

Long-Short Quarterly Report – Sep 2017

Portfolio Performance

As at 30 Sep 2017	3mth	6mth	1yr	Since Inception
Alleron Long-Short*	3.69%	7.47%	16.91%	29.08%
S&P/ASX 100 Acc**	0.41%	-1.29%	9.72%	15.09%
RBA Cash Rate	0.38%	0.75%	1.50%	1.50%

Performance figures are net of fees and expenses

*Inception date is 1 July 2016

** Performance benchmark

Portfolio Commentary

Alleron's Long Short Fund produced a strong return of +3.69% for the September 2017 quarter after following a similarly strong +3.65% quarterly return to June. This takes the total return for the fund since inception to +29.08% after fees nearly doubling the market return of +15% over the same period.

The Australian market produced a relatively flat result for the quarter despite international markets continuing to reach record highs. The quarter contained the financial year end reporting season which was generally in line with expectations and resulted in earnings growth for the past year of +20% driven mainly by the rebound in resource company earnings. Australian news flow was dominated by the civil legal case brought against banking giant Commonwealth Bank for contraventions of the Anti-Money Laundering act. This along with the cutting of Telstra's dividend dragged very large cap stock prices down over the three months. Once again, given Alleron's preference for mid-sized companies that exhibit changing growth profiles, the long side of the portfolio was the driver of portfolio performance for the quarter. Strong results and outlooks for Alleron's largest positions, Cochlear and Treasury Wines, supported by positive outlooks from Monadelphous, Lovisa and Carsales.com drove the Long side performance.

The Short side of the portfolio also added to absolute return. Alleron had maintained short positions in Healthscope Limited, Telstra, Vocus Communications, Sirtex and Domino's from the previous quarter which all added strongly to portfolio returns. These stocks all exhibited weakening quality attributes according to our process which supported their continued short holding. These strong performers were marginally offset by short positions in Santos and Cybg PLC.

Portfolio Highlights

Positives:

Lovisa Holdings Ltd (Long) - The Company's FY17 result beat its own updated EBIT guidance and announced expansion into 3 new geographic territories in Spain, Vietnam and Bahrain. Management forecasts 20-30 new store openings in FY18 with long term target same store sales growth of 3-5%.

Telstra Corporation Ltd (Short) - The Company confirmed prospective dividend cuts from current levels of 31cps to 22cps in FY18 mainly due to the loss of its high margin fixed line business. The NBN rollout is estimated to have a negative effect on EBITDA of between \$2bn and \$3bn.

Healthscope Ltd (Short) - The Company's FY17 result disappointed the market with margins being squeezed by both higher input costs and lower occupancy in some hospitals. Management has also forecast no growth for FY18, mainly affected by cost pressures in the private hospital market.

Negatives:

Santos Ltd (Short) - Despite a relatively low and volatile oil price, the Company has managed to cut production costs and increase free cashflow. However, the planned repayment of debt and divestment of non-core assets has not occurred as previously announced by management.

Japara Healthcare Ltd (Long) - The share price fell on the FY17 result as NPAT fell due to higher depreciation and amortisation costs as well as increased staff numbers. The company has secured new sites and licences for medium term growth through to FY20 but have forecast FY18 to be broadly in line with FY17.

Elders Ltd (Long) - The share price pulled back on concerns of a dry Australian winter affecting revenue across the industry. Recent acquisitions have confirmed the company's ongoing expansion plans for its core agency business.

Australian Eagle Trust Long Short Fund - Net Monthly Returns

	Jul	Aug	Sep	Oct	Nov	Dec	Jan	Feb	Mar	Apr	May	Jun	FY
2016/17	10.52%	0.99%	-1.08%	-4.14%	2.94%	5.16%	-0.25%	5.15%	-0.06%	1.94%	1.31%	0.36%	24.48%
2017/18	-1.70%	5.27%	0.20%										3.69%



Market Overview

The Australian market rose slightly as the big miners rose with commodity prices while Commonwealth Bank fell on news of money laundering and the CEO being forced out by mid next year. Cochlear's CEO resigned with the COO taking over during a handover period. Fortescue doubled its FY17 dividend on the back of higher iron ore prices. Treasury Wine Estates strategy of selling US wine into China increased margins in Asia. Monadelphous increased headcount for an anticipated ramp up in construction and maintenance activity.

Portfolio Changes

Stocks purchased:

Altium Ltd (+1.50%; New Long): A printed circuit board design software company. The Company has grown at double digit rates in all territories with China being its fastest growing market. Management has targeted 35% EBITDA margins and US\$200m revenue by FY20.

Iluka Resources Ltd (+3.00%; New Long): A zircon and mineral sands miner. Strong free cash flow from a rise in both sales volume and mineral sands price was used to reduce debt. The Company flagged a restart of the Jacinth-Ambrosia mine due to more favourable market conditions.

Flight Centre Travel Group Ltd (+2.75%; Closed Short): A corporate and retail travel agent. The Company achieved its revised guidance at the FY17 result and announced its new transformation program to target \$4.5bn TTV growth, increase net margin and lower cost growth.

Stocks sold:

Coca-Cola Amatil Ltd (-1.25%; New Short): A beverage manufacturer and distributor. The core Australian carbonated soft drinks business has been under revenue and margin pressure from competition and increasingly health conscious consumers.

James Hardie Industries plc (-1.50%; New Short): A fiber cement products manufacturer. Increased production costs and a delayed execution of its US expansion strategy has resulted in a reduced margin outlook for the company.

Suncorp Group Ltd (-2.50%; Long): An Australian insurer and bank. The company had increased claims in its NZ insurance segment and the Bank result was impacted by lower net interest margins. Plans for a potential return to future growth have been flagged as medium term.

Quarter-End Position & Portfolio Exposures

As at 30 September 2017, the fund had a net exposure of 96.34% and gross exposure of 194.69% to equities. Cash was 3.66%.

Major portfolio exposures were to medical devices & services and resource stocks with less portfolio weight in major banks and retailers.

Stock Highlight

Lovisa Holdings Limited (LOV) – Long Position

Energy Argument: Lovisa, a women's accessories retailer, was listed on the ASX in December 2014 with 220 stores in eight countries after only starting operations in 2010. The company is exploiting a trend in affordable cheap fashion which is constantly changing and being replaced. With the ability, systems and supply chains to have a concept on the shelves within 2 months, the company is likely to have appeal to multiple global markets and have the ability to greatly expand the number of stores it owns.

Trigger: As with other companies that Alleron has mentioned in the past, the trigger for Lovisa was a mosaic of information that resulted in comfort that they will be able to execute Alleron's expectations despite market conditions. Firstly, the company went through their first sales slowdown in FY16 and subsequently cleared all excess stock within 6 months and returned to historical growth rates and margins showing management's ability to effectively manage difficult trading environments. Secondly, they began the UK rollout of stores after a successful pilot program, indicating the conservative, well planned nature of their next stage of growth. Finally, with the results from the 1H FY17 highlighting the relatively small cost of growing their network of stores at about \$120,000/store in capital expenditure and inventory, the expansion risk is greatly reduced, relative to most retail companies.

Outlook: Alleron made its first investment in Lovisa after the stock price and revenue growth had recovered from its first downgrade in 2016. At the time the growth profile, management's ability to quickly adjust to the downturn and an undemanding PER multiple of 13X FY17 earnings offered a stock with a strong growth outlook at a relatively attractive valuation. While the past reporting season has resulted in a re-rating of the valuation, the company has the ability to double the number of stores within currently exposed geographies along with a stated target of a new country exposure each year offers potential of a very long term growth profile.



About the Australian Eagle Trust Long-Short Fund

Alleron is an Australian boutique wholesale fund manager specialising in Australian equities. Alleron's investment process seeks to deliver significant outperformance by identifying mispriced stocks with changing growth profiles and building concentrated portfolios of those stocks.

The Australian Eagle Trust Long-Short Fund aims to achieve strong double digit returns by allowing clients to access Alleron's demonstrated historical strength in constructing Australian share portfolios applied to a long-short product.

Modelling a combination of Alleron's actual long investment performance since 2005 in conjunction with a short selling discipline, suggests that this product can provide strong investment returns along with an alpha performance that is negatively correlated to the broader Australian equity market.

How to Invest

The Australian Eagle Trust Long-Short Fund is only available to investors via the Australian Eagle Trust Information Memorandum that is available on www.alleron.com.au/how-to-invest/. The Information Memorandum offers investors the opportunity to invest a minimum of \$500,000 in the Australian Eagle Trust (the Fund). Alleron has the discretion to waive or vary this minimum requirement.

The offer of units in the Fund are available to investors both resident in Australia and elsewhere receiving this document (including electronically) in Australia or elsewhere who qualify as "wholesale" clients as that term is defined in section 761G and 761GA of the Corporations Act. The Trustee may also accept applications from investors who are otherwise permitted to invest as permitted by the Corporations Act. Investors who are not resident in Australia can invest in the Fund where they are permitted by law to do so. The Trustee and Investment Manager of the Fund is Alleron.

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