APIR Code ECL7259AU

Ellerston Equity Income KIS Fund

Monthly Newsletter, February 2023

Investment Objective

The investment objective of the Ellerston Equity Income KIS Fund ("KIS" or "the Fund") is to provide investors with returns and income growth greater than the S&P/ASX 200 Accumulation Index over rolling 5 year periods.

Investment Strategy

The Fund is a fundamental, bottom up, concentrated Australian equities strategy with a clear focus on delivering sustainable dividend income for investors through an actively managed portfolio of stocks throughout the market cycle.

Key Information

Strategy Inception^^	1 May 2019
Portfolio Manager	Chris Kourtis
Application Price	$1.0671
Net Asset Value	$1.0644
Redemption Price	$1.0617
Liquidity	Daily
No Stocks	32
Strategy FUM	$32.6m
Management Fee	0.70% p.a.
Performance Fee	10%
Buy/Sell Spread	0.25% on application 0.25% on redemption
Minimum Investment	$10,000
Minimum Additional Investment	$5,000
Distribution Frequency	Quarterly

FY23(E) Key Portfolio Metrics	Fund	Benchmark
Grossed Up Dividend Yield (%)	7.6	5.7
Price/Earnings (X)	10.6	14.8
Dividend Yield (%)	5.9	4.3
Dividend Growth Rate (%)	1.1	-0.7
Beta	0.87	1.00

PERFORMANCE SUMMARY

Performance (%)	1 Month	CYTD	3 Months	FYTD	Rolling 12 Months	2 Years (p.a.)	3 Years (p.a.)	Since Inception (p.a.)^^
Net^	-1.59	3.74	2.02	9.41	4.48	10.08	9.07	9.30
Benchmark*	-2.45	3.63	0.30	13.80	7.16	8.66	7.93	7.61
Alpha	0.86	0.12	1.72	-4.40	-2.68	1.41	1.14	1.69

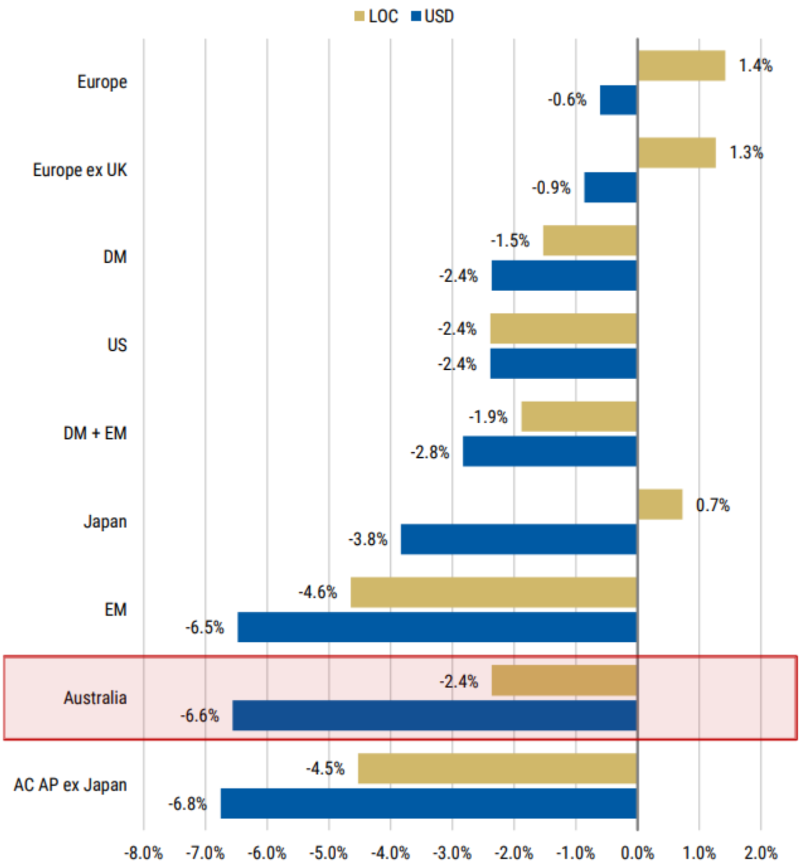
^ The net return figure is calculated after fees & expenses. Past performance is not a reliable indication of future performance

*S&P/ASX 200 Accumulation Index.

MARKET OVERVIEW

Across the globe, equity markets pared back the previous month's surge to close lower, triggered by macro headwinds and a rebound in bond yields due to persistent inflation. The MSCI Developed Markets were down 1.5%, with the S&P 500 (-2.4%) losing momentum. The ASX 200 also failed to buck the trend, falling 2.4%, with Materials acting as the largest drag during the month, -6.9%.

MSCI Global Country/Regional Indices Performance for February 2023



Source: Morgan Stanley.

USA

Economic indicators continued to soften in February, employment data remained elevated and contrary to expectations, inflationary pressure increased further. US January Non-Farm Payrolls rose 517k versus +260k previously (consensus was +185k) and the unemployment rate fell to 3.4%, the lowest since May 1969. The January Core Personal Consumption Expenditure (PCE) price index, the US Federal Reserve's (Fed) preferred inflation measure, confounded many observers and actually accelerated from a revised up December's 4.6% to +4.7% YoY. The Fed, as expected, raised its benchmark interest rate by another 25bps, to a range of 4.50% to 4.75% and signalled more tightening in 2023.

During a post-meeting press conference, Fed Chair Jerome Powell commented the FOMC "anticipates that ongoing increases in the target range would be appropriate", the "disinflationary process has started", but there is "still more work to do". Since then, data has pointed to risks of more rate hikes rather than less, which saw the US 10-year bond rate rise sharply 40bps in February. Powell will now testify to the House Financial Services Committee on 8 March, which will set the tone ahead of the FOMC meeting on 21-22 March.

US equities gave back some of January's strong gains as rising bond yields put the brakes on the market. The NASDAQ Composite Index was the standout relative outperformer, falling 1.1%, the S&P 500 finished 2.4% lower (dragged down by a -7.6% drop in the Energy sector) and the Dow Jones Industrial Average was the laggard, posting a -4.0% return as inflation fears and the poor performance of Consumer Discretionary continued to weigh on sentiment. Dominoes (DPZ, -16.8%) was the worst performer, with the pizza chain back-peddling on its longer term growth targets….

Europe

Eurozone economic indicators were mildly better, with the composite PMI increasing from 50.3 to 52.3, hinting at accelerating growth over the course of the first quarter. While underlying weakness is still apparent, the economy is proving very resilient this winter. With service sector selling price expectations still high, the European Central Bank is expected to remain vigilant and put through a 50bps rate rise at their 16 March meeting.

The Euro STOXX 50 Index finished the month up 1.9% on the back of resilient corporate earnings, with Auto and Parts driving gains, up 6.5% (Volvo and Porsche leading the charge). Among the major exchanges, France's CAC 40 was 2.6% higher, UK's FTSE 100 rose 1.8% (BP and Shell being top performers after announcing record profits) and Germany's DAX finished 1.6% higher.

Asia

China's recovery is underway as headline manufacturing PMI accelerated to 52.6 in February from 50.1 in January, its highest reading since April 2012. However, Chinese equities sold off as geopolitical tensions with the US outpaced reopening tailwinds.

Asian equity markets were generally weaker. The Nikkei 225 being the standout, up 0.5% as weakness in the yen continued to buoy the export sector. China's SSE and Korea's KOSPI fell 0.5%, India's SENSEX was 0.8% lower and the Hang Seng was the laggard, down 9.4% after its January surge of 10.4%.

Commodities

Commodity prices weakened, despite further China stimulus and abandonment of its Zero-COVID stance driving positive sentiment. Iron ore continued to edge lower, with the price down 4% to US$124/tonne. The Brent oil price closed flat at US$84/barrel and natural gas prices fell sharply (the spot Asian and European prices were down ~23%), as weather conditions continued to improve in Europe, also dragging thermal coal prices down 23% for the Newcastle benchmark. The base metals complex was softer, with the major metals; copper down 3%, aluminium 11% lower and nickel fell 18%. Gold was 5% lower at US$1828/ounce, as the US dollar strengthened as US bond yields rebounded.

Bonds

The US 10-year yield rose 40bps to 3.92%, a reaction to a surprisingly strong labour report and higher inflation prints. The Australian 10-year bond yield also surged in sympathy, up 30bps to 3.85%, upon a strong CPI print and the Reserve Bank of Australia (RBA) signalling further official rate hikes.

Australia

As expected, the RBA delivered another 25bp interest rate increase (the 9th in a row) to 3.35%, with its next meeting scheduled on 7 March. The messaging was clear, the RBA expected more rises in 2023 and the size and timing of future rate increases will continue to be determined by the incoming data and the board's assessment of the outlook for inflation and the labour market. Nothing new there.

The A$ closed the month down 5% at US$0.67, on the back of the retreat in iron ore and other major commodity prices, plus a stronger US dollar.

In the month of February, the S&P/ASX 200 Accumulation Index finished down 2.4%. The Utilities sector (up 3.4%), was the best performer (led by Origin Energy +9.4%, after announcing that its takeover by Brookfield and EIG was still on track with the price still effectively $9 per share), followed by Information Technology (+2.7%) and then Industrials (+1.5%). The bottom three sectors were Materials (-6.6%, dragged down by heavyweights BHP, RIO and Mineral Resources), Financials (-3.1%) and Real Estate (-1.0%).

For the month, the top stocks that made a positive contribution to the Index's return were QBE Insurance (+9bps, after posting a clean set of numbers for once), Aristocrat Leisure (+8bps), Origin Energy (+6bps), Brambles (+6bps) and Transurban Group (+5bps). Conversely, the bottom five stocks detracting from the Index's performance were BHP Group (-96bps), Commonwealth Bank (-55bps), National Australia Bank (-25bps), Westpac (-19bps) and Rio Tinto (-17bps). The ASX Small Ordinaries fell 3.7%, underperforming the broader benchmark by 1.3%. Within the ASX Small Ordinaries, the Small Resources lagged at -9.1%, with the worst performer being gold miner Red 5, down a whopping 38.1%.

Reporting season take-outs:

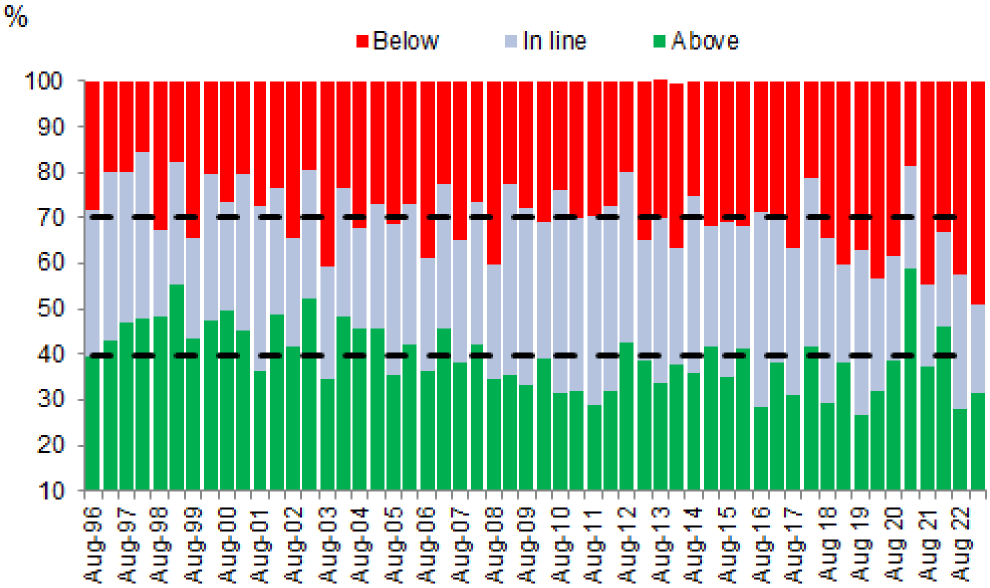
- Few indications of any significant signs of slowdown in demand, with 38% of ASX 200 stocks beating at the revenue line, while only 18% missed, but firms found it much more challenging to pass on higher costs - nearly 50% of companies missing at the earnings line (versus ~30% long-run average). Operating costs grew at an average of 14% YoY, a new post pandemic high, but most companies reported that cost pressures have now likely peaked. While earnings missed much more frequently than normal, on the positive side, they were typically small in magnitude and downgrades to consensus earnings have been no larger than average.

- Price action around results suggested that there was a relatively low bar for many cyclical stocks given they typically outperformed, despite tending to miss/downgrade at a higher hit-rate, but extreme style/factor rotations continue to dominate price moves, with the market struggling to find a consistent direction in recent months.

- Sector wise, Banks are starting to see pressure on margins, as competition intensifies, but no material degradation in asset quality, yet! Resource companies were among the hardest hit by cost and capex blowouts. While forward indicators of housing have rolled off sharply, construction activity still remains strong given the large backlog of work. Most health care service providers are continuing to see a slower than expected return to pre-COVID volumes. Higher inventory levels in some pockets increases the risk of discounting in a weaker environment, while the Classified Platforms and Insurers were two sectors that were still able to demonstrate solid pricing power.

Weaker than expected margins saw a larger than average number of firms Miss (49%) vs Beat (30%) consensus earnings expectations. For the pessimists, this was a near record level of misses.

Percentage of companies beating/in-line/missing EPS consensus



Source: Goldman Sachs.

COMPANY SPECIFIC NEWS

The Market Hits

G.U.D. Holdings (GUD +25.3%)

GUD is a product marketing company, actively managing a number of consumer and industrial product businesses. GUD has diversified across three discrete business segments: Automotive aftermarket products (Ryco, Wesfil, Goss, Brown & Watson), APG (4WD accessories) and Water Products (Davey). GUD delivered a very credible result, with earnings 14% above consensus and provided a trading update for the first 6 weeks of 2H23 showing that sales were up strongly on the pcp. Highlights included another robust performance from the core Auto business (EBIT +9%) and much improved cash conversion. The core Automotive Products Division was helped by both acquisition and organic drivers (Vision X acquisition in Dec 21 for US$71m and 10% organic growth at the revenue line). The pent up demand for new cars was caused by supply chain issues, with a number of companies (including GUD), reporting that supply chains had improved, benefiting companies like GUD, which have strong operating leverage to increased new car volumes. Investors jumped on this theme, also pushing up beneficiaries such as Eagers Automotive, SG Fleet Group and Smartgroup Corporation, just to name a few. While no explicit earnings guidance was provided, outlook commentary by management added to the market's confidence in stronger 2H23 earnings, particularly in relation to expectations for a heavy 2H skew in APG. Looking further ahead, investors stayed bullish on the structural growth in demand for 4X4s and SUVs theme and by association, the outlook for APG. Export opportunities (most notably across auto electrical and 4WD) provide another layer of potential future growth. Along with a gradual deleveraging of the balance sheet, this supported a further re-rate in GUD's share price.

Eagers Automotive (APE + 19.9%)

APE's FY22 result came in stronger than expected, with underlying PBT of $405.2m beating consensus of $386.1m (~5% beat), underpinned by continued demand for new and pre-owned cars. Revenue was in the end bang in-line with consensus at $8.54bn vs $8.56bn. While revenue was impacted by supply constraints during the period, positive momentum in the underlying business continued, with the total new car order book growing by +74.4% since December 2021. APE's revenue outlook comments for FY23 stole the show, given a relatively in-line result at the PBT level (+3%). With APE not expecting any material improvement in vehicle supply, the revenue outlook ($9.5-10.5bn) was particularly pleasing. APE's new FY23 revenue guidance uplift of +$1.5bn was based on a 12-month contribution from recent acquisitions (~40%), organic and greenfield developments (~10%) and its BYD joint venture (~50%), noting potential upside through BYD with two more models widely expected to be released in CY23.

Link Administration (LNK +19.3%)

LNK's 1H23 operating EBIT of $80.2m was pre-announced and hit the top end of the original guidance range of $75-80m. NPATA of $48m was however, below consensus of $56.9m,due to a higher tax rate, lower PEXA contribution (including one-offs and acquisition expenses) and higher net finance costs. While underlying business momentum was mixed (with RSS and corporate markets very strong, FS and BCM soft), the core RSS business delivered, which was well received by the market. Key highlights included: (1) Strong growth in Retirement Super Solutions (RSS) recurring revenues (+7% YoY) as LNK benefited from industry consolidation and new business wins, assisting member growth (+9.6% YoY), inflation indexation and international expansion. The RSS division grew EBITDA by a better than expected 18% YoY and also successfully renewed contracts with several existing large clients. Combined with tight cost management (+2% YoY), this led to ~300bpts of EBITDA margin expansion; (2) Higher margin income ($16m vs $1m in 1H22), with further increases expected in 2H23E. That's all very well, but the main driver for LNK in the near term is the Funds Solution (FS) sale and the finalisation of the onerous FCA Woodford dispute and redress in the UK. LNK has been in discussions to potentially sell the division to Waystone - with LNK suggesting that a sale broadly offsets the FCA fine of $605m. The company also stated the sale was not contingent on the FCA settlement, but importantly, if both are concluded, the likely outcome is that LNK would receive no net proceeds from the sale of its FS business, but the matter would at least be laid to rest.

Flight Centre (FLT +18.8%)

Hot on the heels of a fresh capital raise, there were few surprises with FLT's 1H23 results, having been preannounced. FLT's 1H23 EBITDA of $95m pleased the market and came in at the upper end of recent guidance, with FY23 EBITDA numbers of $250-280m re-affirmed. The 60% lift in 1H EBITDA was driven by: (i) revenue margins which improved across all brands; (ii) improving cost margins (now at 9.9%), with management citing that the majority of their fixed costs are embedded, delivering material operating leverage (39% incremental margin in 1H vs an aspirational target of +40%); and (iii) Total Transaction Value trends which continued to recover, with a step up observed in Jan/Feb (consistent with other travel operators). FLT has also benefitted from ongoing corporate travel wins, currently at 80% of TTV vs 1H20, with Corporate expected to be at >$10b in FY23, increasing further in FY24. As a reminder, Corporate delivered ~$80m of EBITDA in the first half. The resumption of China travel post-reopening, where FLT is more exposed to, also lifted investor sentiment and the shares rallied.

Orora (ORA +18.5%)

ORA shares staged a powerful post result rally after the packaging company delivered a clean beat in a slowing environment, with 1H23 EBIT of $166m ~4% better than consensus. Compositionally, Australasia was the stand out, with revenue up ~21% YoY on strong pricing power and disciplined inflation recoveries. Despite a major Australian wine producer reporting commercial wine volumes down 11%, ORA surprised the market to deliver a solid +3% uplift in Australasian volumes. This implies Can growth was at least double digit, with ORA close to, if not exceeding its production capacity. North America also continued to turnaround, with a 30bps improvement in margin in a tough economic climate. Investors praised the resilient result, with its price over-recovery thesis playing out nicely in the US.

AUB Group (AUB +17.4%)
AUB delivered a solid ~4% NPATA beat, driven by Australia Broking and Tysers' excellent performance. Delivery of a better 2Q23 from the Tysers acquisition than was first guided at the company's December's trading update was welcomed, as was further disclosures of one-off costs included in underlying earnings and the synergy benefits already locked in. AUB management expect rate increases in 2H23 to be in-line with the ~7.5%-9.5% seen in the half, with the acceleration in property rates being especially positive given their portfolio mix. Execution was particularly strong, suggesting robust sustainable run-rate growth, even before the benefit of premium rises kick in. The ~410bps margin uplift on pcp was a particular highlight, as was top-line revenue growth of 14%. Over the Tasman, NZ top-line growth of 4% was also better than expected, with further progress on the turnaround strategy. Given that elevated technology spend is ending by June'23 and premium rate rises are expected to be higher than in prior periods, when coupled with continued cost discipline, the margin expansion story looked clearer to investors. Post the update, sell side analysts upgraded their earnings and lifted their price targets, driving the shares higher.

Medibank Private (MPL +13.6%)
Despite the unfortunate cyber-attack incident on 12-Oct-22, MPL surprisingly stabilised residents' margins and actually managed positive policyholder growth in 1H23. The shares rose post its 1H23 results, revealing greater policyholder stability than feared, with moderate growth expected into 2H23. Alongside this, MPL's Health Insurance margin outlook also improved, as evidenced by the 40bps 1H23 gross margin expansion, driven mainly by their non-resident (+30bps) business. As broader inflation pressures intensify (including ongoing hospital recontracting), MPL management feel the business is well insulated, as claims trends continue to benefit from a potential structural shift/reduction in rehab, respiratory and prostheses claims. The market also liked the fact that management gave more definitive guidance, including policyholder growth, cyber costs and more productivity savings. FY23 Outlook provided: 1) Residents' policyholder growth: 0.5%-0.75% (removed at the time of the cyber incident); 2) Underlying average net claims per policy unit: +2.3% (unchanged); 3) Non-recurring cyber cost $40-45m pre-tax ($26m in 1H23); 4) Management expenses of $560m ($274m in 1H23 or ~49%); 5) Targeting $30m productivity savings in FY23-FY25, a year longer than previously guided, with an additional $10m; 6) Health Fund Capital to premiums - 13.0% vs. the 11% - 13% target range which against the new capital standards, this would equate to ~2.0x PCA and 7) COVID-19 Deferred Claims Liability decreased to $411.6m ($448.3m at Jun '22) with no new claims being put into the provision on the back of the end to government mandated lockdowns

Smartgroup Corporation (SIQ +13.1%)
SIQ is a provider of employee benefits and workforce optimisation services for public-benevolent-institutions (PBI), government, health, and corporate organisations. SIQ also provides fleet management and is the number 2 novated leasing provider in Australia. As we commented above about GUD, pent up demand for new cars has been caused by supply chain issues, with a number of companies, reporting that supply chains have been improving, benefiting companies like SIQ which for a while, have been constrained by vehicle supply. SIQ delivered solid FY22 result and improved optimism on the outlook for novated volumes, as well as the huge number of new enquiries for qualifying EV quotes under the electric cars FBT exemption changes from 1 July 2023. This tax change materially benefits novated leases. The highlight was the healthy dividend beat, with a final dividend of 15cps and a special dividend of 14cps, taking FY22 dividends to 46cps - representing a fully franked yield of 7.2% based on SIQ's February closing price.

Kelsian Group (KLS +12.5%)
KLS provides land and marine transport and tourism services in Australia, Singapore and the UK, operating through Marine & Tourism (M&T), Australian Bus (AB) and International Bus (IB) segments. KLS's 1H23 result was in line as M&T rebounded strongly post COVID affected prior comps, with EBITDA +37%. Labour challenges in KLS' AB and IB were well flagged at the FY22 result, and whilst a drag on 1H23, these headwinds have been largely confined to the 1H. Looking ahead, investors liked the high degree of revenue visibility (83% contracted) and earnings stability (cost profile indexed to inflation) which provide a stable growth outlook, with upside risk associated with: 1) performance of recent contract wins; 2) new contracts wins, and 3) potential acquisitions. Investors were satisfied with this outlook, pushing the stock price up 5.4% on the day.

Inghams Group (ING +11.7%)
Poultry producer ING delivered a 5% ($10m) better than expected 1H23 result at the EBITDA line, which was 6% below 1H 22, but 33% ahead of 2H 22, demonstrating that the ING earnings recovery from significant COVID-related impacts is underway. Management highlighted some remaining headwinds in 2H23, including labour, fuel, freight, packaging, utilities and ingredients, but felt they were through the worst of it.

The Market Misses

Domino's Pizza Enterprises (DMP -33.1%)

DMP delivered a very disappointing 1H23 result with Network sales -4% YoY and Group EBIT -22% YoY, highlighting major execution gaps. More concerning, was management walking away from the FY23 guidance that was reaffirmed at its capital raising in December 2022. Australia and New Zealand EBIT was up 5%, Asia was down 20% and Europe fell a whopping 48%. Network growth was a pedestrian +2.1%, impacted by weak franchisee sentiment and performance. Furthermore, the company provided a trading update for the first few weeks of 2H23, with LFL sales actually down 2.2%, which was below consensus at +5%. It would appear that volumes proved to be highly price sensitive, with recent price hikes resulting in much softer pizzas volumes flying out the franchisee doors. DMP also stated that it was unlikely to meet their medium term growth target of 3-6%, nor could they achieve their 8-10% new store openings aspiration in FY23. The combination of a weak interim result, sales and rollout pace, combined with DMP walking away from its earnings guidance so soon after raising equity, spooked investors who ran for the exit door, pushing the stock price down 24% on the day of the release.

Lake Resources (LKE -23.3%) / Core Lithium (CXO -19.8%)

Lithium stocks came under pressure with lithium carbonate and spodumene prices falling 20% and 13%, respectively during the month, as de-stocking across the EV chain put pressure on lithium prices. Fledgling developers, LKE and CXO suffered much more than producers such as Pilbara Minerals and Allkem, which were only down 12%.

Silver Lake Resources (SLR -22.7%) / Regis Resources (RRL -18.7%)

The gold sector fell 9% in February as higher interest rates and the stronger US dollar resulted in a 5% lower gold price, which affected all gold companies. The exception was Newcrest Mining (+3.3%), having received a takeover offer from North American major Newmont Corporation at 0.38 Newmont shares for each Newcrest share. Newcrest rejected the offer; however, the Board indicated to Newmont that it was prepared to provide access to limited, non-public information on a non-exclusive basis.

AMP (AMP -22.5%)

AMP delivered a messy FY22 profit result, which included the discontinued AMP Capital business. Underlying earnings missed analyst expectations, largely due to lower group investment income, lower Wealth (AWM) earnings and a miss on controllable costs. Combined with increased wealth outflows and higher than expected FY23E cost guidance, investors saw downside risks to FY23 consensus numbers. The DPS of 2.5c surprised on the upside, but was paid out of previously flagged capital returns, with the pro-forma surplus down. AWM earnings fell sharply in 2H22, from $36m in 1H22 to $14m 2H22, despite assistance from lower investment costs, with results impacted by negative investment income (-$2m 2H) and higher controllable costs. Larger 2H outflows of -$2.4bn (consensus -$1.5bn) and a confusing -$1.2bn restatement of 1H AUM, coupled with the 2H AUM of $124.2bn which also proved to be below forecasts, all underwhelmed. AUM-based revenue margins declined to 53bps in 2H22. Along with the rest of the banking sector, the only highlight was that the AMP Bank business benefited from stronger NIM - Bank NPAT of $103m was 4% above market ($99m), mostly driven by a stronger 2H NIM of 144bps, expanding 12bps on 1H22, with its loan impairment expense (-$2m) and expenses largely in line. Lending growth increased from 3% 1H to 5.7% in 2H. For FY23E, AMP is now targeting above-system growth and a NIM in line with FY22 (~1.38%, but still well below peers). AMP's Group capital position had weakened - the payment of a 2.5cps final dividend certainly surprised - as it was the first dividend payment since 1H20. However, the ~$400m 2H22 dividend was part of the $750m previously flagged capital management initiatives for FY23, thus reducing remaining capital returns to $350m. Group surplus capital was now reduced to $923m as at Dec-22, with a pro-forma outlook (post the AMP Capital sale) at $1.25bn, well below the $2.0bn figure as at Jun-22. This is despite only $267m of capital returns and $266m hybrid redemptions.

When long suffering AMP investors put it all in the melting pot, it was a scheiß sandwich for a former iconic branded financial services company which on an adjusted basis post equity raisings, has fallen from $14.00 back in 1999, to a mere $1.05 (good effort given the Australian equity market has nearly tripled since 1999!).

Paladin Energy (PDN -18.2%)

PDN gave back most of January's +21.4% outperformance, as the momentum in the spot uranium price stalled after the spike in January. PDN's 1H result highlighted a sharp increase in finance costs, as it ramps up the re-start of its idled Langer Heinrich uranium mine in Namibia in 1QCY24, however, it's all about the uranium price momentum as investors patiently await the mine re-opening.

InvoCare (IVC -17.5%)

Funeral and related services provider IVC disappointed with its full year results. Of particular concern was the market share losses (IVC case volumes +7% vs industry volume growth of +11%). Management attributed the market share losses in the year on the back of an inability to handle the surge demand in funeral volume given the labour challenges with smaller operators and an increase in the more economic "no service, no attendance" cremations, taking the substantial share of excessive volume.

Star Entertainment Group (SRG -17.5%)

It was a rollercoaster ride for SRG, which released a very disappointing trading update early in the month stating that EBITDA for FY23 was expected come in at $330-360m, implying a run-rate for 2H23 of ~$150m. While a range of possible outcomes exist, the market assumed that the negative impacts related to increased operating restrictions would result in a permanent step down in earnings and cash flow. As a result, valuations across the Street declined materially. More importantly, as part of the trading update, SGR announced that it anticipated incurring a non-cash impairment charge of $400m to $1.6bn in 1H23 in relation to the operational changes following the Bell Review, amendments to the NSW Casino Control Act, as well as a potential increase to the NSW casino duty rates. SGR is still in discussions with the NSW government regarding the proposed changes to NSW casino duty rates (firstly announced in Dec 2022) and the company noted that the changes would require either legislation to be passed or an agreement between the NSW government (bearing in mind election pending) and SGR. Given this uncertainty and potential balance sheet stress, investors headed straight for the exit gate and the shares collapsed, closing down 20.8% on the day of the announcement. Towards month end, Star raised $800m of fresh equity at a discounted price of $1.20 to pay down existing debt, bringing pro forma ND/EBITDA to ~0.8x (from 2.7x at 31 Dec 22). The new gearing now provides more space to absorb potential impacts such as a higher AUSTRAC fine, a material increase in NSW casino duties, or a worsening consumer demand picture. Also, as part of the plan, SGR was granted covenant relief until June 2025 and has committed not pay dividends until it returns to full suitability under its licences and is back within target gearing of 2.0-2.5x ND/EBITDA. SGR subsequently partially re-rated following the recapitalisation (trading ~7% above TERP) and the shares recovered off their intra month low of $1.18.

Downer EDI (DOW -16.2%)

Downer delivered a shocking 1H23 result. Management downgraded guidance yet again, for underlying NPATA of $170-190m (previous: $210-230m), after only issuing guidance on 8-Dec-22, which was very concerning, keeping investors scratching their heads on the overall earnings visibility of this business, despite the strong end-market demand and thematic. The operating result was soft across the board. While the market had overestimated the 2H 23 skew, given weather related issues affecting their Roads segment, weaker Utilities, the overall results were soft, and there was broad-based weakness. FY23 guidance was downgraded given losses associated with the utilities power maintenance contract, heightened risk of Water project losses on unrecoverable prolongation costs and a slowdown in minor government capital works (management suggested this was localised to one government and due to budgetary constraints). This resulted in a ~18% NPATA guidance downgrade at the mid-point for FY23, with management anticipating NPAT of A$170-190m subject to no 'further material COVID-19, weather, labour shortages or other disruptions, and excluding restructuring costs. With previous guidance only issued on the 8th of December, investors were concerned re management's visibility over earnings, noting DOW's repeat offending history in downgrading earnings guidance issued at the start of the year, with FY19/20 seeing NPATA downgrades of c.13% and c.36%, respectively, at the mid-point.

Accounting issue resolved? Well, no one has a clue. Management commented that the post-tax $22.5m earnings irregularity was 'isolated to one contract', with the 'root cause' and contributing factors identified by external lawyers and forensic accountants. However, the market was left with little additional confidence in management, restricted in details that it was able to provide. That said, the previous management team responsible for this particular onerous contract are no longer with DOW. Zero consolation to existing holders watching the stock plummet 23% on the day of the update!

FUND PERFORMANCE

With a suspenseful and frantically busy results season behind us, the Fund fared relatively well, returning -1.53% in February and thus outperformed the benchmark decline of -2.45%. This brings the return for the CYTD to a credible +3.86%, slightly outpacing the broader market at +3.63%.

The reporting season was characterised by 30% beats (49% misses), but a heightened price reaction to earnings and outlook misses. Pleasingly, we were generally on the right side and avoided the memorable big blow ups like Dominos, AMP, Star Entertainment Group and Downer just to mention a few.

Small and Mid Cap stocks, where the Fund remains significantly overweight as a sector, underperformed this month relative to their Large Cap peers. Growth outperformed Value as a style, which acted as a further headwind to performance.

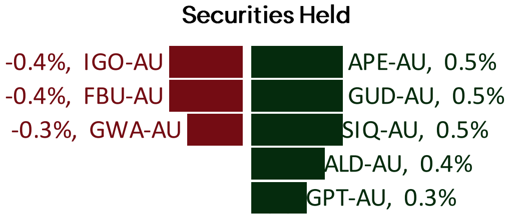
Industrials, which rose 1.5%, posted the largest contribution to the market's return in February. Utilities was the best performing sector (led by Origin Energy +9.4%), followed by Information Technology (Computershare +5.7%) and Industrials (Brambles +7.3%).

Financials and Real Estate were two of the three weakest performing sectors, with Materials faring the worst, closing down 6.6% (pulled down by BHP Group -8.5% and RIO -8.4%).

Returns[1] (%)	*Gross*	*Benchmark*	*Excess*	*Net Return*
1 Month	-1.53	-2.45	0.92	-1.59
CYTD	3.86	3.63	0.24	3.74
3 Months	2.20	0.30	1.90	2.02
FYTD	9.96	13.80	-3.85	9.41
Rolling 12 Months	5.55	7.16	-1.61	4.48
2 Years (p.a.)	11.30	8.66	2.64	10.08
3 Years (p.a.)	10.24	7.93	2.31	9.07
Since Inception (p.a.)	10.46	7.61	2.85	9.30

[1] The return figures are calculated using the redemption price 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. Returns of the Fund may include audited and un-audited results. Past performance is not a reliable indicator of future performance.

Month of February Attribution



Source: Ellerston Capital.

In February, the main positive contributors were active overweight positions in Eagers Automotive (APE +19.9%), G.U.D Holdings (GUD +25.4%), Smartgroup (SIQ +11.6%), Ampol (ALD +8.7%), GPT Group (GPT +3.3%) and zero holdings in Commonwealth Bank (CBA -6.6%).

The main detractors for the month were our overweights to IGO (IGO -9.9%), Fletcher Building (FBU -7.5%) and GWA Group (GWA -16.3%).

FUND ACTIVITY

The Fund was again highly active during the month of February, profitably exiting residual positions in Harvey Norman (pre a poor result), Premier Investments and Treasury Wine Estates, with the aim of culling our exposure to the consumer and also locking in profits in stocks that had re-bounded sharply off their lows recorded in late 2022, namely Blackmores, GPT, QBE and Reliance Worldwide. The proceeds were re-deployed in five new positions: well known companies Wesfarmers and Nine Entertainment, as well as the lesser known Bapcor, Bega Cheese and Incitec Pivot (see write-ups below). We also strengthened existing positions in Ampol, Elders, Fletcher Building, IGO, Iluka and Metcash on the recent pull back.

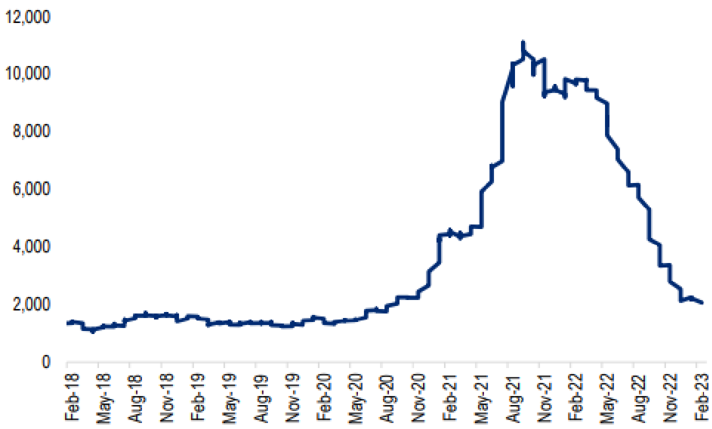
NEW STOCKS ADDED	STOCKS EXITED
• Bapcor	• Harvey Norman
• Bega Cheese	• Magellan Financial Group
• Incitec Pivot	• Premier Investments
• Nine Entertainment	• Treasury Wine Estates
• Wesfarmers	

INCREASED	DECREASED
• Ampol	• Blackmores
• Elders	• GPT Group
• Fletcher Building	• QBE Insurance Group
• IGO	• Reliance Worldwide
• Iluka	
• Metcash	

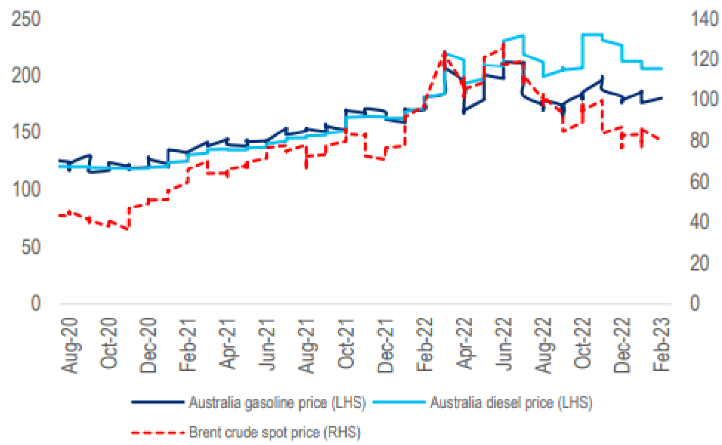
Bapcor (BAP) is an aftermarket parts distributor, with a predominantly Trade focused business. It also operates a Specialist Wholesalers and Retail & Service store business that focuses on DIY customers. Bapcor has operations in Australia, New Zealand and Thailand. The BAP CEO, who was well regarded by the market, announced his retirement in November 2021 and the stockprice tanked 10% on the day. The Board saw this as an opportunity to install a more contemporary leadership and management approach to drive the company's future growth, while also ensuring that consistent with changing stakeholders' expectations, an appropriate governance and oversight framework remained in place. The stock continued to sell off another 10% subsequently. The new CEO (the previous CFO) has set about a positive strategic direction called"Better than Before" launched in July 2022 which is targeting a ~$100m EBIT benefit in FY25.

Pleasingly, the company's 1H23 result did not disappoint and was in line with market consensus at NPAT of $62m. BAP's Trade business demonstrared its resilience, underpinned by double-digit LFL sales growth, store expansion driving a further ~5% sales growth and an aging car fleet. Higher freight and fuel costs which have hugely impacted BAP, are abating, especially freight pressures.

Freightos Baltic Index – Global



Australian gasoline and diesel (cents per litre) vs. Brent Crude (US$/bbl)



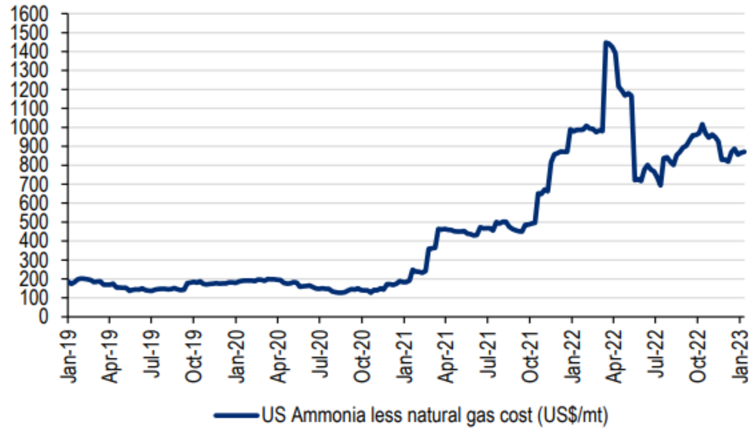
Source: Citi Research

We see the company's relatively non-discretionary product offering as being well placed to outperform the broader retail sector in an increasingly challenging consumer environment and believe the market has been too conservative factoring in the benefits from "Better than Before", with consensus FY25 EBIT only increasing by <$20 million, compared to the ~$100m target. BAP is trading at an attractive 8x FY24 EV/EBITDA, a 30% historical discount, has a strong balance sheet (1.5 times Net Debt/EBITDA) and with cost headwinds abating, makes for an attractive medium term investment proposition.

Bega Cheese (BGA) has grown in the last 5 years from a commodity processor and contract packer to becoming a multi-channel branded company with branded sales representing ~82%. It has a portfolio of category leading iconic Australian brands, including Bega, Vegemite, Dairy Farmers, Yoplait, Dare and Farmers Union just to name a few. It also has a significant surplus property portfolio and post a large $401m capital raise back in late 2020, where the proceeds were used to partially fund the acquisition of Lion Dairy & Drinks Pty Ltd, the balance sheet was significantly strengthened. The share price has underperformed the market by a massive 30% in the past 12 months, mainly due to the milk undersupply in Victoria. BGA management and the market expected to experience a farm gate milk price increase for FY2023 in the range of 15%-20%, based on the stability and strength of global dairy commodity markets and currency relativities. Initial milk price announcements by Bega Cheese and other dairy companies on 1st June reflected this expectation. However, particularly strong competition amongst milk processors for FY2023 and a reduction in the milk pool led to price increases way above management's initial budget, to an unprecedented level ~30% higher than FY2022 prices. Pricing moves into July 2022 saw major processors reach ~$9.40/kg. As a result of the lag in being able to pass on these input price increases to the likes of Woolies, Coles etc, BGA's FY23 EBITDA guidance was cut. Since then, BGA have implemented price rises in the 1Q and have been successful in achieving price realisation, which is now being reflected in monthly performance, however the 1H result was beyond redemption. At its 1H23 results, BGA guided towards the bottom of the $160-$190m range. BGA also announced the departure of its CEO, to be replaced by its COO Peter Findlay, who was integral to BGA's cost out and supply chain restructure a couple of years ago and knows the FMCG industry well. Despite a number of acquisitions in recent years (Lion Diary being the most transitional), BGA has not achieved the earnings the market had expected. It is estimated that the step up in BGA's FY23 farmgate milk price since 1st June 22 has cost it ~$150m. We expect the new management line up to aggressively pursue the 2nd wave of synergies associated with the Lion Dairy and Drinks (LDD) business acquisition.

Looking forward, FY23 should be the trough year for BGA's earnings, as FY24 farm gate milk prices are likely to trend lower and should normalise. This is because dairy processing capacity closures are continuing due to industry over supply (as demonstrated by BGA's recent move in the ACT), especially the export oriented Tier 2 & 3 players. Also, significant operational inefficiencies have mostly normalised, although some bottlenecks still remain, especially within logistics. We believe the earnings downside risks are already priced into expectations. BGA's balance sheet is not at risk at 2x ND/EBITDA and the gap between asset backing and the current share price is large, attracting corporate interest such as Andrew Forest's Tattarang Agrifood Investments at 11.5% of the register. BGA is trading at an FY24 EV/EBITDA of 7x, a 30% historical discount, an attractive entry point for what we see as a strategic Australian dairy asset with earnings capacity materially higher than currently.

Incitec Pivot (IPL) is a global fertiliser and explosives manufacturer. Formed back in 2003 via the merger of Incitec Fertiliser and Pivot Group, supplying about half of Australia's agricultural nutrients. IPL expanded into explosives in 2008 with the purchase of Dyno Nobel, the world's second-largest manufacturer of ammonium nitrate and initiation systems. The company remains highly leveraged to fertiliser prices and explosives volumes. IPL's new management team (the previous had a history of poor execution, operational hick-ups and underperformance), is now focused is on improving manufacturing reliability, reducing costs and improving capital discipline, which should set the stage for higher returns over the medium to longer term, in our view. The collapse in US gas prices should improve IPL's ammonia margins, which were squeezed last year, but have been ticking up and have begun to drive sell-side estimates higher.



Source: Citi Research

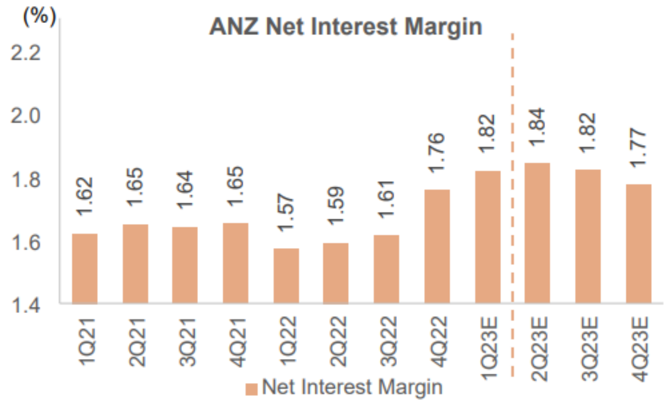
Importantly, IPL has decided to conduct a strategic review of its US Waggaman, Louisiana ammonia plant (WALA) ahead of the demerger of the Dyno Nobel (Explosives business) and its Fertiliser business. This was a major focus at its FY22 results and caught our attention. More open minded management said the environment had changed in the past six months, including significant value uplift of the WALA plant (improved operating performance and tight supply/demand dynamics). On WALA valuation, management stressed that it would be difficult to build the asset for less than US$1.5bn, with 20-30% of WALA ammonia production used internally, while 70-80% is sold to external parties. IPL confirmed that maintaining that supply for internal uses is critical and a key consideration with any potential asset sale agreement. The review is expected before the May 1H23 result. On our estimates, a whole or partial sale would represent ~60-105cps or ~17-30% of the current market cap, resulting in the prospect of a significant buy-back or higher dividends post the sale. IPL is already sitting below its target 1-1.15x Net Debt/EBITDA. Irrespective of what happens with WALA, IPL is trading at a very attractive 4.8x EV/EBITDA, with a way above market 6.2% dividend yield.

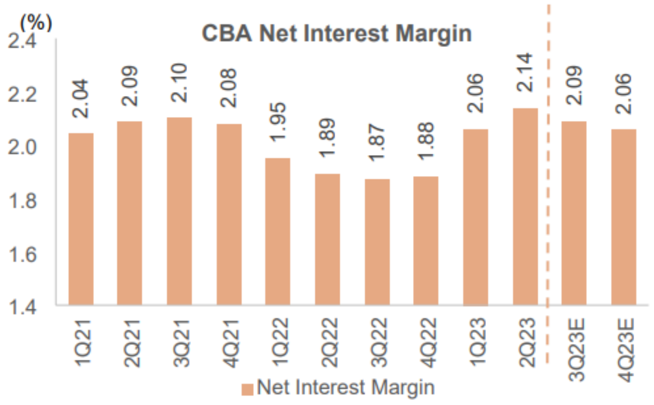
FUND STRATEGY AND OUTLOOK

We have written ad nauseam about the pending "mortgage cliff", as borrowers on historical low fixed mortgage rates (>2.0%) roll over into higher current rates (5.75-6.00%) impacting at least 1 in 10 households, so we won't dwell on that. **However, our post result channel checks with non-bank financial lenders and intermediaries, supplemented by endless post result calls with companies at the consumer coal face, *reinforces our confidence in our ZERO BANK stance.***

The tsunami is finally coming, **and the big 4 Banks are the last place you want to be, given the current bout of irrational and aggressive loss leading competitive behaviour to entice depositors to stay. Worse still, $10,000 up front cashback bonuses, free NBN service sweeteners** and 150bps discounted rates to entice borrowers to switch their mortgages **can only end in tears for banking sector NIM's down the track.** Perhaps the biggest surprise during the reporting season was CBA's proclamation that margins peaked back in October 2022.

NIM's are clearly peaking



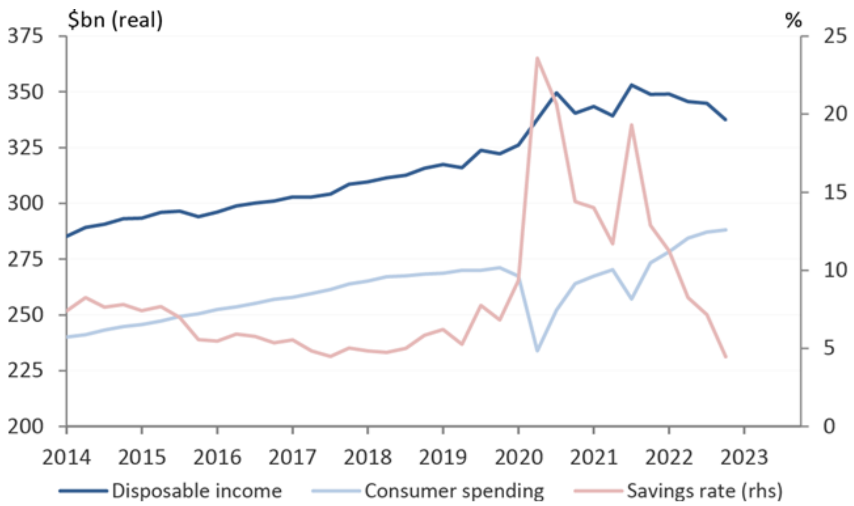


Source: Barrenjoey Research

At the time of writing, the ABS reported home loans for January (excluding refinancing) fell 5.3%, weaker than expected. Since the record high level in January 2022, home loans are now down by a cumulative 35.0% YoY, the weakest on record (since at least 1992).

We expect continued slowing in credit growth and in broader economic activity through 2023 as the higher interest rate impacts build. Consumer spending, which slowed again in the 4th quarter 2022, has slowed further, as evidenced by "canary in the coal mine" Harvey Norman's surprisingly weak January (-10% LFL sales) Australian trading update. This pulls forward our softening in household goods demand thesis, as cost-of-living pressures, which have been rising at a staggering pace over the past 9 months now start to bite. Discretionary spend clearly continues to decelerate. Another data point is that the Savings Rate has now fallen Below Average. The level of savings rate has been a key focus point for investors trying to calculate "buffers" and calibrate the impact of tightening conditions. As evidenced by the Q4 GDP official ABS data, the level dropped below average to 4.5% from 7.1% and rather than being a boost to spending, most of the drawdown appears to have been consumed by higher interest costs.

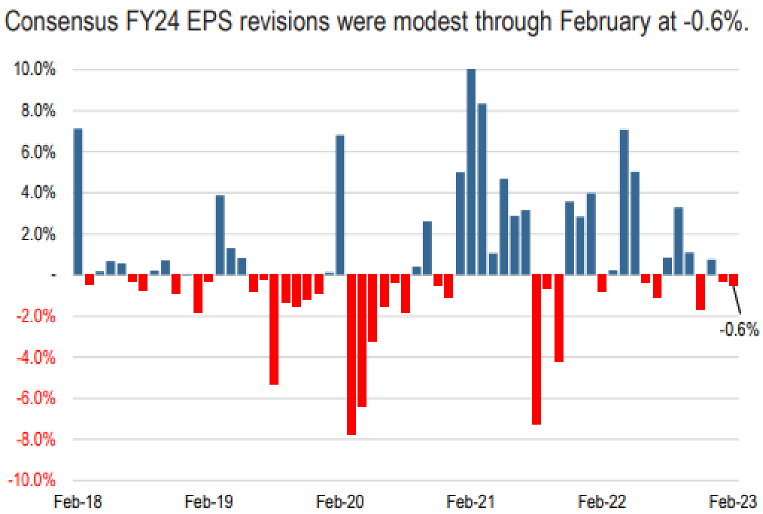
The Savings rate has now fallen below average levels, whilst the deceleration in retail spend continues - suggesting that buffers are fast being depleted.



Source: Morgan Stanley

To conclude, Banks are currently seeing a combination of intense mortgage competition, rising deposit rates and restless deposit mix rotation. The recent round of bank results/updates demonstrate that NIMs have clearly peaked. Further, with the market now pricing a terminal official RBA cash rate of 4.2% and holding at 3.5% until 2025, a moderate credit cycle now appears inevitable, implying a rise in BDD from historic low levels. At the moment, consensus forecasts and bank valuation multiples imply sustained high NIMs and a very benign BDD cycle, we seriously question this.

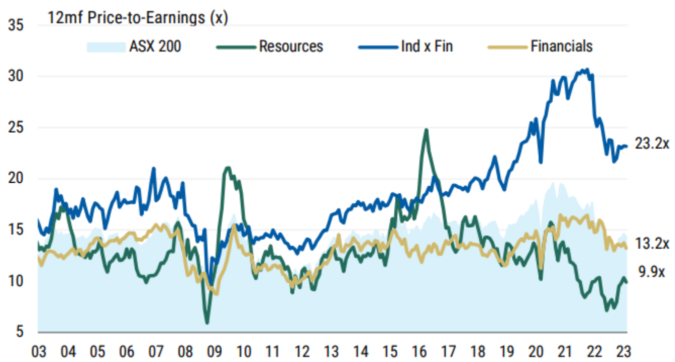
The earnings season in Australia has just concluded, with company results meeting rather than exceeding/missing consensus expectations across EPS and DPS (there was a slight net beat on revenues). The price reaction to a results beat/miss was greater for a miss in magnitude, with misses punished more than historical experience. Outlook commentary that did not meet analyst expectations also observed further downside pressure. Investor patience now seems exhausted, as the recently experienced larger observed drawdown on disappointment suggests that the extended window of forbearance is closing.



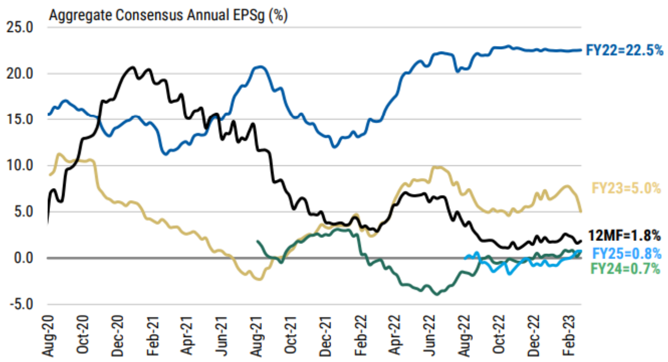
Source: JP Morgan

Valuations: The domestic market multiples which de-rated meaningfully over the past year have reversed somewhat in the past few months (as the market bounced off lows), with the 12MF P/E now standing at 14.3x. Outer year earnings growth forecasts remain fairly anchored in the low-single-digit territory.

Valuation: the 12M forward PE of the Industrials ex-Financials has Fallen from 30.2x to 23.2x



Annual Consensus EPS Growth Trends FY22-25

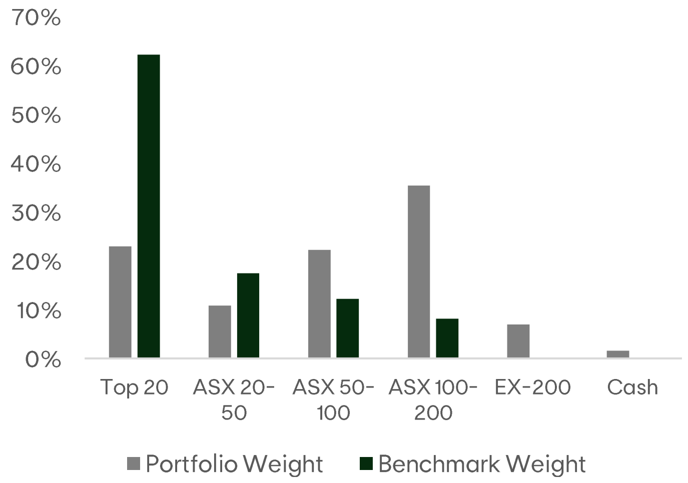


Source: Morgan Stanley Research.

Apart from the changes outlined in the Activity Section, and the deliberate reduction in exposure to Consumer Discretionary (where many retail pockets are seeing a rapid slowdown), the Fund strategy remains as per last month and we are holding the course.

The grossed up dividend yield on the portfolio now rests at 7.6%, which remains superior to the market dividend yield, despite owning no Banks, Telstra, and other traditional income payers.

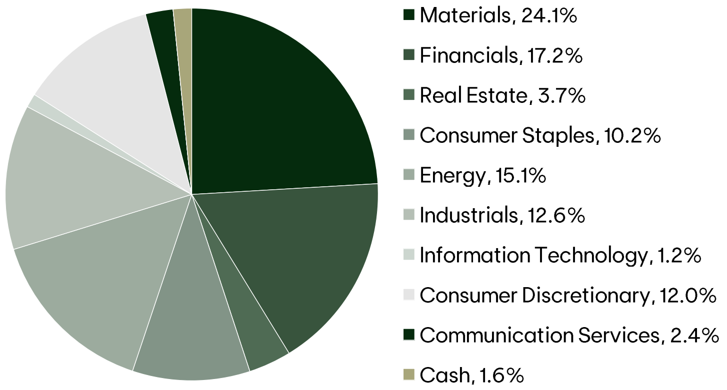
MARKET CAPITALISATION



TOP 10 HOLDINGS

TOP 10 HOLDINGS	
PERPETUAL	8.6%
BHP GROUP	8.2%
FLETCHER BUILDING	6.6%
IGO	5.7%
AMPOL	5.6%
SANTOS	5.5%
WESFARMERS	5.2%
METCASH	5.1%
LIBERTY FINANCIAL GROUP	4.5%
WOODSIDE ENERGY GROUP	4.1%

SECTOR ALLOCATION



Source: Ellerston Capital.

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Find out more

For new or additional applications into the Fund, please click here.

The Fund is also available for application through the NetWealth and HUB24 Platforms.

All holding enquiries should be directed to our register, Automic Group on **1300 101 595** or Ellerstonfunds@automicgroup.com.au

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

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