APIR Code: ECL0984AU

Ellerston Australian Micro Cap Fund

Monthly Newsletter, July 2021

Investment Objective

To provide investors with long term capital growth by 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	$1.6315
Net Asset Value	$1.6274
Redemption Price	$1.6233
Liquidity	Daily
No Stocks	55
Management Fee	1.20% p.a.
Performance Fee	20%
Buy/Sell Spread	0.25% on application 0.25% on redemption

Performance Summary

Performance	1 Month	3 Months	6 Months	1 Year	3 Years (p.a.)	Since Inception (p.a.)^^
Net^	4.45%	6.62%	12.57%	38.29%	24.20%	25.34%
Benchmark*	0.68%	4.06%	11.80%	32.30%	9.22%	11.71%
Alpha	3.77%	2.56%	0.77%	5.99%	14.98%	13.63%

^ 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 Micro Cap fund delivered 4.45% return in July, outperforming the Small Ordinaries Accumulation Index by 3.77%. The month saw the Delta strain of COVID-19 see tighter restrictions in NSW (and flowed into other States) with the protracted lockdown expected to continue through August. We also saw both US and Australian 10-year bond yields fall by c35bps to 1.18% which is the lowest level since February. With this backdrop we saw strength in the Resources and Energy sectors driving the performance of the market in July. Conversely, Healthcare, Consumer Discretionary and Financials weighed on the markets performance.

As is customary, July was a busy month for the team with numerous companies in the portfolio either releasing their quarterly results or providing trading updates ahead of the upcoming reporting season. We also saw M&A pick up in the space with one of our holdings Japara Healthcare receiving another bid and E-Roads making an acquisition. We believe M&A will continue to be a core theme for our market over the coming months.

Turning to stocks, one of our core position Generation Development delivered a solid month, increasing by over 23% on the back of a strong June quarter update. Net inflows and FUM increased by 54% and 38% respectively, on the pcp. This exceptional quarter reflects market share gains in investment bonds, driven by product enhancements and additional investment options which drove an uplift in the number of advisers recommending the product. We expect this momentum to continue, enhanced by the recent Lonsec acquisition and the upcoming lifetime annuity product.

Another stock that we recently added to the portfolio was Earlypay. Earlypay has been a solid performer, putting on 11% in July, and up 19% on our $0.42 entry price at the recent capital raise. The company is the second largest non-bank provider of invoice factoring and also provides equipment finance, mainly focusing on the SMB and SME markets. The capital raise was to expand further into the trade finance adjacency, where it is already fielding strong demand, and presents an attractive cross-sell opportunity for the existing client base. The operating momentum is strong, and we see several catalysts on the horizon including further funding cost reduction, and potential bolt-on acquisitions.

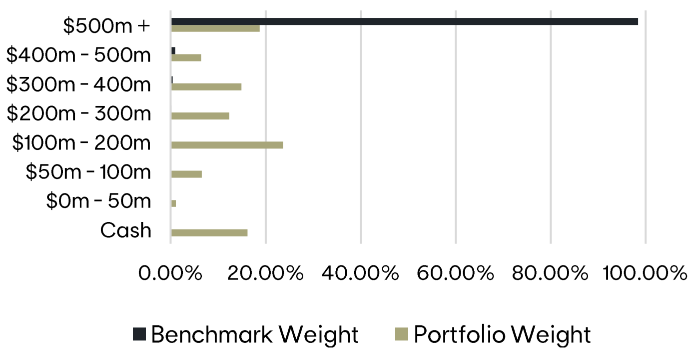
As we head into reporting season in August, we will be keeping a close eye on a number of factors including:

- **Cost inflation:** with the increase demand and constraints in both supply chains and the labour market we are anticipating margins will be a key topic of discussion.
- **Working capital blowouts:** given supply chain constraints we think business are likely to build inventory which will be putting pressure on cash and payment terms.
- **Cycling government stimulus:** we will be looking for how companies are treating one-off payments such as Job Keeper and whether this is inflating either their top line growth or margins. While this problem will not be as prevalent as in FY20, we do think it may cause results to be somewhat messy to unpick on the day.
- **M&A:** with ultra-low interest rates and more confidence in equity markets we believe businesses will look for inorganic growth opportunities. In the last few weeks, we have seen two of the largest M&A transactions in Australian history with Sydney Airport being bid by a consortium and Square bidding for Afterpay.
- **Outlook commentary:** We do not anticipate many companies to provide quantitative guidance for FY22, given the unpredictability of the current economy. However, in many cases we are likely to see trading updates for the first 6 weeks of the financial year, which will give a good indication of how the companies are faring. In our view, the companies which exhibit sound capital management and cashflow strength will be rewarded by the market. While those stocks that have been clear COVID beneficiaries, who will struggle to cycle their earnings, are likely to continue to see a sell-off in their share price.

While looking at reporting season through a COVID-19 lens has become more mainstream, given the fact that this is our fourth reporting period where at least some of the country has been in lockdown, we will continue to stress test our portfolio positions. We remain confident of our process and believe that our portfolio is well positioned to weather the current environment.

PORTFOLIO CHARACTERISTICS

Market Capitalisation



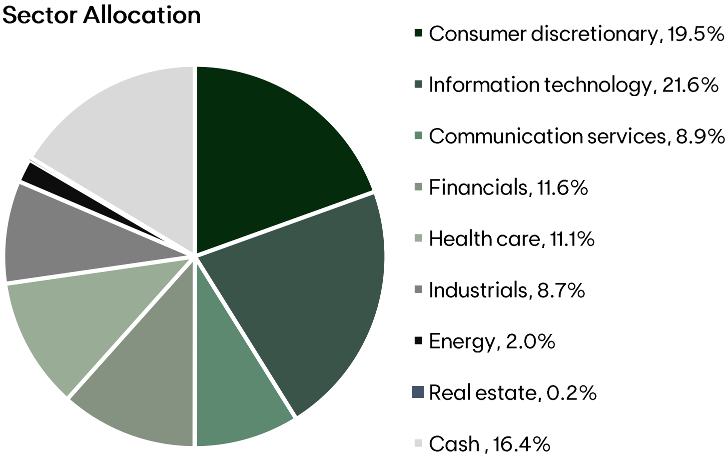
Source: Ellerston Capital.

Key Portfolio Metrics

FY22e	Fund	Benchmark
Price/Earnings	20.1x	23.2x
Dividend Yield	2.4%	2.45%
Net Debt/EBITDA	0.1x	1.22x

Source: Ellerston Capital.

Sector Allocation



Source: Ellerston Capital.

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Find out more

Should investors have any questions or queries regarding the Fund, please contact our Investor Relations team on 02 9021 7701 or info@ellerstoncapital.com or visit us at ellerstoncapital.com

All holding enquiries should be directed to our register, Link Market Services on 1800 992 149 or ellerston@linkmarketservices.com.au

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