

# Ellerston Global Mid Small Cap Fund

Monthly Newsletter, September 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 <sup>^^</sup>	1 March 2017
Portfolio Manager	Bill Pridham
Class A Application Price	\$1.5965
Class A Net Asset Value	\$1.5925
Class A Redemption Price	\$1.5885
Class B Net Asset Value	\$1.3686
Class B Redemption Price	\$1.3652
Liquidity	Daily
No Stocks	20 – 40
Management Fee (Class A)	0.75%
Performance Fee	10% <sup>**</sup>
Buy/Sell Spread	0.25% on application 0.25% on redemption

<sup>\*\*</sup>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 <sup>^^</sup> (p.a.)
Class A <sup>^</sup>	-3.45%	3.03%	10.74%	38.87%	17.77%	17.95%
Benchmark <sup>*</sup>	-2.79%	3.51%	11.82%	32.04%	11.66%	13.39%
Alpha	-0.66%	-0.48%	-1.08%	6.83%	6.11%	4.56%

Performance	1 Month	3 Months	6 Months	1 Year	3 Years (p.a.)	Since Inception <sup>***</sup> (p.a.)
Class B <sup>^</sup>	-3.39%	3.23%	11.13%	40.65%	-	31.57%
Benchmark <sup>*</sup>	-2.79%	3.51%	11.82%	32.04%	-	26.47%
Alpha	-0.60%	-0.28%	-0.69%	8.61%	-	5.10%

<sup>^</sup> The net return figure is calculated after fees & expenses. Past performance is not a reliable indication of future performance

<sup>\*</sup> MSCI World Mid Cap Index NR (AUD)

<sup>\*\*\*</sup> Class B Inception Date is 18 August 2020

## ESG IN FOCUS

The 26<sup>th</sup> summit of the "Conference of the Parties" (COP26) will be held in Glasgow during the first couple of weeks in November. There will be a great deal of headlines around the event as it is becoming increasingly evident that the risk of climate change, or actually the consequence of not addressing this risk, is now a priority concern globally.

The Paris Agreement was borne out of COP21 in 2015 where attending countries committed to plans in setting out how much they would reduce carbon emissions, with a goal of limiting global warming to below 2 degrees and aim for 1.5 degrees. Unfortunately, these commitments are not proving sufficient as we are running closer to 2 degrees and potentially up to 3 degrees by 2100 compared with pre-industrial levels.

Given our run rate and the urgency in addressing this, COP26 is focused on four key objectives:

**1. Secure global net zero by mid-century and keep 1.5 degrees within reach** by accelerating the phase out of coal, curtailing deforestation, accelerating the shift to electric vehicles and encouraging investment in renewables.

**2. Adapt to protect communities and natural habitats** thereby protecting and restoring ecosystems while building defences, warning systems and resilient infrastructure to avoid loss of homes and potentially lives.

**3. Mobilise finance** with developed countries earmarking at least \$100bn of climate finance per year while international financial institutions co-ordinate in unleashing trillions in private and public financing vehicles.

**4. Work together** to deliver and finalise the Paris Rulebook while accelerating collaborative actions between governments, business and society in addressing the climate crisis.

## PORTFOLIO COMMENTARY

The Ellerston Global Mid Small Cap Fund – Class A declined 3.45% net during the month which was slightly behind the MSCI World Mid Cap Index (AUD) which declined 2.79% for the same period. The market focus has shifted from the Delta variant impact on growth to supply chain holdups (bottlenecks and shortage of pretty much everything), input cost inflation (commodities, energy and labour) and the potential for a Fed misstep, just to name a few.

The portfolio's top three contributors for the month **Webster Financial**, **Advantest** and **WillScot Mobile Mini** added 99 bps to performance while **Bed Bath & Beyond**, **Travis Perkins** and **Sensata** detracted 184bps. The Fund had two portfolio companies report results during the month with the majority expected in October and November.

**Bed Bath & Beyond** reported disappointing sales and earnings as moderating end markets coupled with management execution issues weighed on the quarter. This result reversed the strong execution track record we had been witnessing over the past few quarters as marketing and pricing actions fell behind. We have materially trimmed the position and will look to discuss the longer term prospects with the company in the coming weeks.

**Ciena** delivered a good set of numbers with revenue coming in above the top end of its guided range while strong margin growth drove earnings some 16% ahead of the street. Secular demand in network investment is very strong as customers add capacity to address bandwidth demand. Backlogs are expected to expand as supply chain constraints limits its ability to deploy its kit. Fortunately, this demand is not going away, only getting more intense, as data growth continues unabated.

## STOCK IN FOCUS: TKH Group (TWEKA NA, €2.4bn Market Cap)



TKH Group operates on a global scale, providing high end niche technologies in high growth markets around the world. Over the past several years it has shifted its portfolio from commoditized products to that of integrated solutions increasing the efficiency, safety and security of its customers. Its products are often embedded with software to create smart technologies in a one stop shop approach. With seven identified verticals expected to deliver outsized growth at incremental margins, the key ones to us include fibre optic cables, energy cables for infrastructure and wind farms, 3D vision technology for machine vision/5G consumer electronics and tyre manufacturing systems.

These growth verticals have a common platform underpinned by its three core technologies which are leveraged across many solutions:

**1) Vision and Security** – Consists of 2D and 3D camera sensor technology and 3D laser technology. We understand TKH is the global leader in the more specialised 3D camera applications inspecting 5G phones etc. Vision technology is used for inspection, quality, product and process control in medical solutions, industrial automation (think Industry 4.0) and consumer electronics.

**2) Connectivity** – Focuses on a complete portfolio of cable systems for energy distribution (offshore wind farms) and electrical applications in medical, construction and infrastructure sectors.

**3) Smart Manufacturing** – With technology and controls around industrial process it boosts the reliability and flexibility of manufacturing systems in tyre manufacturing, robotics, medical and mechanical engineering industries.

The business is organised into three key reporting segments with Building and Industrial applications representing the bulk of its €1.4bn of revenues expected this year:



Source: TKH.

Telecom is predominately made up of **fibre optic cables** and network solutions serving the European markets. It is really benefiting from fibre to the home (FTTH) rollouts in Germany and France.

TKH's Building division houses its **Machine Vision** segment which is really benefiting from factory automation, logistics and strong orders in consumer electronics. Additionally, with the increased demand in **offshore wind farms**, TKH is seeing strong order intake for its offshore subsea cables which effectively link up the turbines to each other to transfer energy. It is also seeing a promising sales funnel for its **Aircraft Ground Lighting** (AGL) business which is a category disruptor in next generation runway lighting and is already installed in Vancouver, Geneva and Amsterdam airports.

Industrial is largely comprised of its **VMI Tire manufacturing system** business which is pioneering new technologies to address just in time requirements associated with multiple tyre SKUs as well as those associated with electric vehicles. It has approximately 70% global market share outside the top 5 (in which it is increasing its presence) and will benefit from the replacement of existing technology (12-15yrs old) with high productivity, waste reduction, quality improvement and "track and trace" capabilities of its systems. Another exciting business within its Industrial segment is **Indivion** which is a fully automated medical dosage system utilising its machine vision capabilities in dispensing repeat prescriptions. It is a one-of-a-kind system globally with all the large online and bricks and mortar pharmacy companies lining up for the product.

TKH delivered strong first half results in late August and provided full year guidance which was well ahead of market expectations. It is continuing on a "Simplify and Accelerate" strategy which is focused on pruning its portfolio to concentrate on its high growth verticals and will expand on this during its Investor Day on 17<sup>th</sup> November 2021. We have owned the business for just over 3 years now and are actually more intrigued by the story today than at any time of our ownership.

Kind Regards,

Bill Pridham

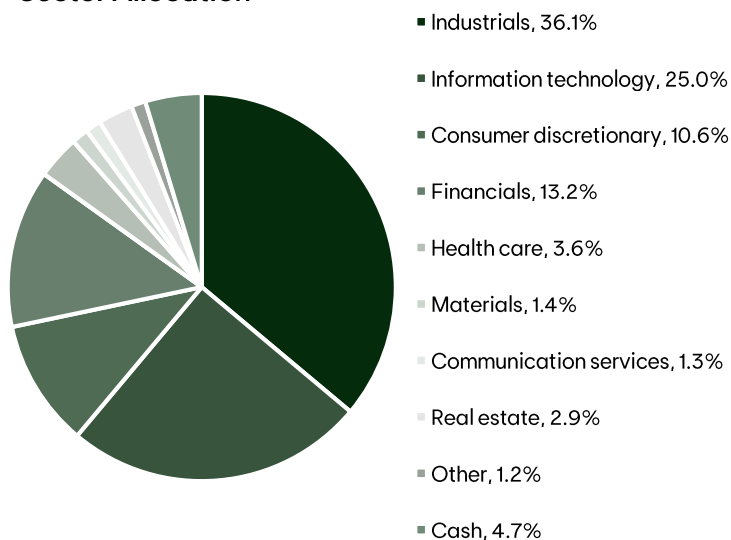
## Portfolio Characteristics

### Holdings

Top 10 holdings	Country	Sector	%
Sensata Technologies	United States	Industrials	5.26%
Webster Financial	United States	Financials	5.23%
Tempur Sealy	United States	Consumer Discretionary	4.72%
WillScot Mobile Mini	United States	Industrials	4.64%
Flex Ltd.	United States	Information Technology	4.61%
XPO Logistics, Inc.	United States	Industrials	4.50%
PVH Corp.	United States	Consumer Discretionary	4.08%
Bureau Veritas	France	Industrials	3.80%
Anritsu	Japan	Information Technology	3.79%
PTC	United States	Information Technology	3.58%

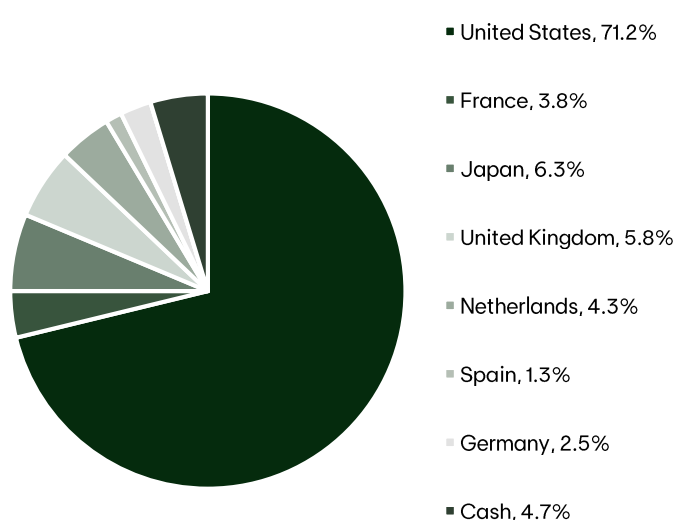
Source: Ellerston Capital.

### Sector Allocation



Source: Ellerston Capital.

### Geographic Allocation



Source: Ellerston Capital.

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### Find out more

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All holding enquiries should be directed to our register, Mainstream Fund Services on **02 8259 8550** or **InvestorServices@MainstreamGroup.com**

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