

Ellerston Australian Pre-IPO Fund

Performance Report | March 20

COMMENTARY

Welcome to the inaugural Ellerston Australian Pre-IPO Fund quarterly newsletter. Our philosophy around pre IPO's is very simple. We are looking for high quality businesses that have clear pathways to IPO, which offers superior opportunities to achieve returns that are lowly correlated to the market. We are looking to achieve a 20% IRR and given the current state of the market we believe we are well placed to deliver on this target.

Turning now to the broader market, the last six weeks of this year have been challenging. To provide some context towards the back end of February and early March we saw an aggressive sell-off in equities. What was unusual was the fact that the ASX100 (-30%); Small Ordinaries (-32.7%); and Emerging Index (-30%) all suffered similarly between the 20th of February and 17th of March. Whereas normally in market downturns the smaller market cap companies lead the sell-off. Since the peak (c19th of Feb) in February until 3 April the ASX 100 is down 29%; Small Ordinaries' are down 32% and Emerging index is down 40%. While the ASX Small Industrial index was down 33% over the same period of time.

This downturn has been driven by the global spread of the COVID-19 virus, and its far-reaching economic consequences. While the initial bite was felt by the retail, tourism and leisure sectors, as the situation evolved it became clear that very few industries are immune to the economic impact. Several industries were deemed 'non-essential' by the government and many unable to operate under the recently introduced social distancing policies.

The market enjoyed some reprieve later in March, recovering by double digits in the final week of March, which has continued into April. We attribute this rally to the government's unprecedented scale stimulus package which includes wage subsidies, increased and expedited welfare payments, and cash flow assistance/relief for struggling businesses. Whilst the situation has been extremely challenging and clouded with uncertainty, encouraging signals are emerging and we are starting to see light at the end of the tunnel. Australia has successfully flattened its curve of new cases, while other parts of the world appear to be approaching their peaks. China is returning to more normal activity, and it will only be a matter of time until Australia starts to do the same, albeit at a gradual pace.

Given the turmoil in the market, we have many investors wonder how the current situation may change our behaviour and how we choose to invest in pre IPO's. The simple answer is that it doesn't. We continue to look at business with a three to one risk/reward basis that have strong pathway towards cashflow breakeven or are able to stand on their own two feet in the current environment. We are looking to invest predominately in founder lead business who need growth capital to enter their next stage of life.

While we never like to see the environment which we are currently in, we do note that we are in the perfect position being 100% cash and none of our powder has been deployed. We believe the number of opportunities out there has increased exponentially as organisations have to reassess their plans to IPO, or capitalise on opportunities to acquire other organisations which may have attractive IP/geographical exposure at cheaper prices.

When we were on the road we discussed a number of opportunities that we were in late stage due diligence on. All of these deals remain on foot, however, we will note we are taking our time in completing the due diligence, and every opportunity is examined through a microscope, particularly given the current environment. Pleasingly, we are seeing multiples fall and the terms of our deal structures becoming increasingly favourable as time progresses. We also believe new opportunities will continue presenting themselves as companies struggle with working capital or IPO plans are now delayed given market conditions.

Once again welcome to the Ellerston Australian Pre-IPO Fund and we will continue to provide quarterly updates to our shareholders with our next communication coming in June. We look forward to being able to share our deal pipeline going forward and how our future investments are tracking.

Regards

David Keelan & Alexandra Clarke

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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