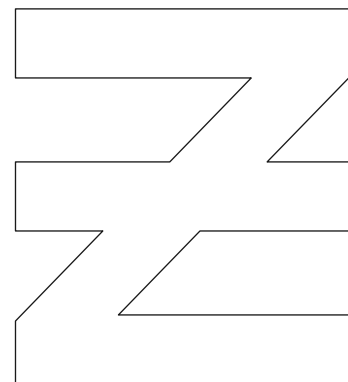


# Ellerston Australian Micro Cap Fund



Monthly Newsletter, November 2022

## 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     | \$1.1316                                    |
| Net Asset Value       | \$1.1288                                    |
| Redemption Price      | \$1.1260                                    |
| Liquidity             | Daily                                       |
| No Stocks             | 51  |
| Management Fee        | 1.20% p.a.                                  |
| Performance Fee       | 20%   |
| Buy/Sell Spread       | 0.25% on application<br>0.25% on redemption |

## PERFORMANCE SUMMARY

| Performance | 1 Month | 3 Months | 6 Months | 1 Year  | 3 Years (p.a.) | 5 Years (p.a.) | Since Inception (p.a.)^^ |
|-------------|---------|----------|----------|---------|----------------|----------------|--------------------------|
| Net^        | -2.29%  | -5.02%   | -8.19%   | -28.69% | 5.06%          | 8.92%          | 13.32%                   |
| Benchmark*  | 4.92%   | -0.81%   | -3.37%   | -14.03% | 2.57%          | 4.36%          | 6.51%                    |
| Alpha       | -7.22%  | -4.21%   | -4.81%   | -14.67% | 2.48%          | 4.56%          | 6.81%                    |

^ 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

November was a challenging month for the Ellerston Australian Microcap Fund which delivered -2.29%, compared to the Small Ordinaries Accumulation Index which put on 4.92%. Our lack of resource exposure hurt us with the Small Resources index rallying 12%, compared to a modest 3% increase in the Small Industrials. We also had a few "own goals" with the likes of Bravura Solutions and Helloworld Travel trading down significantly which we will discuss in detail below.

Looking more broadly at the market, the strong rally in November was a function of the softer than expected US CPI print, and dovish commentary from the Fed. Accordingly, the markets have peeled back their terminal rate expectations and the Australian 10-year bond yield declined by 20bps. In November we saw significant news flow with many of our portfolio companies - and the general market - providing trading updates at their AGMs and broker conferences. The updates were mixed with the consumer holding up surprisingly well although the headwinds are building, with cost pressures still present (albeit moderating) and funding costs continuing to rise. The markets remain extremely volatile which is creating opportunities and we think well-funded companies will look at resuming M&A activity to capitalise on current conditions.

Turning to stocks, and where our performance went wrong in November. Firstly, it was a tough month for Bravura Solutions (BVS AU) a provider of middle and back-office technology solutions for the funds administration and wealth management sectors. The stock fell materially after revealing initial take outs from their strategic review which has been ongoing since the full year result. As a result of this review, BVS significantly downgraded their revenue, EBITDA and NPAT guidance on the back of delays in signing new contracts as well as an increase in their cost base that exceeded our expectations. While we understood that BVS had a number of hairs on it, we were a fan of its sticky customer base and integrated technology. We were of the view that the elevated cost base could be right-sized and the business could be more streamlined going forward. The announcement in November took us (and the market) by surprise when it was announced that further costs were going to be added into the business and some smaller clients' contracts were winding down. Given the material change in the earnings outlook and the lack of clarity on near term earnings and increasing costs, we exited the position.

Secondly, Helloworld Travel (HLO AU) which is an integrated travel company shares fell 23.3%, on the back of Qantas selling its c10% stake in the business in a sloppy sell down. HLO is a core position for the portfolio and the fundamentals of the stock keep improving. During November, HLO provided a positive trading update to finish the month, with TTV, revenue and EBITDA all accelerating from month to month in FY23 as travel recovery is underway back to pre-COVID levels. On the last day of November, HLO provided another trading update on October trading which saw the group print EBITDA of \$5.2m for the month vs full year guidance of \$22-26m. Given the strong momentum in the business and the fact that HLO is tracking towards the top end of guidance we remain comfortable holders of HLO and believe at current prices the valuation is compelling.

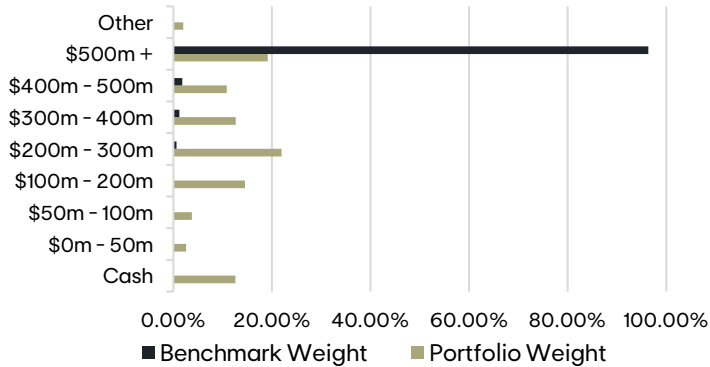
Moving to more positive news, Smartpay (SMP AU) had a solid month, gaining 26%. During November, SMP announced its 1H23 result which showed very solid expansion at the gross margin line as they were able to reduce switching and processing fees on incremental customers. We also saw strong acceleration in terminal roll-out numbers, with end of quarter terminals sitting well above consensus estimates. This result demonstrated operating leverage kicking in and margins continuing to expand despite ongoing investment in marketing. SMP remains a core holding for the portfolio given its growth profile, undemanding valuation and attractive business model to global players.

Another strong contributor in November was Aroa Biosurgery (ARX AU) which gained 25.7% over the month. ARX is a commercial stage medical device company, with its primary offering being the proprietary AROA-ECM, a bioscaffold derived from sheep stomach used in the treatment of soft tissue repairs. In November, ARX report its 1H23 results where they reiterated their recently upgraded guidance of NZ\$62-64m, maintained gross margin of 84% and FY23 normalised EBITDA breakeven. We like the outlook for ARX given the strong growth profile ahead for the business, coupled with a robust balance sheet position.

Moving forward, we expect the volatility to remain high for the near term which will continue to create new and interesting investment opportunities. We will stick to our process, looking for high quality businesses which resilient revenues, pricing power, strong management teams and ideally companies which are catalyst rich.

## PORTFOLIO CHARACTERISTICS

### Market Capitalisation



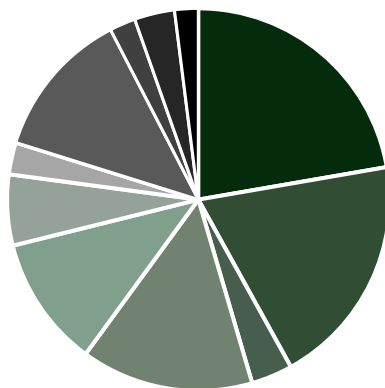
### Key Portfolio Metrics

| FY23e                  | Fund  | Benchmark |
|------------------------|-------|-----------|
| <b>Price/Earnings</b>  | 14.8x | 19.8x     |
| <b>Dividend Yield</b>  | 2.1%  | 3.5%      |
| <b>Net Debt/EBITDA</b> | -0.2x | 1.2x      |

Source: Ellerston Capital.

Source: Ellerston Capital.

### Sector Allocation



- Consumer discretionary, 22.3%
- Information technology, 19.7%
- Communication services, 3.5%
- Financials, 14.6%
- Health care, 11.1%
- Industrials, 6.0%
- Energy, 2.7%
- Cash, 12.6%
- Materials, 2.2%
- Real estate, 3.4%
- Other, 2.0%

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](mailto:info@ellerstoncapital.com) or visit us at [ellerstoncapital.com](http://ellerstoncapital.com)

All holding enquiries should be directed to our register, Automic Group on 1300 101 595 or [ellerstonfunds@automicgroup.com.au](mailto:ellerstonfunds@automicgroup.com.au)

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