

## Long-Short Quarterly Report – June 2018

### Portfolio Performance

As at 30 Jun 2018	3mth	6mth	1yr	2yr p.a.	Net Return p.a.	Total Net Return
<b>Alleron Long-Short*</b>	<b>10.46%</b>	<b>12.12%</b>	<b>25.13%</b>	<b>24.82%</b>	<b>24.82%</b>	<b>55.76%</b>
S&P/ASX 100 Acc**	8.45%	4.22%	12.05%	13.34%	13.34%	28.44%
Out/(under) performance	2.01%	7.90%	13.07%	11.48%	11.48%	27.32%

Performance figures are net of fees and expenses

\*Inception date is 1 July 2016

\*\* Performance benchmark

### Portfolio Commentary

Alleron's Long Short Fund has now been in operation for 24 months with net returns totalling +55.76%, outperforming the ASX 100 index by +27.32%. This past financial year has improved on the FY17 return with the Fund outperforming in all 4 quarters of FY18. The Fund's long term focus on Quality, Valuation and Energy has seen its returns exceed the ASX 100 in this period of strong market performance.

The Australian market outperformed global markets in the June quarter as international markets experienced increased volatility from trade war tensions between China and the US. Financials fell early in the quarter but recovered to end flat despite continued negative media attention surrounding the Royal Commission into bank misconduct. Energy stocks followed the rising oil price.

The Long side of Alleron's portfolio contributed to the strong June quarter performance mainly led by the FY18 result from Xero which showed continued momentum towards sustainable profitability. Strong shareholder support for NXT's plan to build more data centres pushed it well above its capital raising price. Resmed's 3Q18 result showed double digit growth in Brightree, a recent, highly complementary, cloud-based acquisition.

The Short side of the portfolio also added to performance as some stocks downgraded earnings in the lead up to the August reporting season. A short position in Telstra added as management struggled to convince the market of the sustainability of the dividend. Ramsay Healthcare downgraded its earnings guidance for FY18 blaming onerous UK lease provisions and lower inpatient admissions in Australia. AMP suffered severe reputational damage from the Royal Commission resulting in a large scale renewal of senior executives and board of directors.

### Portfolio Highlights

#### Positives:

*Telstra Ltd* (Short) – The market has continued to punish the Company's share price due to competitive pressures on its core mobile division along with lack of new growth options to fill the earnings void from the NBN disintermediating its high margin fixed line business.

*Xero Ltd* (Long) – The Company's recent FY18 result showed continued strength in international subscriber number growth and its maiden positive annual EBITDA result. Recurring revenues from the Company's platform almost doubled in the last 12 months.

*Seek Ltd* (Long) – The share price was buoyed by the supportive domestic economy as evidenced by solid May employment numbers and ANZ job advertisements.

#### Negatives:

*Japara Healthcare Ltd* (Long) – The share price fell due to aged care sector weakness from a court case decision regarding the mandatory cessation of an asset replacement charge. The Company reaffirmed an EBITDA uplift from its ongoing refurbishment program.

*National Australia Bank Ltd* (Long) – The share price fell on Royal Commission sentiment as well as a HY18 result where higher costs resulted in a dip in cash earnings. The Company declared a flat dividend for the half and reiterated its commitment to \$1bn in cost savings by FY20.

*Monadelphous Ltd* (Long) – The share price fell on concerns that the Company is not winning new contracts despite the positive environment for mining and energy projects. The Company did announce contract wins in its renewable energy division.

### 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%	5.35%	1.05%	1.10%	2.41%	3.08%	-3.86%	4.18%	2.34%	3.60%	25.13%



## Market Overview

The Australian market rose despite global market volatility from trade war tensions between the US and China. The big banks's HY results declared flat dividends and showed minimal growth. CBA announced plans to demerge its wealth management and mortgage broking divisions. Treasury Wine Estates was targeted by a media campaign which allegedly exposed the oversupply of lower quality wines in China. Vocus discontinued its NZ asset sale due to lack of reasonable offers. Healthscope rejected multiple takeover offers from 2 competing parties on the basis of unsatisfactory price.

## Portfolio Changes

### Increased Exposure:

*Healthscope Ltd* (+2.60%; Short): An Australian private hospital company. Multiple takeover bids from numerous parties have given support to the share price despite continued industry-wide headwinds.

*Xero Ltd* (+1.60%; Long): A cloud-based small business accounting software and platform company. The Company's recent FY18 result showed continued double digit subscriber growth in local and international markets along with new recurring platform revenues.

*Auckland International Airport Ltd* (+1.50%; New Long): A New Zealand airport owner and operator. The Company's expansion plans for a 2<sup>nd</sup> runway as well as significant capacity upgrades to Pier B and its Departure Hall are new drivers for future growth.

### Decreased Exposure:

*Bank of Queensland Ltd* (-3.90%; New Short): An Australian bank. The Company's 1<sup>st</sup> half result showed a combination of factors hindering growth including higher costs, lower credit growth and regulatory uncertainty.

*IOOF Holdings Ltd* (-3.90%; New Short): An Australian wealth manager and financial advisor. The Company's acquisition of ANZ's wealth management business has increased gearing whilst experiencing subdued fund inflows.

*AMP Ltd* (-3.50%; New Short): An Australian wealth manager. The Company is facing substantial changes to its operations and business model as a result of pressure from the Royal Commission into misconduct by financial institutions.

## Quarter-End Position & Portfolio Exposures

As at 30 June 2018, the fund had a net exposure of 95.42% and gross exposure of 196.22% to equities. Cash was 2.90%.

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

## Stock Highlight

### Altium Limited (ALU) – Long Position

*Energy Argument:* Altium Limited is a listed technology company with a very long history. The company was founded in Tasmania in 1985 and listed in July 1999 as Protel Limited before changing its name to Altium Limited in 2001. Alleron's long history in researching the company had found that the company had a very high quality product that was well regarded in its niche market within the Electronic Circuit-board Design industry. This had resulted in the company growing revenue by a very commendable 10% pa since listing in 1999. The issue for Alleron was that the stated available market size for the company was about US\$400m of which in 2017 they had close to 30% share and hence limited opportunity in its previous form to significantly change and accelerate its growth profile.

*Trigger:* In 2015, Alleron noticed that Altium had started the process to increase its available market size through the purchase of adjacent market products beyond simple Printed Circuit Board Design. The purchase of Octopart and Ciiva, started the process to expand the offering to a wider market. While this was a good initial indication, the Trigger for investment was the August 2017 result where the company had purchased Upverter and highlighted that integration of previous acquisitions had expanded their available market to be about US\$10 billion. The results also highlighted that they were executing operational goals well and increased the outlook for revenue growth to +22% pa for the next three years. This was a significant change in the potential growth profile and evidence that the strategy execution was going well.

*Outlook:* Since Alleron had made its initial investment, through very good earnings results, the market has become much more comfortable with the Company being able to achieve its 2020 target of US\$200 million in revenue and at least 35% operating margins. Altium has potential to grow at rates beyond that of the high growing electronic markets for years beyond 2020. The integration of collaborative tools, parts catalogues and SaaS distribution could position them at the centre of the electronics manufacturing industry. The Cloud only availability will convert the 100,000 unauthorised Chinese users to paying subscribers compared with their current global customer base of 36,000.



### **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/](http://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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