

# Ellerston Global Mid Small Cap Fund

## Monthly Newsletter, March 2023

### 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 Fund's 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 the 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 ^^	1-Mar-17
Portfolio Manager	Bill Pridham
Class A Application Price	\$1.3212
Class A Net Asset Value	\$1.3179
Class A Redemption Price	\$1.3146
Class B Net Asset Value	\$1.1178
Class B Redemption Price	\$1.1150
Liquidity	Daily
No Stocks	20-40
Management Fee	0.75%
Performance Fee**	10%
Buy/Sell Spread	0.25% on application 0.25% on redemption

\*\*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

#### Class A

Performance	1 Month	3 Months	FYTD	3 Years (p.a.)	5 Years (p.a.)	Since Inception (p.a.)^^
Net^	1.99%	11.57%	13.22%	12.36%	9.64%	10.89%
Benchmark*	-0.34%	5.79%	12.16%	12.52%	7.95%	9.15%
Alpha	2.32%	5.78%	1.05%	-0.16%	1.69%	1.74%

#### Class B

Performance	1 Month	3 Months	6 Months	1 Year	2 Years (p.a.)	Since Inception (p.a.)***
Net^	1.99%	11.56%	15.28%	0.11%	-0.77%	7.75%
Benchmark*	-0.34%	5.79%	11.93%	1.72%	3.47%	9.03%
Alpha	2.32%	5.77%	3.35%	-1.62%	-4.25%	-1.28%

^ The net return figure is calculated after fees & expenses. Past performance is not a reliable indication of future performance.  
\* MSCI World Mid Cap Index NR (AUD)  
\*\*\* Class B Inception Date is 18 August 2020

### ESG IN FOCUS

Food Security is the physical and economic access to sufficient quantities of safe food to meet the basic nutrition requirements for an active and healthy lifestyle, as described by the United Nations. Food security is a fundamental necessity for economic growth and development.

Approximately 9% of the world's population is classed as severely 'food insecure'. By geography, concentrations occur in Africa, South America, the Middle East and Southeast Asia. Without guaranteed access to safe food, emerging nations will continue to be disproportionately burdened.

Crucial to solving the issue of food security is ensuring that food stays safe at every step of the supply chain; from farming to harvest, processing, storage, distribution and consumption. Food Safety is a social and economic issue that requires significant investment and innovation. A great solution is underpinned by aseptic packaging which is being increasingly used globally by Fast-Moving Consumer Goods (FMCG) companies to ensure that regardless of geography, their products are both safe and nutritious by the time they reach the end consumer.

## PORTFOLIO COMMENTARY

The Ellerston Global Mid Small Cap Fund increased 1.99% net during the month compared to the MSCI World Mid Cap Index NR (AUD) which was down by -0.34% over the same period.

Despite all the gyrations during March, global equity index performance was actually quite solid, although the flow of funds was clearly steered towards large and mega cap stocks as yields came down and risk went up. The S&P 500 and NASDAQ closed up 3.7% and 6.8% respectively while the smaller capitalised Russell 2000 index closed down 4.8% - massive divergence in March. In Europe, the DAX and CAC indices both closed a good month increasing 1.7% and 0.9% respectively, while the Japanese Nikkei was up >3.0% during March.

There is an old saying that to combat inflation central banks will tighten monetary conditions until something breaks, well something broke. Over the past year, the US Federal Reserve has raised rates at the fastest pace since the 1980's and this new rate regime is now manifesting itself in the world's banking system and primarily in the US regional banks.

Firstly, it does appear that this is more about near term liquidity rather than capital or asset quality issues. The failures of Silicon Valley Bank (SVB) and Signature Bank (SBNY) were very specific to the concentration of exposures within each bank. There was an asset/liability mismatch, a weakness which an elevating rate environment uncovered at the expense of equity and bond holders. Subsequently, we have seen Credit Suisse being purchased by UBS and continued liquidity speculation around large and small banks alike.

Although we have just experienced the second and third largest bank failures in US history, the resolution of a globally systematic important bank (G-SIB) in Credit Suisse and a \$300bn expansion of the US Federal Reserve's (Fed) balance sheet in a matter of days, the Fed continued to raise short term interest rates as it maintains its focus on getting the job done on inflation.

Global economic conditions remain relatively solid at this point and while the most recent inflation print in the US was roughly in line with expectations, the previous report came in higher than market expectations at 0.5% month on month (0.4% was expected) when it was reported mid-March. Following the March release, expectations for the next Fed meeting quickly moved from a 25bps increase to 50bps with the forecast of potential cuts being pushed out to 2024.

This was enough to break the back of Silicon Valley Bank and we all know the outcome. Interestingly, following the bank failures, rate cut expectations quickly moved from 2024 to mid-summer 2023 as rate volatility skyrocketed.

The events during March have exposed some idiosyncratic issues regarding mismanagement of balance sheet rate risk however they don't appear to be endemic in the broader financial system - look how fast these defunct bank books are being bought by other players. Going forward these events are likely to weigh on near term economic growth (and potentially the pace of further rate increases) as regional banks hoard capital, restrain loan growth and increase provisioning to bolster balance sheets. The key from here is remain mindful and vigilant around any further contagion flow on effects and focus on earnings resiliency, cash flow and balance sheet strength.

The portfolio's top three contributors **Rentokil Initial, Graphic Packaging and Advantest added 158 bps to performance while Webster Financial, WillScot Mobile Mini and Montrose Environmental detracted 188 bps** during the month.

Rentokil reported its full year 2022 results on 16th March which highlighted its attributes as a global pest control powerhouse now that the Terminix acquisition has been completed. FY22 organic revenue and earnings came in at the top end of expectations and with early synergies from the Terminix deal coming through, Management upgraded its synergy target to "at least" \$200m which was a nice increase from previous guidance of \$150m. With organic growth of its US pest control business now expected to outpace the industry by 1.5x, overall organic growth guidance was increased from 4-5% to 5%+ with operating margins increasing by 460bps to ~19.0% in the next couple of years - solid growth on expanding margins creates a nice long-term compounding set up for us as shareholders.

There was little stock specific news on Graphic Packaging or Advantest however Graphic Packaging Management had been quite active during the month at broker conferences (we met with CFO Steve Scherger this month in the US as well) with a clear and consistent message around organic growth benefits associated with the shift from plastic to paper packaging and confidence around its new Waco plant development in positioning it as the lowest cost producer for the foreseeable future.

Advantest was seemingly driven by the expectations of high performance compute needs (and associated testing) as the fever around ChatGPT and other large language networks gained airplay. As the stock has reached our fair value we took some profits but remain exposed for the long term benefits associated with increased semiconductor testing needs as chips get more plentiful and smarter.

Webster Financial was obviously caught up in the regional bank storm despite holding a very comprehensive and positive investor day which we attended in early March. The comment I left with the investor relations was "a very solid set of hands" running this business. Despite the industry issues overhanging the sector, we consider Webster as best in class in terms of loan growth, asset quality and deposit relationships. We had a position in Comerica at the start of March however a concern from its past result regarding deposit outflow was accentuated in a broker presentation during the first week of the month and we fortunately exited the position before the Silicon Valley bank storm hit or close to 40% higher than where it is currently trading.

Montrose Environmental reported its FY22 result on 1st March which came in below expectations as it continues to spend on growth initiatives such as PFAS pilot projects in Europe, carbon capture developments as well as building on its M&A path which has a short term drag on margins. In talking with Management, it is clear that better guidance is required as the business has long cycle environmental testing, measurement and remediation drivers rather than short term guideposts that the market likes to hang its hat on. It is currently our smallest position in the fund however will look to add to it when we have greater visibility of PFAS pilot projects becoming reality.

WillScot Mobile Mini was impacted on two fronts. Firstly the stock has been an absolute winner this year, appreciating >59% FYTD so likely some profit taking and secondly with the regional banking storm there are increasing concerns around funding for small scale projects which could impede near term growth prospects. We get the logic behind both drivers but remain very positive on Management and the ability to drive earnings and cash flow regardless of economic conditions.

## STOCK IN FOCUS: SIG Combibloc (SIGN SW, €8.9bn Market Cap)

SIG Combibloc is headquartered in Neuhausen am Rheinfall, Switzerland and operates in a global market duopoly with Tetra Pak in aseptic packaging. The global aseptic packaging market size was valued at \$15.5 billion in 2020, and is projected to reach \$32.3 billion by 2028, growing at a CAGR of 9.8% from 2021 to 2028. The industry itself is growing as the world shifts to more sustainable packaging solutions in developed markets and safer packaging solutions in emerging markets.

SIG is also slowly taking share from Tetra Pak at about 0.5% a year on average due to the advantages and increased efficiency of their filler machines which help its customers deliver billions of litres of food to consumers around the world every year, keeping food safe for months without the need for refrigeration or preservatives. Critically reviewed life-cycle assessments, conducted in line with recognised international standards, show that SIG's aseptic cartons have a 28–70% lower carbon footprint than alternative packaging such as plastic and glass bottles and aluminium cans for dairy, noncarbonated soft drinks and food.

# SIG IS A LEADING PROVIDER OF PACKAGING SOLUTIONS FOR A MORE SUSTAINABLE WORLD

### Well-positioned & strengthened system offering



<sup>1</sup> Fillers include fillers and pouch makers <sup>2</sup> SIG reported 2021 revenue (MEA for 10 months only), Evergreen Asia and Scholle IPN unaudited USD 2021 revenue translated to EUR at a rate of 1.183 EUR/USD

### Strong profile & capabilities

<p>Best-in-class ESG profile, focus on circularity &amp; lowest impact packaging</p>	<p>Proprietary, fast and flexible filling technology, most versatile pack offer + proven lowest TCO</p>
<p>Well-established global service network + Digital service solution offering</p>	<p>Industry partner with strong solution orientation &amp; product development capabilities</p>

### Expanding global footprint

<p><b>31</b> Production sites</p>	<p><b>49</b> Sales &amp; Service locations</p>
<p><b>~2,400</b> Number of fillers<sup>1</sup> in the field</p>	<p><b>2,671</b> Pro-forma revenue 2021<sup>2</sup> (€M)</p>

Aseptic carton filler = ~1,300  
Pouch/bag-in-box filler = ~730  
Chilled carton filler = ~380



Every day, it meets the needs of millions of people around the world as well as here in Australia (look at the bottom of some of the long life products on the supermarket shelves) filling over 48bn packs a year in over 50 categories (with use cases expanding). SIG operates in over 100 countries and partners with >200 of the leading food and beverage producers around the globe.

# HOW WE CREATE VALUE FROM OUR ENLARGED PLATFORM

1	<b>ATTRACTIVE INDUSTRY AND END-MARKETS</b>	<b>Global Leadership</b> – Strong #2 in aseptic carton & spouted pouch, #1 in BiB <sup>1</sup> <b>Resilient</b> and <b>growing</b> end-markets
2	<b>WINNING BUSINESS MODEL ENABLING GROWTH</b>	Leader in <b>sustainable</b> packaging innovation Multi-faceted <b>growth strategy</b> along geographies, categories & channels <b>Consumer-centric innovation</b> enabled by proprietary technology <b>Solutions selling</b> approach coupled with customer partnership model <b>Systems based</b> business model enabling long-term customer relationships
3	<b>STRONG FINANCIAL PROFILE</b>	<b>Above market growth</b> and <b>best-in-class margins</b> Strong <b>recurring</b> cash flows
4	<b>... WITH OUR CORPORATE SUSTAINABILITY AMBITION FOCUSED ON NET POSITIVE</b>	
5	<b>... DELIVERED BY A DIVERSE GLOBAL LEADERSHIP TEAM WITH PROVEN TRACK RECORD</b>	

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SIG reported a solid set of full year results with organic revenue growth of 8.0% (+34.8% with recent acquisitions) driving Adjusted EBITDA of €652m and >€260m of Free Cash Flow – all metrics were ahead of expectations. Return on Capital Employed came in at an impressive 27.3% which is clearly well ahead of its cost of capital and thereby generating positive economic returns to shareholders.

Management guided FY23 revenue growth of 20-22% (7-9% organic) as it continues to benefit from recent acquisitions, recent pricing initiatives and growth of its end aseptic markets. EBITDA margins are expected to expand 50-150bps to 24-25% as it marches towards its medium-term goal of 27% margin.

## 2023 financial guidance

<b>Revenue growth</b> (constant currency)	<b>20–22%</b>	Includes organic growth of <b>7–9%</b>
<b>Adjusted EBITDA margin</b>	<b>+50–150</b> bps	Range of <b>24–25%</b>
<b>Adjusted effective tax rate</b>	<b>26–28%</b>	
<b>Net CAPEX</b> (% revenue)	<b>7–9%</b>	
<b>Dividend payout ratio</b> (of adjusted net income)	<b>50–60%</b>	

- Organic<sup>(1)</sup> price increases expected to be of similar magnitude to 2022
- Resin escalator for bag-in-box and spouted pouch not included in guidance
- Annualisation of M&A consolidations
- Guidance subject to input cost and forex volatility



<sup>(1)</sup> Organic growth represents SIG revenue growth at constant currency, excluding the impacts of the Scholle IPN and Evergreen Asia acquisitions.

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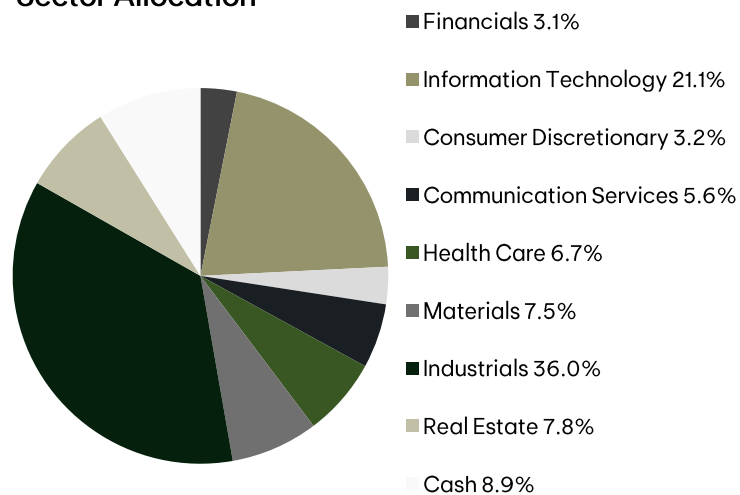
SIG will continue to innovate on its filler and sleeve technology to win share of the aseptic packaging market. In turn, its food and beverage customers have certainty that their products remain nutritious and safe for the end consumer in all regions of the globe. With the growing and urgent demand for access to nutritious food and beverages coupled with the enormous food loss between farmers to manufacturers and from retailer to consumers, better packaging is part of the solution. SIG's aseptic packs retain the nutrients and vitamins of their contents over many months without the addition of preservatives. The availability of different pack sizes helps the consumer to avoid overbuying. In addition, food and beverages can be transported and stored in ambient conditions, avoiding the need for energy intensive cold chains.

## Portfolio Characteristics

### Holdings

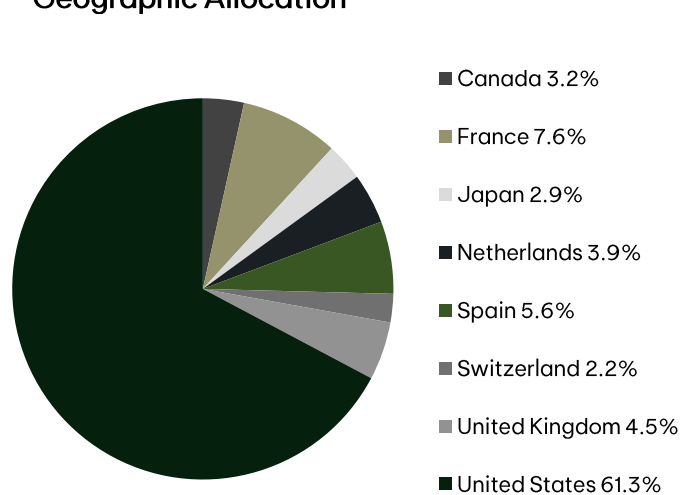
Company	Country	Sector	Weight
Cellnex Telecom S.A.	Spain	Communication Services	5.6%
Graphic Packaging Holding Company	United States	Materials	5.4%
Sensata Technologies Holding PLC	United States	Industrials	5.0%
Rentokil Initial plc	United Kingdom	Industrials	4.5%
PTC Inc.	United States	Information Technology	4.5%
Ciena Corporation	United States	Information Technology	4.5%
Soitec SA	France	Information Technology	3.9%
TKH Group N.V. Cert	Netherlands	Industrials	3.9%
GXO Logistics Inc	United States	Industrials	3.9%
WillScot Mobile Mini Holdings Corp. Class A	United States	Industrials	3.8%

### Sector Allocation



Source: Ellerston Capital.

### Geographic Allocation



Source: Ellerston Capital.

## Regulatory Guide (RG240) Fund Disclosure Benchmark – Periodic Reporting (monthly)

- **Net Asset Value of the Fund and Redemption Price of Units**  
Please refer to details on page one.
- **Any changes to key service providers including any change in related party status**  
There have been no changes to key service providers, including any change in related party status.
- **Net returns after fees, costs and relevant taxes**  
Please refer to details on page one.
- **Any material changes to the Fund's risk profile and strategy**  
There have been no changes to the Fund's risk profile and strategy.
- **Any material changes related to the primary investment personnel responsible for managing the Fund**  
Please refer to details on page one; there have been no changes to the primary investment personnel responsible for managing the Fund.

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### Contact Us

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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, Mainstream Fund Services on **02 8259 8550** or **InvestorServices@MainstreamGroup.com**

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