banks have limited fire power to respond should geopolitical tensions derail global growth.

Our stock-focussed strategy remains unchanged and seeks to identify mispriced companies where we believe the market under appreciates the medium to longer-term growth in earnings.

Our near-term discomfort on the Industrials ex. Financials markets 24.3x valuation is driven primarily by the absence of earnings growth. We continue to point out that most of 2019's rally has been driven by PER expansion. Investor sentiment could be dampened further if US-China trade talks stall or get deferred.

ASX 200 Ind-Ex-Fin P/E at 24.3x



Source: IBES, RIMES, Morgan Stanley Research

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, Medibank, Computershare, Treasury Wines, Aristocrat, Goodman Group, James Hardie Industries and Nextdc

2. Businesses that are highly cyclical or seasonal in nature, facing headwinds

Heavily discounted 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, Origin Energy and Northern Star

Warm Regards,

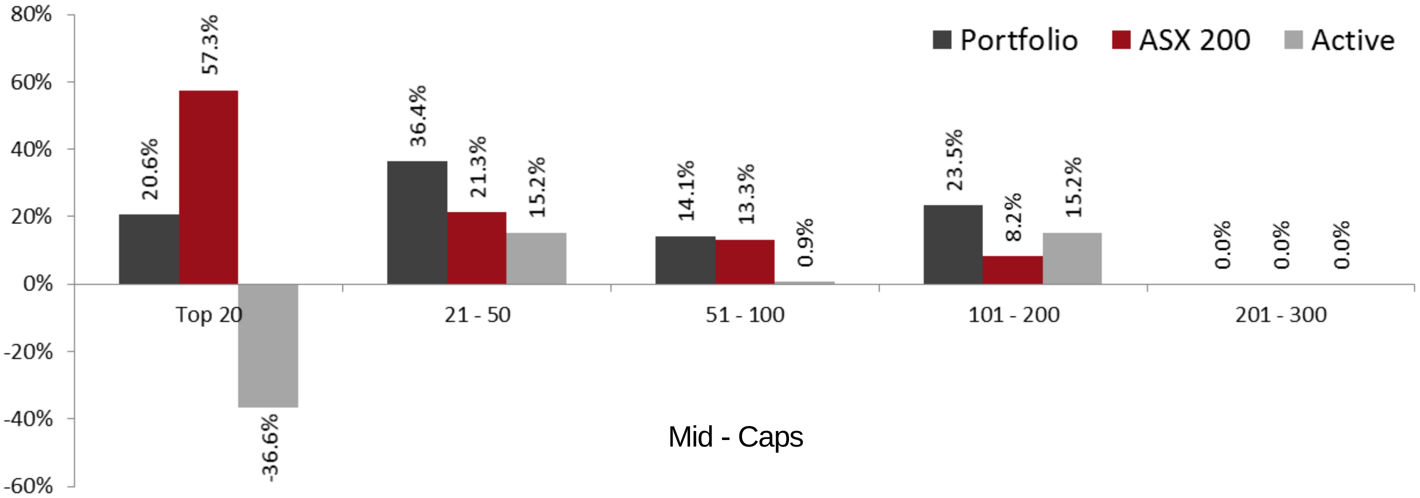
Chris Kourtis

Portfolio Manager

ELLERSTON CAPITAL

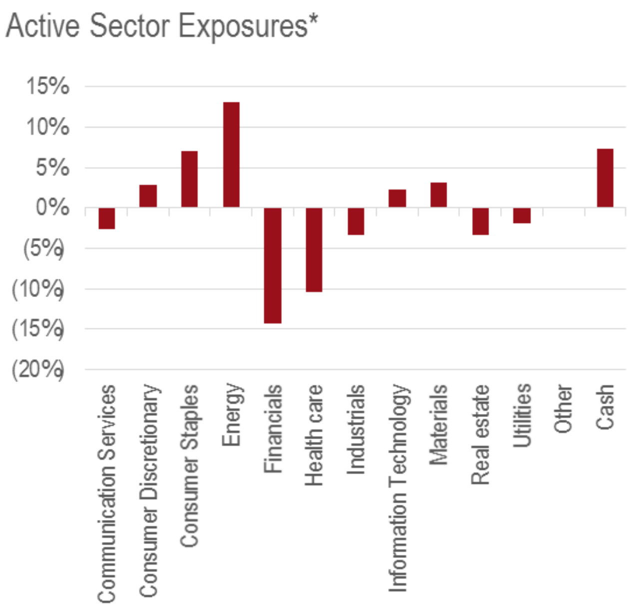
PORTFOLIO FEATURES

Size comparison Chart vs ASX 200^



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

Active Sector Exposures*



TOP 10 HOLDINGS**
ARISTOCRAT LEISURE
CALTEX AUSTRALIA
DOWNER EDI
GOODMAN GROUP
GRAINCORP
MACQUARIE
NUFARM
ORIGIN ENERGY
WESTPAC
WOODSIDE PETROLEUM

Source: Ellerston Capital Limited

* 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	$3.2 BILLION
FUNDS UNDER MANAGEMENT – ASF UNIT TRUST	$39 MILLION
APPLICATION PRICE	$1.0142
REDEMPTION PRICE	$1.0092
NUMBER OF STOCKS	24
INCEPTION DATE	1 APRIL 2009

Source: Ellerston Capital Limited

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