Ellerston Global Investments Limited (ASX:EGI)

Performance Report | March 20

PERFORMANCE SUMMARY

Performance	1 Month	3 Months	6 Months	1 Year	FYTD	Since Inception (p.a.)
Net^	-17.51%	-24.69%	-16.05%	-6.92%	-12.09%	4.77%
Benchmark*	-12.84%	-20.10%	-14.12%	-9.65%	-12.80%	4.49%
Alpha	-4.67%	-4.59%	-1.93%	2.73%	0.71%	0.29%

Source: Ellerston Capital

^ The net return figure is calculated before all tax provisions, after fees & expenses, includes the effects of the share buyback, and excluding the effects of option exercise dilution. Past performance is not a reliable indication of future performance

*MSCI World Index (Local)

Key Facts

Listing Date	20 October 2014
NTA (before tax)*	$0.9712
NTA (after realised tax)^	$0.9712
NTA (after tax)**	$0.9883
Share Price at 31/03/20	0.89
EGI Market Capitalisation	$93.7 Million
Management Fee	0.75%
Performance Fee	15%

* NTA (before tax) – Includes taxes that have been paid.

^ NTA (after realised tax) - Includes a provision for tax on realised gains from the Company's Investment Portfolio.

** NTA (after tax) - Includes any tax on unrealised gains and deferred tax.

PORTFOLIO COMMENTARY

Firstly, our thoughts and prayers to those affected by the devasting impacts of Covid-19 both emotionally and financially. While there are a lot of statistics being thrown around as to number of cases, mortality rates etc., we must remember that behind each number is a real person, a loved one, family or friend. While current headlines are difficult to read and hard to fathom, we do believe that this will pass as we have never lived in an era where problem solving technology and sharing of knowledge is so pervasive and accessible.

Financial YTD the EGI portfolio is down 12.1% after declining 17.5% net during the month of March. The NTA (before tax) at the end of the month was $0.9712 and $0.9883 after tax. EGI invests with a mid/small cap bias, defined as companies with a market cap sub US$10 billion. In times of market duress, correlations typically trend towards one with smaller market cap companies generally declining more than their larger cap counterparts. This was certainly the case during March as the Russell 2000 Index declined 21.9% compared with a relatively more muted 12.5% move lower in the S&P 500.

While Covid-19 started out as a crisis on Main Street, subsequent mass shutdown of global business activity has now morphed to a crisis on Wall Street as liquidity and solvency become front of mind. There is an unfortunate and significant impact on small businesses who do not have the financial wherewithal of larger enterprises which have access to a broader range of liquidity options. Small business is generally viewed as the lifeblood of any economy and we are likely to see many defaults as the severity and pace of the downturn is unprecedented leaving little time to for business owners to prepare both operationally and financially.

Governments and central banks globally have recognised the effect on Main Street (and now Wall Street) and have launched unprecedented policy actions which have been large, swift and decisive. Thankfully much of the fiscal response has been targeted at small business and their employees in an effort to cushion the impact of the pandemic. Larry Kudlow (Director of the United States National Economic Council) described the US fiscal stimulus response as "the single largest Main Street assistance programme in the history of the United States". We, however, view the current fiscal response as support, not stimulus, as it is merely helping offset downside rather than providing upside to the economy. There really can be no debate that we are in a global recession, the real questions encompass the eventual depth and duration of one of the largest growth shocks in our history, will it also be one of the briefest, will its effects linger (second wave) and what are the longer term supply chain, consumer/corporate behaviour and consequent growth implications.

As many companies are withdrawing earnings guidance there really is no consensus or reliable estimates on the near-term eventual impact. This creates uncertainty as markets try to get a grip on the ramifications of Covid-19 and significant volatility as headlines rather than long term fundamentals drive share prices.

Understanding what you own, making position changes when your thesis changes and taking a longer-term perspective in holding high quality businesses will ultimately prove a winning strategy and generate capital growth.

As a long only portfolio, we are focusing on and well positioned in businesses with strong balance sheets, high recurring revenues, secular tailwinds and increasingly essential services. With that frame in mind, our earnings rebound thesis on Tempur Sealy has changed as we have no clarity on where earnings will base. The health of its distribution partners and end customers are unknowable with potential defaults impacting receivables and future sales pipeline. As such will be watching for a potential re-entry point from the sidelines. Conversely, we have taken advantage of share price weakness to add to existing positions in Amedisys, Health and Happiness and Assurant while maintaining our exposure to companies such as Ciena, Keysight and Cellnex Telecom which are benefiting from the long term secular tailwind of data growth.

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Similar to last month, with the current market volatility we thought it useful to provide brief paragraphs on the top 10 positions in the portfolio. In connecting tomorrow's returns today, we typically gravitate towards quality businesses which demonstrate some or all of the following attributes: High or dominant market share, high recurring revenues, high revenue retention rates, secular tailwinds and exceptional Management team.

We consider these characteristics underpin pricing power, margin expansion, capital allocation optionality and increasing returns on invested capital. We want investors to be aware of and hopefully comfortable with the long-term opportunities held within the portfolio:

ciena

Ciena's business is driven by the growth in global data traffic and is the optical market share leader globally despite not operating within China. For countries to talk to each other you need fiber subsea cables and for data centers to talk to each other (within country or overseas) you need fiber interconnect. Ciena provides the optical hardware to "light up" this fiber and has over 50% market share globally in subsea cable and data center interconnect. It is benefiting from a number of secular growth drivers and has guided to >20% EPS growth over the next three years. We are seeing a significant increase in retail data traffic and telco operators around the world will be looking at accelerating network investment similar to Telstra's recent announcement around network and 5G spending increases. The business has a net cash balance sheet and generated >$300m of FCF last year.

KEYSIGHT TECHNOLOGIES

Keysight is the global research and testing market share leader in several multi-year mega trends including 5G, electric and autonomous vehicles and next-gen batteries. When someone is trying to move up the speed of a network or they're trying to invent a new cloud, 5G cell phone or a base station there are basically only three players globally who can provide this expertise: Keysight, Anritsu and private German company Rohde & Schwarz (we own the two listed players). Keysight generated $4.3bn of revenue, >$1.1bn EBITDA and just under $900m of FCF last year and recently upgraded long term guidance in its Analyst Day in early March. While near term spending on R&D and next generation products will no doubt slow, the long-term need for innovation and especially 5G architecture has only increased in our view.

cellnex

Cellnex Telecom is the largest independent owner of mobile phone towers in Europe and is benefiting from a long term outsourcing trend (as telcos sell towers to independent operators) and data growth associated with current and next gen technologies such as 5G. The business benefits from very high recurring revenues underpinning EBITDA margins close to 70%. Cellnex has made a number of strategic and value accretive purchases over the past couple of years and now commands a €44bn contracted revenue backlog providing excellent visibility. Cellnex will continue to augment its market positioning and still has €7bn of available liquidity for future M&A. The business currently generates a mid-single digit FCF yield in Europe where sovereign yields are negative and would represent a great pension asset.

Anritsu
envision : ensure

Anritsu has all the same 5G drivers previously highlighted with Keysight and as mentioned we own two of the top three players in the space. Anritsu has a very strong balance sheet which we estimate net cash to represent 18% of its market cap next year. The test and measurement market will continue to benefit from the growth in 5G development and deployment and while the launches of new 5G smartphones will be delayed due to Covid-19, they are not going away. Conversely, the investment in 5G infrastructure (akin to Telstra's announcement) could accelerate as telco operators support work from home and video conferencing demands on bandwidth.

DIGITAL REALTY

In our last newsletter we highlighted that Digital Realty had bid for one of our top data center holdings, Interxion, and we were likely to accept Digital Realty scrip in exchange for our position in Interxion. The deal was finalised, and we have now converted our shareholding into the larger company structure. Digital Realty is one of the largest public companies in the global data center space with c270 data centers operating across 20 countries. Interxion adds a strong foothold into the European data center market and the combined group will benefit from cross selling, operational and financing synergies over the coming years. With data growth expected to remain robust (and likely accelerate with cloud adoption and 5G), owning the digital factory where the cloud lives is very attractive to us.

Amedisys is one of the largest pure play healthcare services companies in the US which provides care in the home through two main divisions, Home Health and Hospice. The secular drivers behind the “Aging in Place” thematic are profound as the 85 and older cohort is the fastest growing demographic in the US and these are closely followed by 78 million baby boomers. Nearly 90% of older adults want to age in their homes rather than in institutional settings and the cost/quality of life benefits around at home care are indisputable. Amedisys will provide significant outsourcing support to the US Health system as it grapples with Covid-19 demands on hospitals. Recent regulatory changes have strengthened its market position and long-term growth optionality.

Graphic Packaging operates in a duopoly in the US serving the packaging needs for large consumer goods companies such as Kellogg’s, Coca Cola and Nestle to name a few. It produces 52% of all CRB (Coated Recycled Board which is used in consumer goods packaging) and 58% of all CUK (Coated Unbleached Kraft which is made from recycled materials and used to carry beverages). The business is benefiting from a shift in packaging preference from plastic to paper as well as quite high barriers to entry. Graphic Packaging recently confirmed its FY20 guidance at the end of February, generates a double digit FCF yield and should be a beneficiary of increased at home food and beverage consumption.

QTS Realty is a US centric data center operator which we have owned over several years within Ellerston and past endeavours. QTS owns and operates 25 data centers across 14 US Metro areas and provides a one-stop shop for outsourced data center solutions. It provides customers custom wholesale data centers as well as hybrid co-location offerings with hybrid colo representing approximately 2/3rd of bookings. At the end of March, QTS provided a Covid-19 update which highlighted all facilities are operational and considered essential service. Usage of its Service Delivery Platform had accelerated during March as work from home mandates are driving significant network demand. We consider QTS’ highly recurring and growing revenue stream as very attractive with no significant debt maturities until 2023.

WillScot has over 40% market share in modular office leasing in North America and is by far the dominant player in a space which should benefit from increased infrastructure spend associated with any fiscal stimulus. Modular units are typically leased for over 30 months providing excellent visibility associated with highly recurring revenues. It is delivering mid-teens pricing growth as it re-prices returning units at higher rates and fits these out with value added products which drive both revenue and margins. WillScott has also announced an all scrip merger with Mobile Mini which has continually proven itself to be a leader in portable storage solutions with a rental fleet of approximately 200,000 units across 156 locations in the US, UK and Canada. The combined business will have significant scale and is truly transformative due to the complementary nature of the businesses.

LiveRamp is a business with strong network effects and basically makes it safer and easier for every company to use data more effectively online. It views itself as the Switzerland of data and provides the essential infrastructure to connect the offline and online worlds for more effective advertising. Think of a supermarket who has your email address (this is called first party data) but cannot effectively identify and deliver relevant ads to you when you are on your mobile phone, desktop or tablet. LiveRamp provides this conduit in a secure, private manner and as a result, publishers can generate a 10x yield increase because the ad is relevant to you. LiveRamp has guided revenues to grow 25-30% next year with gross margins trending to >70%. The business has a $2.0bn market cap with just under $800m of net cash on its balance sheet.

Kind Regards,

Bill Pridham and Arik Star

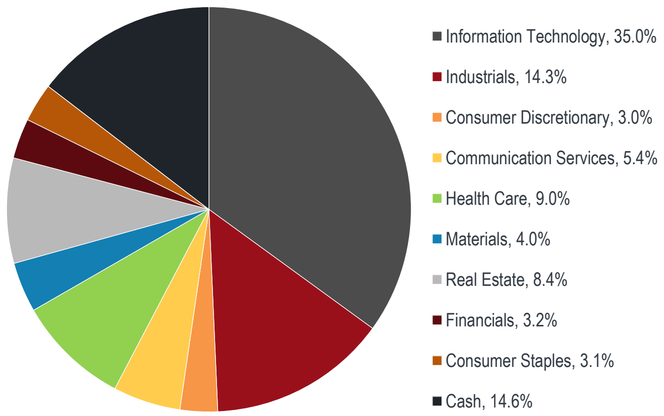
EGI Co-Portfolio Managers

PORTFOLIO CHARACTERISTICS

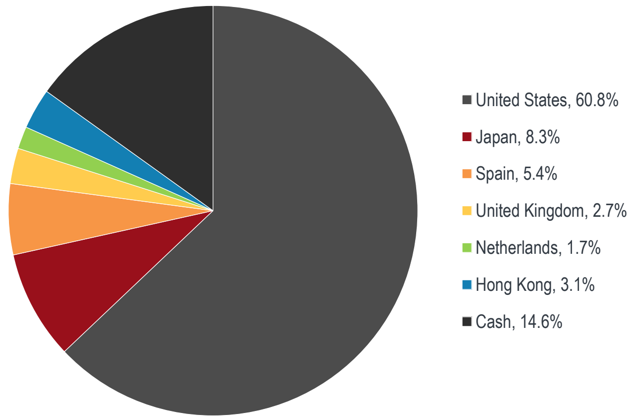
HOLDINGS

Top 10 Holdings	Country	Sector	%
Ciena Corporation	United States	Information Technology	6.09%
Keysight Technologies Inc	United States	Information Technology	5.68%
Cellnex Telecom	Spain	Communication Services	5.44%
Anritsu Corporation	Japan	Information Technology	5.00%
Digital Realty Trust	United States	Real Estate	4.60%
Amedisys	United States	Health Care	4.54%
Graphic Packaging	United States	Materials	3.99%
QTS Realty Trust	United States	Real Estate	3.84%
WillScot Corporation	United States	Industrials	3.60%
LiveRamp Holdings	United States	Information Technology	3.57%

SECTOR ALLOCATION



GEOGRAPHIC ALLOCATION



Source: Ellerston Capital

All holding enquiries should be directed to our share registrar, Link Market Services on 1300 551 627 or EGI@linkmarketservices.com.au

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

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