

Ellerston Global Mid Small Cap Fund

Monthly Newsletter, July 2021

Investment Objective

To outperform the MSCI World Mid Cap NR (AUD) Index 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 Funds investment strategy is to construct a concentrated portfolio of global mid small cap 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
Class A Application Price	\$1.5572
Class A Net Asset Value	\$1.5533
Class A Redemption Price	\$1.5494
Class B Net Asset Value	\$1.3332
Class B Redemption Price	\$1.3299
Liquidity	Daily
No Stocks	20 – 40
Management Fee (Class A)	0.75%
Performance Fee	10% ^{**}
Buy/Sell Spread	0.25% on application 0.25% on redemption

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

Performance Summary

Performance	1 Month	3 Months	6 Months	1 Year	3 Years (p.a.)	Since Inception ^{^^} (p.a.)
Class A [^]	0.49%	6.84%	13.95%	38.32%	18.91%	18.02%
Benchmark [*]	3.25%	8.21%	19.19%	35.25%	12.76%	13.86%
Alpha	-2.76%	-1.37%	-5.24%	3.07%	6.15%	4.16%

Performance	1 Month	3 Months	6 Months	1 Year	3 Years (p.a.)	Since Inception ^{***} (p.a.)
Class B [^]	0.56%	7.17%	14.31%	-	-	34.16%
Benchmark [*]	3.25%	8.21%	19.19%	-	-	31.19%
Alpha	-2.69%	-1.04%	-4.88%	-	-	2.97%

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

^{*} MSCI World Mid Cap Index NR (AUD)

^{***} Class B Inception Date is 18 August 2020

Portfolio Commentary

With the July newsletter release timing very closely with the June quarter earnings season, we will devote the space this month to run through the majority of our company results to provide you with an insight into how our businesses are performing in these extraordinary times. We will look to resume the ESG in Focus and Stock Focus in the next edition.

The Ellerston Global Mid Small Cap Fund (Class A) increased 0.49% net in July and despite all the headlines around peak growth, delta variant case explosions and continued supply chain issues, the MSCI World Mid Cap Index returned 3.25% during the month, ie it didn't feel like that strong of a month to us!

The portfolio's top three contributors for the month **Rentokil, Tempur Sealy and Chart Industries** added **111bps** to performance while **Bed Bath & Beyond, Webster Financial and AZEK** detracted **122bps**. The Fund had 17 portfolio companies reporting quarterly results during July. We will now run through these as well as some early August reports.

We started the season with our regional US Banks, **Commercia, BankUnited and Webster Financial** reporting results well ahead of expectations with earnings coming in between 20% and 45% ahead of the street. The beats were primarily driven by reserve releases as the US economy continues to improve faster than expected. If you remember in a past newsletter we highlighted that the banks reserved c9% of their market caps at the peak of the pandemic – this is now being reversed. The key to outperformance going forward will be a resumption of loan growth and we noted that the June exit rate was much better than full quarter average

and this portends well for future periods. On balance, we left positioning unchanged however added to Webster Financial as it will benefit from synergies associated with its merger with Sterling Bank (completes early Q4), has >27% of its market cap held in excess capital above well capitalised levels and trades on pro-forma EPS <10.0x.

Next, we had **Chart Industries** which is a global leader in mission critical equipment for processing, storage and delivery of industrial gases and a relatively new entrant to the Fund. It is benefiting from the mega trend of clean energy with an estimated revenue opportunity of >\$30bn over the next several years. It upgraded full year revenue and earnings guidance with good visibility from its \$1.1bn backlog driven by an 83% increase in quarterly order growth on pcp. While the business is experiencing significant raw material price inflation in stainless steel and aluminium, most contracts have cost pass through (albeit with 3-month lag) with 8-12% price increases implemented as of July 1st to cover the rest. It traded down post result and we added to the position given its significant long term growth potential.

Groupe SEB reported a very strong first half with like for like consumer revenues up 27% and professional coffee flat (which is a significant improvement). Management upgraded full year sales growth from about 10% to now exceeding 10% with margins holding in line with past forecast. The result included significant raw material and logistics (4x increase in container prices) inflation with the full year impact increased from €100m to €220m. SEB is increasing prices 5-10% to offset the inflation and therefore margins will remain in line with expectations. We had trimmed the position before the result given concerns around raw material and logistic inflation signals – we are monitoring pricing traction and raw material cadence to determine our next move.

SIG Combibloc delivered outstanding results with c9% constant currency revenue growth met with higher than expected margins. As expected, raw material inflation had very little impact (actually a positive) given a large portion of its COGS is comprised of long term liquid paper board contracts and remains 80% hedged on the rest. Management upgraded revenue expectations to now come in at the top end of its guided range. Over the past few months we have been trimming to a core position as the business reached our fair value (stock is up 62% over the past year) however we remain holders as new deals, such as the recently announced flavoured water packaging for Danone, will likely accelerate from here.

Sensata was the next cab off the rank and it was worth the wait. Despite the semiconductor chip shortage impacting the global auto industry, the business delivered almost \$1bn of quarterly revenue which was above the top end of its guided range. Earnings were almost 3x the pandemic induced levels of last year with end market auto outgrowth of 990bps dwarfed by heavy vehicle outgrowth of 2,850 bps. New business wins are coming in very strong and primarily driven by mega trends of electrification (vehicle and charging) and smart fleets. Management upgraded full year revenue and earnings which are now expected at +25% and +60% growth respectively. Despite the strong result and earnings upgrade the stock was down marginally post result which gave us the opportunity to make it our largest position.

Advantest operates in a global duopoly (c 50% market share) in system on chip (SoC) testing with US based Teradyne. It reported strong results with revenues up >45% and EBIT almost doubling on last year and 37% sequentially. Management upgraded full year results well ahead of the street in conjunction with a buyback of 5% of its market cap. It will benefit from strong chip demand and greater complexity of chips for the foreseeable future.

Bureau Veritas continues to impress with organic revenue growth of 22.5% in the second quarter well ahead of the market which was looking for something closer to 16%. The strong result was driven mainly by an increase in certification, consumer products, building and infrastructure demand. Management upgraded revenue expectations given the strong performance however we are more attracted to the long-term secular drivers associated with zero carbon initiatives, supply chain transparency and ESG certification and monitoring. The stock is up >50% in the past 12 months and we trimmed the position marginally in recent days as it gets closer to fair value.

XPO Logistics reported its final result as a combined group as it has now spun out its global contract logistics (GXO) business effective August 2nd. We had strong signals on freight inflation and had been adding to the position into the result. XPO did not disappoint as the company delivered the highest revenue and EBITDA quarter in its history with both metrics well ahead of expectations. Management upgraded revenue and EBITDA guidance by more than the second quarter beat for both XPO (Remainco) and GXO (Spinco). Since spin, both GXO and XPO share prices are up double digits. We have been adding to XPO as its valuation remains very attractive to its growth prospects and remain holders of GXO.

PTC delivered revenues >6% above market expectations with EPS some 34% ahead. The business is benefiting from double digit bookings growth with CAD/PLM up 13.5% while its growth segment was up 23% organic. Management upgraded full year revenue, margin and earnings guidance and expects to be in the market buying back shares in the next quarter. The stock was off high single digit % post result (perhaps not enough given it had rallied into the result) which gave us the opportunity to add back the shares we had trimmed when it ran up earlier in the month.

Cellnex generally provides very predictable results with organic growth typically in the 5%+ range. This quarter was well above that with implied organic growth in the second quarter of 9.6% driven by increased colocation and acceleration of its build-to-suit programs (likely some timing benefit here). Adjusted EBITDA grew 53% with margins expanding 400bps to 79.0% driving recurring free cash flow growth of 47%. Growth is being driven by past deal closures with Management upgrading full year guidance due to earlier than expected Polkomtel deal closure with remaining deals said to remain on track. The stock is up >50% over the past 5 months and is getting closer to our estimate of fair value however we remain attracted to the European tower outsourcing and 5G tailwind thematics.

Kion had pre-announced an upgrade a few days before its official results release, as stronger than expected conditions in global industrial forklifts and warehouse automation contracts will result in revenues and earnings ahead of previous guidance by c6% and c12% respectively. The upgrade comes despite second half impacts from increased raw material pricing and component shortages impacting second half margins. We had trimmed our position on the back of concerns around raw material pricing impacts on its P&L however the business looks to be performing better than expected.

Anritsu operates in a global oligopoly in the 5G testing and certification market (alongside long time holding Keysight). Anritsu was the only company to report numbers below expectations for the quarter as semiconductor chip and component constraints impacted its ability to sell systems – the stock was down high single digit % on the day. With a solid backlog, 5G adoption tailwind and the prospect of an improving supply chain, Management maintained full year revenue and earnings expectations. While Anritsu has been a positive contributor to the Fund over the past few years, we have communicated to Management that we would like to see more shareholder friendly capital allocations given >20% of its market cap is held in cash.

Rentokil provided a very positive first half earnings report with organic revenue growth of c12% delivering EPS some 20% ahead of consensus. Management upgraded full year earnings expectations as Pest Control and Hygiene are performing quite well as economies re-open. One of the attributes of Rentokil is its ability to consolidate the fragmented global Pest Control and Hygiene markets. With strong deal traction in place, it upgraded its M&A pipeline to come in between £450-£500m compared with previous expectations of around £400m. This generates mid-single revenue growth alone and sits nicely on top of mid to high single digit organic growth over the long term. The stock bounced strongly post the result and has increased >20% since May and as such we have trimmed the position slightly.

Tempur Sealy literally blew away earnings expectations with revenue 62% above 2019 second quarter levels (a period not impacted by the pandemic) and EBITDA of \$270m came in >21% ahead of market expectations. The company achieved this result despite significant supply chain constraints in the bedding industry which are expected to peak in the next quarter. Tempur recently acquired Dreams which is UK's leading bedding retailer and will be immediately accretive to earnings. Full year guidance was upgraded to reflect >35% revenue and over 40% EBITDA growth to \$1.1bn this year. As it continues to benefit from North American growth and expands its presence in the \$30bn International market (where it is underweight), Management expects to deliver double digit growth next year and beyond.

Flex Group is one of the largest contract manufacturers globally primarily serving Healthcare, Automotive, Industrial as well as Consumer products. Reported revenue came in c3% ahead of the street however on the back of expanding margins, Adjusted EBIT of \$290m was some 9% ahead. It continues to benefit from increased outsourcing share from existing customers as well as new customer wins across the business segments. Flex is winning in key areas such as diabetes care, medical imaging, throughout the EV ecosystem, on ADAS, premium durable goods, cloud and renewables. Management upgraded full year expectations with EPS now expected at \$1.78 midpoint which is c6% ahead of prior guidance. We have added to the position post result.

Travis Perkins is the largest distributor of building products in the UK and has recently restructured its business to become a pure play in this space. Management had provided a significant earnings upgrade in a trading update near the end of June however also marginally upgraded again in this result due to higher property profits. Group revenues expanded 14.5% on pre-Covid impacted 2019 levels as the repair, maintenance and improvement (RMI) market in the UK rebounds. Inflation is clearly picking up in the UK with 2% first quarter inflation met with 7% in the second quarter. As a distributor, Travis Perkins passes on cost inflation through its fixed cost network and therefore benefits from greater gross profit dollars. With the UK government's commitment to decarbonisation, infrastructure and house building, Management expects the RMI market to remain strong for some time to come. The Board reinstated the dividend and we will get a further special dividend in the coming quarters on the back of a recent asset sale. Travis Perkins is holding an Analyst Day in September which will provide more detail on its growth levers.

Assurant reported a solid quarter which was ahead of the market however really driven by lower cat losses and higher investment income than expected. Connected Living, Global Automotive and Multi Family Housing platforms are expected to continue to grow strongly. The sale of Preneed has been completed with \$900m of the net \$1.2bn proceeds earmarked for a share buyback over the next 12 months. This will be in conjunction with the remaining \$150m from its previous \$1.35b 3yr capital return program. Management re-affirmed full year EPS growth of 10-14% despite increased investments in its mobile phone protection and service business as the 5G trade in cycle starts to accelerate.

Option Care Health was a standout this reporting season with a significant beat coupled with strong upgrades to full year revenue and earnings. As the nation's largest independent infusion provider in the US, it is benefiting from hospital referrals returning to pre-Covid levels with high single digit Acute growth augmented by double digit growth in Chronic therapy. Revenues this quarter grew 16% while Adjusted EBITDA expanded >33% driving strong FCF generation. Management had previously expected FY21 revenues to grow 6-7% however with strong momentum in the first half it now expects 10-15% growth. With margins benefiting from operating leverage, midpoint EBITDA has been upgraded by >11% to \$280m. On the day following the result a further sell down by private equity was announced which resulted in share price weakness. We used the opportunity to add to our position.

Willscot Mobile Mini benefits from double digit embedded pricing growth in its model however this quarter really surprised to the upside with pricing up almost 20% in its North American modular office fleet. This drove revenues and EBITDA 6% and 9% ahead of the street respectively. We noted that deliveries were up strongly this quarter which portends well for future utilisation absorption as the fleet is still less than 70% utilised (strong leverage on existing base). With the ERP system now fully implemented between Willscot and the recently purchased Mobile Mini, we will see synergies really ramping over the next few quarters. This is a powerful statement from Tim Boswell, CFO - "in the second quarter, we saw improvement across virtually every financial and operational metric in our business". Management is holding an Analyst Day in November now that the integration is complete.

We understand there is a significant amount of information here around our company results and if you made it this far, well done. We hope that this extensive coverage of our recent reporting season was of value to you and demonstrates why we remain highly convicted in our positions.

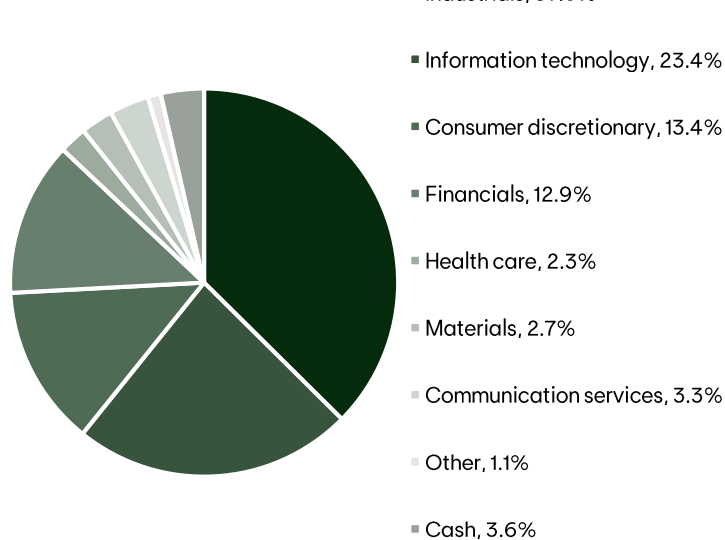
Portfolio Characteristics

Holdings

Top 10 holdings	Country	Sector	%
Sensata Technologies	United States	Industrials	5.53%
Flex Ltd.	United States	Information Technology	4.61%
Bureau Veritas	France	Industrials	4.46%
Tempur Sealy	United States	Consumer Discretionary	4.32%
XPO Logistics	United States	Industrials	4.16%
WillScot Mobile Mini	United States	Industrials	4.13%
Webster Financial	United States	Financials	4.00%
Travis Perkins	United Kingdom	Industrials	3.71%
Chart Industries	United States	Industrials	3.67%
Rentokil	United Kingdom	Industrials	3.62%

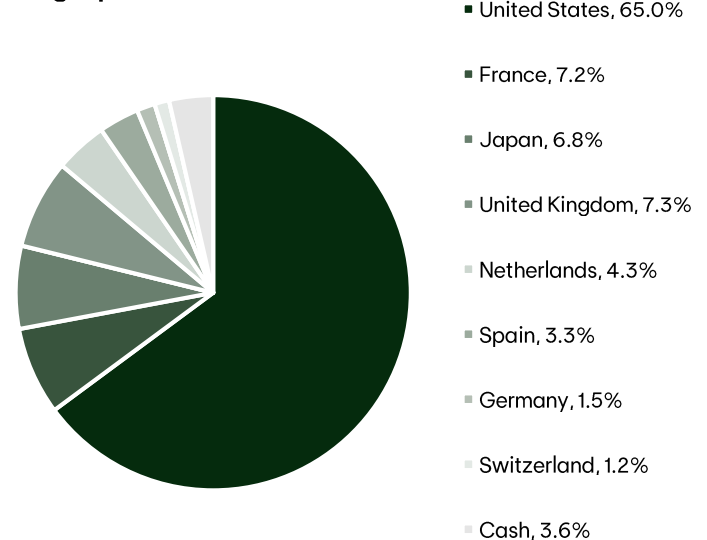
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Find out more

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