

Ellerston Global Mid Small Cap Fund (Unhedged)

Performance Report | February 20

PERFORMANCE SUMMARY

| Performance | 1 Month | 3 Months | 6 Months | 1 Year | 2 Year | Since Inception (p.a.) |
|------------------|---------|----------|----------|--------|--------|------------------------|
| Net [^] | -4.33% | 0.57% | 8.94% | 24.54% | 12.62% | 14.44% |
| Benchmark* | -5.60% | -3.52% | 3.73% | 11.76% | 9.46% | 11.40% |
| Alpha | 1.27% | 4.09% | 5.21% | 12.78% | 3.16% | 3.04% |

Source: Ellerston Capital Limited

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

* MSCI World Mid Cap Index (AUD)

PORTFOLIO COMMENTARY

The Ellerston Global Mid Small Cap Fund (Unhedged) ('Fund') portfolio declined 4.33% in February outperforming its benchmark by 1.27%.

After a very strong start to the month, equity markets globally have been rocked by the uncertainty surrounding the outbreak of the COVID-19 virus. There is, and will be, an associated economic impact as citizens and businesses globally curtail activity to contain the spread. While Central Banks will lower rates to provide monetary stimulus, the marginal benefit is becoming less apparent as rates are already at low levels. In our view we will need to see concerted fiscal stimulus and while this is not a panacea to the virus, the economic benefits should help partially offset the impacts associated with the dampening activity.

Contributors to performance this month included **SolarEdge**, **Free** and **Keysight**. Detractors from performance included **LivePerson**, **Tempur Sealy** and **XPO Logistics**. We had 14 portfolio companies reporting results during the month and have highlighted a few below:

Keysight reported its first quarter 2020 result with revenues and earnings coming in well ahead of market expectations and above the high end of its guidance. Revenue growth in the quarter was driven by ongoing strength in 5G related investments and increased spending in aerospace defence and semiconductor measurement. Its consistent financial performance illustrates the strength of its differentiated solutions targeting a diverse set of end markets. Also in early March it held an Analyst Day in NYC where Management upgraded long term revenue and margin expectations and while they were broadly in line with existing expectations, it was good to see more granularity around the secular drivers underpinning the business.

LivePerson reported Q4 and full year 2019 revenues ahead of expectations and confirmed FY20 revenues to grow at least 20% with an acceleration in FY21 to at least 25%. While revenues are consistent with past indications, Management indicated it would be spending an additional \$16m in FY20 to build out a payment capability to handle commerce transactions within the messaging platforms it connects with. LivePerson is doing close to 60m conversations per month and with many potentially transactional, it wants to help facilitate payment capability which will benefit both brands and consumers. Along with increased spend, LivePerson announced the transition of its CFO duties to John Collins who has significant data science expertise. The market clearly did not like investing for the future coupled with a CFO change and marked the stock down materially. We continue to believe in the long-term opportunity for LivePerson however did trim the position as we look for further clarity on potential sales impact associated with travel and conference restrictions as LivePerson's customer summits generate strong lead generation.

Tempur Sealy reported a very strong finish to FY19 with fourth quarter revenues and EBITDA ahead of expectations by 13% and 9% respectively. It guided to midpoint EBITDA growth of 20% for FY20 which was pretty much in line with expectations however Management are typically quite conservative. The combination of its powerful omni-channel distribution platform coupled with market leading brands and products continues to drive market share gains and solid financial performance. Tempur Sealy recently acquired a majority interest in Sherwood Bedding, a major manufacturer in the US private label and OEM bedding market. This will give the company a full suite of products offering ranges from private label up to its high end Tempur-Pedic brand. In early March, Tempur Sealy provided a COVID-19 update which indicated North American and European sales were ahead of expectations and more than offsetting weaker

Investment Objective

To outperform MSCI World Mid Cap NR (AUD) benchmark by 3% over a rolling 5 year period on a net of fees basis, with a focus on risk management and capital preservation.

Investment Strategy

The Fund's investment strategy is to construct a concentrated portfolio of global mid small securities using the Manager's distinctively contrarian high conviction, benchmark independent investment approach. The Manager believes that the trade-off between risk and potential returns is improved by implementing highest conviction ideas from a filtered universe of securities that are in a period of "price discovery" and offer the best risk/reward.

Key Information

| | |
|--------------------|--------------------------|
| Strategy Inception | 1 March 2017 |
| Portfolio Manager | Bill Pridham & Arik Star |
| Application Price | \$1.2602 |
| Net Asset Value | \$1.2571 |
| Redemption Price | \$1.2540 |
| Liquidity | Daily |
| No Stocks | 20 - 40 |
| Management Fee | 0.75% |
| Performance Fee | 10% |
| Buy/Sell Spread | 0.25%/0.25% |

*10% of the investment return over the benchmark return (MSCI World Mid Cap Index (AUD)), after recovering any underperformance in past periods.

Asia Pac. On the back of share price weakness, it will be doubling its quarterly share buyback from \$50m to \$100m. Tempur Sealy is one of the few companies providing assuring updates and remains a key position in the Fund.

While we have been providing individual company snapshots, with the current market volatility we thought it useful to provide brief paragraphs on the top 10 positions in the Fund. In connecting tomorrow's returns today, we typically gravitate towards quality businesses which demonstrate some or all of the following attributes: High or dominant market share, high recurring revenues, high revenue retention rates, secular tailwinds and exceptional Management team.

We consider these characteristics underpin pricing power, margin expansion, capital allocation optionality and increasing returns on invested capital. We want investors to be aware of and hopefully comfortable with the long-term opportunities held within the portfolio:



Keysight is the global research and testing market share leader in several multi-year mega trends including 5G, electric and autonomous vehicles and next-gen batteries. When someone is trying to move up the speed of a network or they're trying to invent a new cloud, 5G cell phone or a base station there are basically only three players globally who can provide this expertise: Keysight, Anritsu and private German company Rohde & Schwarz (we own the two listed players). Keysight generated \$4.3bn of revenue, >\$1.1bn EBITDA and just under \$900m of FCF last year and recently upgraded long term guidance in its Analyst Day in early March. It will have a net cash balance sheet this year while generating close to \$1bn of FCF and trades on Non-GAAP PE of 16.5x.



Ciena's business is driven by the growth in global data traffic and is the optical market share leader globally despite not operating within China. For countries to talk to each other you need fiber subsea cables and for data centers to talk to each other (within country or overseas) you need fiber interconnect. Ciena provides the optical hardware to "light up" this fiber and has over 50% market share globally in subsea cable and data center interconnect. It is benefiting from a number of secular growth drivers and has guided to >20% EPS growth over the next three years. The business has a net cash balance sheet, generates close to \$400m of FCF and trades on just over 11x Non GAAP PE (ex cash) and 7.1x EBITDA.



WillScot has over 40% market share in modular office leasing in North America and is by far the dominant player in a space which should benefit from increased infrastructure spend associated with any fiscal stimulus. Modular units are typically leased for over 30 months providing excellent visibility associated with highly recurring revenues. It is delivering mid-teens pricing growth as it re-prices returning units at higher rates and fits these out with value added products which drive both revenue and margins. WillScot has also announced an all scrip merger with Mobile Mini which has continually proven itself to be a leader in portable storage solutions with a rental fleet of approximately 200,000 units across 156 locations in the US, UK and Canada. The combined business will have significant scale and is truly transformative due to the complementary nature of the businesses. WillScot should generate about \$425m EBITDA this year which represents a 6.8x multiple and this is not dissimilar to the proforma valuation despite the combined group delivering long term operational and synergistic benefits.

TEMPUR+SEALY

Tempur Sealy is the global leader in mattresses and bedding with close to 35% market share in the US bedding industry which typically grows about 6% on average. Tempur has been spending pretty aggressively on new innovative product lines such as "Tempur Breeze" and will now benefit from pricing and distribution expansion of the new product lines. Additionally the largest mattress retailer in the US, Mattress Firm, recently came out of bankruptcy and Tempur Sealy has won significant floor space which should drive EBITDA up >20% this year. In early March, Management confirmed solid operating performance despite COVID-19 and doubled its buyback intentions to take advantage of the weak share price. Tempur Sealy is trading on 11.6x PE and 7.5x EBITDA while delivering >9% FCF yield.



Cellnex Telecom is the largest independent owner of mobile phone towers in Europe and is benefiting from a long term outsourcing trend (as telcos sell towers to independent operators) and data growth associated with current and next gen technologies such as 5G. The business benefits from very high recurring revenues underpinning EBITDA margins close to 70%. Cellnex has made a number of strategic and value accretive purchases over the past couple of years and now commands a €44bn contracted revenue backlog providing excellent visibility. Cellnex will continue to augment its market positioning and still has €7bn of available liquidity for future M&A. The business currently generates a mid-single digit FCF yield in Europe where sovereign yields are negative and would represent a great pension asset.



Anritsu has all the same 5G drivers previously highlighted with Keysight and as mentioned we own two of the top three players in the space. Anritsu has a very strong balance sheet which we estimate net cash to represent 18% of its market cap next year. The business is trading on 14.4x PE (ex cash), 8.7x EBITDA and is expected to generate >6% FCF yield this year.



LiveRamp is a business with strong network effects and basically makes it safer and easier for every company to use data more effectively online. It views itself as the Switzerland of data and provides the essential infrastructure to connect the offline and online worlds for more effective advertising. Think of a supermarket who has your email address (this is called first party data) but cannot effectively identify and deliver relevant ads to you when you are on your mobile phone, desktop or tablet. LiveRamp provides this conduit in a secure, private manner and as a result publishers can generate a 10x yield increase because the ad is relevant to you. LiveRamp has guided revenues to grow 25-30% next year with gross margins trending to >70%. The business has a \$2.2bn market cap with just under \$800m of net cash on its balance sheet.



Graphic Packaging operates in a duopoly in the US serving the packaging needs for large consumer goods companies such as Kellogg's, Coca Cola and Nestle to name a few. It produces 52% of all CRB (Coated Recycled Board which is used in consumer goods packaging) and 58% of all CUK (Coated Unbleached Kraft which is made from recycled materials and used to carry beverages). The business is benefiting from a shift in packaging preference from plastic to paper as well as quite high barriers to entry. Graphic Packaging recently confirmed its FY20 guidance at the end of February and currently trades on 11.4x PE and 6.7x EBITDA while generating double digit FCF yield.

XPO Logistics

XPO Logistics is a top 10 global logistics company with about \$17bn of annual revenue operating under transportation and logistics. It operates in 30 countries with >1,500 locations providing good earnings diversity to the group. It holds leading positions in the fastest growing areas of transportation and logistics with more than 60% of revenue coming from sectors that are growing at 2-4x GDP. It has announced a new 10 point profit initiative that is specific to XPO. In total, these initiatives represent an estimated \$700 million to \$1 billion of potential profit improvement by 2022. Strategically, CEO Brad Jacobs has determined that the market is not attributing full value to the group and has embarked on a sale or spin initiative to unlock shareholder value. XPO is currently trading on a little over 7x EBITDA which represents a significant valuation discount to its peer group.

interxion™

Interxion was the last pure play data center owner in Europe covering >75% of European GDP with assets almost impossible to replicate. The reason we say "was" is because Digital Realty (US based data center owner) has bid for the company with the deal likely to close shortly. We consider the combined group will be more powerful than standalone as cross sell and financing options become increasingly apparent. We have voted with the deal and will accept our Digital Realty shares in exchange for our long-held position in Interxion.

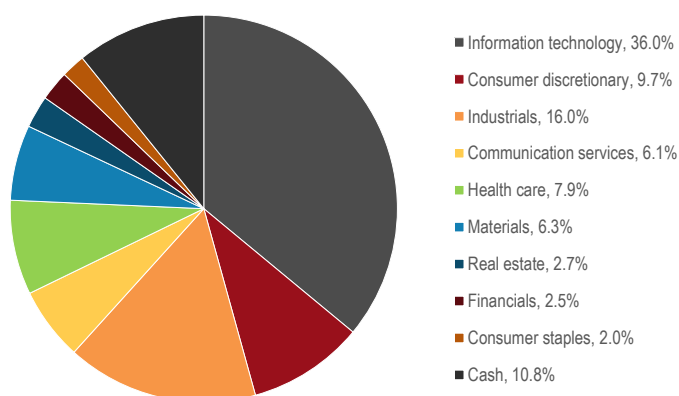
Kind Regards,
Bill Pridham and Arik Star
Co-Portfolio Managers

PORTFOLIO CHARACTERISTICS

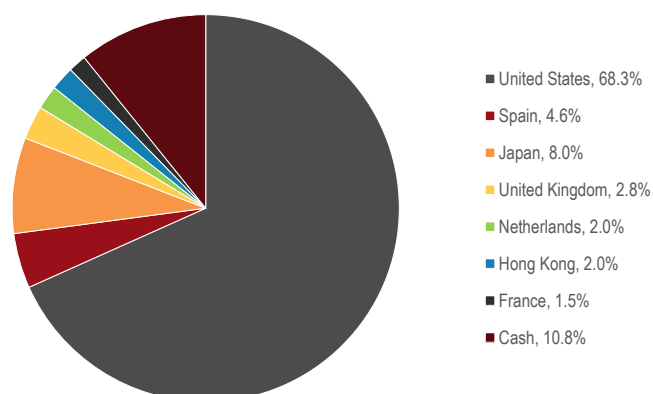
HOLDINGS

| Top 10 holdings | Country | Sector | % |
|----------------------------|---------------|------------------------|------|
| Keysight Technologies Inc | United States | Information Technology | 5.5% |
| Ciena Corporation | United States | Information Technology | 5.2% |
| WillScot Corporation | United States | Industrials | 5.1% |
| Tempur Sealy International | United States | Consumer Discretionary | 4.8% |
| Cellnex Telecom | Spain | Communication Services | 4.6% |
| Anritsu Corporation | Japan | Information Technology | 4.2% |
| LiveRamp Holdings | United States | Information Technology | 4.0% |
| Graphic Packaging | United States | Materials | 3.7% |
| XPO Logistics | United States | Industrials | 3.6% |
| Interxion Holding | United States | Information Technology | 3.3% |

SECTOR ALLOCATION



GEOGRAPHIC ALLOCATION



Source: Ellerston Capital

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

Should investors have any questions or queries regarding the fund, please contact our [Investor Relations team](mailto:investorrelations@ellerstoncapital.com) on 02 9021 7701 or info@ellerstoncapital.com or visit us at <https://ellerstoncapital.com/>

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