Ellerston Australian Share Fund (ASF)

Monthly Newsletter, August 2021

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*	1 April 2009
Portfolio Manager	Chris Kourtis
Application Price	$1.0697
Net Asset Value	$1.0670
Redemption Price	$1.0643
Liquidity	Daily
No Stocks	21
Management Fee	0.90% p.a.
Performance Fee	15%
Buy/Sell Spread	0.25% on application 0.25% on redemption

Net (%)	1 Month	3 Months	FYTD	1 Year	2 Years (p.a.)	3 Years (p.a.)	5 Years (p.a.)	10 Years (p.a.)	Since Inception (p.a.)*
ASF	4.20	8.23	6.11	38.58	14.52	7.07	8.15	9.39	9.42
Benchmark	2.50	5.97	3.63	28.15	10.29	9.87	10.94	10.19	10.57

Past performance is not a reliable indicator of future performance.

MARKET OVERVIEW

Global equity market performance was strong in August from both Developed and Emerging markets, particularly after July's sharp Asian sell-off. Global bourses were led by Information Technology, Healthcare and REITS. Bond yields were slightly higher, in line with inflation indicators. Weaker key economic activity data and dovish central bank commentary continued to keep the tapering tiger in the cage, for now.

The Australian equity share market performed strongly, notching up its 11th straight month of positive returns, despite the ongoing lockdowns in NSW, Queensland and Victoria and the collapse in iron ore prices. The August reporting season was slightly better than expectations, with results more evenly distributed between beats and misses.

The first trading day in August was met with the largest ever Australian M&A deal, with Afterpay agreeing to be acquired by Square Inc. in a A$39bn deal. Then on 18th August, BHP Group made two major announcements – the merger of its Petroleum business with Woodside Petroleum and the unwinding of BHP's 20 year old dual listed structure. This will have major future implications for Australian equity benchmarks, with BHP increasing its index weight by 4-5% from 5.9% currently, but also to the broader resources component of the Australian market.

USA

The eagerly anticipated Fed Chair Powell's Jackson Hole speech was mildly hawkish with regards to tapering. In particular, Powell highlighted that "if the economy evolved broadly as anticipated, it could be appropriate to start reducing the pace of asset purchases this year." The speech reinforced market expectations of a tapering announcement at either the November or December FOMC meetings. More importantly, Powell decoupled the taper and rate increase decisions. In relation to inflation, Powell was modestly dovish, reiterating his view that the recent inflation news is transitory.

Recent economic data points were mixed. Spending on goods and housing slowed sharply, in part because pandemic related migration flows out of cities have ceased, housing inventories are starting to rebuild and household sentiment toward home buying has soured. The change in trend was echoed in softer retail sales, as households shift spending toward services. The July CPI surprised positively, as the 0.33% rise was less than half the pace of the prior 3 months. Also, the July jobs growth print accelerated to 943K, its highest rate in 2021, signalling lessening bottlenecks in labour supply.

Against this backdrop, American equities notched up their seventh straight monthly advance, the longest winning streak since January 2018, amid a tonic of strong corporate profits and moderate monetary policy. The Nasdaq Composite Index was up 4.1%, the S&P 500 ended the month up 3.0%, with the laggard being the Dow Jones Industrial Index, +1.5%.

Europe

On the economic front, Eurozone Manufacturing PMI figures came in stronger than expected at 62.8 and better labour numbers offset delta variant concerns. UK GDP grew by 4.8% in Q2, broadly in line.

European equities advanced further and recorded ten straight days of gains – a feat not seen since 1999. Amid the Chinese crackdown on exuberance, stemming from President Xi Jinping's outline for 'Common Prosperity", some of the biggest losers during the month were luxury stocks. Burberry, LVMH and Christian Dior were amongst the biggest decliners. The Euro STOXX 50 Index finished the month up 2.6%. Among the major exchanges, the UK's FTSE 100 was up 2.1%, Germany's DAX rose 1.9% and France's CAC 40 was the laggard closing up 1.0%.

Asia

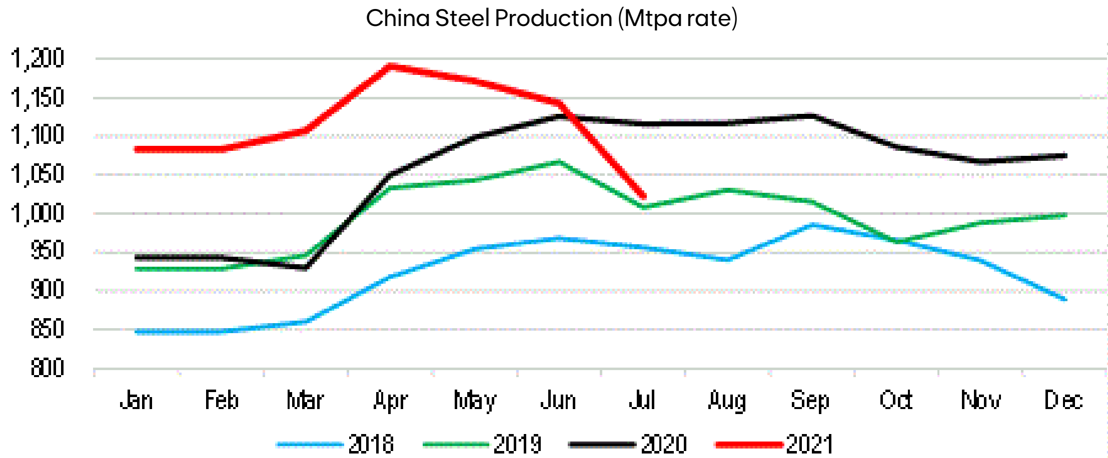
China's economic activity weakened across the board. COVID related restrictions, heavy rain and floods have severely dampened July activities. Retail sales and Industrial Production both softened notably, while infrastructure investment contracted 10%y/y. The NBS manufacturing PMI fell further in August by 0.3% to 50.1, marking the lowest reading since March 20. Forward-looking demand data was most concerning, with marked declines in new orders (-1.3%) and export orders (-1.0%).

China's "Common Prosperity" push kicked off a new wave of micro policy fine-tuning in line with the 5-theme policy framework of Social Equality, Data Security, Aging Population, Domestic Circulation and Carbon Neutrality. This had a major negative impact on China tech stocks, foreign listings, education stocks and more recently, gaming and entertainment companies. China will now limit the amount of time children can play video games to just three hours a week. This is a dramatic escalation of restrictions which dealt a blow to the world's largest mobile gaming market, as Beijing signalled it would continue a campaign to control the expansion of large tech companies. Gaming platforms from Tencent Holdings to NetEase can only offer online gaming to minors from 8 p.m. to 9 p.m. on Fridays, weekends and public holidays.

Asian equity markets did better after July's savaging with China's SSE index up 3.3%, followed by the Nikkei 225 up 3.0%, whilst the Hang Seng and Korea's KOPSI were both down 0.1%. The standout was India's SENSEX which rallied a staggering up 9.5% on the back of very strong GDP growth and lower inflation.

Commodities

Iron ore tumbled another 15% as Beijing's "jawboning" measures to cap Chinese steel output have finally gained traction, with production falling in the last few months. The Iron Ore benchmark price has now pulled back from the record high of US$238 (A$304) per tonne in May and closed at US$154 per tonne for the month.



Source: JP Morgan.

These are some of the reasons why we believe that despite the sharp correction iron ore will fall further:

- China's August steel PMI showed little evidence of current demand changing course. New orders component came in at 31.6, which is the weakest reading in recent times and shows ongoing contraction in demand for inputs.
- Seasonal weakness pending, as September and November are seasonally the weakest months of the year.
- Seaborne demand is shrinking given the previous two points and seaborne supply is expanding, with major producers (especially Brazil) increasing output by 10%+ in the 2H21 versus the 1H.
- Port inventories are rising - China's iron ore port stocks are now +12% y/y.

The Brent oil price ended 4% lower to US$73 per barrel, as concerns that the spread of the delta variant may delay further improvement in demand. Also weighing on the oil price was the OPEC+ pledge to lift oil supplies by an extra 400,000 barrels per month under the new production agreement. Gold finished the month where it started at US$1,817 per ounce, although it traded in a $150 range as US bonds traded up and down with the economic data and tapering expectations. The base metals complex was generally flat with the exception of aluminium which rose for the seventh consecutive month +5% to a 10 year high of US$2740/t.

Bonds

The Fed maintained its transitory inflation stance and combined with weaker economic data kept bonds in a narrow range. US 10-year treasury yields rose 8 basis points to 1.30% and the Australian 10-year bond moved 2 basis points to 1.16%. The AUD was flat at US73 cents, despite the collapse in iron ore prices as the US dollar was weaker.

Australia

The Australia equity market advanced for an 11th straight month in its longest rally since 2007.

In August the S&P/ASX200 Accumulation Index rose 2.5% with the Financials sector (up 4.8%) the most significant contributor to the Index's performance, adding 139 basis points, followed by Healthcare, contributing 69 basis points and Information Technology (up 17.0%, led by Afterpay) contributing 66 basis points. The bottom three contributing sectors were Materials (-154 points), Energy (-11 points) and Utilities (+2 points).

The best performing sub-index was the ASX 200 A-REIT index which rallied 6.3%, followed by the ASX 200 Industrial Index up 5.6%. The major underperformer was the ASX 200 Resources Index, which fell 8.8%, dragged down by the sudden collapse in iron ore prices.

The top five stocks that made a positive contribution to the Index's return were: CSL (+50 points), Afterpay (+44 points), NAB (+28 points), Westpac (+23 points) and CBA (+22 points).

Conversely, the top five stocks detracting from the Index's performance were: BHP Group (-111 points), Fortescue Metals (-31 points), Rio Tinto (-24 points), Woodside Petroleum (-9 points), and Wesfarmers (-7 points).

There was an expectation that the RBA would delay its planned tapering of QE from September 2021 to early 2022 in light of recent lockdowns, the significant hit to the economy and likely negative impact on the labour market. Instead, the RBA stuck to its guns, leaving QE unchanged (to be tapered to $4bn/week from the current $5bn), noting that the "economy bounces back quickly" from virus outbreaks and that "domestic financial conditions remain very accommodative". Not surprisingly, the RBA left the cash rate on hold at 0.10%.

COMPANY SPECIFIC NEWS

The Market Hits

WiseTech Global (WTC +57.0%)

Despite reporting only a slight revenue beat for FY21, shares in supply chain IT platform operator WTC roared ahead after materially beating on the EBITDA line and providing strong outlook commentary. The 13% EBITDA beat was mainly driven by better-than-expected cost-out and margins normalising towards the core CargoWise margins. Investors were further impressed by the FY22 cost-out guidance of $40m ($20-$30m previously) and CargoWise EBITDA margins of 55%, with further margin expansion expected in FY22. Incremental gains from global customer roll-outs (at a low incremental investment) should help to drive up their so called "customer lifetime value". These positives were partially offset by slightly lower acquisition growth, as per guidance for flat revenue growth in FY22. The strong organic growth delivered in FY21 helped dispel persistent investor concerns on WTC's growth profile. Guidance for 30-40% organic growth in FY22 is supportive of its underlying business model, as clients accelerate the digital transformation of their operations in a COVID world.

Afterpay (APT +39.2%)

On 2 August, APT and US based point-of-sale software solutions provider Square Inc. announced they had entered into a Scheme Implementation Deed under which Square agreed to acquire 100% of APT, paid fully in Square script. The deal valued APT at the equivalent of $126.21/share (or US$29bn), a 31% premium to its previous close, implying 24x multiple on FY22e Sales. This was in-line with the last 12 month trading average for APT. At its peak price of $160 in February 21, APT was trading on ~35x FY22e Sales. The key elements of the deal are i) APT shareholders to be paid 0.375 Square shares for each APT share (with APT shareholders eventually owning ~18.5% of the company on a fully diluted basis), ii) APT's Co-Founders and Co-CEO's to join Square upon closure of the transaction and iii) Square to appoint an APT director as a member of their board. Also of note was the proposed establishment of a secondary listing on the ASX to allow APT shareholders who wish to accept the bid to trade Square shares on the ASX. The APT Board unanimously recommended the transaction to its shareholders, with the next steps being all the regulatory and other approvals. The transaction, subject to all of the above, is expected to close 1QCY22.

Blackmores (BKL +37.4%)

After years in the doldrums, BKL shares finally rose 37% following an 89% increase in NPAT and reporting a net cash balance of $70m (vs FY20 net debt of $37m). BLK continues to execute on their strategic plan, including cost-out and efficiency savings. Management has targeted investment in growth opportunities across key markets and is focusing on margin improvements to be steadily delivered each coming year. Encouragingly, for the first time in a long time, BLK surprised the market by confirming strong sales momentum moving into FY22, particularly in the international and China segments. This is expected to offset the disrupted trading in Australia and New Zealand due to extended COVID lockdowns. Efficiency and product mix initiatives are starting to deliver sustainable margin improvement, enabling reinvestment in growth markets. E-commerce and pet segments are also providing some relief in the overall sales gap in ANZ, as some customers shift to buying products online.

Clinuvel Pharmaceuticals (CUV +35.6%)

CUV shares jumped after reporting FY21 revenue of $48m (+47% vs pcp) and a significant step up in EBITDA of $26m (102% vs pcp). The result was driven by US sales which made up circa $17m of revenue and a minimal 2% lift in operating costs. Importantly, CUV's update provided evidence of the effectiveness of the roll-out of SCENESSE for US patients with erythropoietic protoprophyria (EPP), who suffer from severe pain on exposure to sunlight and some types of artificial light, giving the market confidence in the growth trajectory of its US market aspirations

Domino's Pizza Enterprises (DMP +35.2%)

DMP's results were in line with consensus but significantly beat on store openings, up 10.4% for the year. Moreover, the company lifted its total store target (+700) to 6,650 stores and its annual openings to 9-12%. This, along with a higher dividend payout ratio, fuelled strong demand for the stock.

Redbubble (RBL +33.6%)

Following a sell-off at the start of the calendar year and further declines thereafter, RBL shares rebounded after reporting their FY21 results. RBL logged a record year of T-shirt, mug and face mask sales, resulting in a 57% increase in sales revenue to $657m. Although RBL expects negative growth in the first half of FY22, as it cycles tough COVID comps, the company expects to return to growth in the second half. Importantly, RBL provided colour on its reinvestment plans, which should squeeze EBITDA margins into mid-single digits in FY22 and also outlined a multi-year investment plan targeting brand advertising, as well as geographic expansion. RBL management flagged that they remain acquisitive, keeping watch for merger and acquisition opportunities with other e-commerce players or strategically aligned businesses.

Pilbara Minerals (PLS +26.0%)

Lithium producer PLS continued to rally after last month's massive increase in spodumene prices which stuck during the month. Management also gave higher production and shipments together with lower cost guidance for FY22, driving upgrades.

Downer EDI (DOW +25.5%)

The market finally embraced the evolution of Downer from volatile contract chaser to consistent service provider with its FY21 results. The hallmark of which was significantly improved cash conversion, with ~100% delivered in FY21. With the buyback in full swing and upgrades from the street, the stock enjoyed its best month in many years.

HUB24 (HUB +25.0%)

Having dropped 15.6% last month, HUB24 shares recovered strongly post their FY21 results update. The company reported an in-line result and had previously flagged higher cost investment in sales and tech into the FY22 reinvestment phase. Operating leverage was already expected to be muted in that year, before accelerating beyond FY23 on the back of strong FUA growth guidance of $63-70b (vs $62.5b previously). Encouragingly, the first seven weeks of FY22 have seen more than $1.5b of net inflow, with 1Q22 to date already eclipsing the whole of 1Q21. HUB now trades on a like-for-like FY23e PE of 53x, in line with platform peer Netwealth (NWL) at 53.7x, yet HUB is expected to grow comparable EPS in FY21-24e by a whopping 65% p.a. vs NWL at only 16%.

GrainCorp (GNC +21.0%)

GNC shares rallied strongly in August following yet another upgrade to the company's previous FY21 earnings guidance. Underlying EBITDA was raised to $310-$330m (previously $255-$285m) and underlying NPAT was raised to $125-$140m (previously $80-$105m). At the midpoint, EBITDA guidance is 19% higher and, impressively, at the NPAT level guidance is 43% higher, reflecting strong performance across the east coast Australian grains business following a bumper 2020/21 harvest. The company is finally benefiting from higher volumes going through their key infrastructure, demonstrating strong operational leverage.

The Market Misses

Champion Iron (CIA -22.5%) / Fortescue Metals (FMG -15.7%) / BHP Group (BHP -14.7%) / Rio Tinto (RIO -10.7%)

All of the above iron ore producers were severely impacted by the sudden collapse in iron ore prices from the sky high prices which have ruled this year, peaking at US$238/t in May. It was a rollercoaster ride during the month, with the benchmark price falling 30% to a low of US$130/t, before bouncing and finishing the month down 15% at US$154/t. China's steel production has turned down with weaker end demand and iron ore stockpiles building, thus we expect iron ore prices to weaken further in the next few months - see the Fund Strategy and Outlook section for our detailed comments.

Separately, BHP announced that will exit petroleum, enter the potash market and collapse its 20-year-old dual-listed company structure in the 1HCY22. As a result, the 21% spread between the Australian (BHP Limited) and UK (BHP PLC) companies contracted sharply. BHP Limited fell 7% on the day of the announcement.

Boral (BLD -15.0%)

BLD shares pulled back despite reporting FY21 EBIT of $445m, at the upper end of guidance. Further progression of asset sales will see BLD focus on the Australian business, with upwards of $4b in surplus capital intended to be returned to shareholders. The company has made reasonable progress in its transformation plan, as exemplified by a 90bps EBIT margin improvement in Australia. However top line revenue growth was weak, driven by a decrease in volumes and softer prices. The outlook guidance for FY22 was a mixed bag, with detached activity supportive, but key markets including infrastructure and multi-residential building remaining depressed, underwhelming investors hoping for a pick up. Infrastructure spending (particularly in Queensland) has been slow to gain pace, with management signalling that BLD should see improvement from late FY22 into FY23. Disappointingly, Sydney and South Australia construction shutdowns also impacted July EBIT by ~$16m and management expect a ~$50m negative impact in the first quarter of FY22 from lockdowns, as their impacts broaden across other regional construction markets, including Victoria.

Altium (ALU -11.8%)

ALU delivered a messy unaudited preliminary FY21 result which totally underwhelmed investors. Having missed two strategic acquisitions and outright rejecting a takeover offer at a significant premium by Autodesk (without even offering due diligence), the market was not impressed. FY21 underlying EBITDA of $62 million was below market, with the miss driven by lower than expected margins. The main negative was the Americas performance in 2H21 with i) Revenue declining -5% yoy, ii) Underlying EBITDA margin (including Tasking) of 36% was lower than guidance of 37% as ALU stepped up its cloud investment, iii) Renewal rates in the June quarter for on-premise subscription in Developed countries declining from 87% to 84% with management highlighting renewal weakness among customers who had bought licenses at discounted rates in 4Q20 and iv) Active users of A365 were 12,846 as of 1st August, which is down from 13,000+ as of 1st June. Of more concern, was the company back peddling on recent aspirational glide-path targets which it espoused to justify its rejection of the approach by Autodesk. In its flight path to US$500 million in revenue, ALU has now removed specific guidance for FY23 to FY25, noting that it expects revenue to grow at 20% CAGR between FY21 to FY26, with an EBITDA margin floor of 34%.

Beach Energy (BPT -11.7%)

Following its major reserves downgrade in April, BPT once again disappointed investors with its August update. The company guided to a weaker than expected production outlook for FY22 at 21-23mmboe, down 14% on FY21 at the mid-point. The main shortfall came from the Western Flank and BassGas declines, coupled with the shut-in of the onshore SA Otway Katnook facility. The revision confirms that their most highly profitable Western Flank oil is in serious decline, with guided production at less than half of its peak in FY20. The lower production level also resulted in higher operating cost guidance of ~18%, resulting in significant downgrades to consensus FY22 estimates.

Mesoblast (MSB -11.2%)

The woes at MSB continued, with the shares dropping another -11.2% in August after recording a dismal 77% drop in sales, resulting in a net loss of $US98.9m in FY21. Further to the market's disappointment, the group revealed the FDA has advised that it needs to complete another clinical study in the use of its drug remestemcel-L for the potential treatment of COVID-19 associated acute respiratory distress syndrome. The share price closed at $1.66 for month end, a far cry from $5.50 a year ago.

Reece (REH -11.2%)

Following a stellar run, REH shares retreated in August, despite reporting a 4.5% increase in operating revenue and record underlying EBITDA of $720m, largely driven by strong demand in ANZ. Pleasingly, ANZ EBITDA margins expanded by 100bps due to an increase in sales volume and exceptional operational execution. However, investors focused on REH's US performance, which was well below market expectations, with EBITDA ending the financial year flat versus the prior period, catching everyone off guard. US operations were disrupted by COVID-19, leading to capacity constraints, labour market shortages and tight supply chains. Accordingly, operating cash flow dropped sharply from $601m to $372m due to increased inventory levels and an unfavourable FX impact of $362m. Ongoing investment in the business has led to margin estimates being pared back, prompting downgrades in the market. Unsurprisingly, REH did not provide quantified guidance for FY22 given the high degree of uncertainty.

St Barbara (SBM -10.7%)

Gold producer SBM hit 5 year lows through a combination of a $349m asset impairment charge on its Atlantic gold mine in Canada (acquired for just $768m two years ago) due to permitting delays and higher capex, and a reduction in the gold reserve grade of its Gwalia mine by 18%.

FUND PERFORMANCE

In the wash up to a frantically busy reporting season, characterised by an even match between beats vs misses and a heightened price reaction to misses, your Fund fared well and delivered a solid return. The Fund return of 4.29% outperformed the benchmark return of 2.50%, which was pleasing given not everything went according to plan.

When we said last month we believed that the iron ore market was at a key inflection point and expected a significant correction, we didn't expect it to happen so quickly. Our conviction in not owning BHP, RIO, Fortescue or Mineral Resources more than offset significant contributions to the benchmark return by Afterpay and WiseTech Global, where the Fund had no exposure.

In terms of factor analysis, low risk and growth outperformed. Low risk sectors such as Consumer Staples (+6.9%), Healthcare (+6.8%) and Real Estate (+5.8%) were favoured, along with growth, particularly the IT sector (+17.0%), driven by the Afterpay take-over offer, Zip Co also buoyed by the news and a strong WiseTech Global result.

Returns[1] (%)	*Gross*	*Benchmark**	*Excess*	*Net*
1 Month	4.29	2.50	1.79	4.20
3 Months	8.53	5.97	2.56	8.23
2022 FYTD	6.30	3.63	2.67	6.11
1 Year	40.10	28.15	11.96	38.58
2 Years (p.a.)	15.77	10.29	5.48	14.52
3 Years (p.a.)	8.23	9.87	-1.64	7.07
5 Years (p.a.)	9.30	10.94	-1.64	8.15
7 Years (p.a.)	8.73	8.58	0.15	7.57
10 Years (p.a.)	10.56	10.19	0.37	9.39
Since Inception (p.a.)	10.61	10.57	0.04	9.42

Past performance is not a reliable indicator of future performance.

[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.

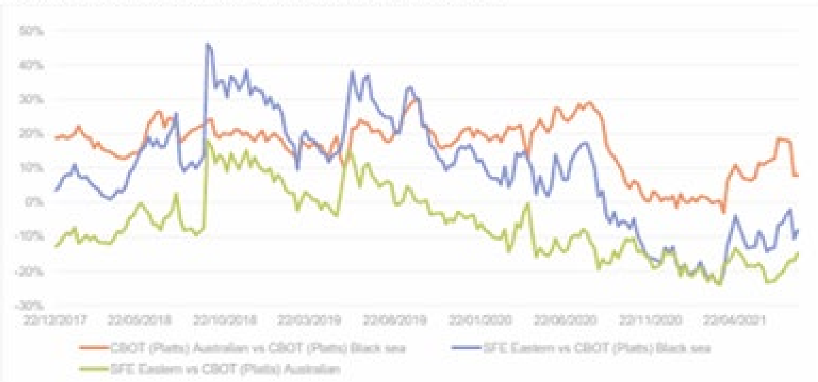
* The benchmark was changed from the S&P/ASX 200 Accumulation Ex REITS Index to the S&P/ASX 200 Accumulation Index on 1 July 2012.

GrainCorp and **Suncorp** were amongst two key contributors to this month's performance.

GrainCorp (GNC) shares rallied strongly following yet another upgrade to the company's previous FY21 earnings guidance. Underlying EBITDA was raised to $310-$330m (previously $255-$285m) and underlying NPAT was raised to $125-$140m (previously $80-$105m). At the midpoint, EBITDA guidance is 19% higher and, impressively, at the NPAT level guidance is 43% higher, reflecting strong performance across the east coast Australian grains business following a bumper 2020/21 harvest. The company is finally benefiting from higher volumes going through their key infrastructure, demonstrating strong operational leverage.

Post-harvest winter receivals and higher summer receivals, coupled with a favourable outlook for the upcoming winter crop, have supported buoyant export volumes, forward contract sales and supply chain margins. Impressively, GNC notched up their largest month of contracted sales in its operational history in the month of July, fuelled by robust demand for high quality Australian grain. Weaker grain supply/demand dynamics in the northern hemisphere also helped. GNC now expects total exports to come in towards the top end of guidance at 8.0 million tonnes. Importantly, grain carry out from the FY21 crop into FY22 is also expected to land at the upper end of their range (at 4.5 million tonnes), underpinning a very strong start to FY22. Carry out is an important factor for FY22, boosting storage revenue by earning a higher grain carry fee and enabling GNC to maintain the heightened export volumes ahead of receipt for the 2021/22 crop.

Figure 1: Australian grain prices are cheap



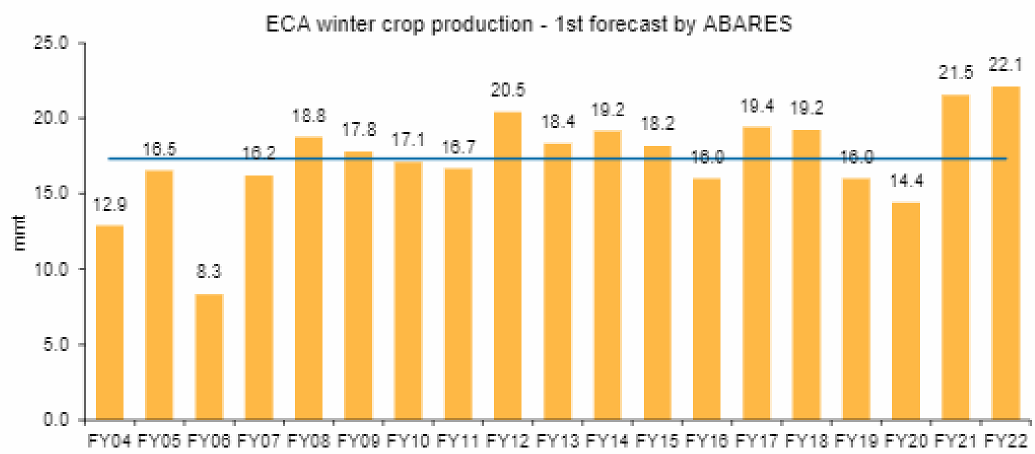
Source: Refinitiv.

Not to be forgotten, GNC's processing business has also exhibited solid performance. Global demand for vegetable oils remains elevated, ensuring high utilization of oilseed crush facilities and strong crush margins. At the macro level, oilseed prices are forecast to remain historically high in 2021-2022 due to strong global demand and tight inventories. Global canola prices are forecast to increase, as consumption outstrips production supporting historically high crush margins.

GNC is preparing for what is expected to be another above average grain harvest with a strong maintenance and capital investment program, building 1 million tonnes of new storage capacity in time for harvest and re-opening 'flex' sites to service heightened anticipated demand. The outlook for the FY22 crop remains positive, with the residual sub-soil moisture from the rainfall received over summer, autumn and winter across the cropping areas on the east coast providing a solid foundation for crop establishment and growth. This is further reinforced by longer term rainfall forecasts from the Bureau of Meteorology, supporting the prospect of a consecutive year of above average crop and a higher carry. Laser focus will be on the ABARES next winter crop forecast due 14 September 2021, with the expectation the initial 22.1mmt target will be revised upwards to reflect the favourable growing conditions.

With the relatively new management team executing well, we remain very positive on the medium term prospects for the company. Our investment thesis is playing out nicely.

Fig 2 Largest 1st forecast by ABARES on record of 22.1mmt which is +28% above LTA 17.3mmt



Source: ABARES, Macquarie Research, August 2021

Suncorp (SUN) delivered a stellar FY21 set of results with Cash Earnings of $1,064m (~10% above consensus). Pleasingly, underlying GWP growth of 6.7% was the strongest since 2013, almost double IAG's. SUN also announced a much higher than expected final dividend of 40cps, a special dividend of 8cps and an on-market buyback of up to $250m. Management maintained its previous guidance for FY23E, targeting an Insurance Margin of 10-12% and cost-to-income ratio of 50% in the bank.

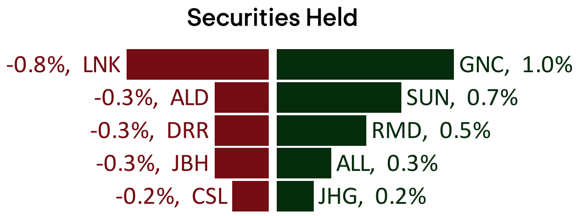
The underlying Insurance Margin (ex COVID benefits) improved 30bps to 7.4%, with the margin trend improving in the 2H. Considering this included opex headwinds of ~1% from strategic and growth initiatives (some of which are non-recurring), with improvements in rate vs claims inflation, we see further upside potential. Most of the FY22E margin improvement is expected to occur in 2H22E. FY21 motor growth of 7% was strong, with normalised 2H21 rate increases of 5.4% and unit growth of 3.2%. Motor unit growth was particularly pleasing and SUN believes its strategic brand investments can deliver further improvements.

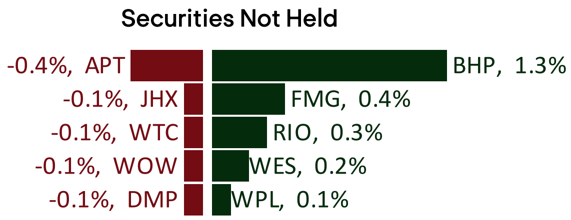
SUN reduced its Business Interruption provision by $5m and has only 5% of in-force policies with Quarantine Act wordings, so the risk here looks manageable. Prior provisioning of over $200m seems very conservative.

Stable opex of $2.8bn was in-line with guidance, giving confidence in the outlook. Bank profit before impairments was up 4.6%, with NIM up to 2.07bps, as lodgements over the second half of the year were exceptionally strong, up 71% vs pcp. With mortgage processing times now better than most major banks, and higher retention than market, good growth is expected in FY22E onwards. Benign bad debts tailwinds should add further earnings upside. A key highlight of the banking division was FY21 Australia home growth of 7%, with normalized 2H21 rate increases of 8.6% and minimal volume losses of 0.8%.

With Steve Johnson at the helm, SUN has demonstrated very strong execution and with excess capital alongside continuing industry tailwinds, we see potential for further solid EPS and DPS growth. This should drive a re-rating of the stock.

Month of August Attribution





Source: Ellerston Capital.

The main positive contributors to this month's performance were overweight positions in: Graincorp (GNC +21.0%), Suncorp (SUN +12.2%), Resmed (RMD +11.4%) Aristocrat Leisure (ALL +8.9%) and Janus Henderson (JHG +6.2%).

Zero weight positions that also helped included BHP Group (BHP -14.7%), Fortescue Metals (FMG -15.7%), Rio Tinto (RIO -10.7%) Wesfarmers (WES -1.9%) and Woodside Petroleum (WPL -9.2%).

The main detractors to performance for the month were overweight holdings in: Link Holdings (LNK -8.7%), Ampol (ALD -2.2%), Deterra Royalties (DRR -6.9%) and JB Hi-Fi (JBH -2.7%).

Not holding the following shares that outperformed the broader market and somewhat constrained returns were: AfterPay (APT +39.2%), James Hardie Industries (JHX +16.0%), Wisetech Global (WTC +57.0%), Woolworths (WOW +7.7%) and Domino's Pizza (DMP +35.2%).

FUND ACTIVITY

Whilst many stocks and sectors have re-rated significantly from their March 2020 lows, we continue to seek and more importantly, are finding opportunities that we believe are highly compelling at this juncture.

The Fund strengthened core positions, namely Aristocrat Leisure, Janus Henderson, Northern Star and Telstra. The Fund also locked in further profits and de-risked holdings that have outperformed over the past few months (NEXTDC, United Malt Group and Western Areas), including exiting Paladin Energy and NAB. During the month we introduced Origin Energy into the portfolio (see detailed write up below), which has been belted in recent times.

We exited the Fund's holding in NAB and remain significantly underweight the banks, having progressively locked in solid profits in the sector. Balance sheet growth trends have started to moderate in July, as the impact of lockdowns appears to be taking its toll. Housing credit growth across the majors ex ANZ (which is lagging significantly), has moderated to ~6-7% (annualised) from double-digit annualised growth in June. While the full impact of the current lockdown will not be known for some time, we would expect balance sheet growth to dampen in 4Q21 and potentially in 1Q22. Persistent lending price competition is also likely to put some pressure on margins. While banks continue to hold abundant liquidity following TFF drawdowns in June, deposit pricing benefits look like they have run their course. In a nutshell, we would expect macro trends to drive banks performance in the near term, given their leverage to rates, the potential deteriorating outlook for impairments and the prospect of reduced provision reversals looking forward to prop up their P&L.

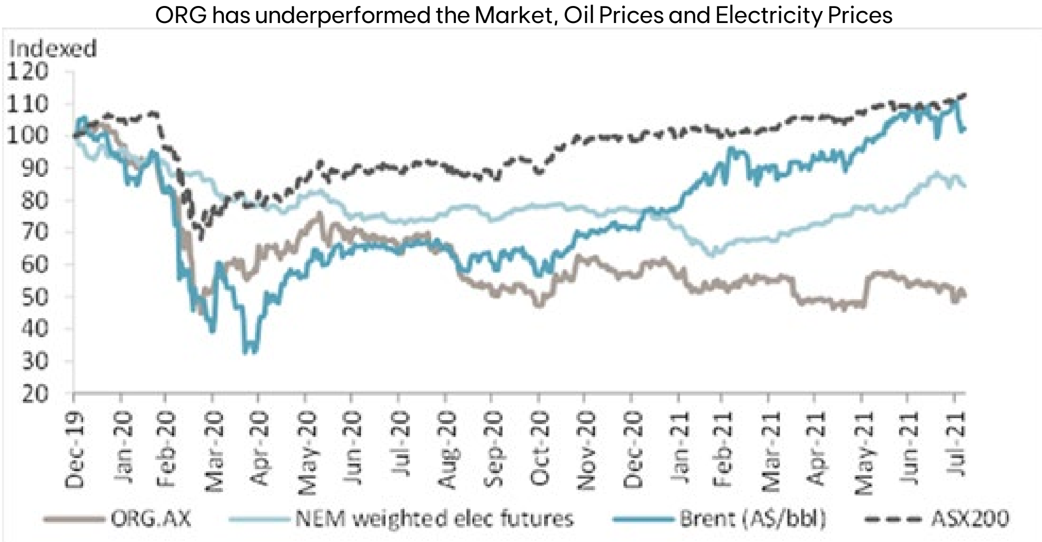
NEW STOCKS ADDED	STOCKS EXITED
• Origin Energy	• NAB
	• Paladin Energy
INCREASED	**DECREASED**
• Aristocrat Leisure	• CSL
• Janus Henderson	• NextDC
• Northern Star	• United Malt Group
• Telstra	• Western Areas
	• 29Metals

Origin Energy (ORG): *Light at the end of the tunnel*

Apart from coal, few sectors have lost more favour than energy retailers, as ESG focused investors abandon companies that rely heavily on fossil fuels. ORG has endured a long period of significant underperformance, exacerbated by the headwinds of falling electricity prices, coupled with weak LNG and oil prices. There has also been a disconnect between low wholesale electricity prices and market earnings forecasts. On 30 July, ORG provided Energy Markets (EM) FY22 EBITDA guidance of $450-600m, 30% below consensus and the stock fell 8% on the day. But encouragingly, they also guided to EM FY23 EBITDA recovering to $600-850m, based on current forward pricing. The market has now rebased the earnings expectations and we see upside for both the (IG) and (EM) businesses driven by recovery in crude oil (and linked LNG pricing) and electricity prices.

APLNG is a cash cow which at US$60/bbl (15% below current spot) should generate $1bn+ per annum of free cash flow for ORG. Given the project only requires stay-in-business capex, the free cash flow will be used for corporate debt reduction, capital management and renewable energy opportunities. The medium term drag remains in the EM business, which won't get the benefits of the recent rise in electricity prices until FY23 due to certain regulatory price determinations. Draft determinations will occur in six months' time. FY23 should be the light at the end of the tunnel for ORG and investors should have better visibility in the 2H of FY22.

ORG has underperformed the Market, Oil Prices and Electricity Prices



Source: Credit Suisse.

Integrated Gas

ORG owns 37.5% of APLNG which was hit hard when the COVID-19 induced demand collapse resulted in the ~35% fall in average oil prices in FY21, impacting the LNG gas price received by a similar amount. **Current pricing is ~50% higher than the FY21 average!** Moreover, spot LNG has spiked to over US$18/mmbtu, from lows of US$2/mmbtu year or so ago and prices for Henry Hub gas in Louisiana (a good barometer) have also recovered strongly to over US$4/mmbtu.

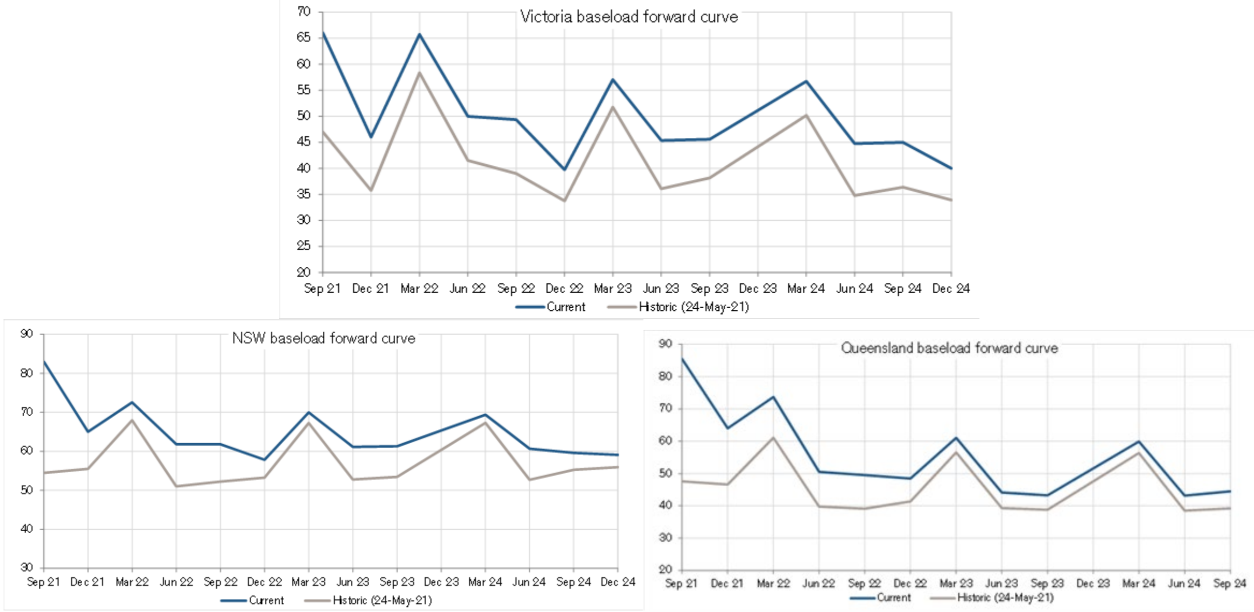
Energy markets

Wholesale electricity prices have been falling over the past 3 years which not only affect ORG's power generation assets, but also form part of the setting of retail and business price caps under the Victorian Default Offer (VDO) and Default Market Offer (DMO) in other states. Lower DMO/VDO prices for FY22 were set in April 2021, negatively impacting ORG. Policy measures to encourage renewables has been the main driver of lower wholesale electricity prices.

Source: AEMO.

Electricity prices have spiked more recently, given outages in May by Callide (Qld) and Yallourn (Vic) power stations. Lower prices over the past few years have impacted power station profitability with a number of large power stations running with fewer operating units. As more renewables are brought on stream, it raises the risk of potentially more frequent outages occurring and consequently, much higher price volatility. This normally results in more hedging and **higher forward prices**.

Change in electricity forward curve ($/MWh) in Victoria, NSW & Qld



Source: Credit Suisse.

ORG's gas margins have also been severely impacted by the recent arbitration outcome with Beach Energy resulting in an unexpected ~35% increase in ORG's gas costs, causing a $60-80m hit to EBITDA in FY22. ORG will look to recover this impost by increasing gas prices to its customers as existing contracts roll over.

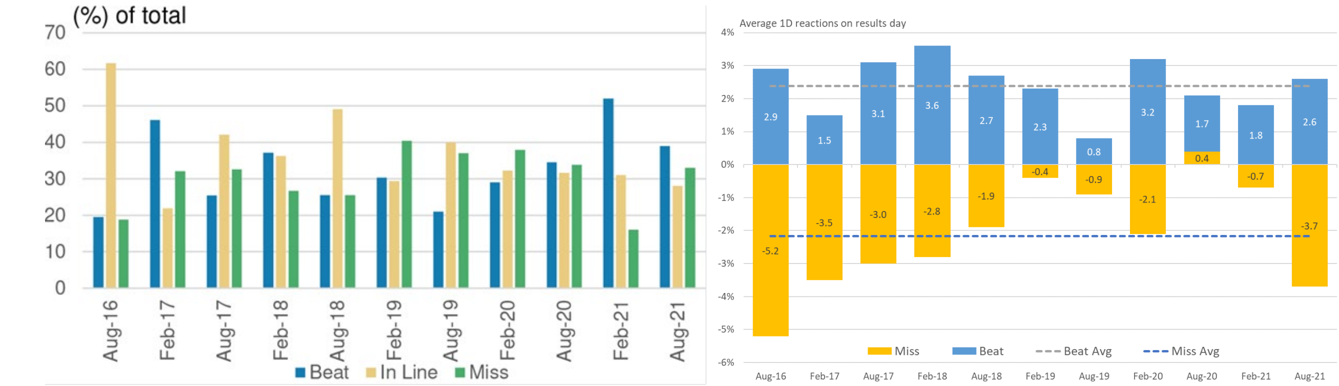
We are being selectively contrarian here, buying a totally unloved and bombed out former market darling which three years ago was trading at $10.00. We see significant upside from where ORG is currently trading, at less than 5 times FY23 EV/EBITDA.

FUND STRATEGY AND OUTLOOK

There is little that has changed with respect to our views since our July update. However, we continue to pivot where necessary as discussed in the Fund Activity section.

August Reporting Season Take-outs

Result season closed with a more normal balance of Beats vs Misses and harsher treatment of Misses



Source: Morgan Stanley.

- The heightened level of reaction for misses in the market suggests that investors have less tolerance for timing differences. Despite the FY21 season having produced a more normal skew of outcomes, volatility was elevated.
- The EPS positive surprise skew finished at 1.2:1 (lower than in 1H21), and guidance remains scarce. Only ~37% of companies have provided outlook commentary.
- Dividends continued to beat estimates (1.9:1) as payout ratios normalized and yield credentials were rebuilt. Buyback activity has generally been well received, with a large cap bias to announced activity.

Lockdown impacts continue with vaccine penetration the key to determine social easing paths and reopenings. Critical milestones loom for October/ November and will drive reopening sentiment for CY22. After a strong calendar year upgrade cycle, earnings momentum looks to have peaked, with EPS projections cut during results. The only exceptions were Healthcare and Financials.

EPS REVISIONS

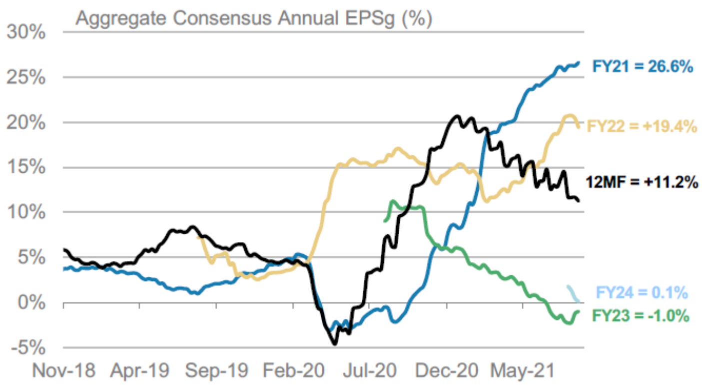
SECTOR	Post PF*	EPS Rev**	U-grade	Flat	D-grade
Health Care	-0.7%	3.6%	50%	19%	25%
Financials	2.8%	1.1%	31%	31%	31%
Materials	0.0%	-0.4%	46%	17%	34%
Real Estate	3.7%	-0.8%	9%	72%	19%
Consumer Staples	-0.6%	-0.9%	20%	40%	40%
Communication Services	3.6%	-1.6%	18%	27%	55%
Industrials	-1.8%	-2.0%	39%	33%	28%
Energy	-1.1%	-4.4%	0%	33%	67%
Consumer Discretionary	0.3%	-5.3%	31%	14%	55%
Information Technology	-3.3%	-10.0%	10%	24%	57%
Utilities	-5.1%	-11.4%	0%	0%	100%
Grand Total	0.3%	-2.7%	28%	31%	41%

* Relative performance since results released. ** EPS (12M, BF) revisions since result date

Source: JP Morgan.

Notable misses included AGL Energy, Altium, Ansell, Boral, Cochlear, Harvey Norman, Link Administration, Magellan Financial, Mesoblast NIB Holdings and Reece.

A re-emergence of incremental headwinds for the Banks and an aggressive move lower in iron ore prices will certainly feed into the post results wash up, combining to pressure earnings from here.



Source: Morgan Stanley.

Since our last newsletter, equity markets globally have bolted higher and continue to flirt with all-time highs. Valuations have been supported by US 10-year treasuries and local long bond yields staying below 1.3% and earnings growth, which thus far, has also surprised on the upside. The inflation genie has been kept in the "transitory" bottle for the time being, but this needs to be monitored closely.

In summary, despite the prospect of tapering by the Fed and RBA, central banks will aim to keep interest rates low. Pent up global consumer demand, when overlaid with unprecedented Government and Central Bank stimulus and coupled with massive infrastructure spending, sews the seeds for an interesting growth cocktail.

We believe that the portfolio is well positioned against this backdrop, with the right mix of sensibly priced growth stocks with competitive advantages (e.g. Resmed, Aristocrat, CSL and Carsales.com) Contrarian Value stocks (Ampol, GrainCorp, Janus Henderson, JB Hi-Fi, Link Administration and Suncorp), Cyclicals and select Financials.

Taking a medium term view, these stocks continue to trade at attractive valuations and should re-rate over time.

To summarise your portfolio's positioning:

1. Quality Franchises, Growth at Reasonable, Attractive Valuations

Solid companies with strong/leading market positions and credible management with good balance sheets

Aristocrat Leisure, Carsales.com, CSL, JB Hi-Fi, Link Administration (cheaper entry into Pexa), NextDC, Resmed and United Malt

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

Heavily discounted companies with strong market positions and strategic assets, but very sensitive to economic conditions/seasonality/weather

Ampol, Graincorp, Origin Energy and Suncorp Group

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

Janus Henderson and Telstra

4. Deep Value Resource Plays

Stocks trading at discounts to NPVs, where much of the heavy lifting has been done (cost out, self help deleveraging)

29Metals, Deterra Royalties, Northern Star Resources and Western Areas

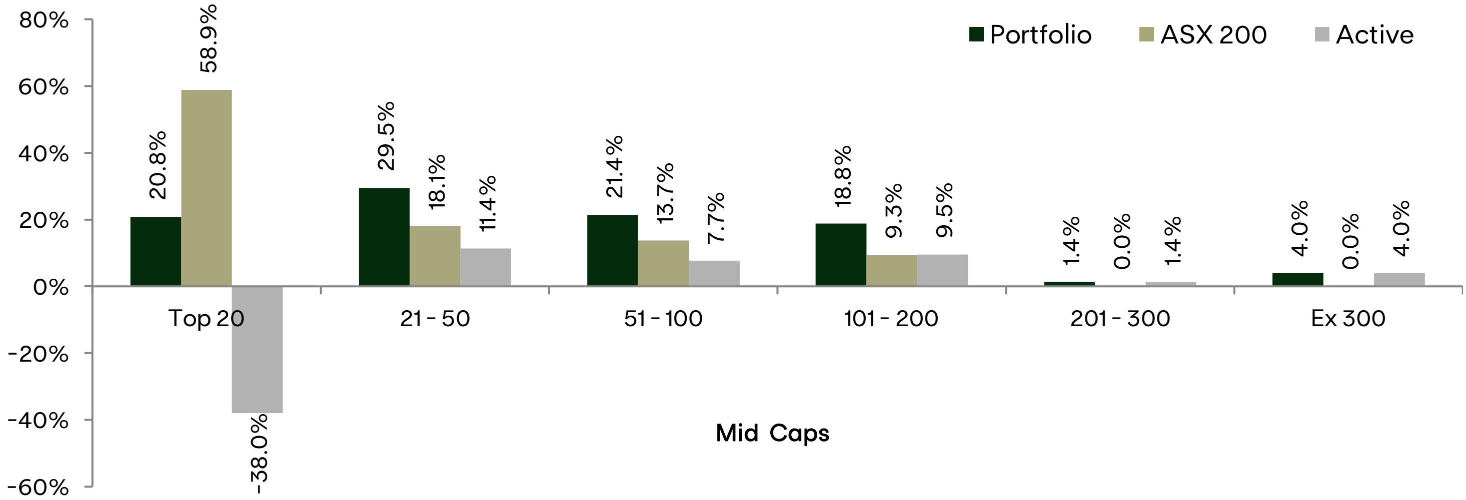
We are truly grateful for your continued support.

Warm Regards,

Chris Kourtis
Portfolio Manager

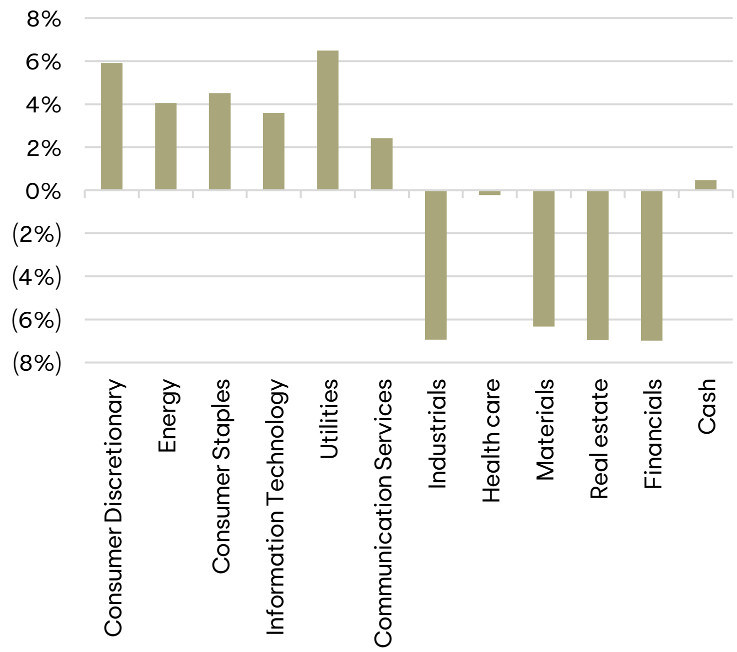
PORTFOLIO FEATURES

Size comparison Chart vs ASX 200^



^Size Comparison Data as at 31 August 2021.
Source: Bloomberg, Ellerston Capital.

Active Sector Exposures*



TOP 10 HOLDINGS**
AMPOL
ARISTOCRAT LEISURE
GRAINCORP
JANUS HENDERSON
JB HI-FI
LINK ADMINISTRATION
NORTHERN STAR
ORIGIN ENERGY
RESMED
SUNCORP

Source: Ellerston Capital.

* 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	$866 Million
FUNDS UNDER MANAGEMENT – ASF UNIT TRUST	$3.50 Million
APPLICATION PRICE	$1.0697
REDEMPTION PRICE	$1.0643
NUMBER OF STOCKS	21
INCEPTION DATE	1 APRIL 2009

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**

Ellerston Capital