Ellerston Australian Emerging Leaders Fund

Monthly Newsletter, February 2023

Investment Objective

To provide investors with long term capital growth by investing in a portfolio of quality Australian & New Zealand 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 a portfolio of smaller company Securities with the aim of delivering superior returns to the Benchmark over time. The Fund will 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 the downside risk. Positions are actively managed within the Fund.

Key Information

Strategy Inception ^^	13 August 2021
Portfolio Manager	David Keelan & Alexandra Clarke
Application Price	$0.7549
Net Asset Value	$0.7530
Redemption Price	$0.7511
Liquidity	Daily
No Stocks	42
Management Fee	1.10% p.a.
Performance Fee	20%
Buy/Sell Spread	0.25% on application 0.25% on redemption

Performance Summary

Performance	1 Month	3 Months	6 Months	1 Year	Since Inception (p.a.)^^
Net^	-2.76%	-4.15%	-8.01%	-18.02%	-16.40%
Benchmark*	-3.70%	-1.21%	-2.01%	-7.97%	-9.76%
Alpha	0.94%	-2.94%	-6.01%	-10.05%	-6.64%

^ The net return figure is calculated after fees & expenses. Past performance is not a reliable indication of future performance
* S&P/ASX Small Ordinaries Accumulation Index

COMMENTARY

The Ellerston Australian Emerging Leaders Fund finished the month down 2.76% outperforming the Small Ordinaries Index which finished down 3.70%. Statistically, reporting season disappointed the market with more companies missing consensus estimates which resulted in net downgrades across the board. However, what we would say is the drivers of the earnings downgrades were very much inline with our expectations and what we have been discussing in these newsletters over the last 6 months. We saw higher wages impacting costs bases; we saw rising interest rates impacting net interest costs; and we saw inventory levels that couldn't be cleared or if they were cleared, with the use of discounting. The mixture of all these issues meant that cash balances have diminished (or debt has increased) and management discussions around price rises, "right sizing" and re-considering their capital allocation policy were front of mind. This reporting season highlighted the markets grapple with what are the right multiples for businesses with an uncertain earnings trajectory. On one hand we had GUD Holdings which supplies aftermarket parts up 28% verse a Temple & Webster an online retailer down 38%. While there are many differences between these two names, most simply we have defensive retailer verse an expensive cash burning retailer. This dichotomy played out across the market with a rotation back towards defensives over the growth/ risk shift we saw in December and January.

Three companies which reported a reasonable result in February whose valuations over the last 6 months have come back into more agreeable territories are DGL Group, Aussie Broadband and Kelsian Group.

DGL group (DGL AU), a provider of diversified services within the chemical manufacturing, warehousing, distribution and environmental services, closed the month of February up 20%. The share price ran throughout the month in anticipation of the H1 FY23 results, which was released on the 28th February. DGL demonstrated strong revenue growth of 52% on the prior period, driven both by acquisitive activity in the half as well as strong organic growth. Cash flow conversion, which had been an issue in previous results, came in very strong for H1 FY23 at 108%. The result was accompanied by an upgrade to the guided EBITDA range, from $70-$72m to $71.5-$73.5m for FY23, and was coupled with guidance to strong underlying cash flow conversion of 90-95%. We hold DGL as one of our core positions and look forward to a strong half in which DGL continues to leverage their specialised solutions in the chemical manufacturing and logistics space.

Aussie Broadband (ABB AU), one of Australia's fastest growing telecommunication providers, had a positive month putting on around 5% and gaining even more momentum after it reported. Historically, the stock had been one of our high conviction positions which we trimmed last year due to the valuation becoming stretched and the market getting ahead of itself. The stock has since pulled back and we think market expectations are much more realistic. The first half result demonstrated healthy subscriber growth, improving earnings mix, and most importantly that costs appear to be well managed. We think it represents attractive value at the current price, trading at sub 9x EBITDA on FY24, continuing to take share in residential, business and enterprise, with several catalysts in the pipeline.

Kelsian Group (KLS AU) is Australia's largest integrated multi-modal provider and tourism operator. Over the month of February, the KLS share price closed 12.5% up on the back of new contract wins and a strong 1H FY23 result. KLS, through its wholly-owned subsidiary Transit Systems, announced that they have entered into a binding contract with Transport for NSW as the sole operator in Regions 2 and 15 in south-western Sydney. These contracts within Sydney solidify an already strong geographical presence within the region, and should be able to realise greater efficiencies with each additional adjacent region won. 1H FY23 results for Kelsian were strong, with revenue growth reflecting the strong rebound in domestic tourism market over the half, with outlook for the segment in the form of forward bookings also high. We continue to hold KLS as a core position, as we feel they are well positioned to win new transport contracts, both within Australia and internationally, as well as benefit from further recovery in the tourism sector.

Moving to March, we continue to believe volatility will remain, however, the February reporting season gave us the data to reassess our views on reliability of earnings, margin sensitivities and management teams' ability to navigate the current environment. This updated data allows us to tweak our positioning and opens up opportunities for new investments into the funds, with stocks that have come back into our valuation universe. As such while we can never pick the timing of a "normalised market', pleasingly opportunities are appearing.

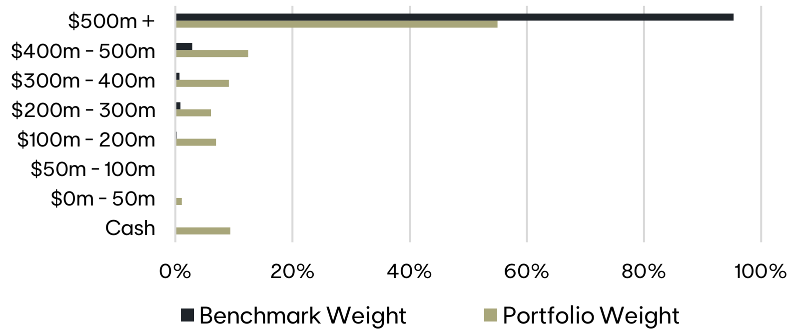
PORTFOLIO CHARACTERISTICS

Key Portfolio Metrics

FY23e	Fund	Benchmark
Price/Earnings	16.65x	18.35x
Dividend Yield	1.92%	3.33%
Net Debt/EBITDA	0.10x	1.22x

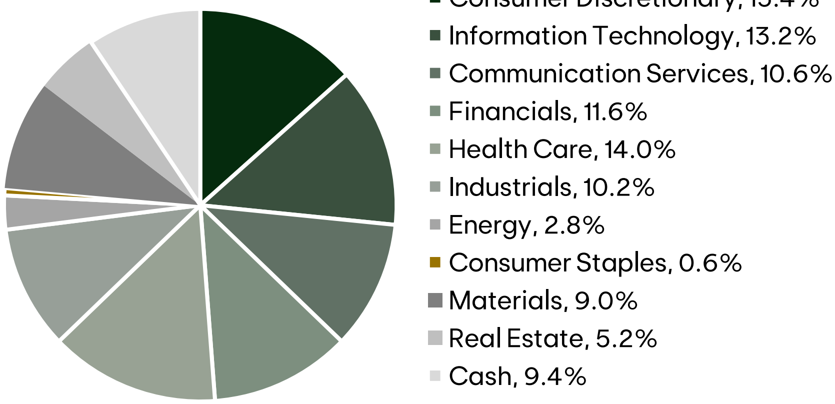
Source: Ellerston Capital.

Market Capitalisation



Source: Ellerston Capital.

Sector Allocation



Source: Ellerston Capital.

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Find out more

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

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